INDIA's GROWTH EXPERIENCE IN RECENT TIMES: A Note
(An Extract from Economic Growth in Gujarat in Relation to the Nation and Other States in Recent Times - A Statistical Analysis, Sebastian Morris, W.P. No. 2012-11-02, Nov. 2012, Indian Institute of Management, Ahmedabad)

Indian Growth Experience[1]

Indian growth experience since the reform of 1991-92 can be considered in several phases. After a year of decline in 1991-92 and 1992-93, growth accelerated for reasons that are well known[2]. The textbook fashion in which stabilization was carried out (deep depreciation, monetary tightening, and large cuts on public expenditure) reduced expenditures and redirecting them to tradables goods production to allow the economy to reach a non-inflationary position of demand being well within the supply potential even though inflation could come down only with a lag. The major and coordinated structural initiatives that were simultaneously or quickly followed - freeing private investments, opening the economy to foreign investments both portfolio and direct, abolishing the Industrial Policy Resolution 1956, that had kept many important sectors reserved for the public sector, complete convertibility on the current account, unleashed the inherent and long suppressed potential of the economy to grow rapidly. It grew at rates than exceeded 6.5% on the back of exports that grew at nearly 20% p.a. in US$ terms. For nearly four years after the reforms, belying the near consensus among economists then that Indian exports and the current a/c gap was unresponsive to currency values. Equally importantly private investments grew so rapidly that despite the fall in public investments, overall investments could growth could accelerate, so that the share of investment in GDP rose to nearly 29% of GDP, by the end of 1996-97. The structural reforms especially de-licensing, FDI openness, and privatization greatly improved the competitiveness as well as overall efficiency of investments. Additionally infrastructural performance improves in areas like telecom, ports and airlines. These meant that the potential output could outpace the demand increases due to export increase and investments to result in a non-inflationary high speed growth.

Rapid growth was arrested largely because the rupee was allowed to appreciate from 1995-96 in real effective terms, which slowed down exports with a lag starting from early 1997. Additionally the lack of clarity with regard to regulation and frameworks for private investments in most of the infrastructure sectors –roads, electricity, water, transport, municipal services, slowed down private investments from 1996 onwards, so that the impending recession could be predicted. (Morris, S., 1997). Indeed growth had slowed down well before the East Asian crisis, which then provided a bogey for policy makers. Monetary conservatism from 1997 -98 onwards, the high interest rates and the attempt to lower the fiscal deficit by cutting government expenditures, kept growth low at under 5.5% from 1997-98 to 2003-03. (Morris, S., 2003). Reserve money growth in this period was no more than 13%. Willy-nilly the money supply growth increased from 2004-05 onwards since the capital inflows which hitherto were largely sterilized, by reducing domestic credit could not so be done as the domestic credit level had turned negative! The high growth in money which had followed the vast increase in government expenditures, on account of the spending on the Golden Quadrilateral (finally the contract form and the policy for highway development the NHAI got right in 2002), the large autonomous increase in service exports, and the revival of the global economy pushed Indian growth to a high level of 9.5, with an average growth of 8.5% over the period from2003-04 to 2007-08. Significantly well before the global crisis began, in response to the largely supply side inflation from 2006 onwards, the RBI began to tighten monetary expansion by raising the CRR repeatedly, and then allowing the rupee to appreciate even in nominal terms.

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[1] Based on Morris, S. 2011, mimeo. India's Growth Experience in Recent Times. Presentation in various teaching sessions, IIMA.

[2] See Joshi and Little (1996) for an early macroeconomic study of the period till 1995-96.

On the eve of the crisis growth had slowed down from a high of 9.5% to under 8.5% when measured on a quarterly basis. The RBIs response to the immediate dollar liquidity crisis was to first restrict dollar availability. Then when the Lehman Brothers' collapse took place resulting in large outflows of capital by all FIIs. The RBI after some delay sold dollars, but without the concomitant reverse sterilization by expansion of domestic credit, to keep reserve money on the RBIs own target. As a result the dollar liquidity shortage was converted to rupee liquidity crisis and that braked the economy sharply! (Varma, J.R., 2009) It was only much later that the central bank in view of the global liquidity could be persuaded to expand liquidity reluctantly, which when carried out resulted in a bounce back, which was sustained on the back of a fiscal boost provided by the central government, which had just been reelected, amounting to some US$50 billion. This boost although not compositionally the optimal, allowed for the quick rise in public spending of growth to restore growth to 8.5%. The composition of the stimulus could have been much better had the share of investment in the same been higher. While there was a significant component of infrastructural spending both urban and rural, not only were these expended at lower levels of efficiency than earlier, but the component of consumption was large, since the increased outlays on the National Rural Employment Guarantee Scheme (NREGS) was a significant part of the stimulus. The tax deduction component was not particularly consumption oriented since the private savings rate did not fall in this period.

In less than a year and a half after the stimulus, under the general demands from policy commentators and the central bank to exit the stimulus, the tax concessions, both direct and indirect were withdrawn first, then government expenditures fell. These combined with the RBIs monetary tightening on account of high inflation resulted in a steady deceleration of growth and especially of investment which now fell to less than 3% growth after having reached a record 19.5% at the peak during the high growth phase. Growth itself would fall to less than 5% in the second quarter of 2012-13. The inflation being on the supply side due to limitations in the growth of agricultural side (on the high demand unleashed by inter alia the NREGS and the high growth period which was also poverty reducing) to quickly respond, and to a resurgence of commodity prices did not count for much in the RBIs thinking. In effect then over the last year a situation of inflation has been converted to a situation of stagflation and the RBIs stance has been that the continuing fiscal deficit gives it little room for action.

References:

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Table 1: Distinct Periods of Growth and Policy Since the Reform of 1991-92 and 1992-93		
Period /year	Characterization	Growth Rate Achieved (approx..)
1993-94 – 1997-98	Post reform high growth, export and private investment led, flexible monetary stance, higher agricultural growth rate	6.7%
1998-99 – 2003-04	Slow down, slowing private investment (little clarity on infrastructure forms and policy), post east Asian crisis effect, very conservative monetary policy –money supply growth less than 13% on average, capital flow volatility could be contained by sterilization fiscal policy too somewhat conservative	5.25%
2003-04 – 2007-08	Rapid growth, kick started by GQ spending, continued by revival of exports on global growth, enhanced by large increases in service exports, and remittances. Large capital inflows initially accommodated, limits of sterilization reached so money growth rises to 17% or more from 2004-05, later reigned in through increase in CRR and rupee appreciation, growth comes down at end of period. High supply side inflation in second half of period.	8.5(+) %
2008-09 (first half)	Global recession, dollar and rupee liquidity crisis and then recovery of liquidity; sharp braking of economy	4.5% ?
2008-09 – 2010-11	Arrested revival, strong revival on fiscal stimulus, withdrawl of stimulus and monetary tightening at end of period	7.6%
2011-12	Continuing tightening, investment collapse and growth falls to less than 5%	< 5.0%?