Getting India Back to the Turnpike: What will it Take?

Rakesh Mohan
Senior Fellow
Jackson Institute for Global Affairs
Yale University
And
Distinguished Fellow
Brookings India

George Washington University
Washington DC
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Getting India Back to the Turnpike: What will it Take?

• Introduction

• The Indian Economy: A Story of Consistent Growth

• Getting Back to the Turnpike: A Simulation for 2017-32

• Policy Imperatives for Getting Back to the Turnpike

• Conclusions
Introduction (1)

• India’s Recent Growth Trajectory
  – The Golden Era 2003-08
  – Growth Pause 2008-09
  – Continued Growth 2009-12
  – The Great Slowdown 2013-14

• Can India Get Back to Sustained High Growth?
Introduction (2)

• The Global Economic Environment
  – Global slowdown caused by North Atlantic Financial Crisis
  – European Sovereign Debt and Banking Crisis, 2010
  – Protracted Recession in Advanced Economies, particularly Europe
  – Global Trade Slowdown
  – Possibility of Secular Stagnation

• Can India Get Back to Sustained High Growth?
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The Indian Economy: A Story of Consistent Growth

• A Story of Sustained Growth
  – Consistent Acceleration Since Independence
    • Interregnum 1965-81
  – Mostly Financed by Rising Domestic Savings
  – High Industrial Growth 6-7 per cent
    • Except 1965-81
  – Variable Agriculture Growth
  – Consistent Acceleration in Services
    • Not just Recent
Indian Growth Record (1)
Consistent Acceleration and Domestically Financed

GDP Growth

Savings and Investment

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Indian Growth Record (2)


Agriculture
Industry
Services
GDP (factor cost)
The Golden Era of Growth (1)

- Prudent Fiscal Policy
  - Combined Fiscal Deficit Halved
  - Improvement in Tax GDP Ratio
  - Subsidies Controlled
  - Increased Public Investment

Growth in Public Sector Savings
The Golden Era of Growth (2)

• Complex Monetary and Financial Management
  – Low Inflation
  – Low interest rates
  – High and Volatile Capital Flows Managed
  – Floating but Managed Exchange Rate
  – Banking Regulation and Supervision Tightened
  – High Credit Growth
  – High Banking Quality
The Golden Era of Growth (3)

• Corporate Sector
  – Sustained Growth in Profitability
  – Availability of Own Savings
  – No Crowding Out
  Step Up in Corporate Investment

• Households
  – Continued Growth in Financial Savings
  – Robust Consumption Demand
  – Housing Investment
The Great Slowdown 2012-14 (1)

• Excess Fiscal and Monetary Stimulus 2008-09
• Some Revival of Growth 2009-12
• Poor Quality Fiscal Stimulus
  – Tax Cuts
  – Increase in Subsidies
  – Reduced Public Investment
• Hesitant withdrawal of Fiscal, Monetary Stimulus
• Revival of Capital Flows, not Managed
The Great Slowdown 2012-14 (2)

• Consequences
  – High Food Inflation/Overall Inflation: Corrected
  – Crowding Out of Private Corporate Sector: Corrected
  – Real Exchange Rate Appreciation: Continues
  – Increase in Current Account Deficit: Corrected
  – Fall in Savings Rate: Continues
  – Fall in Corporate Investment: Continues
  – Fall in Export Growth: Continues
  – Collapse of Manufacturing Growth: ?
Real Deposit Rates: Negative

Note: Real interest rate is nominal deposit rate less y-o-y CPI (Industrial Workers) inflation.

Note: Real_One_Year_Ahead is nominal deposit rate less "one year ahead" inflation expectations of households as per RBI's survey.
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A Macro Economic Approach – RMSM-X model

• Model projects investments possible in economy over next 20 years
  – Reflects change between past trends and future estimates based on key economic assumptions
  – Highlights financing gap for the economy
  – Infrastructure investments and gaps can be derived

• Ensures consistency between projections of balance of payments and national accounts
  – Bottom-up sector-specific financing needs may be much higher than what is feasible for the economy based on macroeconomic scenario

• Model estimates to be interpreted as broad ranges
  – Objective is to present a broad idea of magnitudes implied by a relatively optimistic growth scenario
### Key Assumptions

**Economic growth**
- Agriculture 4% p.a. [share in GDP declining]
- Manufacturing 8 - 10% p.a. [share in GDP: slight increase]
- Services ~ 9% p.a.

**ICOR**
- Incremental Capital Output Ratio ~ 4

**External sector**
- Exports (goods) grow around 12%
- Imports (goods) grow around 10-11%

**Infrastructure investment**
- Infrastructure includes railway, other transport, road and bridges, electricity, water and gas supply, and communication
- Infrastructure investment: from 5.4 % of GDP (2011-12) to around 8% (2017-32)
- Shares in GDP based on national accounts

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GDP Trajectory

GDP (US$ trillion) (2012-13 prices)  GDP Growth (Percent) (right scale)
GDP: Sectoral Trends
Manufacturing Growth Needs to Rise to 10%
Savings and Investment Requirements

Savings

Investment

Household - Financial | Household - Physical | Private Corporate Sector | Public Sector

Public Sector | Private Sector

2007-08  | 2012-13  | 2017-18 to 2021-22  | 2022-23 to 2026-27  | 2027-28 to 2031-32

Savings and Investment

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Investment Trend

- **GDP (US $ trillion)**
- **Total Investment (US $ trillion)**
- **Investment Rate (percent of GDP) (right scale)**

<table>
<thead>
<tr>
<th>Period</th>
<th>GDP</th>
<th>Total Investment</th>
<th>Investment Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>2012-13</td>
<td>1.9</td>
<td>0.6</td>
<td>0.6</td>
</tr>
<tr>
<td>2013-18</td>
<td>2.1</td>
<td>0.8</td>
<td>0.4</td>
</tr>
<tr>
<td>2018-23</td>
<td>3.1</td>
<td>1.2</td>
<td>0.4</td>
</tr>
<tr>
<td>2023-28</td>
<td>4.6</td>
<td>1.9</td>
<td>0.4</td>
</tr>
<tr>
<td>2028-33</td>
<td>7.1</td>
<td>3.1</td>
<td>0.4</td>
</tr>
</tbody>
</table>
Transport Investment

Transport infrastructure investment

Total infrastructure investment

Transport infrastructure investment (Percent to GDP) (right scale)
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Policy Imperatives for Higher Growth (1)

• Public Savings and Fiscal Policy
• Fiscal Consolidation: A Necessary Condition
  – Restrain Subsidies to around 1 per cent of GDP
    • Deregulate diesel prices ✓
    • Progressively deregulate kerosene/LPG prices ✓ ?
    • Necessary for fuel efficiency ✓
  – Increase Tax GDP Ratio to around 18 per cent
    • Implement GST ✓
    • Reduce Tax Expenditure ?
    • Enforce Income Tax Compliance ?
      ➢ 65,000 Black Money Declarers; Average Rs 10 million

• Increase Public Investment in Infrastructure ✓ ?
General Government Revenues: Cross-Country Perspective

All countries

Countries with revenue/GDP ratio above 60 percent dropped
Policy Imperatives for Higher Growth (2)

• Household Savings
  – Monetary Policy for Maintaining Low Inflation ✓
    • Hence positive real deposit interest rates
  – Contain food inflation: Food Supply Chain ? ✓
  – Strengthen Contractual Saving ?
    • Pension Schemes
    • Mix of defined benefit and contribution
    • Provident Fund
    • Life Insurance
Policy Imperatives for Higher Growth (3)

• Private Corporate Sector
  – Reduce Crowding out ✓
  – Manage Competitive Real Exchange Rate for Manufacturing ?
  – Focus on Manufacturing
    • Make in India: But ?
    • Urban Land and Labor Reforms ?
    • SEZs for Labor Intensive Manufacturing ?
Policy Imperatives for Higher Growth (4)

• Foreign Savings and Capital Account Management
  – Maintain judicious Current Account Deficit $\leq 2.5$ per cent ✔
  – Continue Active Capital Account Management
    • Calibrate External Debt Flows Carefully ✔
      – External Commercial Borrowing ✔
      – Limited Opening of Domestic Debt Market ✔
        ○ But Opening of Domestic Bond Market ?
      – Banking subject to Macroprudential Regulations ✔
    • Encourage FDI ✔
    • Continue Foreign Equity Portfolio Investments ✔
  – Accumulate foreign exchange reserves
    • @ 6 months imports ✔
    • $\sim 2$ per cent of GDP ✔
  – Need Net Capital Flows $\sim 4.5$ per cent of GDP ?
Policy Imperatives for Higher Growth (5)

• Structural Reforms: Acceleration in Manufacturing Growth
  – Promote Labor Using Manufacturing
  – Labor Legislation Reform
  – Urban Land reform
  – Environmental and Other Approval Process
  – Special SEZ for Labor Using Manufacturing
  – Active sourcing of Chinese manufacturing
Indian Manufacturing: Continues to Underperform

Manufacturing Growth

Share of Manufacturing in GDP
# Manufacturing: India and Asia

<table>
<thead>
<tr>
<th>Economy</th>
<th>Share in Output</th>
<th>Share in Employment</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Data since</td>
<td>Year of highest</td>
</tr>
<tr>
<td>Cambodia</td>
<td>1993</td>
<td>2004</td>
</tr>
<tr>
<td>China</td>
<td>1965</td>
<td>1978</td>
</tr>
<tr>
<td>Hong Kong</td>
<td>1970</td>
<td>1970</td>
</tr>
<tr>
<td>India</td>
<td>1960</td>
<td>1979</td>
</tr>
<tr>
<td>Malaysia</td>
<td>1960</td>
<td>1999</td>
</tr>
<tr>
<td>Singapore</td>
<td>1975</td>
<td>2004</td>
</tr>
<tr>
<td>Thailand</td>
<td>1960</td>
<td>2007</td>
</tr>
</tbody>
</table>

Memo:

<table>
<thead>
<tr>
<th>Metric</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Average</td>
<td>27.8</td>
</tr>
<tr>
<td>OECD</td>
<td>25.9</td>
</tr>
<tr>
<td>OECD output</td>
<td>20.8</td>
</tr>
<tr>
<td>OECD employment</td>
<td>25.7</td>
</tr>
</tbody>
</table>

* a This refers to both urban and rural manufacturing employment. Available data for employment is only up to 2002.
* The share of urban manufacturing in total manufacturing employment is about 28% (for 2000–2010).
* OECD output and employment averages refer to 23 countries.

Source: Key Indicators for Asia and the Pacific 2013.
Policy Imperatives for Getting Back to the Turnpike (6)

• Transport Infrastructure
  – Office of Transport Strategy ?
    • Central Government
    • State Governments
  – Railways
    • Organizational Reform ?
    • Corporatization ?
    • Accelerate Dedicated Freight Corridors ?
    • Focus on Energy Commodities Transportation ?
    • Modernization of Rolling Stock ?
    • Need for at least 2 Mega Ports ?
    • Coordination of Road and Rail Investment ?
  – Arrangements for Multimodal Transport ?
    • Logistics Parks
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Conclusions

• Return to Growth Turnpike Feasible
  – Fiscal Consolidation
  – Low Inflation
  – Revival of Manufacturing
  – Competitive Real Exchange Rate
  – Step Up in Investment in Energy and Transport
THANKS