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What has changed in Indian Economy

Some structural features

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Introduction

India is argued to be one of the few economies that receded from the impact of global financial crisis of 2008. In the case of India, the economic crisis coincided with national elections, so a fiscal expansion had already been undertaken just prior to the onset of the global crisis. A fiscal stimulus equivalent to 4% of GDP was introduced in the central government's 2008 budget. The crisis also impacted state finances with the result that the combined fiscal deficit grew to 11.4% of GDP that year. While this had serious implications in future years for India's sovereign ratings, given its high and rising current account deficit and poor growth performance, the immediate fiscal sustainability implications in terms of debt dynamics were not negative as feared by some commentators at the time.

However, issues over stalling policy reforms in the past few years in key areas and sectors have concerned global investors.

The political appetite for big-ticket reforms and cooperative federalism within states is there, but the execution of these big-ticket reforms is facing far greater friction than policy makers thought it would. There appears to be a significant level of bureaucratic dissonance and incoherence in implementation of reforms. The risk-averse attitude of the bureaucracy does not seem to have been overcome yet. The abolition of the Planning Commission raises an important fiscal question: will we continue to plan in the old-fashioned way with a range of output targets, and an expenditure programme to achieve these targets specified over the next five years? If so, the current Plan and non-Plan expenditure categories will continue to hold. But it will be necessary then to specify what "Plan" expenditure means in today's India.

Clearly, India is grappling with the challenge of implementing long due reforms. It is, therefore important to understand what has changed in India in the past few years. This short paper discusses some of the structural changes occurred in Indian economy in recent years. The paper is organized as follows. Section I analyses the structural features of the economy. Section II discusses the future outlook and Section III concludes the paper.

Section I- Structural features of Indian economy

Centre-State relations

There is a national consensus that India's combined fiscal deficit must reduce significantly. It is important to notice here that the Indian States, taken together, have for some time been in much better fiscal health than the Centre.

Since 1978-79, the Government of India has been running a revenue deficit. This averaged 1.7% of GDP between 1979-91, 2.9% during the period 1991-2008 and 4.1% in 2008-2013. The States (general category) have also been consistently running revenue deficits from 1985-86. These grew exponentially from 0.1% in 1986-87 to 3.45 of GSDP in 2001. However, after 2003-04, the macro-

fiscal position of the States improved dramatically and the States have been running a balanced revenue budget since 2008-09 (Figure1). If one excludes Kerala, Punjab, and West Bengal, the remaining States have been running fairly healthy revenue surpluses (except in crisis years 2009-11). This is as true for rich States like Maharashtra and Gujarat, as for poorer States like Bihar, Orissa, and UP.

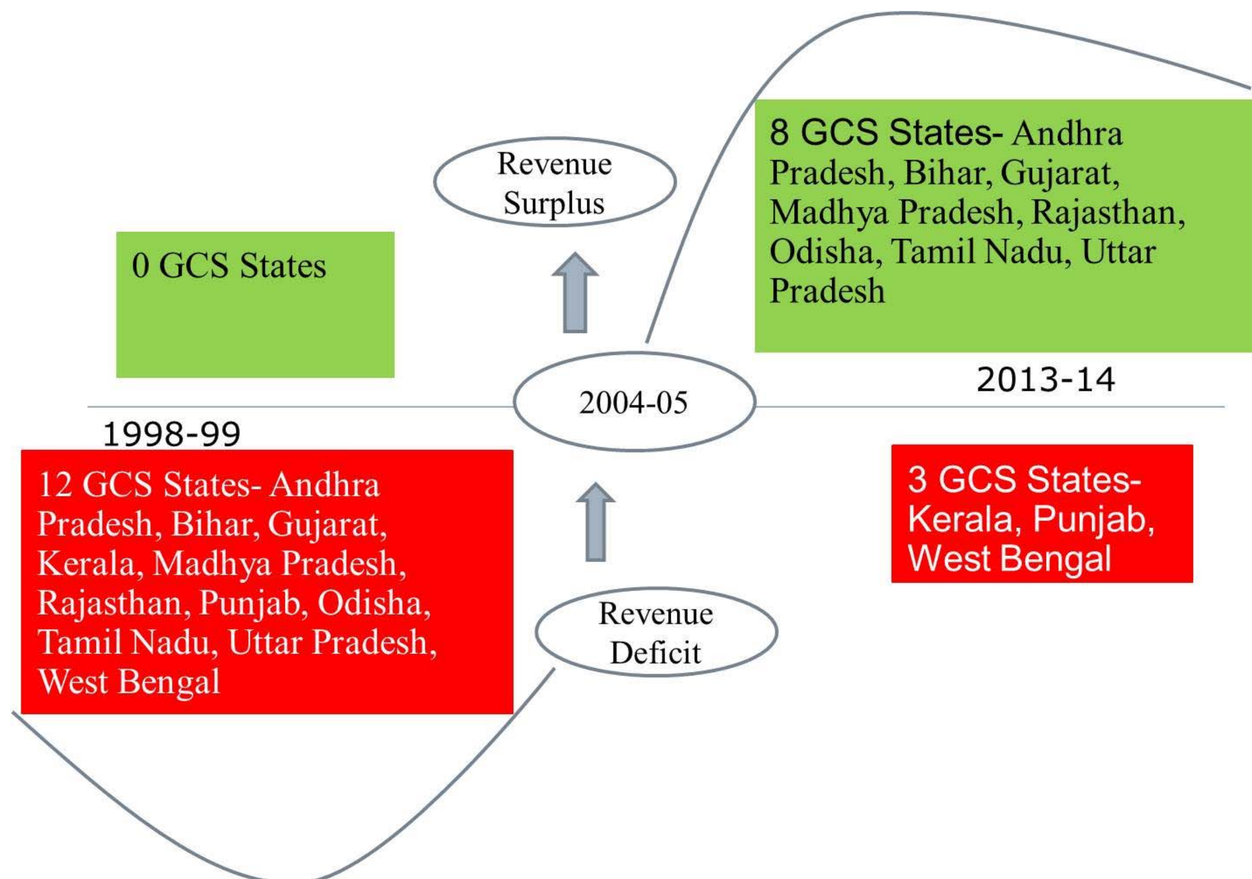

Figure 1. States performance on revenue account

Thus, improvements in own revenue performance and expenditure management have led to this turnaround in the macro-fiscal position of the States. To some extent, this was because of the tradition of fiscal prudence set in place by the 12th Finance Commission (2004) and reinforced by the 13th Finance Commission (2010) led to increased fiscal discipline at the state level. State deficits thus declined to more manageable levels shortly after the crisis. Since the States have secured a revenue surplus, their fiscal deficit is entirely used for public investment. The Centre since 2007-08 has been investing between 1 to 1.5% of the GDP; this includes investment in defence. From 2000-01 the Central Plan capital outlay has declined from 47% of the total plan expenditure to 20.4% in 2012-13. At the same time, the States have been consistently investing 2.5% of their GSDP. Thus the “heavy lifting” in terms of public investment is being done by the States.

Productivity challenge

India's Total Factor Productivity (TFP) was not historically below that of China but China's TFP caught up with other Asian economies after India but exceeded it from 2005 and has been rising since then (Figure2). Therefore, India, in common with many other emerging economies in the world that are not resource exporters has a significant balance of trade deficit with China as it is unable to compete with productivity levels in China. For instance, wages in China are 2.5 times higher than India but productivity is 5 times greater than India.

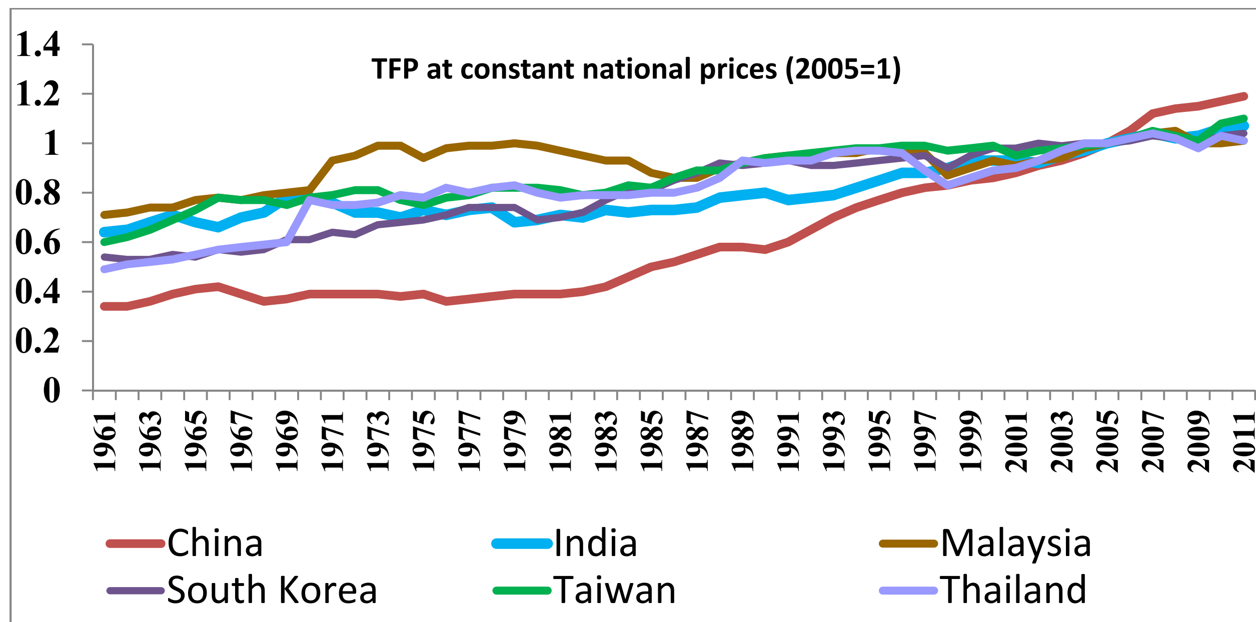

Figure2. Total Factor Productivity in selected economies

Need for public investment push

As stated earlier, the Centre has for some time not been the locus for public investment, which is principally undertaken by the States (Figure3).

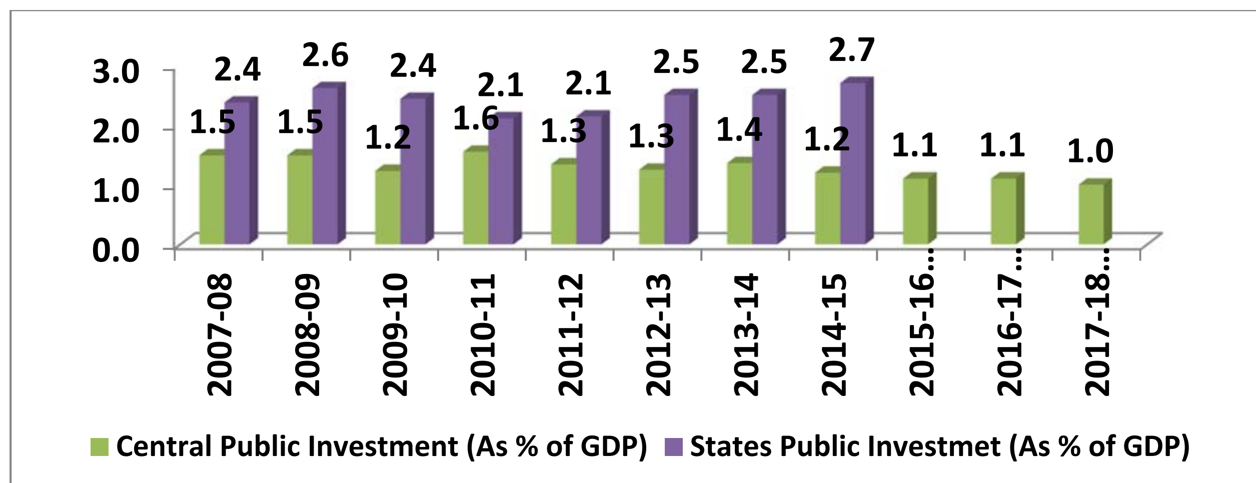

Figure3. Public Investment in India; the numbers for 2016-17 and 2017-18 are projections.

The Economic Survey 2014-15 states, "….it seems imperative to consider the case for reviving targeted public investment as an engine of growth in the short run not to substitute for private investment but to complement it and indeed to crowd it in. The two challenges of raising public investment relate to financing and capacity….". It is often argued that lack of investment in the key sectors like infrastructure have critically affected the potential investment in Indian economy. To a great extent it has been true as most of the stalled projects have been in the key sectors like infrastructure, mining, power etc, with a value of almost 7 percent of GDP by December, 2014.

The key features of the stalling projects in India are:

i. Projects are stalling at an increasing rate over the last five years.
ii. Stalling of projects is severely affecting the balance sheets of the corporate sector and public sector banks which in turn are constraining future private investment.
iii. The stalling of projects does not seem to have a significant impact on firm equity values.
iv. The government's stalled projects are predominantly in infrastructure. Unfavourable market conditions (not delays in regulatory clearances) are stalling a large number of projects in the private sector.
v. The stock of stalled projects has come down to about 7 per cent of the GDP at the end of the third quarter of 2014-15 from 8.3 per cent in the previous year

India's recent PPP experience has demonstrated that given weak institutions, the private sector taking on project implementation risks involves costs (delays in land acquisition, environmental clearances, and variability of input supplies, etc.). Certain areas of infrastructure such as rural roads and railways that provide basic physical connectivity are usually under-supplied in terms of private investment. The public sector, in such conditions can be better placed to absorb some of these risks. The recent reform announcements in FDI in sectors like railways, construction and defence equiments are seen as game changers in this context.

Section II Prospects and Outlook

The near term outlook for Indian economy is stable.

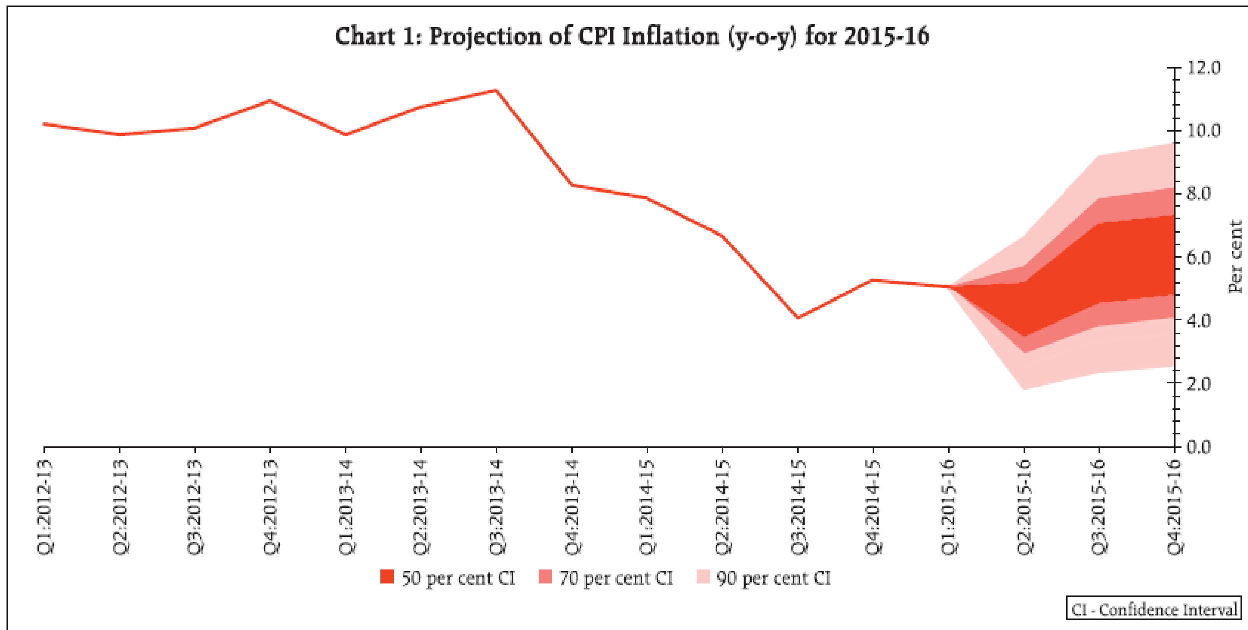

Figure4. Inflation projections; Source: Reserve Bank of India

RBI's recent monthly bulletin (August 2015) states that CPI inflation projections for January-March 2016 are lower by about 0.2 per cent, with risks broadly balanced around the target of 6.0 per cent for January 2016 (Figure4). However, inflationary risks emanating from non-food and fuel categories still remain a concern. The trade deficit in the past few months showed improvements on account of fall in crude oil prices. Further, stability in FDI and net surpluses on account of trade in services has had a positive impact on the current account deficit. Finally, with stronger reserves in hand, the Balance of Payment (BOP) situation seems to be resilient against global adverse shocks at the moment. The uncomfortable zone affecting global stability to which India is no exception, is the changing growth dynamic in China. The RBI and the government of India will have to maintain stronger positions to insulate the economy against the adverse impact of further deceleration in growth outcomes in China.

Figure5. Trade deficit; Source: Reserve Bank of India

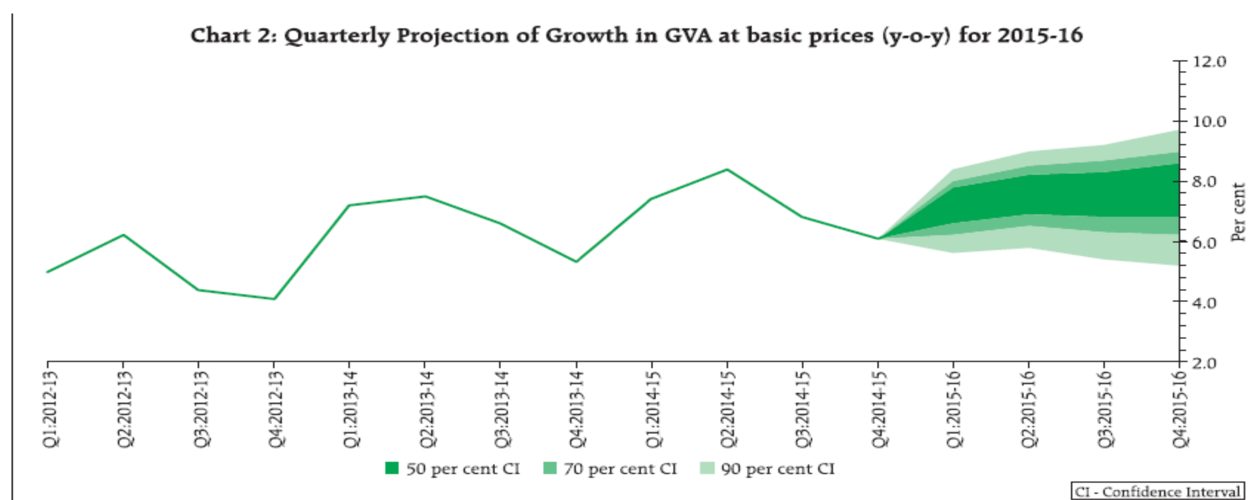

Figure6. Growth projections; Source: Reserve Bank of India

Thus, the overall projections for GDP growth for 2015-16 by RBI are estimated to be at 7.6% (Figure6). RBI also acknowledges that though there are signals of improvements on account of stalled projects, India is yet to kick start the big investment push with both private and public sector playing a critical role in generating new investments demand in the economy.

Conclusion

The government of India is currently in the process of pacing the pending reforms in financial sector and taxation through IFC (Indian Financial Code) and GST (General Sales Tax). The make in India initiative and announcements in FDI in key sectors are intended to revive the contribution of manufacturing sector in the overall GDP of the economy.

India, thus, faces important challenges but by no means have either governments or society allowed these to become overwhelming. The constant search for solutions and ways to move

forward against gigantic obstacles makes India distinctive- a diverse vibrant resilient democracy that refutes global pessimism. It is this capacity that India has to surprise the world and even its own citizens that is the fundamentally unique ingredient of India's story of emergence.

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