Hope with concerns in 2019

This article is related to General Studies-Paper III (Indian Economy).

The Hindu

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04 Jan., 2019

"Five issues need to be addressed comprehensively if India is to achieve sustained high growth."

The New Year is always looked forward to with hope, whatever the conditions might have been the previous year; 2018 has been a mixed bag, both globally and domestically.

Globally, the growth rate in 2018 was high, particularly in the United States. But strong signs of a trade war emerged, dimming hopes of faster international trade. Britain is passing through the pangs of separation from the European Union. Domestically, the first quarter growth rate was high. But signs are not good for the balance of the year. The rupee underwent a severe shock as crude oil prices rose, and abated after a fall in oil prices. While prices fell, agrarian distress accentuated.

India's growth rate in 2018-19 is forecast at 7.4% by the Reserve Bank of India (RBI). But it looks to be a touch-and-go situation. More likely, it will be slightly lower. Looking ahead, 2019 may not show any substantial rise in the growth rate. Even though the Goods and Services Tax (GST) has stabilised, much will depend on the pickup in the investment rate.

The international environment is not that conducive for growth in our foreign trade; this will have an impact on our exports and, therefore, growth. Perhaps the growth rate will be between 7.2% and 7.5%. Though this may be the highest growth rate of any country, it falls short of our requirements.

Going ahead, what are our major concerns?

Investment ratio

In the final analysis, the growth rate depends on the investment rate and the productivity of capital or its inverse incremental capital-output ratio.

The incremental capital output ratio is a catch-all expression. It depends upon a multiple number of factors such as quality of labour, which again depends on education and skill development levels, and technology, which is constantly changing. For ensuring a sustained high growth, we need to raise the investment ratio and keep the incremental capital-output ratio at 4. The Gross Fixed Capital Formation ratio has fallen from 35.8% in 2007-08 to 28.5% in 2017-18. The journey to raise the investment ratio is not going to be easy. 'Animal spirits' must be revived. A tranquil political and economic environment needs to be nurtured.

Banking system

An important factor affecting economic growth is the condition of our banking system. Non-performing assets (NPAs), including stressed assets, as a proportion of loans of public sector banks stood at 16.7% as of March 2018. As many as 11 public sector banks are under Prompt Corrective Action (PCA). This restricts the lending abilities of these banks. Added to this, the non banking financial company (NBFC) system is also under stress. This is partly a reflection of the stress in the banking system since most NBFCs borrow from banks. Recapitalisation of public sector banks will partly solve the problem. It is not clear at this point how much it will help in adding to lending capacity.

Some have advocated providing more capital to banks outside the PCA framework as that will increase their lending capacity immediately.

Today, banks are responsible both for short-term and long-term lending. Their inability to lend affects the availability of working capital as well as capital expenditures.

The decision to pump in more capital to public sector banks must be completed soon. The growth rate in the industrial sector will depend on how quickly the banking system comes back to normalcy.

Employment growth

There is a great concern about the inadequate growth of employment. Honestly, we do not have satisfactory employment numbers. The employment data in the organised sector are reliable. But the employment in the informal sector is much larger. One question that is asked is that if growth is around 7%, why is there no corresponding growth in employment? We need to keep two factors in mind. Growth can occur either as a result of increase in investment or because of better utilisation of existing capacity. It is growth which is led by new investment that leads to a significant increase in employment. But growth caused by improved efficiency of utilisation of existing capital can lead only to a marginal increase in employment. Much of the growth seen in the last few years is of the latter variety.

Second, the increase in employment seen in the period between 2004-05 and 2009-10 was because of the rapid growth of the information technology (IT) and financial sectors. The IT sector has slowed down. The financial sector is under stress. Employment in these sectors was visible and educated entrants into the labour market found ample opportunities. The IT sector growth rate is not likely to pick up significantly as this industry is undergoing many structural changes. The revival of the banking system depends on a number of factors. Thus, even from the point of view of employment, the key factor is the pickup in investment.

India's external sector has grown and is well integrated with the rest of the world. India's trade in goods and services as a percentage of GDP has grown to 42% of GDP. Therefore, what happens in the rest of the world affects India's growth very much. India's balance of payment situation has been comfortable since liberalisation. However, there are vulnerabilities as seen in September-October 2018, when the value of the rupee suddenly plummeted when crude oil prices rose and there were simultaneously capital outflows. RBI intervention and the subsequent fall in crude prices have restored the value of the rupee. In April-November 2018, India's exports of goods grew by 11.6%. However, we need to note that exports growth was 5.2% (2016-17) and 9.8% (2017-18). Strong growth in exports is a must if we have to keep the current account deficit (CAD) at a manageable level.

The forecast for world trade and output is not encouraging. There are too many uncertainties which include an intensification in the trade war. Along with export promotion, we also need to contain some of our large imports. A watch on India's CAD is critically important if we have to achieve growth with stability.

Agrarian distress

The future growth also depends on the performance of agriculture. Agrarian distress is widespread. Strangely, the fall in prices of agricultural products is in one sense a reflection of our success in raising output. Some years ago, the concern was a rise in the price of pulses to abnormally high levels. But today the picture is reversed. Thanks to increase in production, prices have fallen. Similar is the case with respect to vegetables, particularly onion. The need of agriculturists is income in current prices. The solution to the fall in prices lies in government intervening in the market and buying off the surplus over normal levels. The market will then automatically take prices to the normal level. The important requirement in this context is not only the financial capacity of the government to procure but also adequate physical arrangements to procure and store. The procured agricultural products can be sold by the government in later years when output is low or utilised in any safety net programme.

Loan waivers are at best short-term solutions. The fundamental problem is one of increasing productivity and enabling farmers to achieve increased output and better prices. There is also a basic weakness that we have to address. The average size of landholding is so small that any amount of increase in productivity will not give adequate income. Farmers have to think in terms of consolidation of landholdings so that they can get the benefits of larger size. Small farmers will also have to think in terms of higher value-added products like vegetables. A combined attack to increase productivity, consolidate landholdings and improve marketing is needed to assure farmers of better income.

Thus there are five concerns as we stand at the beginning of 2019. These are: raising the investment ratio; putting the banking system back on the rails; employment generation through better growth; enhancing export growth to contain the CAD; and removing agrarian distress by increasing productivity and consolidation of small landholdings. These issues need to be addressed comprehensively, if we have to achieve sustained high growth.

Major Challenges of Indian Economy

Introduction

- In the last few years, the Indian economy has faced challenges due to demonitization, new structure of monetary policy, inflation planning, financial federalism and changes in external areas as well as the implementation of GST.
- All of these impacted on industrial production, investment, consumption and business environment, which is gradually being reduced.
- Apart from this, uneven economic development of the States has been a major challenge for the country's economy.

First challenge: uneven income distribution in the country

- Last year, a report titled "Reward Works, Not Wealth" was released in connection with the increasing unequal distribution of amount of money in the world by the International Rights Group Oxfam Hours.
- According to this report, only one percent of the total population have 73 percent of the total wealth generation in India (with rich people), whereas the income of nearly half the population (67 crore) of the country has increased only by one percent, which is poor .
- Not only this, there has been no increase in income of the poorest population of the country (3.7 crore).

Second Challenge: Creating Fiscal Balance

- There is a lack of financial discipline at the economic level in India, while the economic discipline must be essentially in the country to become an economic power.
- The consequence of this financial indiscipline is fiscal deficit.
- Increasing fiscal deficit affects the economy of any country because it increases inflation rates (inflation) as well as interest rates.
- That is why economists insist on keeping the fiscal deficit at least in the context of Indian conditions.

Third Challenge: Expedite the Disinvestment Process

- Public sector undertakings are the property of the nation and to ensure that this property should be in the hands of common man, public-sector enterprises and enterprises should promote public ownership.
- For this, the government chooses the path of disinvestment, which enables the availability of additional funds, which can be spent on social schemes and development activities.

Fourth Challenge: Growing NPAs of Banks

- India's banking system has been working for a relatively long time in such a challenging background, which has adversely affected asset quality, capital adequacy and profitability of the public sector banks.
- Due to the NPA level of more than Rs 7 lakh crore, it is natural to be worried, because such a large amount is of no use.
- If this amount is realized then the profitability of the government banks will increase, the employment of lakhs of people, the benefits of reduction in policy rates will reach the business, building infrastructure, improving agriculture, strengthening the economy, etc. would be able.

Fifth Challenge: Challenge of Agriculture Sector

- Presently, agriculture's contribution to national income is not very high, yet the decline in agricultural production will definitely affect the growth rate.
- At the time of independence, the share of agriculture in the country's GDP was almost 50 percent, which has now dropped to only 14 percent.
- About 58 percent of the country's population depends on this sector with the highest productivity.
- The decreasing growth rate affects not only the more than 14 million families of the country dependent on agriculture, but also the common man gets disturbed by the price hike.
- Because of the large population of the country is engaged in agriculture for farming and farming, any decline in agriculture also increases the employment crisis.

The Sixth Challenge: The Challenge of Employment

- One of the biggest challenges of the Indian economy is the challenge of job generation.
- There is a need to adopt a holistic approach for solving this problem. About 13-15 lakh youth in our country are transformed into working population every year, who are looking for suitable opportunities for employment.

- Nearly half of the country's population is engaged in agriculture and it is not possible to provide employment to more people. Therefore, the demand of the time is that the steps for generating employment in non-agricultural areas be done.

Seventh Challenge: Crude Oil Prices

- With the rising cost of food products in the country, due to the rise in the prices of crude oil in international markets, oil prices in the domestic markets have reached the highest level recently which could have adverse effects on growth. .
- India imports about 80% of its crude oil by spending huge foreign currency and controlling its domestic prices is a major challenge.

Eighth Challenge: The Need for Labor Reforms

- There are many labor laws in our country at both the center and the state, which often constrains industrial development.
- If there is a need to create more jobs in the country, then the first step will be to reduce the excess of labor laws.
- Due to the harsh labor laws, industrial progress is not possible, which in turn leads to a major cause of non-employment.
- It will be possible to make human resources productive assets by linking labor reforms to business.
- Apart from this, creating a favorable environment for employment generation is also extremely important. For this, where small and medium enterprises need to reduce the burden on one side, the reforms will also have to be linked to the benefits of the workers.

Ninth Challenge: Private Investment

- It is almost impossible to accelerate development in public-welfare country like India, only by government investment.
- In order to strengthen the economy, the government should also consider raising capital expenditure on promoting private sector as well as encouraging the stimulus package.
- Presently private investment has dropped and the reality is that there has been a very small increase in public expenditure on capital.

Expected Questions (Prelims Exams)

1. Consider the following statements -
   1. Reserve Bank of India has forcasted the growth of India to be 7.4% for fiscal year 2018-19.
   2. Animal spirits means the feeling and nature of the influencing behaviour of investor and consumers in market economy.

   Which of the above statements is/are correct?

   (a) Only 1 (b) Only 2

   (c) Both 1 and 2 (d) Neither 1 nor 2

Expected Questions (Mains Exams)

Q. How demonetization, new structure of monetary policy, increasing NPA of banks etc. have affected Indian economy? Discuss.

(250 Words)

Note: Answer of Prelims Expected Question given on 3 Dec. is 1(b), 2(c).