



# India's Economy: How Did We Get Here?

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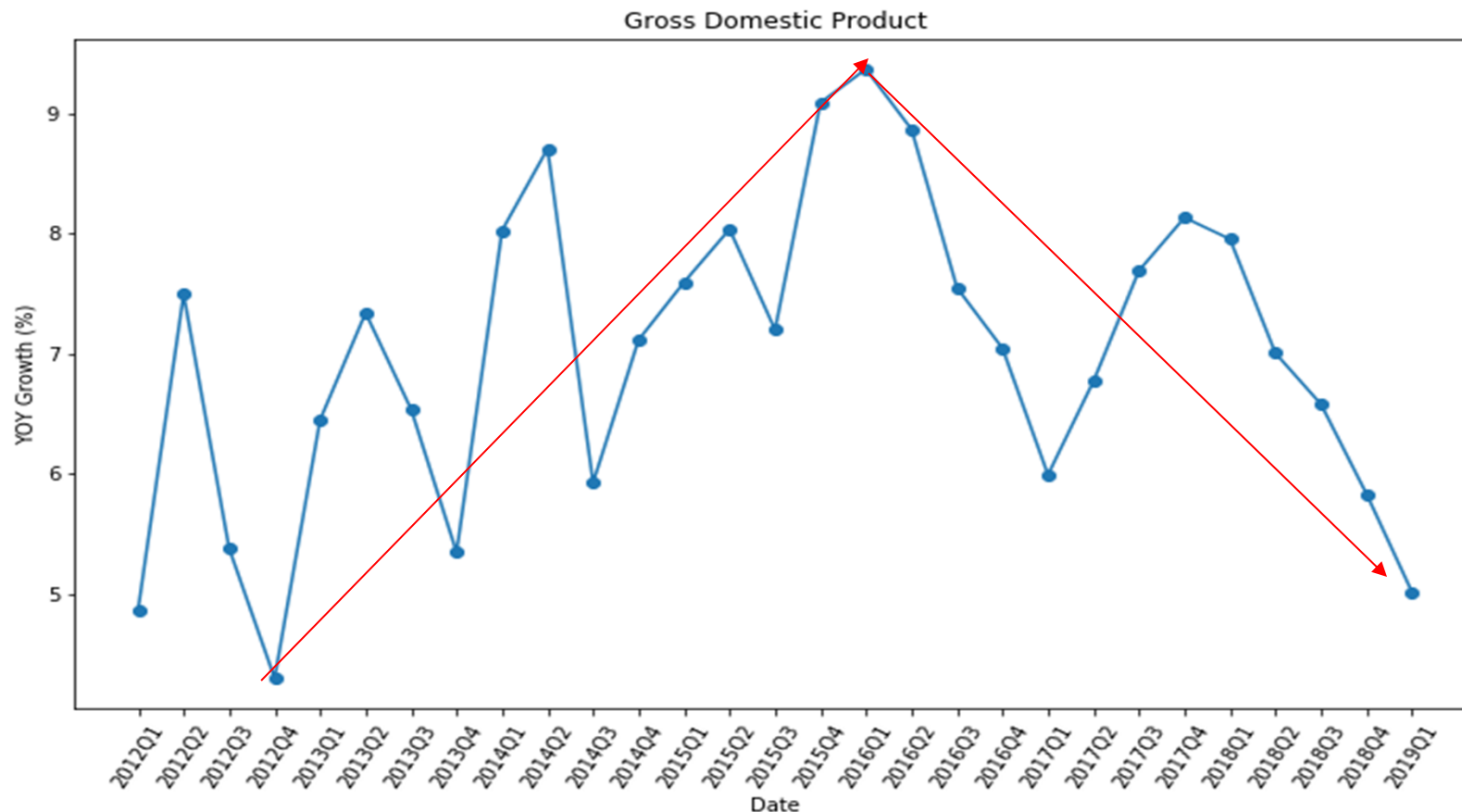


# Outline of talk

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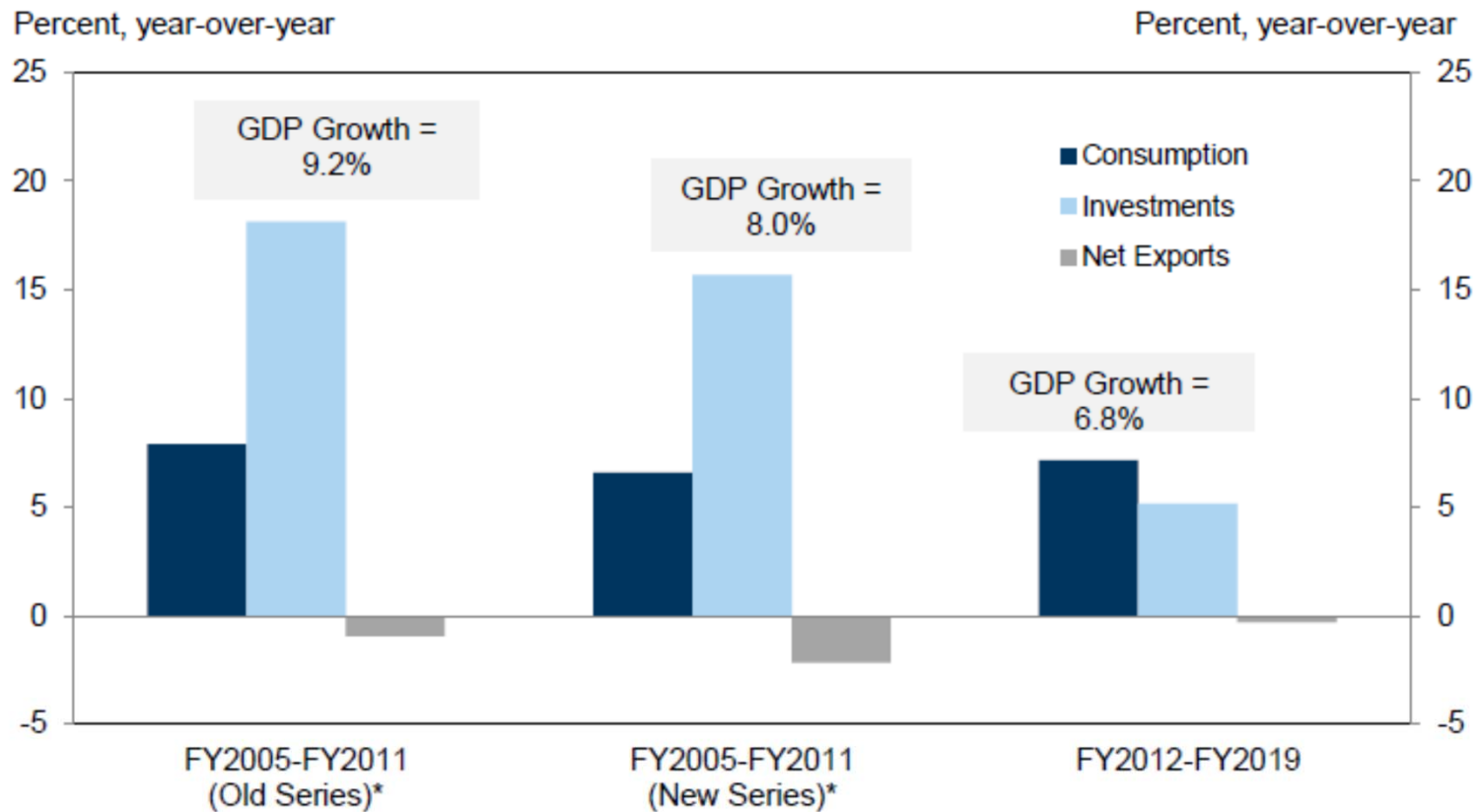
- Signs of deep malaise in the Indian economy
  - Growth is slowing significantly
  - Fiscal space narrowing sharply
  - Debt and distress rising
- What are the roots of the problem?

# Growth and de-growth (not UPA II and Modi I)



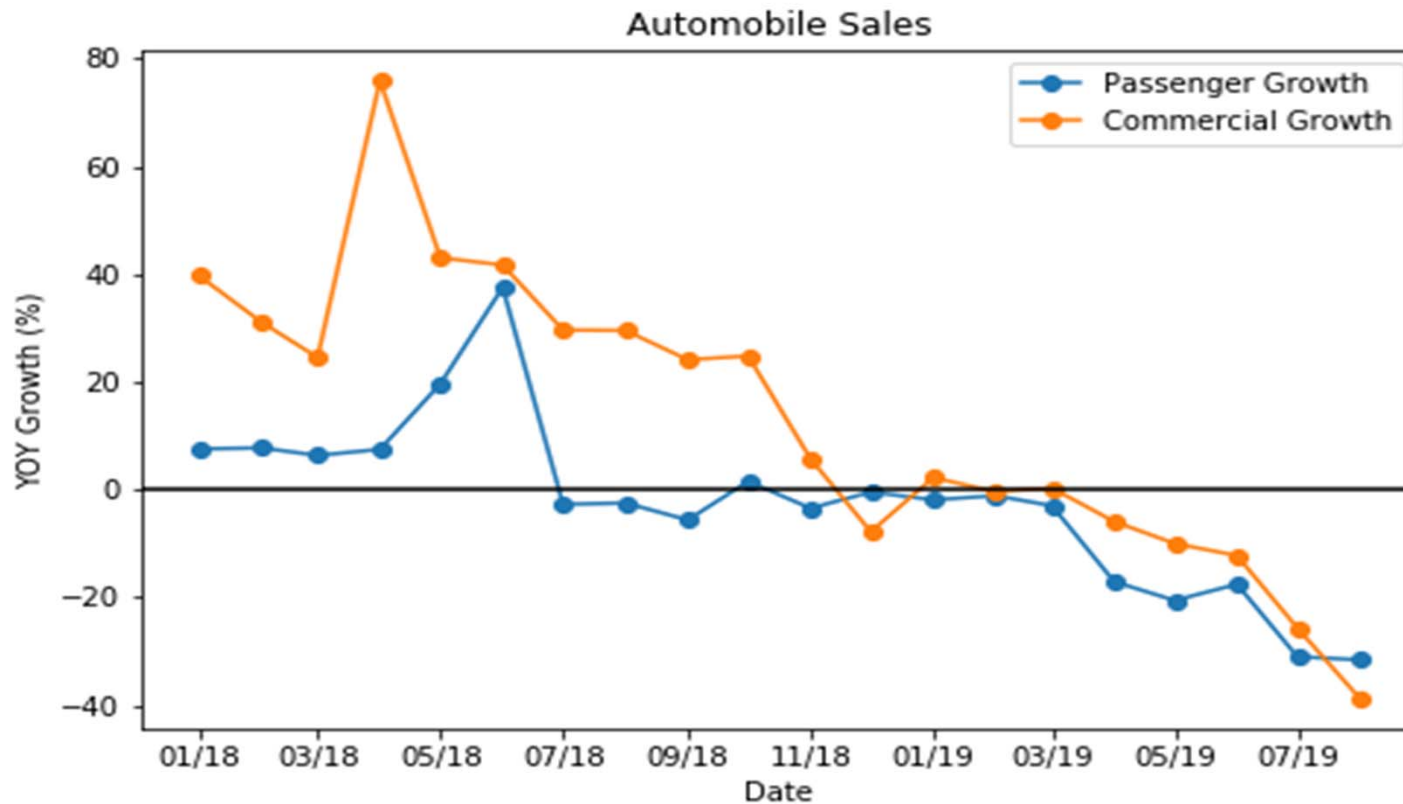
Source: Ministry of Statistics and Programme Implementation  
Based on constant 2011-12 prices

# Long run trends => investment growth falling



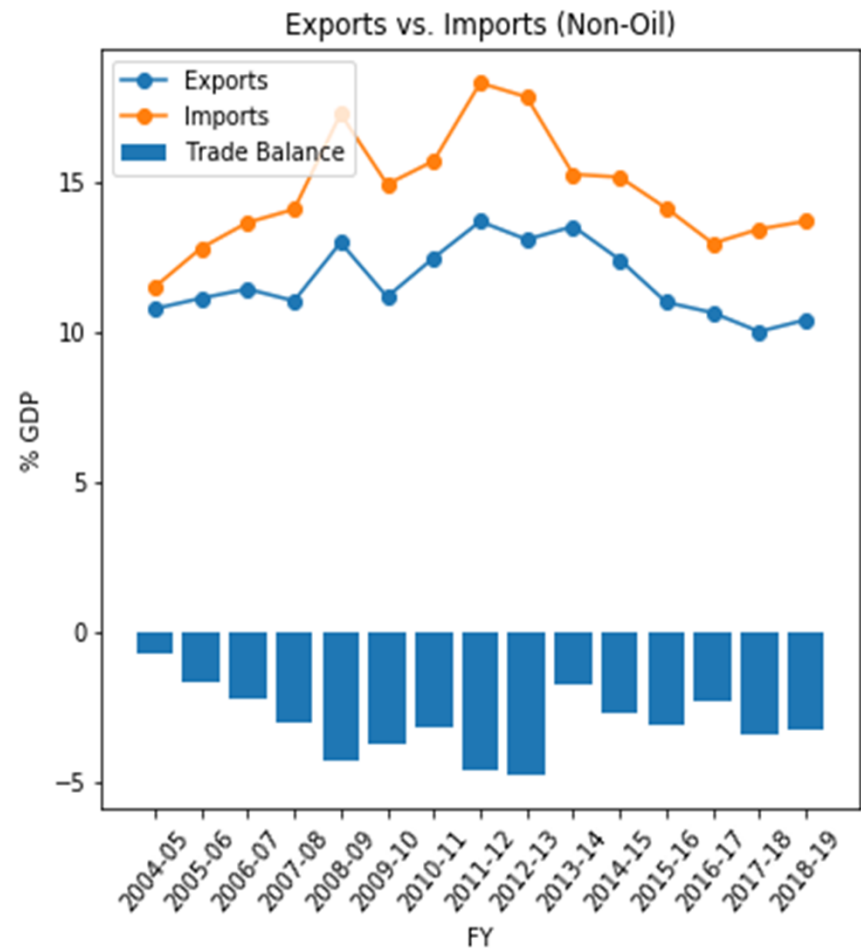
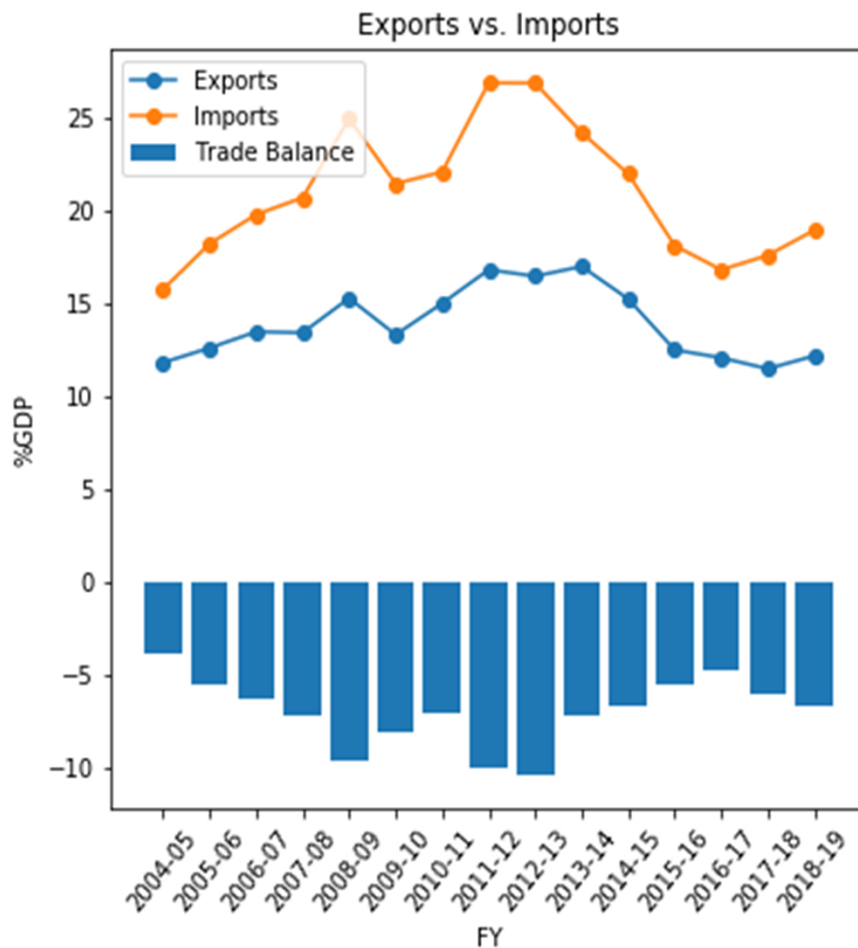
\* Excludes 2009, the year of the Global Financial Crisis

# Consumption was propping up growth – but it is slowing fast too



Source: Automotive Industry Portal Marklines

# Trade Balance – exports have shrunk as a fraction of GDP



Source: Reserve Bank of India

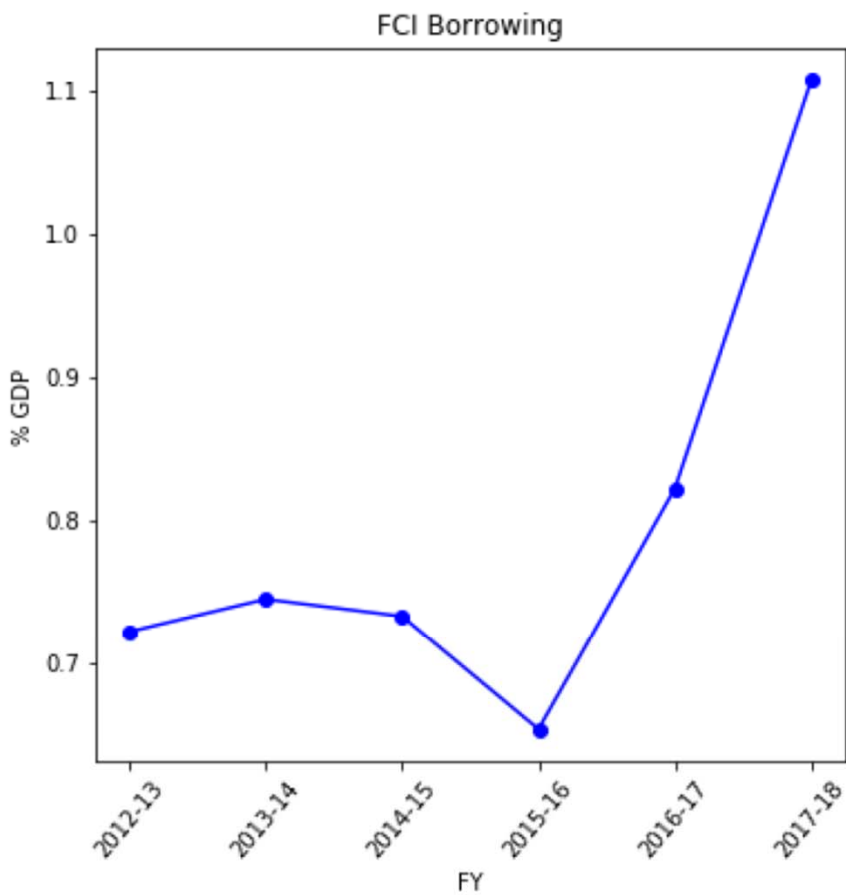


# General government fiscal deficits – officially 7%...

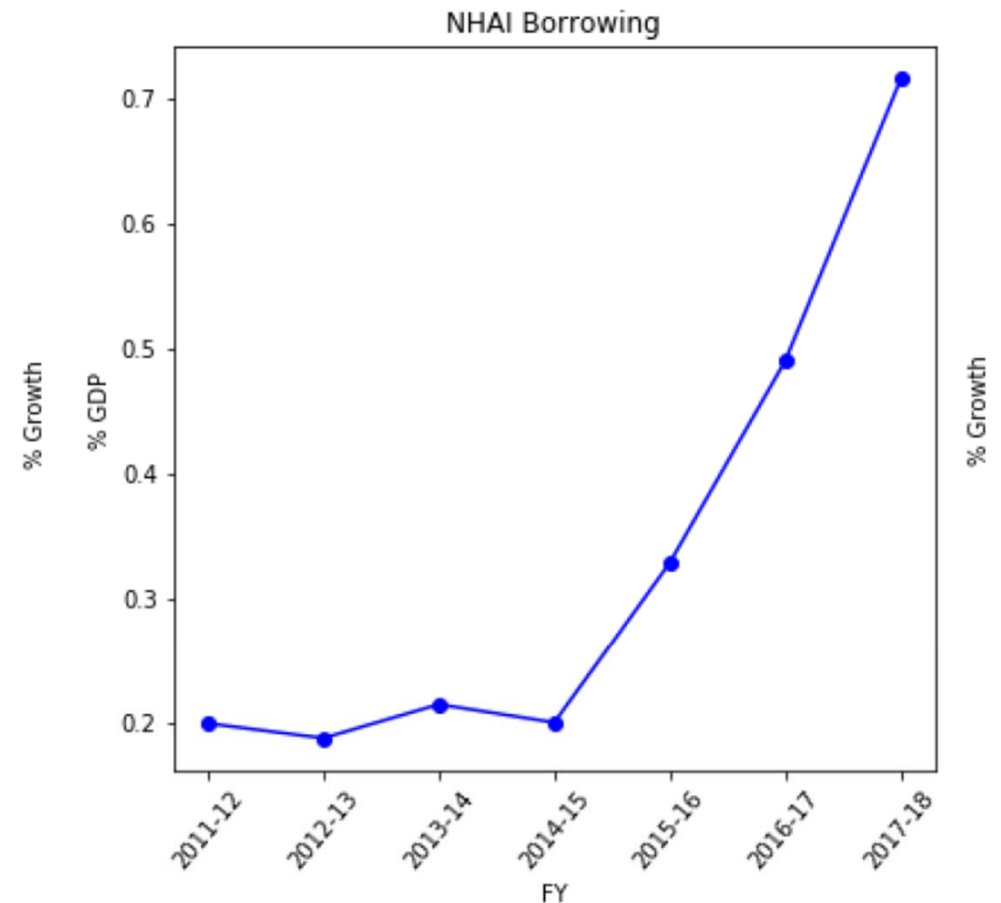
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- But estimated budget revenues are optimistic for both center and states...
- Corporate tax cut adds to burden
- Off-balance sheet **borrowing** (FCI, NHAI, PSB borrowing to pay government dividends) is sky-rocketing
- Contingent liabilities (NPAs, need for recapitalization and bailouts, healthcare commitments) rising
- Public sector borrowing requirement rising – between 9 and 10 percent of GDP today
- **Private debt and distress are growing.**

# Off-balance sheet borrowing



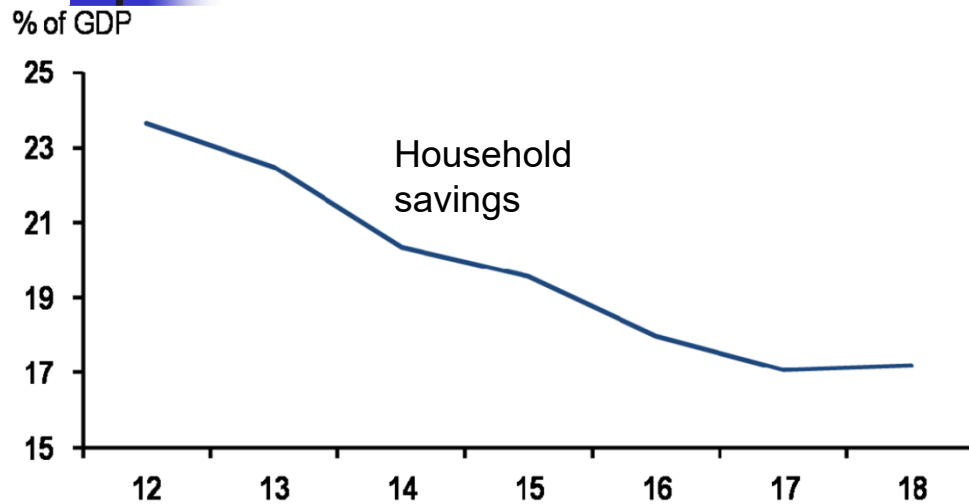
Source: Ministry of Finance and Reserve Bank of India



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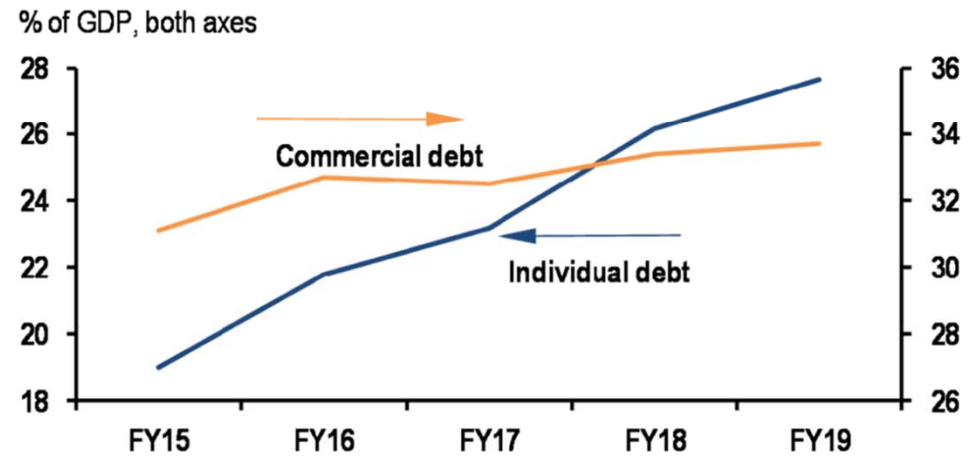


# Private debt and distress rising...

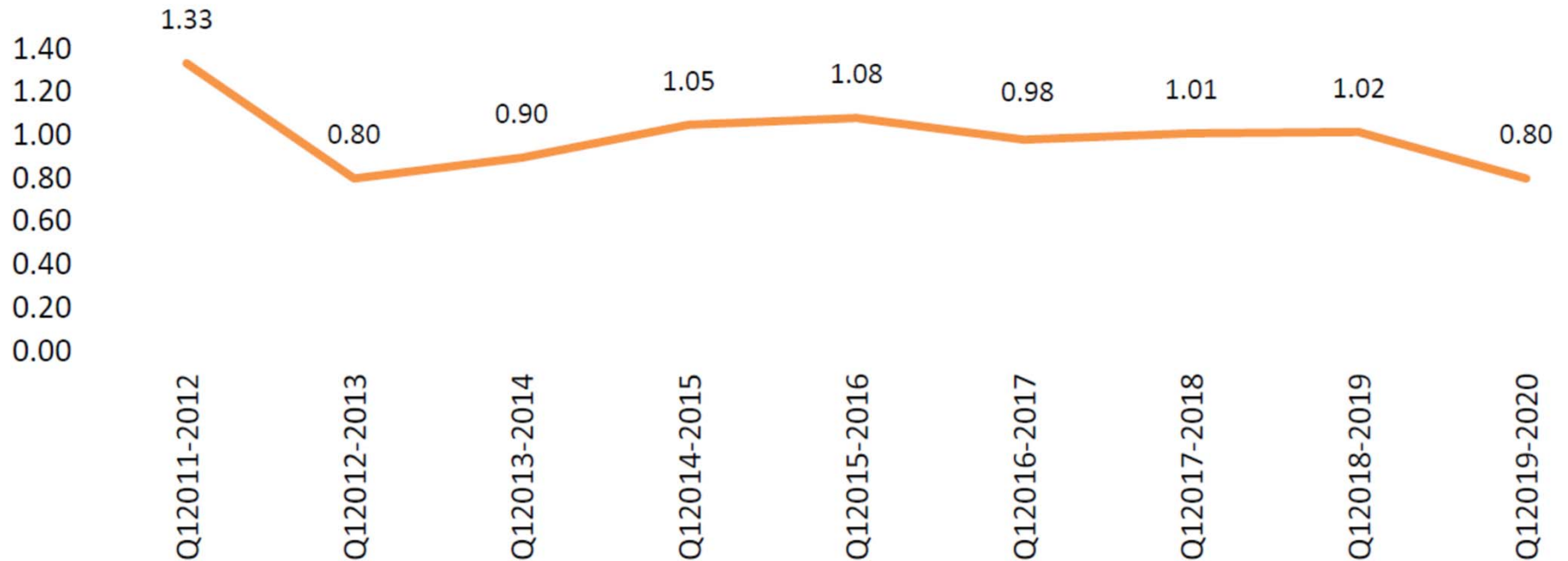


Source: MoSPI

Source: JP Morgan



# Ratio of credit upgrades to downgrades at a six year low



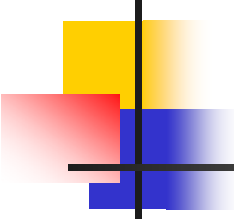
Source: CARE



# Outline of talk

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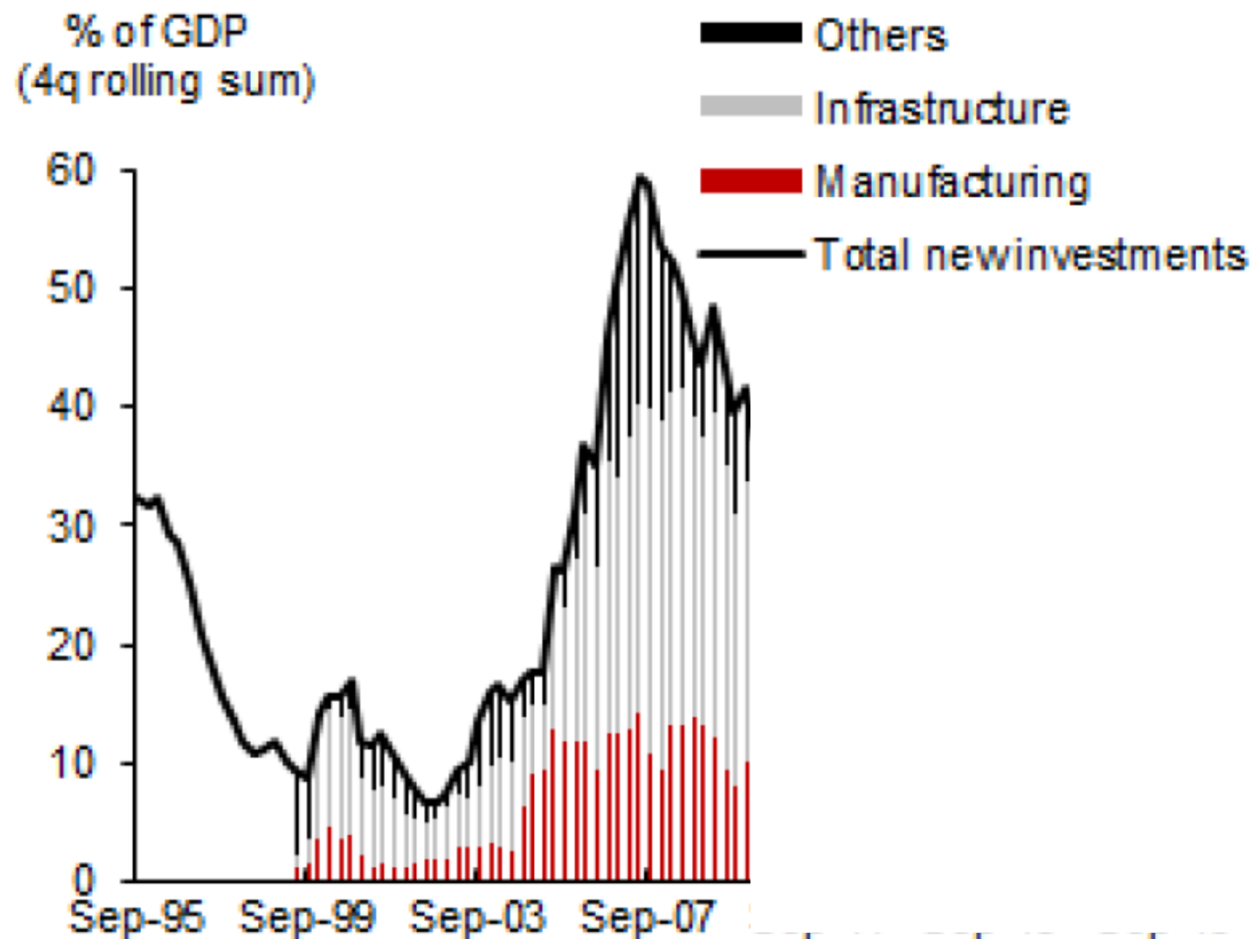


# Growth-friendly liberalizing economic reforms have been scarce since Vajpayee's NDA 1 (1999-2004)

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- NDA 1 did not see strong growth despite significant reforms and its “India Rising” campaign did not convince in the 2004 election
- During UPA 1 (2004—2009) growth benefited from the lagged effects of NDA reforms but coalition partners limited further reforms.
  - Explosion in investment, including infrastructure, strong growth
  - Farm loan waiver rather than growth given credit for UPA's success in returning to power in 2009.
  - Strong growth also put pressure on existing institutions for resource allocation.
    - Land, iron ore, coal, spectrum...

# New projects announced



Source: Nomura based on CMIE Data



# Growth-friendly liberalizing reforms scarce since NDA 1...contd

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- Corruption scandals during UPA II (2009-2014) ...
  - Slowed further growth reforms as opposition turned uncooperative – e.g. GST
  - Refocus on distribution, which had wide support (e.g., food security bill), and expansionary fiscal policy to deal with spillover effects of Great Recession
  - Inflation in double digits
  - Growing road blocks e.g., land acquisition and permissions such as environmental more difficult, exacerbated by new laws and risk averse bureaucracy.
- Course correction on macro-stability started in 2012-13.
  - Government starts fiscal consolidation
- Reinforced by wake up call during taper tantrum in 2013.
  - RBI focused on reducing inflation



# Growth-friendly liberalizing reforms scarce since NDA 1...contd

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- Modi I came in with great expectations: platform of jobs, transparency, and traditional BJP elements like mandir.
- It set about implementing some important reforms.
  - Macro
  - Sectoral
  - Household focused/populist
- Unfortunately, mixed performance and outcomes.

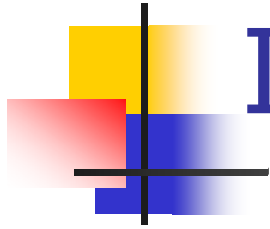


# Modi I – Macro reforms

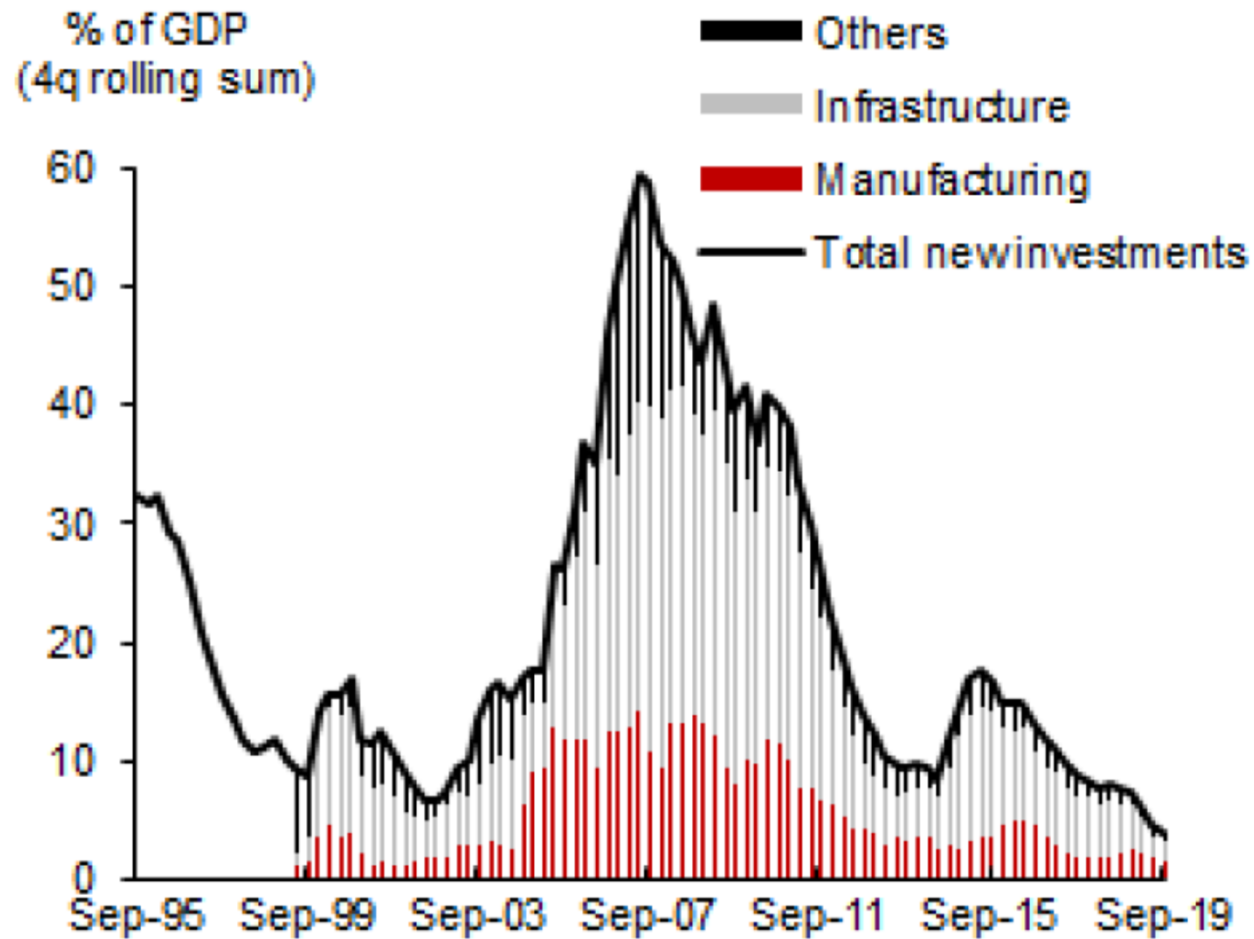
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- Continued UPA II process of identifying project bottle necks and fixing them.
  - With diminishing vigor as promoters lost interest
- Approved inflation targeting by RBI
  - RBI undertook a series of reforms including opening up branching and licensing, improving retail electronic payments, and deepening fixed income and derivative markets.
- Approved AQR (banking sector cleanup), and passed Insolvency and Bankruptcy Code (IBC).
  - But bank recapitalization has been halting.
  - Promoters and judiciary are defanging IBC as they did previous debt resolution approaches.
  - Source of credit growth constantly shifts as sectors get into trouble.
- Demonetization
  - Misguided in concept, initiated without adequate preparation
  - Damage to informal sector hard to measure
  - Damage to construction and real estate maybe “just desserts” but holds back growth
- Goods and Services Tax
  - Sound in concept, initiated without adequate preparation, which undercut compliance, constant fiddling creates uncertainty



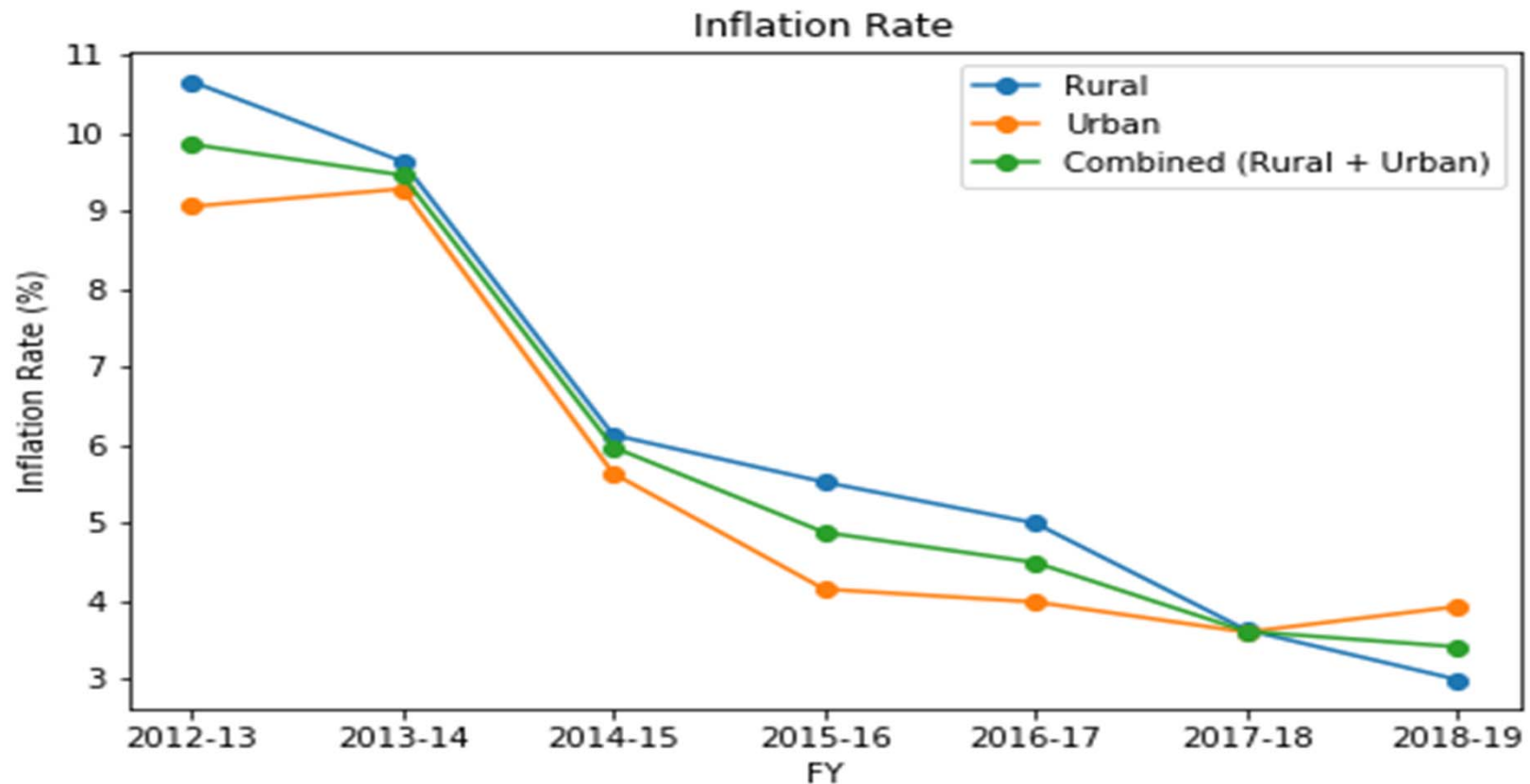


# Investment keeps falling



Source: Nomura based on CMIE Data

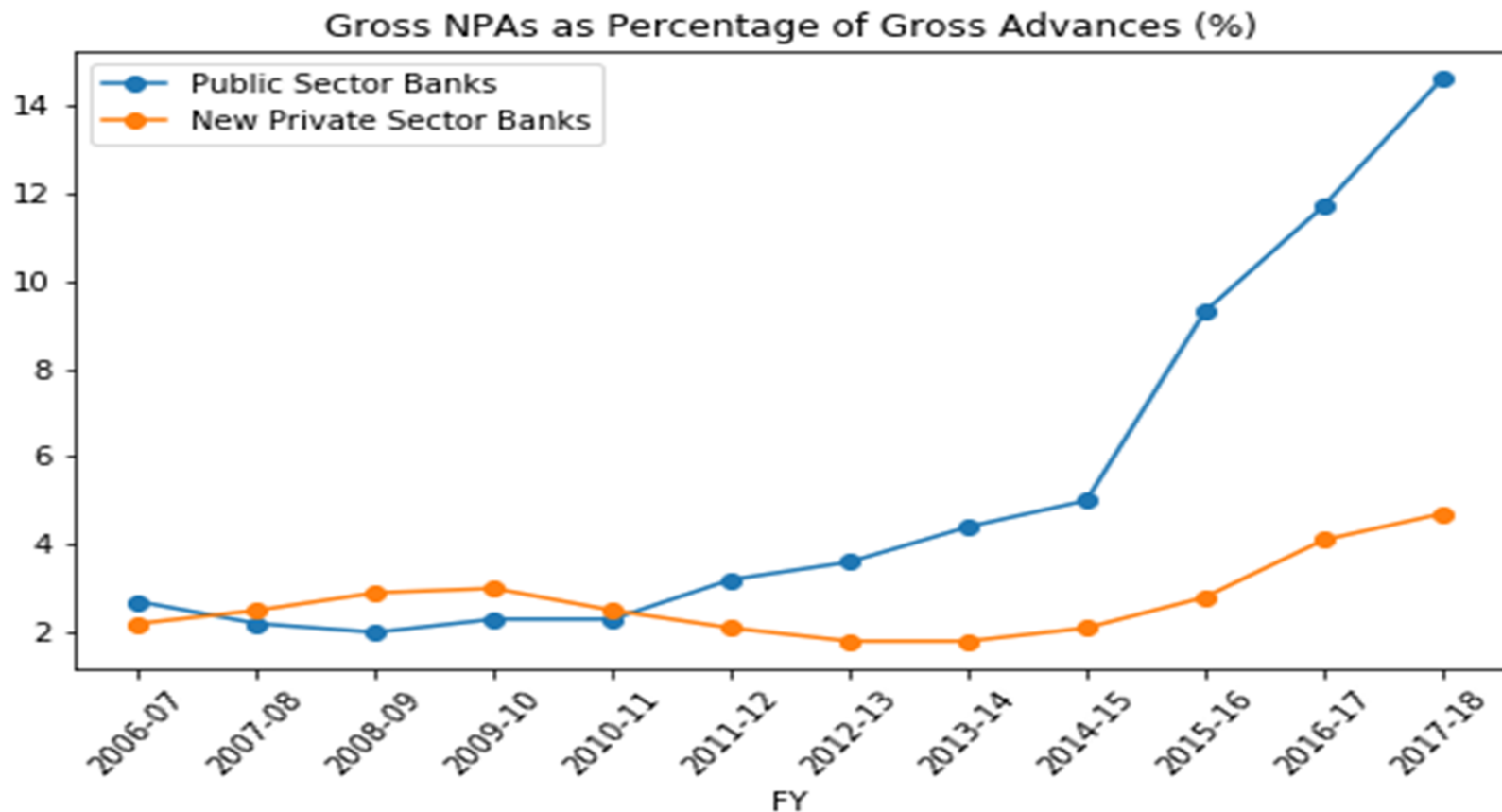
# Inflation control...a success but yet to be fully testedd



Source: Reserve Bank of India

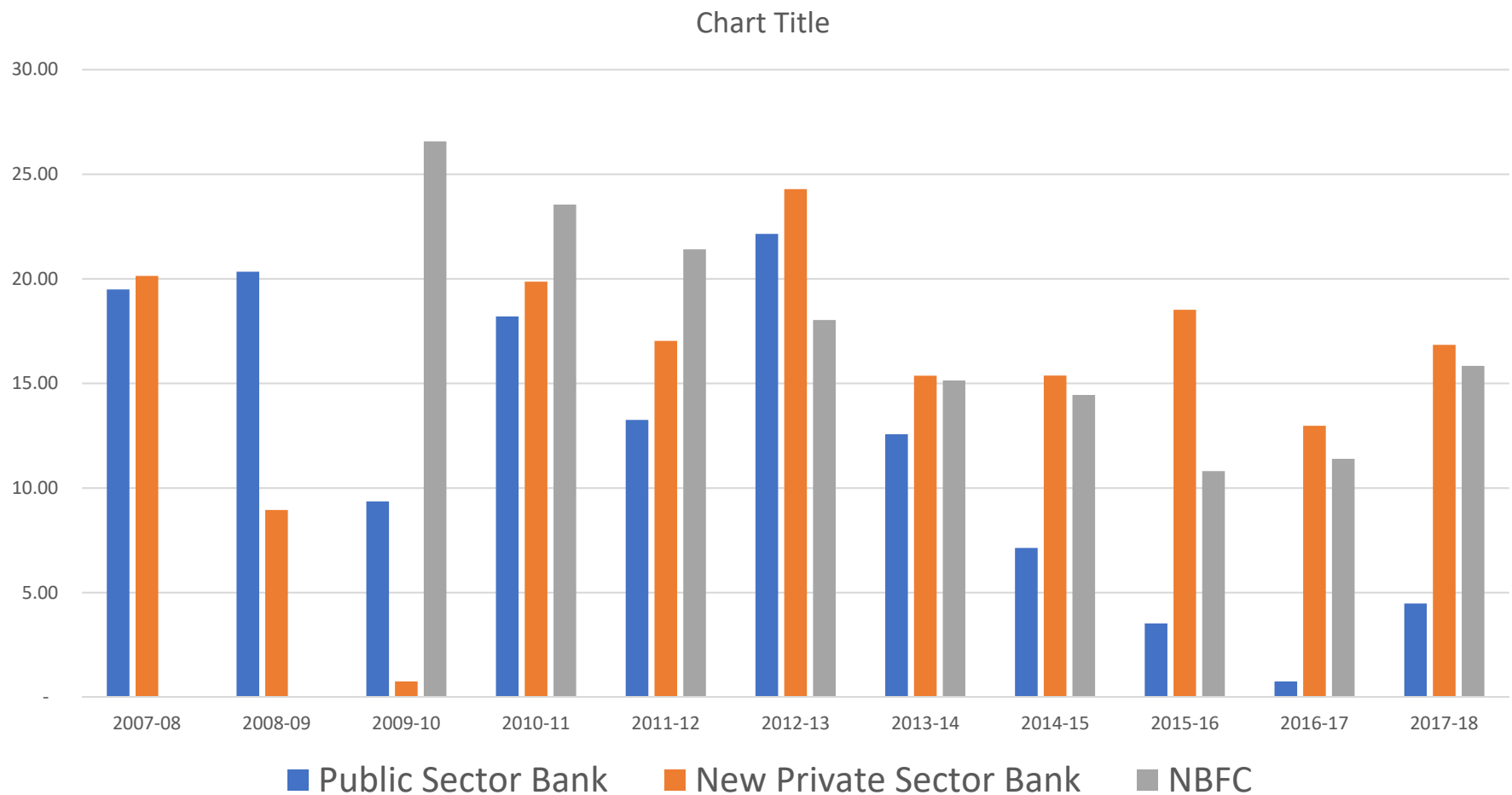
Inflation Rate based on New CPI introduced from January 2011 (Base: 2012=100)

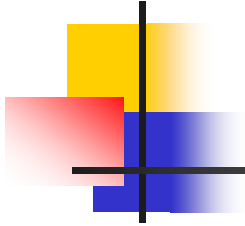
# Rising NPAs, primarily in Public Sector Banks



Source: Reserve Bank of India

# Locus of credit growth – constantly shifting as sectors get into trouble





# **MODI I'S SECTORAL REFORMS**



# Agriculture

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- Objectives: Reduce rents and distortions, enhance productivity
  - Rising production and some reforms (e.g., crop insurance, DBT for fertilizers, e-NAM) but...
  - Not reflected in incomes as productivity growth has been modest, terms of trade have turned down
    - Distortions (costless power, overuse of water, overuse of urea, loan waivers) continue, absorbing resources and diverting production.
    - Agricultural extension, seed provision, and technology upgradation efforts inadequate
    - Fragmentation of landholding continues as tenancy yet to be formalized, increases risk aversion
    - Prevalence of middlemen moderately diminished, but still grab significant rents.
    - Periodic bans on exports favoring customers at the expense of farmers
    - Inadequate procurement in PDS, so support prices ineffective in many parts of the country
  - Inadequate value added to agri products through rural industry, in part because of inadequate links to final markets

# Falling terms of trade in agriculture

Index (Nov95 = 100)



Source: Labour Bureau, JPM Research



# Power

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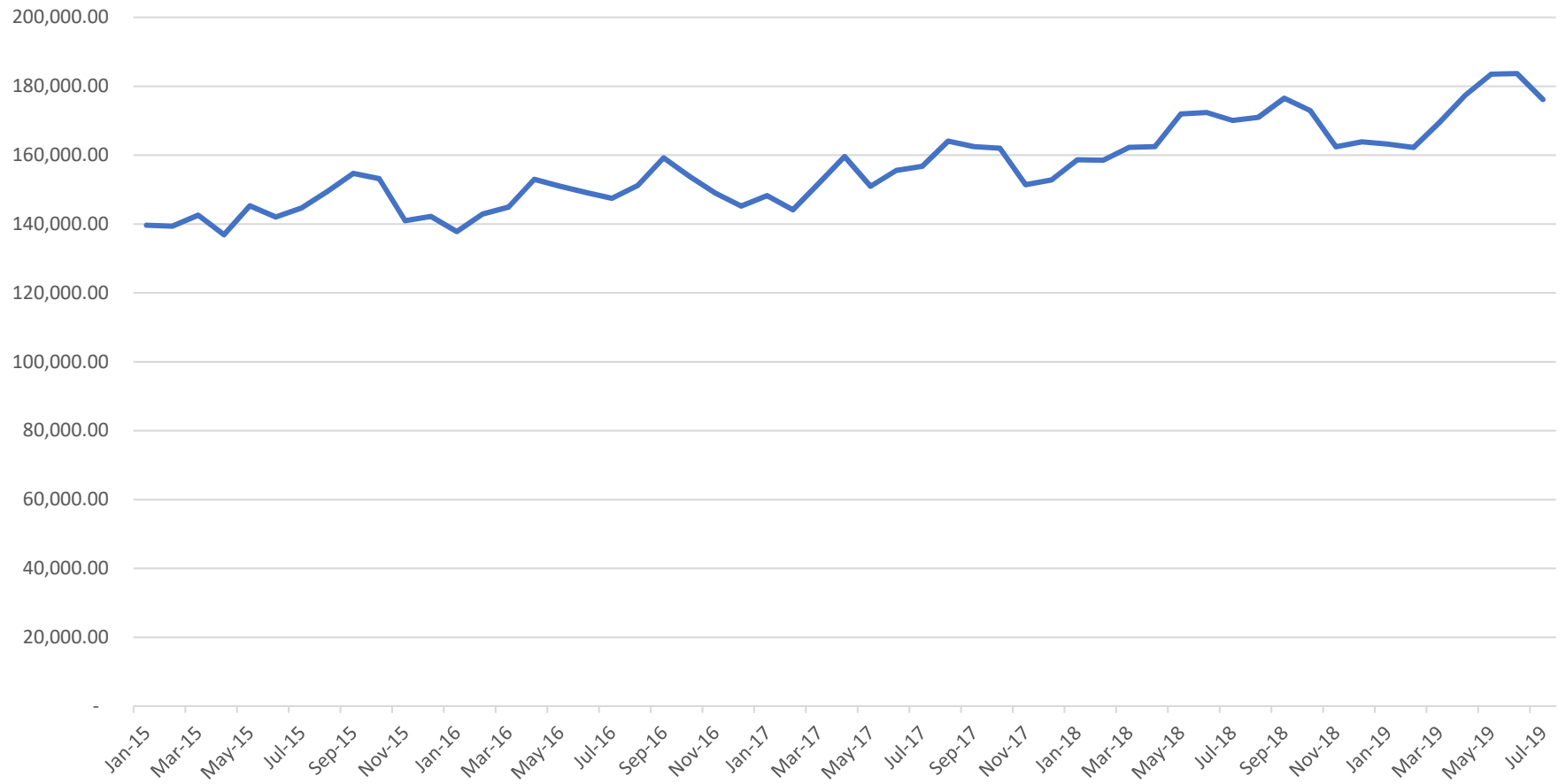
- Power sector objectives
  - Restoring power distribution companies to health: largely unsuccessful thus far
    - Uday – same focus on financial engineering... same outcome: Power underpriced, efficiency low, theft high, losses mounting
  - Moving to renewables: more success
    - Need states to adhere to contracts, and banks to be careful in lending.
    - Need adequate pricing of balancing capacity
  - Revive stranded power plants: work in progress
    - Underutilized generation, but we still lack 24-7 power through the country
  - **Spread of electrification** an important success.



# Electricity supply growth steady at 6.5%, though



Peak Demand (All India)





# Banking and finance

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- Banking sector reforms
  - Limited efforts including creation of Bank Board Bureau to make public sector appointments
    - Undercut by Finance Ministry from outset
  - PSB bank boards have little power and continue to be politicized, banks have limited executive experience and capability in pipeline
    - PSB overstaffing and overpaying at lower levels, underpaying at upper levels and limited capabilities
    - Bank consolidation without any mandate for rightsizing will divert managerial attention and add new bureaucratic battles
  - Government mandates continue
    - Mudra loans, MSME forbearance, loan melas



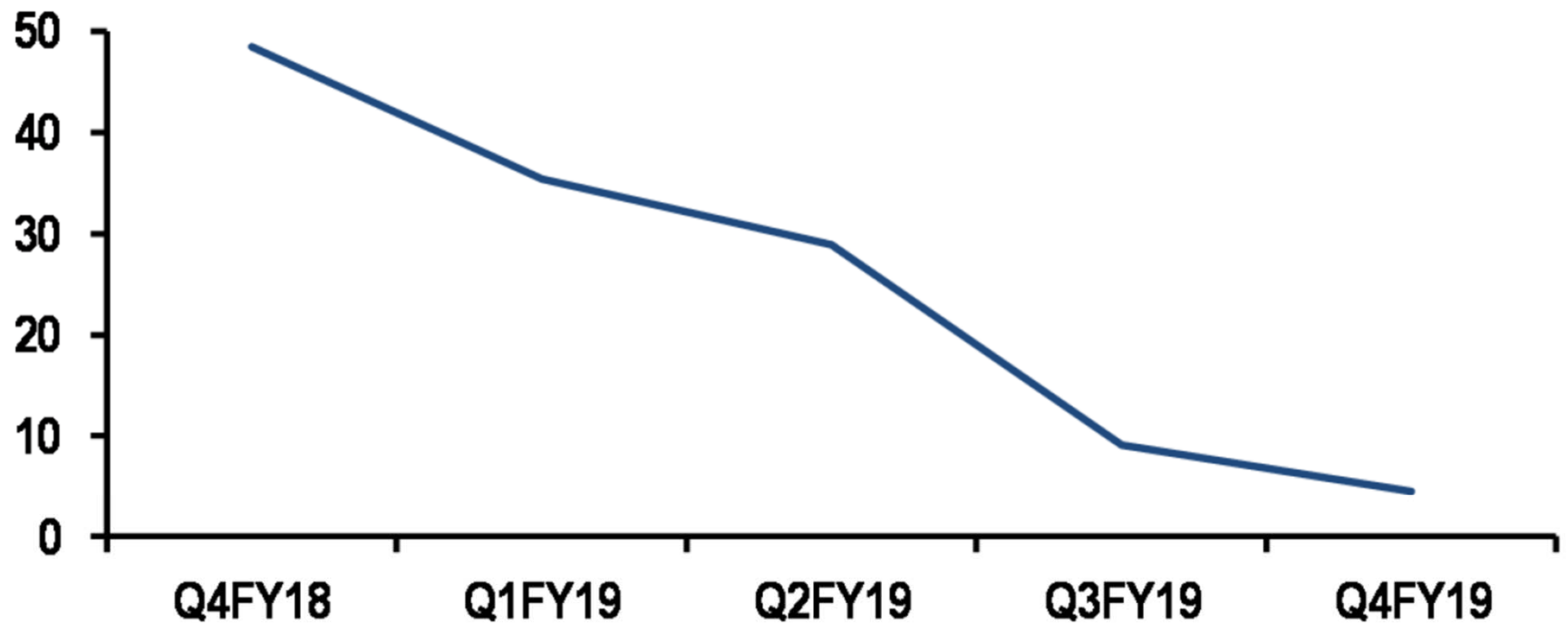
# Banking and finance contd.

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- Shifting problems as growth slows and other reforms stall
  - Private banks, co-operatives, and NBFCs not immune to mis-governance.
  - Corporate credit hard in a slowing economy which has limited means for recovery.
    - Importance of data, informational intermediaries, and IBC.
    - Use shadow of IBC as threat rather than first resort
  - Need to distinguish genuine loss from appropriate risk taking from fraud.
    - Investigative agencies often mix the two up, which chills risk taking and makes it harder to catch the fraudster.
- Perhaps excessive focus now on retail loans as corporate loans become difficult

# NBFC lending after ILFS

% oya



\*aggregate of 8 major NBFCs for which data is available

Source: Company reports

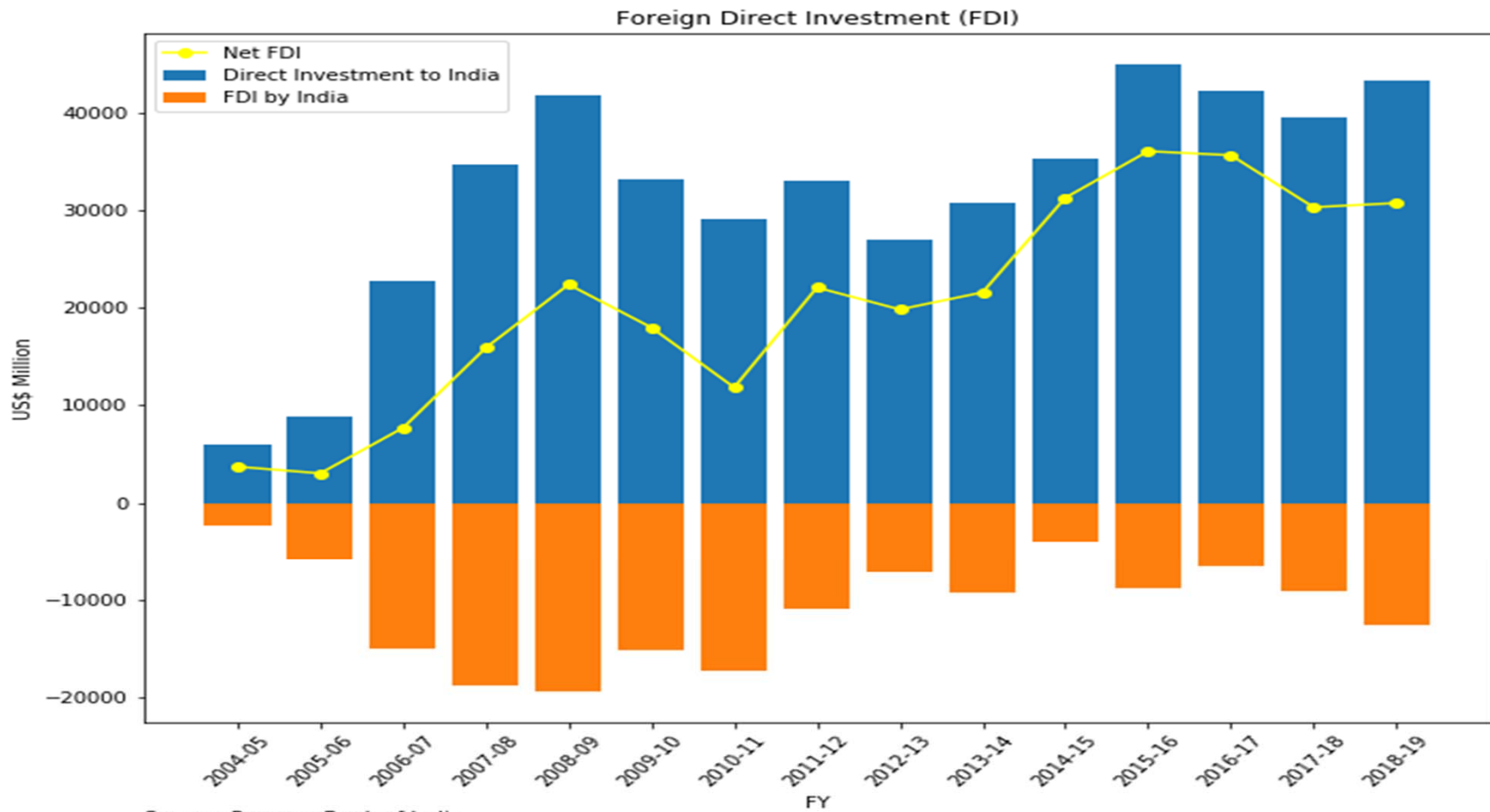


# Trade and investment

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- Attempt to make Indian growth more export-led and substitute imports: Make in India.
- Objective: India should be more business friendly
  - Ease of doing business
    - Unfortunately, focus on World Bank indicators, not the specifics that make India difficult
    - No zero-budgeting on past regulations
    - Arbitrary changes to regulations – e.g., Amazon and Walmart
  - Low and stable taxes and tariffs.
    - Corporate taxes lowered but tariffs hiked. Constant fidgeting with taxes and tariffs makes planning more difficult
    - Tax authorities have been greatly empowered with few checks – they can levy demands that are hard to reverse.
  - Logistics, power, land, office space, and qualified manpower still inadequate and costly compared to India's competitors
  - FDI, textiles, and phones.

# Foreign Direct Investment (FDI) flatlining at best since 2008



# No sharp growth in textile share even as China's share falls

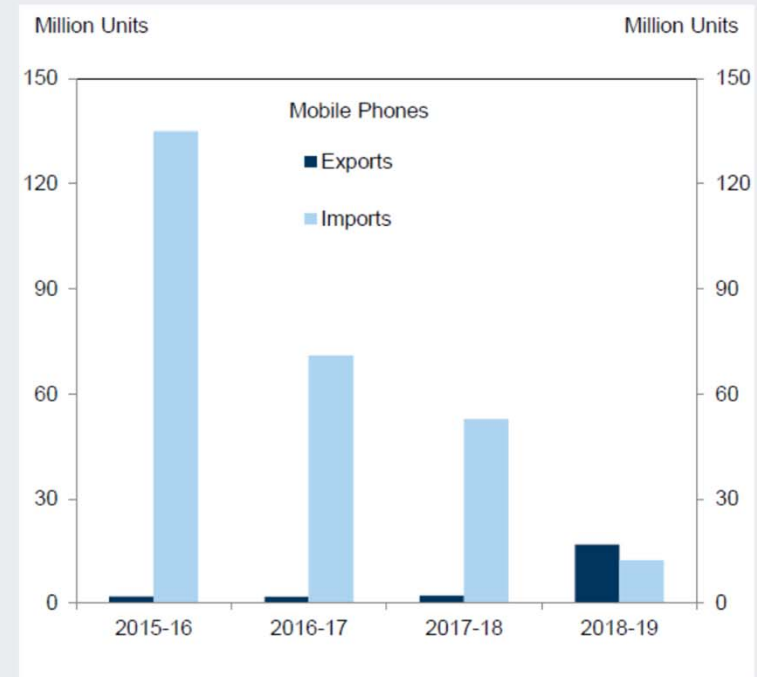
Top exporters of apparel	Value (USD Bn)	Share in world exports			
	2018	2000	2005	2010	2018
China	158	18.2	16.1	36.6	31.3
European Union	143	28.7	31.0	28.4	28.4
Bangladesh	32	2.6	2.5	4.2	6.4
Vietnam	32	0.9	1.7	2.9	6.2
<b>India</b>	<b>17</b>	<b>3.0</b>	<b>3.1</b>	<b>3.2</b>	<b>3.3</b>
Turkey	16	3.3	4.2	3.6	3.1
Indonesia	9	2.4	1.8	1.9	1.8
Cambodia	8	0.5	0.8	0.9	1.6
USA	6	4.4	1.8	1.3	1.2
<b>Total of Above</b>	<b>421</b>	<b>69.0</b>	<b>76.1</b>	<b>83.1</b>	<b>83.3</b>

Source: WTO, Goldman Sachs Global Investment Research

# Growth in phone assembly, but value added likely small

Production of Electronic Goods in India (US\$Bn)	2014-15	2015-16	2016-17	2017-18	2018-19
Consumer Electronics	9.1	8.5	9.7	11.4	11
Industrial Electronics	6.4	6.9	9.3	10.7	11.6
Computer Hardware	3.1	3	3	3.3	3
Mobile Phones	3.1	8.2	13.4	20.5	24.3
Strategic Electronics	2.6	2.8	3.1	3.7	4
Electronics Components	6.5	6.9	7.8	9.2	9.7
Light Emitting Diodes	0.4	0.8	1.1	1.5	1.9
<b>Total</b>	<b>31.2</b>	<b>37.1</b>	<b>47.4</b>	<b>60.3</b>	<b>65.5</b>

Composition of India's Electronic Imports (% of Total)	2014-15	2015-16	2016-17	2017-18	2018-19
Consumer Electronics	11.2	10.3	9.5	8.5	8.8
Electronics Instruments	14.7	14.7	14.5	13.4	14.4
Computer Hardware, Peripherals	19.7	18.8	16.4	15.9	16.1
Electronics Components	14.6	17.8	20.1	19.8	28.4
Telecom Instruments	39.9	38.5	39.5	42.4	32.2
<b>Total</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>



Source: Ministry of Electronics and Information Technology, Ministry of Trade and Commerce, Goldman Sachs Global Investment Research

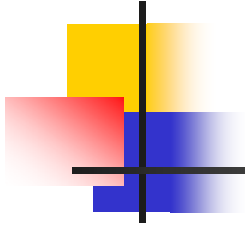




# Household-focused/Populist programs

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- Jan Dhan– Adhaar—Mobile: Direct cash transfer of many benefits, subsidies, pensions, scholarships
- Swacch Bharat: Clean India, toilets for all
- Pradhan Mantri Ujjwala Yojana – cooking gas connections for poor
- Ayushman Bharat – healthcare for the poor
- Probably area where Modi-I has achieved the best outcomes, but needs rigorous evaluation:
  - Usage of accounts/toilets/cooking gas
  - Fraud – e.g., in healthcare claims



# **PUTTING IT ALL TOGETHER: WHAT EXPLAINS THE SLOWDOWN?**



# Is it just global factors?

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- IMF global growth

2013-16: 2.7%    2017-19: 3%

- Global trade volume growth

2013-16: 3.1%    2017-19: 4.2%

- Oil price

2013-16: 73.5 \$/b    2017-19: 60.1 \$/b

=> Global factors don't seem the proximate culprits.

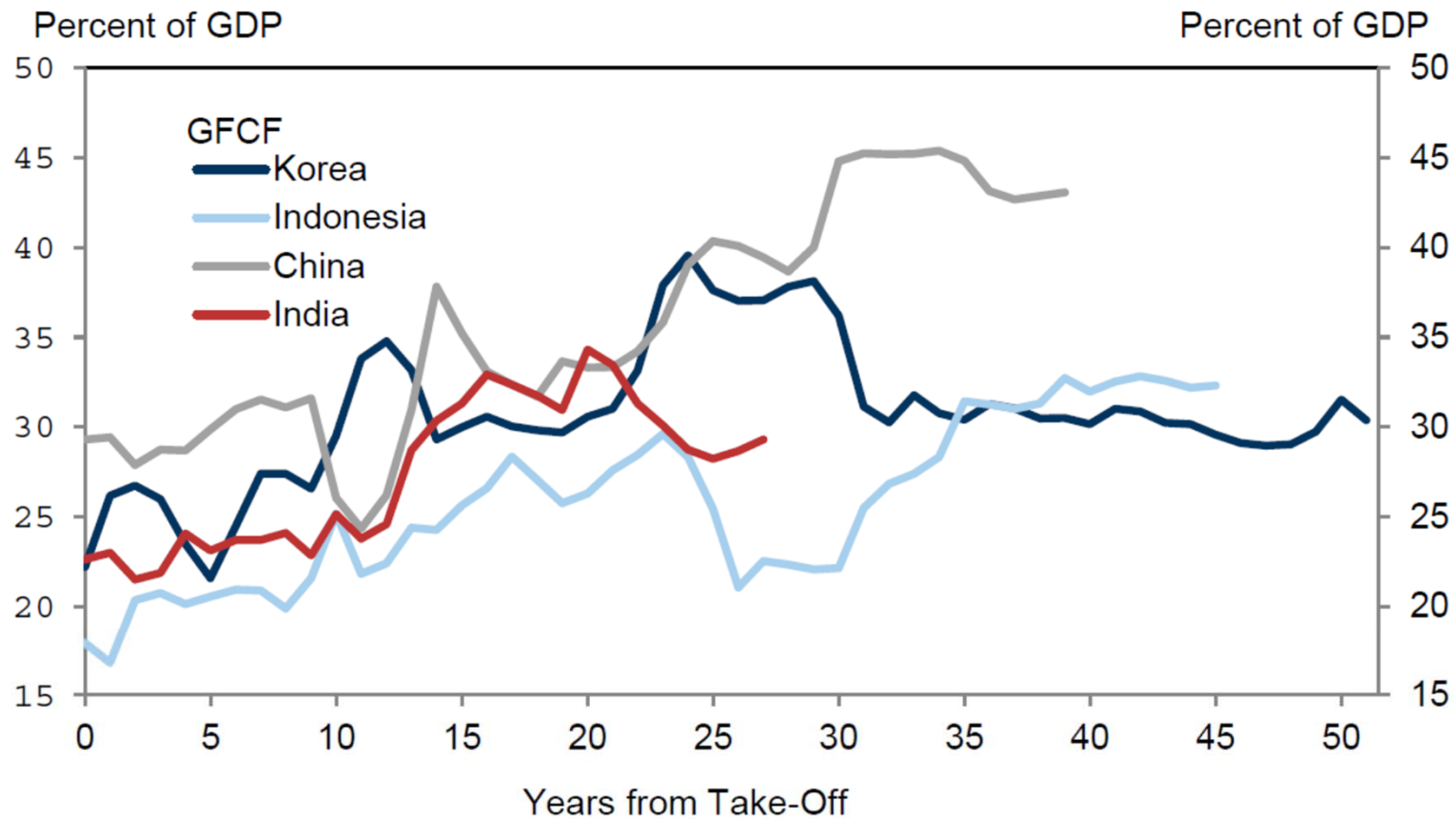


# Alternative suspects

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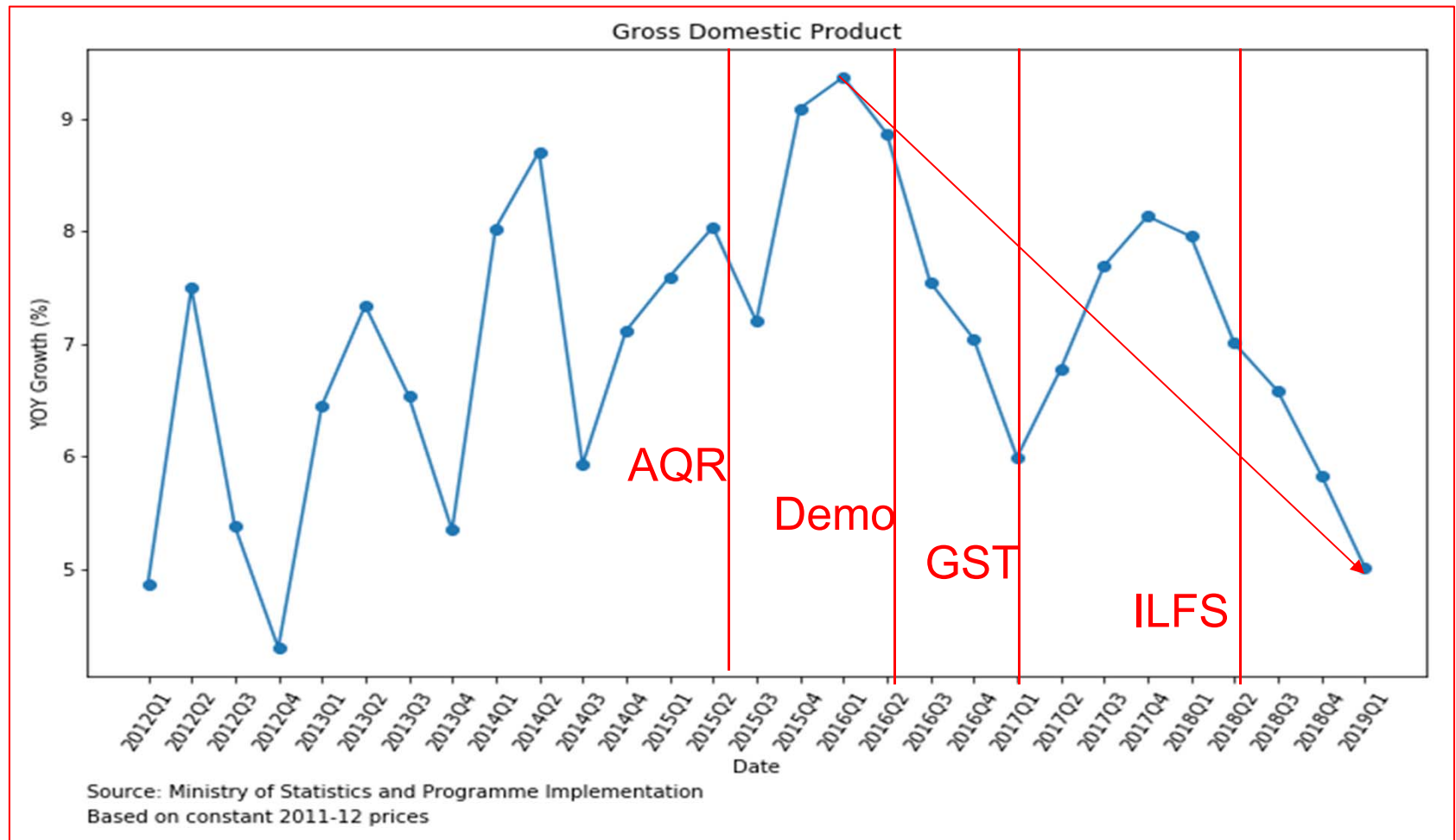
- NBFC crisis? May explain some but not all.
  - GDP growth started slowing before, from first quarter 2018
  - And household leverage was already growing rapidly, with household savings falling.
  - That implies household incomes were not keeping up with consumption needs – eventually borrowing would be unsustainable
- Low job growth and low productivity growth impeding household income growth?
  - Probably a better explanation
  - Linked to **slow investment**, and slow pace of tackling legacy problems like stalled projects and over-indebted firms and banks
  - Compounded by **acts of commission** – poorly conceived demonetization and poorly executed GST – as well as acts of omission – limited factor market reforms: land, labor, logistics, power, finance ...

# Investment slipping relative to fast growing peers



Source: Haver Analytics, Goldman Sachs Global Investment Research

# Net effect of low investment and policy mistakes: slowing growth...





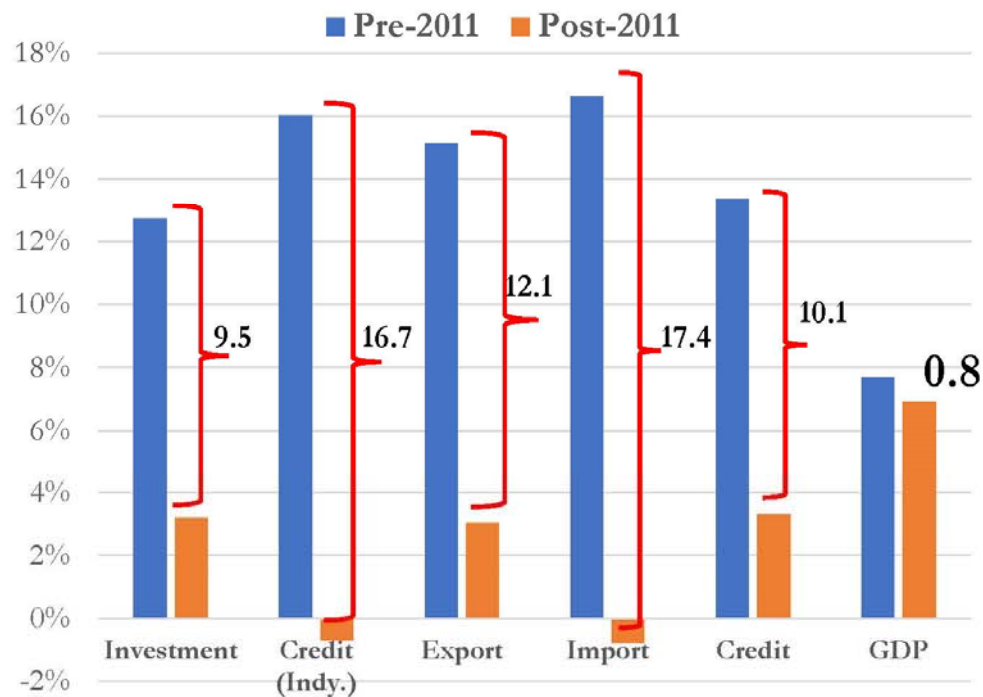
# All this before we even address Arvind Subramanian's critique

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- He estimates growth between 2011-12 and 2016-17 (before the slowdown starting in 2018) to be between 3.5 and 5.5 percent, not the average 7 percent ([see slide from his presentation](#)).
- Attributes it partly to incorrect use of output price deflators in deflating input prices.
- A persuasive reason to look more closely at his concerns: direct tax [data](#)
- Could GDP mismeasurement (in the other direction) account partly for current slowdown?
  - Possibly, but auto sales collapse is real and extends across the board!
- Bottom line from his critique: Need commission of independent experts to analyze our statistics and restore their credibility.

# Central puzzle: Collapse in major demand indicators barely register on GDP

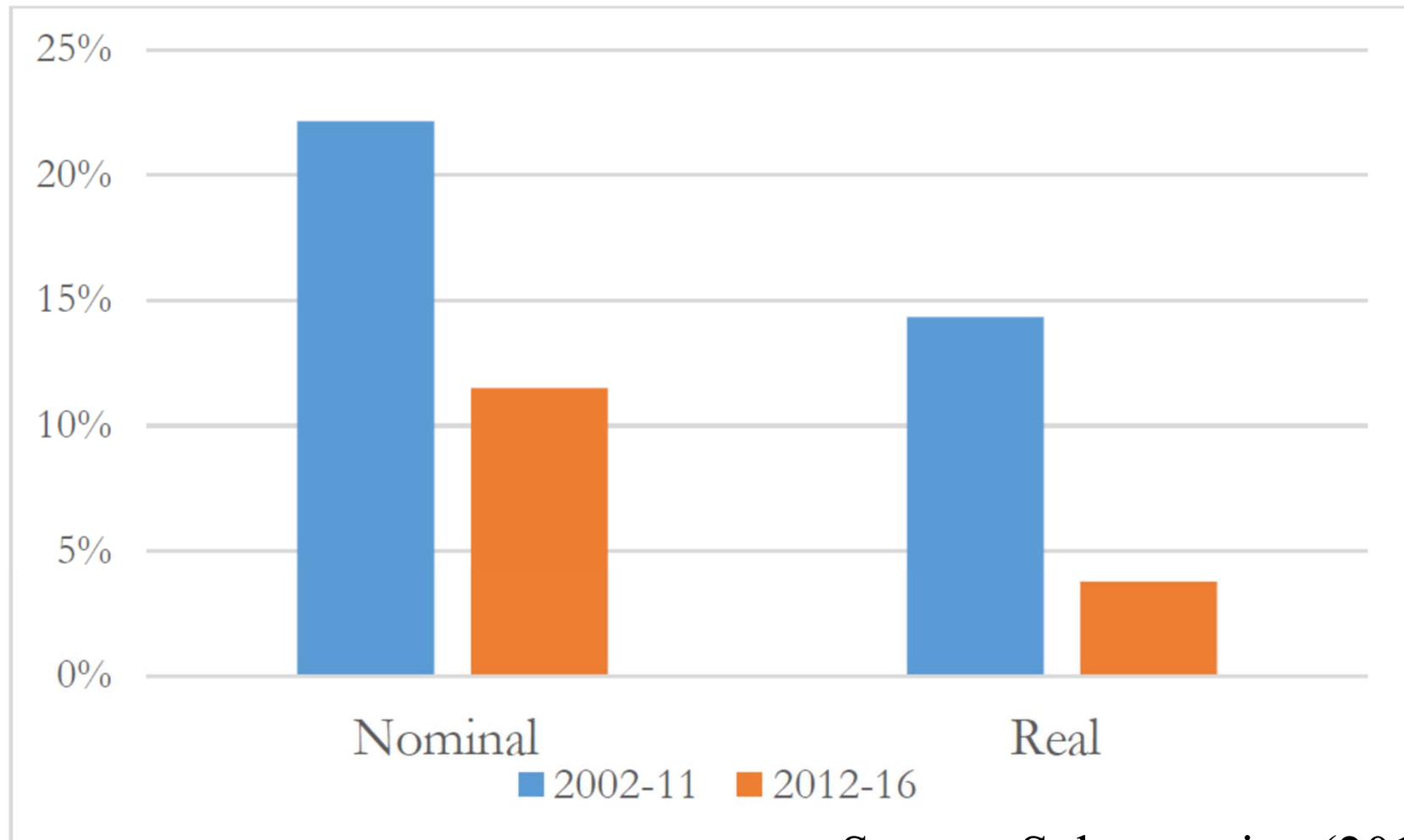
*Growth in Demand Indicators and GDP, Pre-and Post-2011 (%)*



- Shocks caused key macro “engines” to stall:
  - Investment (and credit to industry and profits)
  - Exports
  - Imports
  - Credit
  - Direct tax revenues
- Illustrative magnitudes: A 12 percentage point reduction in export growth can reduce GDP growth by 3 percentage points!
- Yet measured GDP growth slowed only marginally
  - 7.7 percent to 6.9 percent



# Growth in Center's direct tax collections: Pre- and Post-2011



Source: Subramanian (2019)



# Summary

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- Signs of deep malaise in the Indian economy
  - Growth is slowing significantly
  - Fiscal space narrowing sharply
  - Debt and distress rising
- What are the roots of the problem?
  - India is losing its economic way, in part because it is centralizing power without a persuasive economic vision.
  - We risk wasting the demographic dividend and exacerbating internal unrest as joblessness mounts.
- What might be the way forward?
- The issues in red will be the focus of my second talk on Friday