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Indian Economy: Visible Weaknesses and Invisible Strengths

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Dear respected Eisuke Sakakibara San, Governor Haruhika Kuroda San, Excellency Shri Raj Kumar Srivastava, respected Yorihiko Kojima San, respected Takehiko (Ken) Koyanagi San, and respected Hiroshi Sugaya San,

I am grateful to the Institute for Indian Economic Studies and, in particular to respected Sakakibara for bestowing on me the honour of addressing this Symposium. He is renowned globally as Mr. Yen, a currency Czar and is held in high esteem.

Japan came forward with liberal assistance when we were desperate for foreign exchange during the crisis of 1991 and we were selling our gold. Japan had confidence in our determination to discharge liabilities, irrespective of the political turmoil we were going through.

My speech on Indian economy today is by way of expressing gratitude to Japan for the timely help and to explain how India has proved worthy of the trust that has always been reposed by Japan. Professor Joan Robinson, globally renowned economist, commented about India. "Whatever you can rightly say about India, the opposite is also true." Though this quote is half a century old, it still seems to be valid. If we claim that Indian economy is strong, it will be equally true to say that Indian economy is weak. Today I will attempt an overview of weaknesses, the strengths, and performance relative to other countries, the immediate concerns and prospects for the future.

Weaknesses:

Glaring weaknesses in Indian economy are poor social infrastructure, frustrating physical infrastructure and messy administrative setup with a reputation for corruption. The coverage of health facilities and the quality of education are dismal by all accounts, though there are islands of excellence. Our physical infrastructure is by all accounts closer to the poorer developing countries, than middle income countries. On matters relating to energy and water, shortages persist. The inequalities among the regions and between various segments of population continue to widen. Disturbing factors that are extremely difficult to reverse are environmental degradation and collapse of educational system. The size of the government has shrunk since reform while the quality of governance appears to be deteriorating.

Poverty in India has gone down both in terms of absolute number of people as well as percentage of total population. However, we need to grow at a very high rate to eradicate incidence of poverty in a big way

Strengths: Political System Stability

By and large, Indian economy has been stable among the emerging market economies despite the weaknesses. India has been one of the fastest growing economies particularly after the reform. I will mention four possible, but not so visible, sources of strength, namely, Political System Stability; Long-term Performance; Living in Diversity and Competition; and Affirmative Actions and Vibrancy.

Winston Churchill said (1931) famously, "India is an abstraction, ... India is no more a political personality than Europe. India is a geographical term. It is no more a united nation than the Equator."

Many thought that India will end up like Europe where two World Wars were fought to settle the matters of nation-states in the context of languages. Europe is still to realise dream of European Union. Actually, India has become Union of states based on language, with both English and Hindi as official languages of the Union.

Gunnar Myrdal in his monumental book "Asian Drama" (1968) described India as a soft State. Such soft states were seen as unlikely and not capable of imposing "the right development policies".

Selig Harrison in his book "India, the most dangerous decades" (1960) argued that India will break up unless a dictatorship replaces Democracy.

India has proved them wrong. In fact, the problem now is in Britain with Scotland and in Spain with Catalina threatening to secede. USSR, the darling of the developing world at the time of our independence, does not exist.

Long-term Performance

I was in Pakistan in Karachi in February 2018 for a book release event: "Governing the Ungovernable" (2018) by Dr. Ishrat Hussain. He pointed out that Pakistan out performed India after Independence till 1990. Since mid 90s, India's growth accelerated and that of Pakistan decelerated. The critical question raised is: Why Pakistan falls behind, later. Dr. Husain's conclusion is that it is institutions of governance that matter. I agree with him.

Till 1970, we were making India whose benefits are bearing fruit since reforms in 1991. During this period, we built that made India a high growth economy. We preferred to recognise States since 1950s and allowed policy space for diversity in language as a means of unifying the country. In 1960s we sorted out the problem of a national official language. We fought four wars – 1948, 1962, 1965, and 1971. We built world class institutions like Indian Institutes of Technology and Indian

Institutes of Management during the period. More important, economic growth in India has been self-accelerating since independence. The growth in per capita net national income between 1951-52 and 1979-80 was 1.3%. For the next decade, 1980-81 to 1990-91, the average more than doubled to 3.2%. This increased to 4.8% from 1992-93 till 2013-14. This growth performance during this period should be viewed against the backdrop of Asian Crisis, War with Kargil, U.S. sanctions due to nuclear explosion and above all, the Global Financial Crisis.

Living in Diversity and Competition

Every currency note has denomination expressed in fifteen languages, in addition to Hindi and English. Altogether, between Union and State, there are 39 official languages including Urdu, official language of Pakistan and Bengali of Bangladesh.

Many Indians, are living their lives in diversity, especially linguistic, race and language. The art of living in diversity teaches them the art of managing diversity, and well equipped to be successful managers in a globalising world. There are many Indians who are holding top positions as Chief Executives in large multi-national corporations such as Coco Cola, Microsoft and Google.

There is intense competition to survive in India, and in many areas that competition is more intense than global competition. Over one million students compete for entrance to IITs for 11,300 seats in 23 institutes. Similar numbers of graduates appear for Civil Services for over 100 IAS vacancies. They have the option to take the examination in over a dozen languages.

Combination of intense competition and living in diversity seems to give Indians an edge in a globalising environment.

Affirmative Actions and Vibrancy

In 1950, not only was universal adult franchise accepted in India, but it became the government's responsibility to enroll every adult citizen. The eligible voter need not go and register for exercising his right.

Affirmative actions are enshrined in the Constitution. Affirmative actions vary between States, and typically they cover tribals, scheduled castes (traditional untouchables), backward (social and economic) castes and women. Interestingly, those States which undertook affirmative actions earlier, have been registering higher growth subsequently.

The reservation gave hope to many sections of the people who previously felt that they would never be able to move up in life because of several disadvantages.

Ultimately, the reservations may be availed by a few, but many people will work towards succeeding with the realisation that the handicaps could be temporary. Those who are well qualified, but find that there is a discrimination against them locally due to reservation, are incentivised to look for opportunities outside the country.

An important consequence is evolution into a vibrant society.

India leads the world in terms of newspaper circulation with nearly 330 million newspapers circulated daily. The readership of a newspaper in India is often a multiple of circulation, especially in vernacular dailies, since each paper is read by several people. Domestic newspaper market has added 11.2 million new readers during the past four years. Further, 20 per cent of all newspaper readers in urban areas (50lakh+ population) now read newspapers online.

It is noteworthy that *The Times of India* is the largest circulated English-language daily newspaper in the world.

The top daily business newspapers world-wide are: *Nihon Keizai Shimbun*, Japan – (4.6 million), followed by *Financial Times*, United Kingdom – (2.2 million) and *The Wall Street Journal*, United States – (2.1 million). *The Economic Times*, India – (0.41 million); *Il Sole 24 Ore*, Italy – (0.33 million); *Mint*, India –

(0.23 million); *Business Standard*, India – (0.22 million). Three of the above are Indian.

India has six English business dailies, competing with each other, and a record number of newspapers.

My submission is that these are symptoms of vibrancy in the society.

Pre and Post-Crisis Performance

Global Financial Crisis (2008) is a defining moment in our economic history. It will be interesting to assess the performance of India in regard to select Macro Economic Indicators – pre and post-crisis. Useful comparison would be with the performance of Advanced Economies(AEs) and Emerging Market and Developing Economies (EMDEs) based on World Economic Outlook 2018 (See Table below).

Table: Select Macroeconomic Indicators

	Subject Descriptor	2000-2007	*2008*	*2009*	2010-2018
Advanced economies	GDP Growth (%)	2.7	*0.2*	*-3.3*	2.0
	Share in Global GDP(at PPP) (%)	53.9	*48.8*	*47.3*	43.2
	Investment (% of GDP)	23.0	*22.9*	*19.8*	21.3
	Gross national savings (% of GDP)	22.4	*21.1*	*19.1*	22.1
	Inflation, average consumer prices (%)	2.1	*3.4*	*0.2*	1.5

	General government net lending/borrowing (% of GDP)	-2.4	*-3.4*	*-8.6*	-3.9
	General government gross debt (% of GDP)	72.9	*77.8*	*91.0*	103.1
	Current account balance (% GDP)	-0.9	*-1.4*	*-0.2*	0.4
		2000-2007	*2008*	*2009*	2010-2018
Emerging market and developing economies	GDP Growth (%)	6.6	*5.7*	*2.8*	5.2
	Share in Global GDP(at PPP) (%)	46.1	*51.2*	*52.7*	56.8
	Investment (% of GDP)	26.5	*30.4*	*30.6*	32.4
	Gross national savings (% of GDP)	28.8	*33.6*	*31.7*	32.8
	Inflation, average consumer prices (%)	6.8	*9.2*	*5.2*	5.2
	General government net lending/borrowing (% of GDP)	-1.2	*0.8*	*-3.7*	-2.9
	General government gross debt (% of GDP)	45.1	*33.9*	*39.0*	42.3
	Current account balance (% GDP)	2.6	*3.4*	*1.3*	0.5
		2000-2007	*2008*	*2009*	2010-2018
India	GDP Growth (%)	7.1	*3.9*	*8.5*	7.3
	Share in Global GDP(at PPP) (%)	4.6	*5.2*	*5.7*	6.7
	Investment (% of GDP)	30.2	*34.3*	*36.5*	34.1
	Gross national savings (% of GDP)	30.1	*32.0*	*33.7*	31.7
	Inflation, average consumer prices (%)	4.6	*9.1*	*12.3*	6.9
	General government net lending/borrowing (% of GDP)	-3.8	*-4.3*	*-5.0*	-2.9
	General government gross debt (% of GDP)	79.3	*74.5*	*72.5*	69.2
	Current account balance (% GDP)	0.0	*-2.3*	*-2.8*	-2.4

Source: IMF, WEO Database of October 2018.

The period 2000-2007 can be taken as a pre-crisis period and 2010-2018 as post-crisis period and the following inferences can be drawn:

First, India's share in global GDP at PPP made an impressive improvement from 4.6% to 6.7% as compared to the increase in respect of EMDEs from 46.1% to 56.8%.

Second, the GDP growth of India has improved from 7.1% to 7.3%, while there was a drop in regard to AEs (2.7% to 2.0%) and EMDEs (from 6.6% to 5.2%).

Third, Investment as a percentage of GDP in India has increased from 30.2% to 34.1% though it was not as impressive as the record of EMDEs from 26.5% to 32.4%. Gross national savings in India showed a marginal increase from 30.1% to 31.7% compared to significant increase in other EMDEs (28.8% to 32.8%). Investments in AEs have fallen from 23.0% to 21.3%.

Fourth, the public debt as a percentage of GDP has come down from 79.3% to 69.2% for India. The EMDEs debt as a percentage of GDP dropped marginally from 45.1% to 42.3%. In contrast, the debt GDP ratio of AEs has jumped from 72.9% to 103.1%.

Fifth, India performed poorly in terms of Inflation which increased from 4.6% to 6.9% compared to a fall in inflation in both EMDEs (6.8% to 5.2%) and advanced economies (2.1% to 1.5%).

Finally, the overall performance of India in regard to external sector however warrants attention. The advanced economies have shown a turn-around from a deficit of 0.9% to a surplus of 0.4%. The EMDEs experienced reduction in their surplus from 2.6% to 0.5%. In regard to India, however, the current account deficit increased in the post-crisis period to a level of 2.4%.

In brief, the fiscal and external sectors should be of priority policy concern, while other indicators point to strength and stability.

Current Concerns

Currently, the concerns relate to the fiscal deterioration, the pressure on the rupee and the financial sector problems. The problems are well known, but what is not so well known is that there are some explanations as to why these weaknesses are not likely to bring about a crisis, though they do moderate the rate of growth.

Fiscal

In India, the fiscal deficit coupled with Revenue Deficit, has always been a chronic problem, but with varying intensity. However, many analysts are surprised that the persistence of the fiscal problem for several decades has not resulted so far in higher inflation or a spill-over into pressure on currency. The explanatory factors may relate to the level of household savings in India which is high. Further, the households are not as excessively leveraged. They do not borrow too much, though the younger generation is taking recourse to consumer debt. Secondly, the Government debt is held mostly by resident entities and is denominated in domestic currency. Even in regard to holdings by foreign entities, almost the whole of it is denominated in rupee. Thirdly, most of public debt is at fixed coupon rate and not floating. The interest burden on Government remains unchanged in nominal terms.

Fourthly, the regulatory requirements are designed to impose financial repression and ensure smooth borrowing programme. As a result, the links between the fiscal management and the interest rate are moderated.

External

Rupee generally comes under-pressure whenever there are two shocks, namely, high oil prices and global capital flows. If both shocks happen at the same time, then the rupee is under intense pressure. Special financing is normal to manage such stress. In the recent months, perhaps, the rupee was also overdue for correction, and it has taken place. The capital account is managed and the exposure to short-term liabilities is severely limited. The stock of foreign exchange reserves is adequate. They are not as comfortable as they were about 10 years ago. A crisis happening to Indian economy is inconceivable unless there are extreme policy errors within the country.

Finance

In regard to the financial sector, the Non Performing Assets of the banking system and the Non Banking Financial Companies have been in the news in the recent month for several reasons. The problem of the banking sector is essentially one of large non performing assets and inadequacy of capital relative to the regulatory requirements, mainly in the public sector banks. Despite these, the trust of the depositors in the banking system has not been dented mainly because there is virtual sovereign guarantee for the depositors. The question of insolvency does not arise. No doubt, the combination of reluctance of the government to inject capital and insistence on regulatory compliance by the Reserve Bank, have choked the credit flow to some extent. There are efforts to bring about systemic improvements, including recovery mechanisms, which should mitigate the current stress.

The non banking financial companies (NBFCs) have come under stress mainly because of one large entity, namely, ILFS. A large majority of NBFCs other than those involved in infrastructure and housing, are under stress only because of contagion through sentiment. NBFCs may be giving business loans, personal loans, and asset financing. Of these maturity mismatch between assets and liabilities in regard to housing and infra entities is the main culprit. The differences in the business models of different categories and their health are being missed out in the current worry-psychosis.

Challenges for Future

There are several ways in which the challenges for future can be identified and presented. For discussion today, I will mention three of the anticipated critical policy challenges, namely: demography, technology and geo-political developments.

Demography

Admittedly, India has the benefit of demographic dividend in the next two decades. This could, of course, be a demographic disaster if sufficient employment opportunities are not created and adequate skills are not imparted to the large population. There is, however, a redeeming feature in the demographic transition. Demographic transition will be stretched over a long period since we have provinces like Kerala and Tamil Nadu whose profile is close to Northern Europe; while there are others like Uttar Pradesh and Bihar whose profile is closer to sub-Sahara African. Therefore, the demographic structure at any point of time is not as skewed as in most other countries. There is a second feature that moderates the impact of demographic transition and that relates to migration. There has been huge migration between states. This imparts a moderation of the adverse impact of demographic transition in different states.

I believe that the youth play a critical role in taking advantage of demographic dividend; a sense of optimism among the youth in India is a source of strength.

The access to self learning process provided by the technology coupled with the aspirations of young generation could drive the future of India. In particular, the aspirations of Indian girls have been brought out very clearly by a survey conducted by Nandi Foundation. India's teen-aged girls numbering about 80 million are brimming with hope.

Technology

As regards technology, India may not necessarily be at the top in many of the technologies. However, it is among the top five in the world in almost all aspects of technology. The configuration makes it possible for India to evolve as world's one of the low cost advanced technology be it in aerospace or health care. Further, knowledge is increasingly embedded in manufacturing and thus there is scope for Indians becoming more competitive in manufacturing also.

Currently, 1.5 million engineering graduates pass out every year from over three thousand colleges. No doubt, many of them are considered unemployable at this stage. However, they do provide a large pool which can transform itself into a massive skilled workforce in a short time span with marginal investments.

Geopolitics

Recent developments in geo-politics pose a severe challenge for the policy makers to both Japan and India. I will confine myself to one segment, namely, monetary system and global finance. It is recognised that US Dollar, a national currency, has been doubling up as a global currency.

After the Global Financial Crisis, there was a serious search for improving the monetary system. Yuan has been included in the SDR basket. That by itself did not make a difference to the status of U.S. Dollar as a store of value and financial transaction. China intensified its push for the use of Yuan in international trade. Success has been limited so far. Efforts to advance SDR as an alternative to U.S. Dollar have failed.

In parallel, China has been expanding its dominance in world trade. The recent trade war initiated by U.S. obviously is an effort to contain China's dominance in global trade. At the same time, China is trying to bypass the global financial system, dominated by U.S.A.

China had built large amounts of forex reserves which were invested mostly in the financial assets till recently. Of late, China is converting external official financial assets into physical assets abroad. These are outside global financial system, governed by bilateral agreements between governments and their own enterprises. China is investing heavily in real estates, mines and infrastructure in different countries. China is making these investments despite the high risk, low return and illiquidity associated with them. This may be for political reasons also; but the new policy has significant economic consequences. These bilateral agreements are outside the remit of the global financial system. Clearly the world cannot afford to have a global monetary and financial system (or non system) dominated by U.S.A., but is being bypassed by the second largest economy in the world.

In the absence of a clear-cut multi-lateral alternative on the table so far, it is likely that a bipolar world will evolve in which USA and China will lead the two rival camps. This will be a new bipolar world where the leading nations, namely, U.S.A. and China, are highly inter-dependent as far as their economic interests are concerned. This is entirely different from the old bipolar world in which Russia and U.S.A. whose economies were not integrated, and the global economy was less integrated. In the new bipolar world, it is quite possible that there would be strategic cooperation between U.S.A. and China in relation to other countries. This competition for global dominance and cooperation when it suits both of the super powers, places other major economies like India, Japan and Euro Zone in a very difficult situation. It is absolutely essential to develop trade and economic linkages between such major economies, as a buffer against the emerging global bipolar economic order. India and Japan may have to keep this in view in their engagement with global economies as also in their bilateral relations.

Conclusion

There is a fundamental rebalancing in national policies across the world at this stage. There is a rebalancing between national interest and global cooperation. There is a rebalancing between the relative roles of the state and the market. There is also a rebalancing between the financial sector and the real sector, the latter having important implications for employment. In many ways, India and Japan share similar framework in the process of rebalancing. The common intellectual framework in this regard should be of help in our rebalancing to the potentially emerging new bipolar world.

The shared vision for the Future of India-Japan Relations outlined by the Prime Ministers of Japan and India in October 2018 is most appropriate at this juncture. The partnership for prosperity, the partnership for peace and the partnership for global action should be the guide post in our relations.

The reinforced, elevated and deepened relationship between India and Japan is a product of the new millennium. India and Japan, both have huge stakes in not only maintaining regional stability but contributing to multi-polar world. A strong and stable Indian economy is a global public good. I have presented before you how investing in India's future is good for Japan, for Asia, and indeed, for global economy.

Let me conclude by expressing gratitude to the organisers for inviting me and for the excellent hospitality. I am thankful to you all for a patient hearing.