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Asia Times Online
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South Asia

Apr 29, '13

India gets it wrong with growth optimism

By Kunal Kumar Kundu

NEW DELHI - The latest review of India's economy by the Economic Advisory Council to the Prime Minister (PMEAC), though sounding a bit downbeat for the 12 months just passed, projected a relatively bullish view looking forward, with an expectation of 6.4% growth in the financial year ending March 2014. History, however, is against that being close to reality as the council's growth expectations are known to persistently overestimate eventual outcomes.

In August 2012, it estimated 2012-13 gross domestic product (GDP) growth at 6.7% and the current account deficit to be 3.6% of GDP. In reality, the economy is now expected to have grow at 5% while the current account deficit is likely to have ended the financial year at 5.2% of GDP. In July 2011, the council expected 2011-12 GDP growth of 8.2%; it finally came in at 6.2%.

The robustness of a forecasting model depends on the quality of assumptions involved. The PMEAC seems to have over-estimated the growth environment and under-estimated the debilitating impact of domestic politics-led policy inertia. Its optimism stemmed from the belief that every policy announcement by the government would translate into real action on the ground, when history suggests that most of the time the government fails to walk the talk.

This year also, while the PMEAC seems to have been more grounded in its expectations (being all the wiser by now), it is still able to see green shoots that are not visible to a reasonable eye. The Indian economy may have bottomed out, but it is by no means out of the woods. To that extent, some of the assumptions are much more optimistic than reality merits.

For a start, the PMEAC assumes that policy and administrative measures will be successful in hastening investment within the economy - be it re-energizing of stalled projects and/or providing impetus to newer projects - during the first quarter of 2013-14 itself, which should ensure that growth will pick up pace during the first half and make even further momentum visible during the second half.

In reality, the headwinds that the economy faced earlier continue with negligible reduction in their intensity. The government's position is possibly even weaker now than what it was last September when it had the courage to take some policy decisions that were widely hailed as ground breaking.

It is of course another matter that the government has failed to walk the talk post that, as a result of which the euphoria generated then has now vanished. Even the apparently ground-breaking decision of allowing 51% foreign direct investment in the retail sector (with considerable restrictions on the scope of that ownership) has not seen any takers, even six months down the line.

That the government was able to take some hard decisions in September was made possible by the fact that one of its allies, the Trinamool Congress from West Bengal, which was single-handedly blocking all development efforts by the government, finally decided to quit the alliance. The much-relieved government used that opportunity to take decisions that it could not take earlier. However, several months on, the government is barely surviving, as one of its key allies, the Dravida Munnetra Kazhagam from Tamil Nadu has decided to leave the government.

Not only that, more corruption cases are coming out in the open. In the most recent of indictments, the Comptroller & Auditor General (CAG) rapped the government for numerous cases of corruption in its flagship job security scheme for the rural poor, the Mahatma Gandhi National Rural Employment Guarantee Act. The government is also alleged to have tried to influence India's Central Bureau of Investigation (CBI) in its investigation of possible irregularities in the allocation of coal mining blocks.

On April 26, the CBI accepted the fact that its status report on investigations into coal blocks allocation had been "shared" with Law Minister Ashwani Kumar and senior officials in the Prime Minister's Office and the coal ministry. As this is being deemed as a case of the government trying to influence the CBI, the opposition is now seeking the resignation of the law Minister and of Prime Minister Manmohan Singh.

A severely weakened (both politically and morally) government is now finding it difficult to ward off the opposition in parliament. After a month's parliamentary recess, the budget session started on April 22 (it runs until May 10), yet no business could be conducted until April 26. Unless the government gives into the opposition demand that the coal-blocks issue be discussed, no business is likely to be conducted during the entire budgetary session.

Government leaders have indicated that a discussion will not be held on the issue inside parliament before the Supreme Court gives its verdict, which is slated for April 30. Even once a debate on the coal-block allocation finally takes place, the opposition will ensure extreme discomfiture for the government during the process.

As a result, hardly any important decision can be ratified by parliament during the remainder of the present session. As a result, one of the most crucial bills, the land acquisition bill, is unlikely to be approved - and until this bill sees the light of the day, a large number of projects that are stuck at various stages of completion will remain stuck, putting paid to the hopes of an investment-led recovery.

In fact, there is every possibility that the country may experience early elections (which are otherwise scheduled to be held during April-May 2014), which will mean that policy making will be put on hold until then, thereby hobbling the economy further.

The Cabinet Committee on Investment that was set up last year to speed up government clearances for large projects has achieved precious little beyond some meetings.

India last year experienced one of its worst power outages to date. Continued power shortages in the southern states dealt industry there a severe blow. Yet, improved infrastructure for fuel deliveries to power plants to end electricity shortages are still not in place.

Beyond such domestic factors, external factors are not as conducive as the PMEAC would like to believe. As economist Nouriel Roubini pointed out recently, the United States' economy is likely to experience a fiscal drag of about 1.5%, leading to a below-trend GDP growth of about 1.6% during 2013. (The US economy expanded at a 2.5% annual rate in the first quarter, helped by the strongest consumer spending figures in two years, according to data released late last week. Growth was lower than expectations, though up on the 0.4% rate in the final quarter of 2012.)

China is clearly on the throes of a slowdown and Europe continues to struggle. Clearly the global growth environment remains challenging. Importantly, even global export powerhouses like China and Germany are experiencing a slowdown in their exports. In such circumstances, expectations that India's dollar-denominated exports will grow by 10% over the next 12 months may well turn out to be no more than wishful thinking.

Overall then, the Indian economy will be lucky to grow at 6% (maybe even lower if the political situation worsens even further) during 2013-14.

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