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FINANCIAL TIMES

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Opinion: India's double digit growth fantasy

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Published: April 1 2010 12:06 | Last updated: April 1 2010 12:06

The Indian economy has weathered the recessionary storm well, quite well I must say. During the financial year that ended on March 31 2010, I expect the Indian economy to grow by about 7 per cent. This indeed is great going in the midst of economic hubris all around, on the wake of the worst recession the world have ever faced, post the great depression. Not surprisingly, the Indian policy makers (including the prime minister Manmohan Singh) are again talking about double digit growth to whoever cares to listen.

In 2006 the good doc asserted the same. To me, however, this view is over optimistic. The euphoria during 2006 was a result of India being in the midst of a golden period when the average gross domestic product growth was about 9 per cent. The present euphoria is born out of relief for having weathered the storm, including a deficient rainfall and growing at a very decent rate.

The assertion is clearly devoid of reality. To understand this, let us first look at the period of 2002-03 to 2006-07 when the Indian real GDP growth averaged at around 9% per cent. Then, India's strong growth was largely attributed to the strong global growth and not to any domestic market reform.

Suddenly we started to believe that India's growth trajectory had changed, without realising that the huge amount of credit sloshing around the world then acted as a steroid.

While increased credit flows kept the interest rates at low levels, heightened competition, capacity creation and increasing capacity utilization as well as appreciating rupee kept inflation under check then. Not surprisingly demand surged and India grew. Now that the global credit growth has been halted on its tracks and the flow has dried down, the Indian economy is feeling the pain.

In the aftermath of the economic-reform policies undertaken in 1991 India's average GDP growth increased from 4 per cent to about 6.5 per cent, until it hit the purple patch during the period mentioned above.

Now, despite the hype in the media about India's global integration, economic reforms have been halted. As a result, compounded annualized growth rate in the period post 1991 has been of 7.75 per cent, considerably less than the expansion rate of the pre-reform era of 15.5 per cent. Not surprisingly, given the political implication, average growth rate in subsidy remains the same. It needs to be remembered, that there are two types of subsidy. Given the extent of corruption in the delivery mechanism, the subsidy bill has been bloating, although the intended recipients end up getting only a fraction of the benefits. Similarly for various social sector schemes, which are a must for a country where a large number of people are still poor. As a result, India's revenue and fiscal deficits have remained way above the comfort levels.

There has been no major initiative to reform India's educational sector, save for increased allocation for the sector during budget exercises, much of which is again siphoned off due to corruption. As a result while India churns out graduates by huge numbers, roughly half of them are unemployable.

Labour reforms are another case in point. Over the years, numerous academic studies and official reports, including the Second National Labour Commission Report (2002), have recommended major reforms of India's labour laws. The problem is absence of political will. Until that happens, the expansion of decent non-agricultural jobs will condemn many millions to insecure and ill-paid, informal urban employment.

While India desperately needs labour reforms, politicians use up a lot of their time discussing and debating reservations in education and jobs based on castes and religions and hardly on economic background. And, even those are riddled with corruption.

The neglect of the agricultural sector, on which a majority of India's population depend upon, is also widely known. Lack of capacity building haunts this sector and even more than 60 years after independence, food security remains a concern. A large number of rural population lives under abject poverty at less than $2 per day. In this background, how can India reap the supposedly rich (read young population) demographic dividend is anybody's guess.

Since September 2008, India's credit and monetary stimulus of close to 9 per cent of GDP have played the vital role of boosting liquidity, sustaining economic growth and withstanding the global credit crisis. Without the governmental support, India's GDP growth would have been closer to 6 per cent. However, credit growth and domestic demand are still below trend. Also, starting from the third quarter in the year 2009-10, poor agricultural output, high food prices, capital inflows and high fiscal deficit have raised inflation and inflationary expectations. With the Reserve Bank of India having to balance the nascent economic recovery with inflation risks, they have started withdrawing liquidity in October 2009, but they are likely to hike interests during the first quarter of the new financial year. Also, India will continue to tighten monetary policy gradually, as capital inflows pose the risk of asset bubbles and supply-side bottlenecks would lead to overheating of the economy.

The point is that government consumption is likely to account for more than a third of India's incremental growth rate in the past financial year, and as the state is forced to withdraw the stimulus measures, the private sector will have to fill in the void. While there has been some pick up in investment as domestic demand is showing signs of improving, high inflation and looming interest rate hikes will act as a spoil sport as domestic demand might not materialize to the extent expected.

Under these circumstances, what can propel India to the higher growth path? Global growth for one, has to revert to the boom experienced earlier. To me, this is not going to happen. A tectonic shift in India's productivity growth could be another. But due to the constraints mentioned above, this is also highly unlikely.

I would say that India's GDP growth rate can oscillate between 7 to 8 per cent, which still is fantastic by global standards. But, a double digit growth rate? No way.

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