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Towards a New Paradigm of Growth and Development for India

S. N. Misra[1], Lipsa Misra[2] and Sanjaya Kumar Ghadai[3]

[1] Dean, School of Management, Kalinga Institute of Industrial Technology, Deemed to be University, Campus-7, Krishna Campus, Bhubaneswar, Khordha, Odisha, E.mail: misra.sn54@gmail.com & dean@ksom.ac.in
[2] Asst. Professor in Economics, B.J.B. Autonomous College, BJB Nagar, Bhubaneswar, Odisha, India, Pin-751014 E-mail: lipsamisra@hotmail.com
[3] Research Scholar, School of Management, Kalinga Institute of Industrial Technology, Deemed to be University, Campus-7, Bhubaneswar, Khordha, Odisha, India, E-mail: ghadaisk77@gmail.com

Abstract: The initiative towards Liberalization, Privatization and Globalization (LPG) during the last two decades has made India a "Break Out Nation", achieving an average 7% Gross Domestic Product (GDP) growth per year. However, in recent years, there is a curious combination of price stability, low current account deficit with falling GDP growth rates and low private sector investment. There is thus a raging debate whether to persist with a policy of inflation targeting and Fiscal Responsibility and Budget Management (FRBM) Act or be flexible with public debt, depreciate Indian rupee and provide greater fiscal incentives to spur private investment and exports. This paper brings out the macro economic trends during the last four years and then juxtaposes the growth story with the unacceptably low levels of Human Development Index (HDI), marked by high Maternal Mortality Rate (MMR), high percentage of children below malnutrition and non-adherence to the Millennium Development Goals (MDG). The paper makes a strong pitch to abdicate the present obsession with fiscal deficit target and low inflation and devote greater policy attention to maintain a realistic exchange rate, creating effective demand through public & private investment and provide tax incentives to propel "animal spirits" of the investors. It strongly roots for increasing our Tax/GDP ratio, privatization of PSBs, Air India and the Railways, and increasing investment in social sector & infrastructure substantially. By having a flexible fiscal deficit regimen, tapping the market for funding through bond and equity, India can build on its durable assets, while bolstering human capability development. The time for forsaking a hawkish monetary policy and embracing employment oriented growth approach has come.

Keywords: LPG, GDP, FRBM, MMR, HDI, MDG

INTRODUCTION

India is today in the vortex of a policy dilemma; whether to persist with inflation targeting and fiscal deficit ceiling, or be flexible in its fiscal stance, reduce repo rate and devalue its rupee in order to arrive at a higher

GDP growth and development trajectory. Indian economy is today far more open, private sector dominated and much less dependent on the bounty of good monsoon. While inflation remains within the glide path of 4±2%, trade deficit around 1% of GDP and fiscal deficit around 3.2% of the GDP, there is justifiable concern that GDP growth has come down from a high watermark of 8% in March 2015 to around 6.3% in Quarter-2 of 2017. Of particular concern is dipping private sector investment which has come down for a level of 25% in 2011-12 to 20% now. India is also witnessing the spectre of jobless growth. As a matter of fact, because of ill conceived demonetization, there was increase in unemployment by 2.1 million as reported by the CMIE. Of late, India is witness to improvement in credit rating by Moody and Ease of Doing Business by the World Bank. In contrast, its development record shows significant stagnancy after economic liberalization. This paper attempts to capture the (a) Macro economic trends (b) Growth & development disconnects (c) Importance of factor productivity for durable growth (d) Alternative policy option for growth and development.

MACRO ECONOMIC INDICATORS

J.M. Keynes observed in "The General Theory of Employment, Interest & Money" (1936) that private investment is guided by "animal spirits", where investors are not averse to risk taking. In India, private sector investment over the last four years has been decreasing as represented by Economic Survey Volume II and the RBI Annual Report 2016-2017. It would, therefore, be imperative to look at the major macroeconomic indicators since 2013-14 and the sectoral trends.

Table 1
Key Economic Indicators

Parameter	*13-14*	*14-15*	*15-16*	*16-17*	*17-18*
GDP	6.4	7.5	8.0	7.1	6.75
Savings	33	33	33	33	33
Capital Formation	34.7	34.2	34.2	34.2	34.2
Prices (CPI)	9.5	5.9	4.9	3.5	3.75
Current Account Balance	-1.7	-1.3	-1.4	-0.7	1.0
Broad Money (M_3)	12.4	10.8	10.1	7.4	7
Manufacturing	5	3.8	3.0	4.1	5
Agriculture	5.6	-0.2	0.7	4.9	5
Services	11.2	11.1	9.4	5.7	9

Source: Economic Survey, 2016-17, Vol-II, Government of India

It would be seen that GDP is showing a decelerating trend and savings & capital formation have remained stagnant. Besides growth in time deposits have come down, showing a reduction in lending trend from 12.4% to 7%. Manufacturing has remained stagnant. The silver lining is that agriculture sector is the upward swing and is now growing around 5% against an average growth of 2.5% earlier.

GROWTH AND DEVELOPMENT DISCONNECT

The impact of economic growth post economic reforms can be depicted as under-

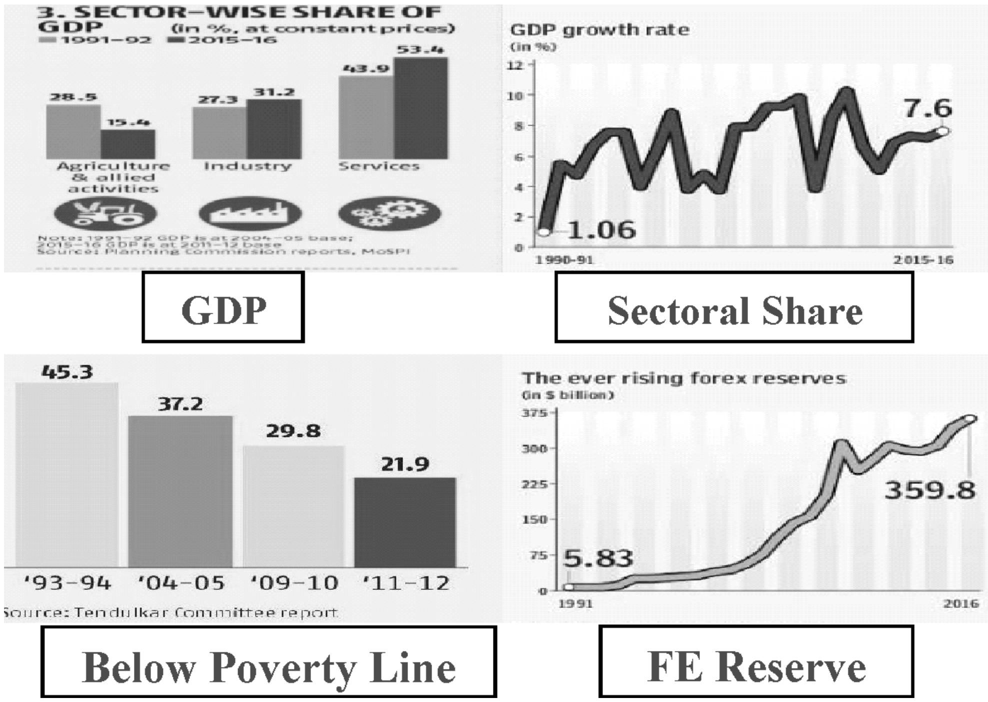

Figure 1: Impact of Reform on Growth, Poverty, Sector & F.E. Reserves

Source: Economic Survey, 2016-2017, Government of India

It would thus be seen that the contribution of agricultural sector to GDP has come down from 28.5% to 15.4%. On the other hand, the percentage of population working in the rural economy has not come down appreciably. This has led to what Ragnar Nurkse called "disguised employment", in our rural economy having 70% of population, marked by very low productivity of labour. The Chinese high growth experience was based on "Lewis Growth Model", when they transferred a large amount of surplus labour from the agricultural sector to the manufacturing sector. This has not happened in India. On the other hand, the manufacturing sector is characterized by stagnancy in terms of its contribution to GDP and employment. The proliferation of small seal sector and unorganized sector are seriously handicapped in terms of access to formal banking system, technology and economy of scale. The only sector which has contributed to employment segmentations are the construction sector, textile and IT.

The National Manufacturing Zone Policy (2011) has really not borne fruits in terms of increasing share of manufacturing from 16% to 25% and generating additional employment of 10 million as projected. The actual employment generation has been only 0.5 million; and that too in the organized private sector. There has been hardly any employment generation in the public sector. The service sector has been India's sunshine sector, with IT and financial services making significant impact on GDP. Social inclusion initiatives like MNREGA have brought down people below the poverty line from 45.3% in 1993-94 to 22% during 2011-12. The FE reserves, which could cater to a "week's import requirement can now take care of 7 months" requirement.

However, the most distressing picture is in terms of growth and development disconnect as the following table would show.

Table 2
Growth & Development Disconnect

Parameter	*1951-1989*	*1990-2016*
GDP growth	3.5	7.0
Savings	16	31
Export as % of GDP	13	25
IMR (1000)	53	44
MMR (1 lakh)	260	174
Mean Year of Schooling	3.5	4.4
% Children with Malnutrition	48	46

Source: Montek Singh Ahluwalia

Quite clearly, poor average schooling, lack of adequate concern for infant & maternal mortality and children who suffer from malnutrition present a dismal development picture.

The fallout of the development shortfall is captured in our shortfall in achievement of MDG as brought out below.

Table 3
Millennium Development Goals

	Goals	*India's Achievement*
1 ERADICATE EXTREME POVERTY AND HUNGER	Eradication of extreme hunger and poverty	23.6% (BPL)
2 ACHIEVE UNIVERSAL PRIMARY EDUCATION	Achievement of universal primary education	Achieved
3 PROMOTE GENDER EQUALITY AND EMPOWER WOMEN	Promotion of gender equality and empower women	Achieved
4 REDUCE CHILD MORTALITY	Reduction of child mortality by 2/3rd	1/3rd
5 IMPROVE MATERNAL HEALTH	Improvement of maternal health by 3/4th	1/3rd

Source: UN Millennium Project Goals [10] & Human Development Report, 2016

KEY LESSON OF FACTOR PRODUCTIVITY

One of the key lessons from the above developed countries like Germany & Japan, who were devastated by the 2nd World War and emerging developed economies like China, is that they invested handsomely in quality education at the grassroots, skill improvement and research in the universities and laboratories. This has helped them to become global manufacturing hubs, with consistent trade surplus.

Prof. Robert Solow, a Nobel Laureate, highlighted the importance of factor productivity, popularly known as "Solow Residual" to underline this aspect. His equation: $Q = A \times K^{a} L^{\beta}$, where A is scale of production & level of technology, K & L are factors of production and a and â are factor productivity, has been seriously taken by these countries to invest handsomely in public education and fund research programmes. It has been estimated that 70% of the average growth of around 2.5% per year noticed in the USA, is due to factor productivity. Similar has been the experience in Germany, Japan and China.

In contrast, the remarkable growth of around 7% per year in India, during the last decade is largely due to inflow of capital, foreign investment and only 30% has been contributed by improvement in factor productivity. This holds a very important lesson for India, to view high growth and human development capability in tandem, rather than being uni-dimensional in our policy approach.

Prof. Nitin Desai, who joined the Planning Commission in 1977 as an advisor has brought out how India has become more open now in the trade sector, private sector oriented and less dependent on good monsoons to ensure food security. The following table brings out the contrasts delectably.

Table 4
Macro Economic Trends: 1977 & 2017

Parameter	*1977*	*2017*
Agriculture as % of GDP	38%	17%
Industry as % of GDP	26%	26%
Services as % of GDP	36%	57%
Export & Import as % of GDP	12%	41%
FDI & FII Inflow as % of GDP	2%	6.8%
Public Sector Investment as % GDP	9.8%	7.4%
Private Sector Investment	1.5%	11%

Source: Macroeconomics: Then and Now by Nitin Desai: The Business Standard

Prof. Desai draws upon the Swan Model to underline a future policy trajectory option for India.

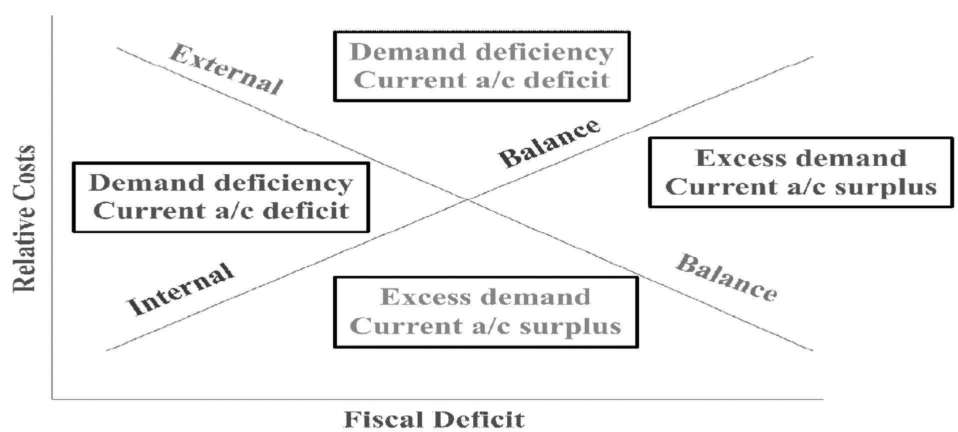

Figure 2: SWAN Model

Source: Macroeconomics: Then and Now by Nitin Desai: The Business Standard

The above model clearly shows that India suffers from demand deficiency and current account deficiency. The demand deficiency is largely due to lack of employment opportunity which is a function of both private and public investment as Keynes had rights pointed out.

INFLATION TARGETING AND FRBM TARGETS

During the past four years the RBI has been singularly focussing on containing inflation and keeping the actual deficits inconsonance with the FRBM targets, placed before the parliament.

The position is on inflation targeting and repo rate is placed below.

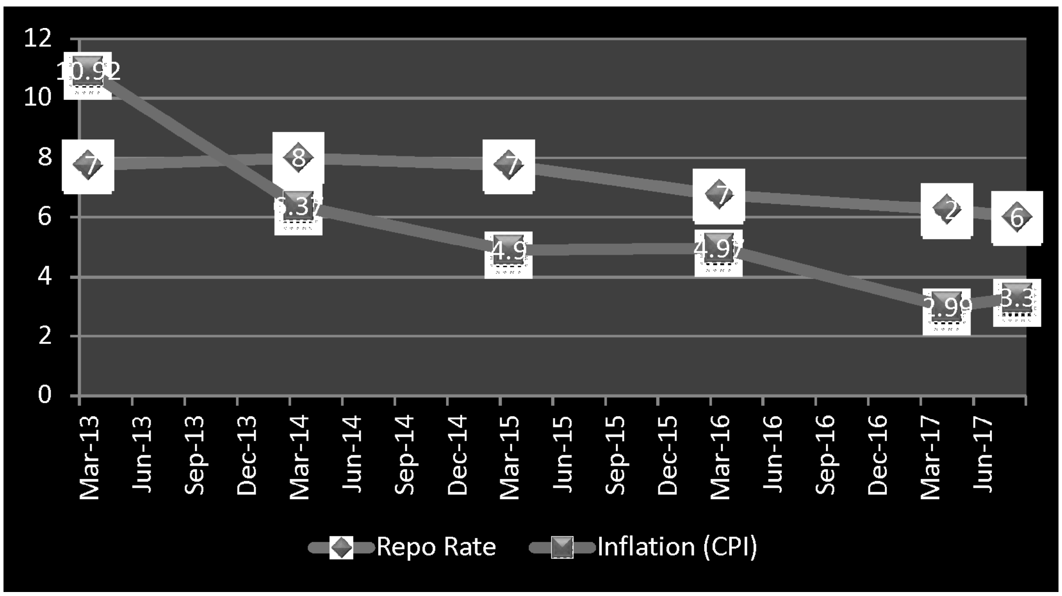

Figure 3: Repo Rate and Inflation (CPI)

Source: RBI Annual Report, 2016-17& World Bank Annual Report, 2016

Quite clearly the inflation rate has come down, in sympathy with the repo rate revisions made by the RBI.

The FRBM Act (2003) was aimed to institutionalize fiscal discipline by targeting elimination of revenue deficits by 2008 and containing fiscal deficit to 3% by that time. Nine years later, the revenue deficit remains at 2.2% and fiscal deficit 3.2%, while some of the slippage in the past can be attributed to the US financial crisis (2007-09), most of it is due to profligacy in non-plan expenditure like huge borrowings and subsidies.

In recent years, however, there is greater seriousness to stick to the FRBM targets. The following trends would buttress the above contention.

The N.K. Singh Committee (2017) to review the FRBM targets has come up with a recommendation to reduce fiscal deficit of the Centre and States, which is around 70% now, to 60% by 2022-23 (40% for the Centre and 20% of the States). This is going to an onerous challenge, given our computation to double public investment on infrastructure and social sector on one hand and maintain fiscal discipline on the other. It would be wise to be fiscally prudent rather than being inflexible.

Table 5
Fiscal & Revenue Deficit Trends

Year	*Fiscal Deficit*	*Revenue Deficit*
2013-14	4.5	3.2
2014-15	4.0	2.9
2015-16	3.9	2.9
2016-17	3.6	2.6
2017-18	3.2	2.4
2018-19	3	2.2

Source: Economic Survey, 2016-17, Vol-II, Government of India

RECENT TRENDS IN GDP GROWTH RATE AND DEFICIT

However, the sector where it has decelerated are agriculture for 2.3% in Q-1 to 1.7 ending September and services where it has dipped for 8.7% to 7.1%. Exports continue to be sluggish. However, manufacturing has picked up significantly for 1.2% to 7% during Q-2. On the other hand, the fiscal deficits have already reached 96% of the BE targets by October, 2017, as per data released by the CGA. This is much higher than deficit percentage during comparable period in 2016-17 which was 79%. This is due to shortfall in realisation of revenue and rise in expenditure what was estimated. Exports' contribution to GDP continues to be anaemic, growing around 1.2%, same as the previous quarter.

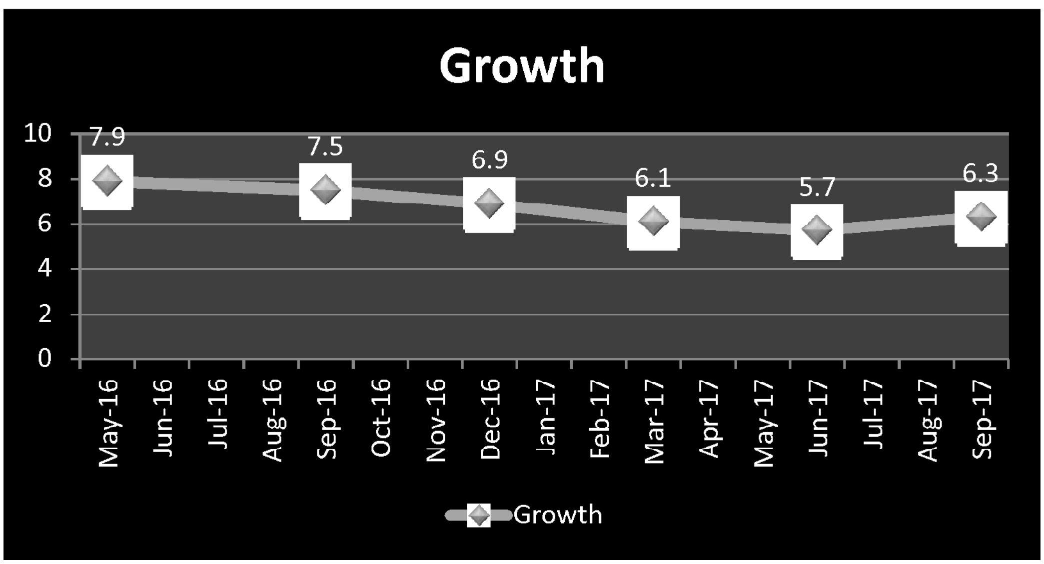

Figure 4: GDP Growth: Quarterly Trend

Source: Central Statistical Office

DEBT & GROWTH

The classic debate amongst the fiscal theorists, owing allegiance to J.M. Keynes and hawkish monetarists spawned by Milton Friedman is whether to spur investment and growth or control money supply through repo rate mechanism. India can ill afford to be indecisive at this critical juncture of the India which option to adopt. The two New Deal Programme (1932) & (1936) under Franklin D. Roosevelt, with public debt ensured that US came out of the economic depression through a slew of high employment generating programme like Tennessee Valley Authority (TNA) by resorting to public borrowing. At the end of the 2nd World War, USA had improved its share of global GDP from 20% (1932) to 40%, achieved near full employment and became the global economic hegemon. On the other hand, the hawkish repo rate stance taken by Paul Volcker, as Fed Governor, inspired by Friedman's monetary squeeze prescription, ensured that the runaway inflation in USA (15-16%) in 1973 came down to around 3% by 1975. But it also set in motion severe economic recession. USA wanted to come out of "stagflation" but could slay only one demon viz. inflation.

The lessons are quite clear for India, which is grappling with serious private investment dip, monetary squeeze after demonetization, which has severely affected the small and unorganised sector. GST, though a welcome fiscal legislation to usher "one India one market" is caught up with many structural bottlenecks. As Prof. Arvind Subramanian, has rightly observed that GST rates would have to a rationalised around 16% for most of the products and have 28% rate only for demerit goods. As the revenue neutral rate would be grow 15-15.5% the rate structure should be three tier, with low rates for merit goods, 16% rate for wage goods and 28% for demerit goods. There is also a strong case to include "electricity" and "POL" in the ambit and have a single GST instead of a "Dual GST regime" eventually.

CONCLUDING THOUGHTS

In this backdrop, the government must increase its investment in the social sector substantially and create necessary conditions for fostering investment in the infra sector. There is a need to implement the Kelkar Committee recommendation which suggested changes in the "PPP" model to come out of the existing "morarss". As Mr. Arun Jaitley has assessed India needs around $200 billion of investment per year for improving social sector and infrastructure substantially. Presently we are investing around $80 billion. In order to achieve this target the fiscal deficit ceiling can be breached by 0.5% of the GDP. Around 1.5% of GDP can be saved by doing away for the fertilizer subsidy which is essentially helping the rich farmers and the LPG subsidy which is unduly benefiting these who can pay the market rate. The rest of the funding requirement can be met by raising government bonds and tapping the equity market.

The government should also come up with big ticket reforms like privatisation of PSBs, privatisation of Air India and most importantly privatisation of the Indian railways in a definitive timeframe. They have become the cesspool of inefficiency and lack accountability. Recapitalisation of PSBs would only shift their goal post of public accountability.

In 1991, the UPA government took a decision to embark on the path of liberalisation, privatisation and globalisation. The Narasimham Committee changed the syntax of functioning of the banking in India, by providing a modicum of level playing field to private sector banks and foreign banks which slashed CRR and SLR substantially. But the PSBs need a more definitive intervention and it's time to give that "Big Push" (Rosenstein-Rodan) of privatisation to improve financial intermediation on sound commercial lines. We need to invigorate the manufacturing sector which alone provide the space to absorb 10/12 million people who join the job market every year. Keynes had presciently observed that "Difficulty does not lie so much in introducing new ideas, but replacing the old ones". The time for abdicating hawkish monetary policy has come to usher in a new synergy of growth, development and employment generation in India.

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