Interview Series:

Dialogues and Discussions

Key Issues Facing the Indian Economy

IN CONVERSATION WITH:
POONAM GUPTA

Anupma Mehta | March 24, 2023

The Indian economy has been attracting widespread attention on the world stage, particularly due to its high-profile ongoing G20 Presidency and the resilience exhibited by it in the midst of global challenges. In this context, we thought it pertinent to seek the views of the Director General of NCAER, Dr Poonam Gupta, on various issues confronting the Indian economy. Being a member of the Economic Advisory Council to the Prime Minister (EAC-PM) and the Chair of the Task Force (T20) on Macroeconomics, Trade and Livelihoods, during India's G20 Presidency, Dr Gupta's views on both the Indian and global economies are both perceptive and apposite.

Reproduced below is the interview in which Dr Poonam Gupta (PG) answers questions posed by the NCAER Editor, Anupma Mehta (AM).

AM: Since we are flagging the key issues currently confronting the Indian economy, please share your opinion regarding the downside risks to the Indian economy that could affect GDP growth in the coming fiscal.

PG: I think 7% for FY2023 and 6.5% for FY2024 as growth targets for the economy are very reasonable and eminently attainable.

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It may be noted that domestically there are no known risks that can impact the growth outlook, be they on account of fiscal policy, inflation outcomes, or monetary policy, health of the financial sector, or the overall macroeconomic environment.

There are also no perceived sectoral risks either. Several segments in the services sector still have the potential to

recover from the impacts of COVID-19. For example, the domestic and international tourism arrivals, and the broader travel and hospitality segments are still operating at below pandemic levels. Increased digitalisation will continue to contribute to growth and efficiency, not just in a cyclical sense, but also in a more profound structural sense.

The manufacturing sector has not done well in the last couple of years. Therefore, the base effect would help bring about a better growth out-turn next year.

AM: The Indian economy is not immune to global shocks. So, how can India shield its domestic economy from these shocks, such as the anticipated slowdown in exports and decline in demand from its major trading partners?

PG: The Indian economy is closely integrated with the global economy through multiple channels, including through the trade of goods and services; import of oil and commodities; as a recipient of capital flows; and through remittances. Thus, it is not surprising that global developments impact India. When global trade slows down, India's export volumes also decelerate.

So, how can India manage these global shocks better?

One obvious way to achieve insulation is through a continued focus on macroeconomic stability. This would entail ensuring prudent public finances; a transparent, well-designed, and well-articulated monetary policy framework with price stability as one of its main goals; maintaining and replenishing foreign reserves when the situation permits, and using them to counter the volatility in capital flows; sustaining relatively competitive exchange rates, while avoiding undue volatility in them; and strengthening different parts of the current account.

A lot of these measures are already being implemented in India. This is the reason why India has emerged relatively unscathed from the global volatility witnessed during the past couple of years.

Let me elaborate a bit on the issue of strengthening the current account. India's current account comprises four important parts, viz., merchandise trade; net oil imports; serviced trade; and remittances. Among these, we generally run a deficit on merchandise trade and on oil imports; but we run surpluses on services trade and receive large remittances. India's services trade surplus and remittances have done consistently well, and in fact have accelerated over the past two decades. They have proven to be very resilient and have not been impacted by global factors.

> *"Overall, all the large emerging markets have to learn to live with global volatility by keeping their domestic policy frameworks strong enough to be able to respond to these global shocks."*

The implication of a global slowdown in trade is primarily a risk to merchandise trade.

Hence, while strengthening our manufacturing capabilities and striving to

achieve greater success in goods exports, we can continue to strengthen our services exports and remittances in order to cushion the impact on goods exports should the global conditions deteriorate during the months ahead.

Overall, all the large emerging markets have to learn to live with global volatility by keeping their domestic policy framework strong enough to be able to respond to these global shocks.

This is one area of economic management in which India has fared quite well.

AM: Your recent co-authored paper recommending the privatisation of all public sector banks barring State Bank of India, received a lot of attention among policy-makers, academics, and the media. Overall, however, the rate of privatisation seems to have slowed down in India, across sectors. What do you propose may be done to boost the privatisation process to kindle better growth prospects?

PG: There is a definite theoretical case to privatise more banks and non-bank enterprises in order to improve efficiency, crowd in private investment, accelerate economic growth, and improve public finances by securing more non-tax resources, thus enabling the government to spend more on priorities such as education, health and infrastructure.

In this context, it is quite heartening that there is firm acceptance, in principle, of the need for more private ownership of activities that are not public goods in nature. The Honorable Prime Minster, the Finance Minister, officials in NITI Aayog, and the Disinvestment Secretary have articulated the Government's commitment to more private ownership time and again.

Yet, the execution of privatisation is often a complex task. The complexity in implementation is not limited just to finding the right political narrative and milieu to undertake privatisation.

The pace, sequencing, and exact modalities of privatisation call for advanced technical expertise, laying down the legal modalities, and delicate handling. The following measures would expedite the momentum of privatisation: ensuring greater technical capacity in the government in order to execute privatisation; learning from and replicating the success cases both within the country as well as internationally; and urging the state governments to take a more proactive stance on privatising their assets as well.

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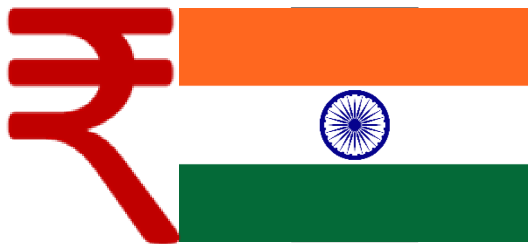
AM: In another of your recent opinion articles, you suggested that monetary policy is a blunt instrument for addressing the persistent challenge of food inflation, especially inflation in vegetable prices. What are your recommendations for tackling inflation to ensure that it does not adversely impact growth, going forward?

PG: There are three facts that are relevant about food inflation in India. First, at a 45% weight, food accounts for a rather large share in the Consumer Price Inflation (CPI) basket of India. Second, food prices, especially prices of vegetables and fruits, have been among the most volatile part of the CPI. Third, food inflation can be attributed to structural factors at play, including poor price guidance to the farmers ahead of the sowing season; weak supply-demand management across India resulting in localised shortages spiking food inflation; and inadequate storage management.



Thus, for the most part, monetary policy can impact neither the demand nor the supply of food over in the short run. Therefore, it is considered a blunt instrument to address food price inflation.

Overall, the worst is behind us in terms of the level of inflation. Even though globally inflation is not declining fast enough, it is not accelerating back either. Food price inflation has settled down globally. Globally, oil prices have come to rest at a manageable level. All of these global factors will help keep inflation range-bound in India as well. Besides, domestically we still have excess capacity, and there is no indication of a wage price inflation.

AM: In the context of the recent US-China trade wars and other issues relating to China, talk of devising a China plus one strategy has been gaining ground across the world. How do you think India can leverage this situation to its advantage and attract nations seeking diversification of their production and manufacturing destinations and options?

PG: The manufacturing sector has been a work in progress and somewhat of an enigma for all of the last 30 years in India. Starting with the 1991 reforms, a disproportionate amount of policy effort has focused on the manufacturing sector. Yet this sector has not yielded the kind of results long expected from it.

This is partly because the policy efforts have been somewhat piecemeal, and cumulatively have not been sufficient to create an ecosystem that could compete with the existing dominant global suppliers of manufacturing goods. However, based on these experiences, one cannot rule out a resurgence in the sector in the coming years. There have been some sporadic successes in different manufacturing activities over the past 30-year period. We have observed some additional successes in recent years, including in the electronic goods sector.

All the policy efforts and initial successes will eventually add up to make India the next manufacturing hub of the world.

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> *"In view of its size; political stability, policy stability, and macroeconomic stability; favourable demography; the untapped potential of its female workforce; unparalleled entrepreneurial zeal; and an earnest political desire to succeed, India is perhaps the only country that is ready to become the next factory of the world."*

factory of the world. This could not only make China plus one a reality; but eventually actually displace China!

What would it take India to reach there?

Continued focus on policies aimed at spurring the manufacturing sector; as well as the focus on overall competitiveness and integration-enhancing policies, focusing on human capital, skills, R&D, logistics, infrastructure, regulatory ease, attracting more foreign direct investment, integrating more with the global markets, continuing to make the land and labour policies more flexible; and the ongoing greater play of the Indian States.

All these ongoing and future policy actions and strong initial conditions would add up to make India the next manufacturing hub, while also simultaneously ensuring that it attains more prominent success in the services sector.

AM: in view of its rising importance as a global player and the widespread traction received by its G20 Presidency, India is seeking to build a consensus on critical issues such as debt restructuring, crypto regulations, and reforms in multilateral organisations. As a member of the Economic Advisory Council to the Prime Minister (EAC-PM), and the Chair of the G20 Task Force on Macroeconomics, Trade, and Livelihoods, what, according to you, are India's current economic priorities?

PG: As you mentioned, India has developed a comprehensive and ambitious agenda during its G20 presidency. This includes debt restructuring, and reforms of the international financial institutions, among others. These priorities are in continuation of the priorities of the past presidencies. It is indeed quite reassuring to see that India is taking these agenda items forward. The issue of a global framework for crypto regulations is an innovative and significant new priority during India's presidency.

There is a unique momentum to attain material results on some of these priorities. One of the reasons for this is that for the first time, the G20 presidency would be held by emerging market countries for four years in a row: Indonesia held it last year, India is holding it this year, and Brazil and South Africa would hold it in the next two years.

This is, in fact, a real opportunity for them to collectively define and shape an agenda that would work for the global south and enable it to make significant and tangible material progress. They can and ought to become a consolidated voice for the global south.

Let me point out two key sets of issues that need to be addressed in G20

from the point of view of the emerging and developing economies.

The first is to examine how large emerging market economies such as Brazil, India, Indonesia, and South Africa, and others can get a fairer deal from the advanced economies and some of the international financial institutions, particularly while bracing the impacts of the spillovers of monetary policy, volatile capital flows, and emerging market sell-off episodes.

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In this context, G20 should encourage the central banks of advanced economies as well as of all other G20 countries to broaden their swap networks. The Federal Reserve should be asked to extend swaps to additional central banks. The IMF's Flexible Credit Line and Precautionary and Liquidity Line ought to be reformed so that many more countries can sign up for these without fear of any adverse signalling effect.

The second set of issues revolves around the latest debt sustainability assessment by the IMF and the World Bank, according to which more than half of the 70 Low-income Countries are either in debt distress or face a high risk of experiencing debt distress. The average debt burden of countries in distress was a staggering 90% of GDP in 2019, increasing further by almost ten percentage points of GDP in 2021. The creditor base includes the multilateral organisations, China as the single largest bilateral creditor, the private sector, and other bilateral creditors.

There is plenty of blame to go around for the current debt situation. Debtor countries that borrowed unsustainably; large creditor countries, especially China, and private creditors, who lent recklessly on opaque and unfair terms; and multilateral organisations that failed to monitor and warn of the unsustainable amount of debts being raised, are all to be blamed.

It is imperative to find ways to chip away at the current stock of debt while simultaneously ensuring that future debt is raised in responsible ways. Multilateral institutions should do more timely and effective debt assessments under realistic scenarios. Countries should build local capacities to conduct their respective debt assessments. Collective ownership of the problem by China, multilateral agencies, the private sector, and the debtor countries themselves, along with a holistic solution, will ensure faster debt restructuring and better debt sustainability.

In addition, future debt raised by Low-income Countries should be de-risked against external shocks, including the climate-related shocks.

Views are personal.