Everything Wrong With Modi Government’s White Paper on India's Economy (Part 2)

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It is already established (as discussed in Part I) that the better economic performing years for India were the 2002-2012 period, a majority of them under the Manmohan Singh-led United Progressive Alliance (UPA) government.

A caveat here: UPA I’s (2004-09) economic performance was of course quite different (and better) than the UPA II years (2009-14). The latter period witnessed a poorer growth outcome combined with the ills of double-digit inflation and an elongated period of policy paralysis, making any significant reforms difficult.

In arguing the latter, the Modi government’s White Paper does rightly emphasise the asymmetries evident in the macroeconomic landscape around the time (2012-2014 years), which were driven by a combination of external and internal factors.

Still, the ‘good’ of what happened in the Indian economy between 2004-2012 needs proportional representation (which the White Paper fails to do).

On Gross Fixed Capital Formation by Private Sector (% of GDP)

Gross fixed capital formation (GFCF), also called "investment", is defined as the acquisition of produced assets (including purchases of second-hand assets), including the production of such assets by producers for their own use, minus disposals.

GFCF data.

Source: World Bank Database

In the 2004-12 period, the GFCF by the private sector (as % of GDP), though volatile, still remained above 24% of GDP on average. However, from 2012 onwards, the drop in GFCF was consistent up until 2015 (from 26.5% to 21%) and then just flattened, only rising slightly to 22% in 2018.

> Basic macroeconomics teaches how a sustained rise in investment is crucial for financing growth, irrespective of an economy's stage of development. India's macro-private sector hasn't invested across sectors *en-masse* despite all the incentives and fiscal measures undertaken by the Modi government.

A lowered GFCF (% to GDP) level for the private sector reflects a lower investment level which adversely impacts any goal to enhance production for private firms. It also reflects a low level of trust in a nation's current/future growth prospects.

Many of us have argued previously that low aggregate demand and poor consumption levels have made the economy enter into a Keynesian trap whereby the aggregate domestic private investment-production scales have tilted towards a lower trend line, also causing a period of "jobless growth".

On Inflation (CPI)

In terms of reigning in consumer price inflation, the Modi government's first few years presented a better track record than the UPA-II period of the Manmohan years, when the inflation rate remained in double digits, especially during 2009-2013. Exogenous factors, i.e., an 'imported inflation' fuelled by a higher rise in oil prices led to a rise in consumer prices.

Inflation data.

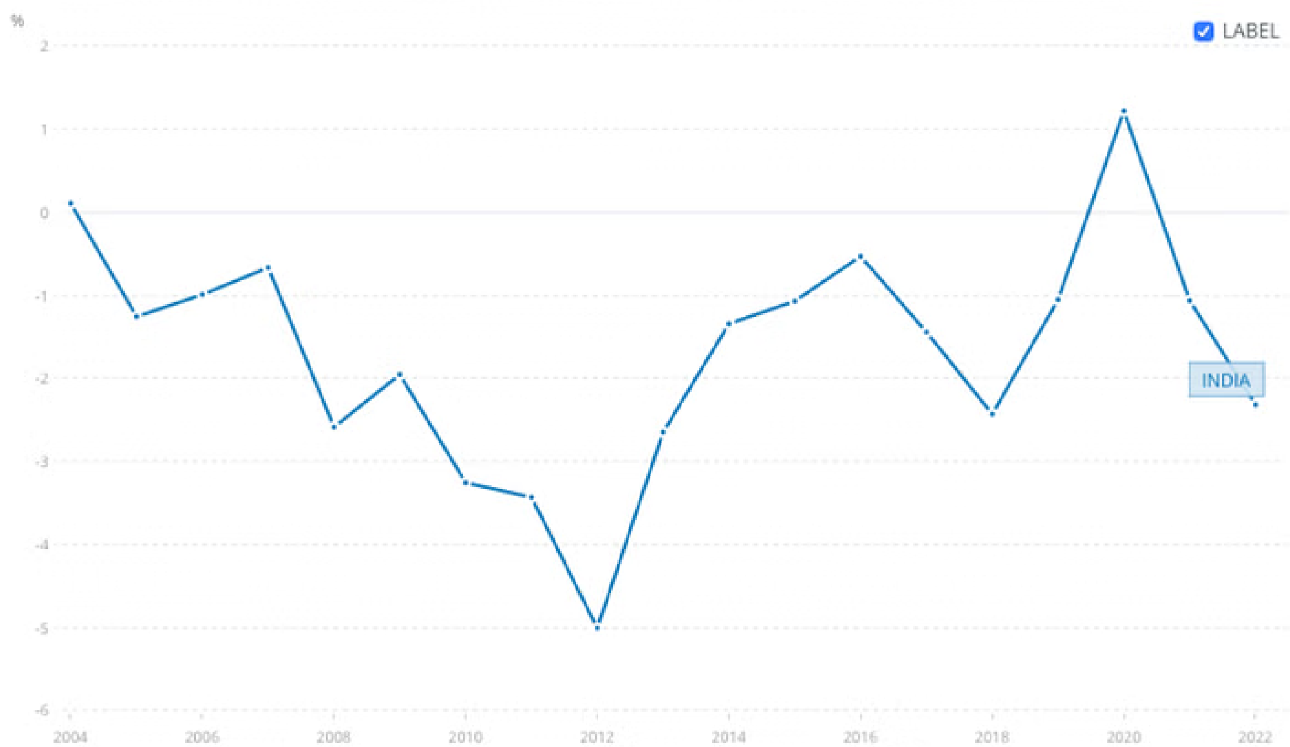
Source: World Bank Database

Oil prices in most of the Modi I-II term period were reasonably low, and now, as they have gone up (triggered by the uncertainty surrounding the Russia-Ukraine war), we are seeing the subsequent effect of that again (like 2009-13) on both WPI (wholesale price index) and CPI (consumer price index) levels.

On Current Account Deficit to GDP

India's Current Account to GDP levels were in the negative for most of the 2004-12 period. They started improving after 2012 and did so till 2016 before seeing a drop again. On macro-trade, the Modi government's record has ensured higher exports but with even higher imports for some years now (including the period of the pandemic).

However, the government's *atmanirbharta* push has unfortunately led to the introduction of protectionist measures with higher duties and tariffs on trade, including ad hoc measures like the wheat, and rice export bans imposed recently, which adversely affects India's vision and credibility to become more competitive in the global market.



Current Account to GDP levels.

Source: World Bank Database

India's export competitiveness in manufacturing still remains weak in relative comparison to neighbours like Bangladesh but with a visible comparative advantage in services (as discussed here). The Modi government has done little to maximise its resources in investing the export potential of the service sector (especially beyond IT and financial services).

On Rising Debt and its Macroeconomic Impact

It’s not as if the general government debt alone has risen in India over the last 10-year period. There is a sustained rise observed in external debt levels too during the Modi years, as seen below, along with a gradual but persistent rise in household debt levels, at a time when real incomes/wages (in urban-rural areas and across sectors) have been regressively stagnant and consumer prices/inflation has remained high (which accrues higher indebtedness, particularly among lower/middle-income earners).

India's GDP growth rate and government debt to GDP.

Source: Trading Economics

India's total external debt and government debt to GDP.

Source: Trading Economics

> The level of government borrowing, as seen above, was broadly contained below the 72-73% (i.e. to GDP) mark in UPA-I years and then became much lower in UPA-II. It started gradually rising from the year 2016 onwards (again, post demonetisation), almost in a parallel continuum with the rise observed in the fiscal deficit.

The inability of the union government to collect its own projected tax-(non)tax revenue outlays (including disinvestment targets) made the government eventually increase its domestic borrowing levels (largely financed through the RBI), which raised the government debt levels to approximately above 81% of GDP. Household debt too has gone up while household savings have considerably fallen.

India's households debt to GDP and government debt to GDP.

Source: Trading Economics

Rising external debt requires a greater robustness of dollar/reserve currency balance for a given country, which has been a concern for India’s balance of payment position in recent times.

The RBI has done everything possible to exercise dollar selloffs for maintaining exchange rate stability in the currency market for a depreciating rupee, and if one looks at the incoming flow mechanism of forex into the country, macro-FDI levels have remained (as per the IMF's Table 1) more or less the same, even though foreign portfolio numbers have remained extremely volatile for India (signalling a rise in hot money inflow/outflow and a loss in the credibility of an emerging market to attract long term stable investment via FDI).

See below.

External trade data.

Source: IMF Article IV Report on India

High Debt, Low Employment, and High Inflation: A New Polycrisis Woes

A high debt level accompanied by a lower employment rate and a higher food inflation level (or more volatile headline inflation level) is the worst possible scenario for any emerging market economy, particularly one that boasts of experiencing a 'demographic dividend' in its working age population composition.

India's growth story is one of 'jobless growth' anchored by higher informalisation and casualisation of work happening, where workers are circumventing the constraints of a low-organised work availability scenario across sectors (i.e. in the absence of 'good jobs').

India's worker population ratio and government debt to GDP.

Source: Author's Calculations (Trading Economics)

India's food inflation and government debt to GDP.

Source: Author's Calculations (Trading Economics)

Manufacturing production is still weak and where the potential for jobs is more i.e., in services, the nature of competitiveness (in an abundant labour/worker surplus economy) yields few opportunities in terms of higher wages. Workers then settle for low-value service work, a lot of which happens at the intersection of 'informal' and 'formal' work.

India's manufacturing production levels and government debt to GDP.

Source: Author's Calculations (Trading Economics)

Some might ask the question: How is this all related to rising government (or macro) debt?

If we look into the bank credit trend accompanying the rise in government debt level, one sees that even as credit is growing in India’s financial sector (which is vital for growth prospects), a higher debt level amidst a lower growth cycle will leave less space for both a long term credit expansion or instances of borrowing.

India's bank loan growth and government debt to GDP.

Source: Author’s Calculations (Trading Economics)

What Do We Learn?

As mentioned earlier, India’s best macroeconomic growth performance was observed between the 2002-11 period. This includes the last two years of Atal Bihari Vajpayee's government and the first seven years of UPA rule.

> 2012 onwards, the economic policy management saw a period of systematic disruptions combined with high inflation and a period of ‘policy paralysis’ under UPA-II when introducing gradualist reforms too became difficult.

Modi’s rise to power was largely pitched on the ‘development plank’, someone who in all projections could deliver high growth and pass tough reforms.

Much of the Indian elite, pro-business class, including upper-class liberals and middle-income groups came in support of Modi to see his government working to recover the economy from the paralysis of UPA II tenure. However, what happened was quite the contrary.

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