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India doing well despite headwinds, says Subramanian

CHAITANYA KALBAG, Contributing writer

NEW DELHI -- India's economy is doing well despite slower growth in the first quarter of fiscal 2016-17, but moribund private investment and a mushroom cloud of huge bad loans over banks are worries, according to the chief economic adviser to the Indian government.

"In the short run, our biggest challenges are private investment and public-sector banks. We really need to turn that around, to get the financing and credit flowing into private investment," Arvind Subramanian told the Nikkei Asian Review in an interview.

India's gross domestic product grew by 7.1% in the April-June quarter, after 7.9% in the previous quarter and overall 7.6% growth in 2015-16. Gross fixed capital formation fell by 3.1% in April-June.

Experts say India needs to grow by between 8% and 10% per year at a minimum for decades if it wants to try to catch up with China. "Export growth in both manufacturing and services will be essential to achieve 8% to 10% growth consistently," said Subramanian, whose book "Eclipse: Living in the Shadow of China's Economic Dominance" was published in 2011. "For example, India has to capture the space created because of China's retreat from sectors such as textiles."

Subramanian said a recent government investment support package for the

Arvind Subramanian, chief economic adviser to India's government

textile sector was an example of incentivizing job creation in manufacturing and simultaneously capturing a greater market share. On Sept. 12, however, the government announced that the index of industrial production fell by 2.4% in July.

"In the medium term I worry that if the international environment continues to be weak, if exports continue to be weak, then a combination of weak exports and the fact that technology is moving more and more towards labor saving solutions, that it could compromise our ability to both provide jobs and provide higher living and income standards," Subramanian said in his office in the imposing colonial-era North Block in New Delhi.

Exports rose slightly in June for the first time in 19 months, only to fall again by 6.84% in July. At the same time, consumer price inflation, which had risen by 6.07% year on year in July -- above the target band set by the government and the Reserve Bank of India -- fell back to 5.05% in August.

These indicators have renewed a chorus of demands that the new RBI governor, Urjit Patel, who took over in early September, should cut benchmark interest rates in his first policy review on Oct. 4, in the hope that lower rates might rejuvenate manufacturing and consumption.

Politically sensitive

Subramanian, 57, is on leave from his position as a senior fellow at the Peterson Institute for International Economics in Washington, D.C. He was named to his politically sensitive Indian post in October 2014.

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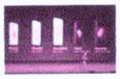

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He noted that the government's annual Economic Survey, which customarily precedes the Indian budget in late February, and which he authored this year, had predicted GDP growth of between 7% and 7.75% in 2016-17.

The Modi government had achieved four major legislative milestones, Subramanian said: A Bankruptcy Act which will make it easier for unviable businesses trammeled by India's labyrinthine labor laws to shut down; the Aadhar Bill, which universalizes a digital identification number and will smooth direct transfers of subsidies to the poor; a Monetary Policy Committee, which will bring the RBI and the government together in setting interest rates; and most importantly a Goods and Services Tax, which was enacted by a rare bipartisan parliamentary vote in August. These steps plus a good monsoon augured well.

"In all these discussions we have to remember that no one instrument is going to turn around private investment. There are multiple things.

Those who say that monetary policy easing is important should not claim that that will cure all the ills. Equally, people on the other side should not say that will have no impact," Subramanian said.

Despite cuts totaling 150 basis points since January 2015, former RBI governor Raghuram Rajan, who coincidentally was also Subramanian's predecessor as chief economic adviser, was criticized by politicians from Modi's Bharatiya Janata Party as well as beleaguered businessmen for not easing further. Rajan argued that the benchmark repo rate, now at 6.5%, was lower in real terms than most other developing countries.

India's banks have been accused of not transmitting the rate cuts to borrowers quickly enough, a point that Subramanian agreed with. "You are right that the pass-through hasn't happened as envisaged. But that is primarily because the banks themselves are not in a position to generate enough resources and the economy is hostage to the 'twin balance sheet' problem of weak corporate profits and banking debts," he said.

An asset quality review ordered by Rajan uncovered a huge non-performing assets crisis in Indian banks. A recent Credit Suisse report estimates that NPAs plus restructured loans now amount to as much as 15% of total assets in India's state-owned banks. Here again Subramanian was not unduly alarmed.

"When we think about our banking challenges, one has to see the difference between India and China. Private sector debt is about 260% of GDP in China. In India it is about 55%. So it's a 1:5 ratio. So they are far more vulnerable to a crisis than we are.

"Let's say 5% of our bad debt is zero value and a complete write-off; 5% the government can easily cough up. It will increase our debt-to-GDP ratio by 5%. So we are not in a crisis situation. The problem is the slow bleed situation, where they are unable to lend and finance growth. That's our challenge."

Sweet spot

In his Economic Survey last year, Subramanian said that the Modi government, with its clear majority in the 2014 elections, was in a "sweet spot -- rare in the history of nations" where it could finally be launched on a double-digit medium-term growth trajectory that would attain the goal of "wiping every tear from every eye." Has this happened?

The World Bank estimates that India is home to 270 million poor people living on less than $1.90 a day, while government data show that India is home to 26% of the world's extreme poor. There has been significant progress in poverty eradication: In the 25 years since economic reforms were launched in 1991, per capita income has risen two-and-a-half times, and official data show that between 1994 and 2012, the share of the population living in poverty halved from 45% to 22%.

Nevertheless, a recent World Bank paper said: "Notably, while consumption levels have increased rapidly in recent years, the poorest 40% of households have seen their incomes grow at a slower pace than the population as a whole." As much as half of India's population is deemed by economists to be vulnerable, "stuck between poverty and the relative stability of the middle class."

Subramanian was quick to point out that his Economic Survey had also said that India needs to follow "a persistent, encompassing, and creative incrementalism" with bold steps that would ramp up investment, rationalize subsidies, and create a clean and predictable tax environment.

Were the middle and lower-middle classes being squeezed? "I don't agree with that at all," Subramanian said. "I think that you could make the case that [the economy] is not growing as rapidly as people's expectations, but the fact that there are sustained increases in living standards, that is undeniable.

"You could say this is not as inclusive and uniformly shared as it ought to be, those are legitimate points. [But] I think poverty is coming down; you look at all the indicators. Even if growth is 7%, that is not a bad achievement given the global environment."

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