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WILL INDIA MAKE IT? 2016

"I don't know what you want to call me... Santa Claus... you want to call me a hawk, I don't know. I don't go by this. My name is Raghuram Rajan and I do what I do"

RAGHURAM RAJAN,
Governor, Reserve Bank of India

A WEAK GROWTH IMPULSE

Recovery remains nebulous despite the exceptional terms of trade gains and other positives

Illustration: SHYAM

RENU KOHLI
DELHI-BASED MACROECONOMIST

The year 2015 may yet go down in Indian economic history for the exceptional fall in the price of oil, a largesse that enveloped the entire year and inspired much optimism throughout. In a stroke, this corrected India's external imbalances, sharply brought down inflation, improved public finances and added another growth driver—increased consumer spending—to existing ones like higher public capital expenditure and structural reforms.

The second major positive that defines 2015 is the turn in monetary policy. In tight mode from 2010, and exceptionally restrictive since late-2013, many regarded high interest rates as a major constraint to investment and growth recovery. Like oil prices, monetary policy too began to relax at the beginning of the year, was pursued throughout, cumulating to 125bps in all. It is hard to be as unequivocal about fiscal policy: Sticking to a committed consolidation path, quality improvements and consumption-enhancing salary revisions are likely a plus for investors, rating agencies and civil servants; others may grumble about higher taxes and cesses that equally marked the year.

The third major highlight of 2015—we don't quite know if this is a positive or a negative—is the enigma about growth, which also arrived in January. A rebased national accounts series marked up the 5% growth in FY14 to 6.9%. Advance GDP estimates for FY15 followed in February, indicating growth would accelerate further to 7.4%. While these robust numbers provoked much confusion, even disbelief, the spin-offs have been distinctly upbeat. India was straightaway propelled into the fast-growers' league and emerged as the world's fastest-growing nation, no doubt helped generously by China, which decided, around the same time, to slow down.

Foreign capital surged in as GDP growth—7% or 5%-plus, depending upon the metric you like—pulled in investors shunning Brazil, Russia and other oil-commodity exporters. The rupee fared well too, holding strongly above the waters even as most emerging market currencies submerged in a global tide of depreciations.

A series of fortunate events, as it were. A platter that could possibly overwhelm the minuses, of which there were several. By a quirk of circumstances, 2015 is also marked by disturbing developments of possibly unprecedented magnitudes. At the top of this pile are high levels of corporate debt and an unending stream of NPAs weighing down the banks. Both continue to hold back investment and lending, pointing to long haul of repair ahead. Another unfortunate constellation is a second successive monsoon failure, weakened international agriculture prices and minimal increases in farm support prices. The phrase 'rural distress' entered the lexicon of economic discourse and dented the sales of many industries that had come to rely upon robust rural demand.

Many indicators touched new lows and were at variance with the buoyant growth numbers. In this basket fall the year-long contraction in exports, the highest levels of idle factory capacity in five years, the feeblest growth in bank credit in more than a decade, a constant decline in corporate earnings and sales each quarter, an industrial output uplift that more disappointed than inspired, the failure of private investment to take off as anticipated and much else. An exceptional configuration, leading to caustic commentary like 'it doesn't feel like 7%-growth' or 'feels more like 5%'! Therein lies the growth enigma.

Externally, the downgrading of world growth and trade projections in succession through the year constituted one of the weakest demand environments since 2008. Then, shockwaves from China's slowdown, the related slowing of many EMEs, US monetary tightening and divergent monetary policies of the advanced countries are some critical factors that increased uncertainty.

Weighing the developments in balance, an obvious question is why most indicators worsened, or improved so little (e.g. industrial production) despite the astonishing size of several positive impulses. Why have growth forecasts resting upon this bounty eventually been scaled down? Why did private investment not take-off as anticipated? Why did the drivers underpinning growth projections at the start of 2015 fall by the wayside, one by one, leaving anxiety even about the sustainability of a consumption revival in the end? Do then the negatives have the power to potentially overwhelm the positives? As 2015 draws to a close, the puzzle is why a recovery remains nebulous despite the exceptional terms of trade gains and other positives. Perhaps 2016 may offer new information and insights.

Leveraging India's frugality bias

GOPICHAND KATRAGADDA
CHIEF TECHNOLOGY OFFICER, TATA SONS

India has all the ingredients to become a global driver of innovation, led by a strong market potential, an excellent talent pool, and an underlying culture of frugal innovation. Innovative countries have demonstrated the leverage of cultural advantage to capture markets. Japan leveraged its cultural emphasis on efficiency and team work to revolutionise the manufacturing and engineering industries. Korea leveraged its cultural emphasis on speed and built world-class companies such as Samsung and LG. China has capitalised on its action bias to sustain a GDP growth in excess of 10% for more than two decades. The US and Israel have leveraged the diversity of their population to lead aggressively on innovation. Similarly, India can leverage its cultural bias of frugality and sustainability to capture markets not only within its shores but globally. For this to happen, our industries need to have the hunger to be at the top of the value-chain, our talent pool has to get more hands-on, our customers have to be more demanding, and our policies have to be more transparent.

Indian corporations and the government should first focus on innovation for the significant internal market needs in energy, water, transport, healthcare, and food security to deliver tangible human and environmental benefits.

Energy: India would need to generate 0.5 kW electric power per person to provide reasonable level of opportunities to its population. Based on current projections for 2025 population, India needs to increase its generation capacity 2.5X, from roughly 280 GW to 710 GW. The energy requirement of 0.5 KW per person is roughly half of the European average and a quarter of the US average. Transmission and Distribution (T&D) capacity should be upgraded accordingly.

Water: India needs to double usable water from 1,000 to 2,000 cubic meters person per year. Less than 1,700 cubic meters of water person per year is considered to be water-stressed. Currently, the US provides 8,000 cubic meters person of water per year to its citizens. Also, India would need to double the sewage treatment facilities in urban areas to even meet its current needs.

Transportation: It is estimated that India will add 1,000 passenger and freight locomotives over the next 10 years and the passenger and freight aircraft market will grow to be 100B+ by 2025. An additional resource to consult is the report submitted to the prime minister of India by National Transport Development Policy Committee in 2013-14, *India Transport Report: Moving India to 2032*.

Healthcare: The country will need to grow from 4%-of-GDP healthcare spend to 5.5%-of-GDP, as per the CII-McKinsey report on Healthcare, "India Healthcare: Inspiring possibilities, challenging journey". The report presents the vision for India's healthcare with clear goals for 2022.

Food security: India will have to develop innovative, accessible, diversified food plans and supply chains to enable at least around 2,100 kcal per capita per day diet for the urban population and 2,400 kcal per capita per day for the rural population.

From a technology leadership standpoint, start-ups should accelerate innovating for the digital economy and large corporations should develop new opportunities at the confluence of emerging scientific knowledge and materials. One such opportunity is the intersection of biology, computing and materials. New developments in genomics, connectomics, deep learning, and 2-D materials provide the palette to create global-first products and services. Applications include higher efficiency energy life-cycles, sustainable fuels for transportation, predicting and preventing disease, improved wellness and better nutrition. In these emerging research areas, industry R&D should double and the government should provide direct R&D grants to industry.

With a positive demographic, political, and market outlook today, India has its best opportunity in many decades to position itself for a century of innovation. India has the ability to create a unique spot in innovation history to meet its requirements using its cultural advantages of frugality and sustainability. It is our time to make it happen!

Servicing India's growth

JERRY RAO
MUMBAI-BASED ENTREPRENEUR

India missed the Industrial Revolution of the 18th and 19th centuries. We did not do that badly in the first half of the 20th century. Textile mills in Bombay, Ahmedabad and Coimbatore, besides many other places, jute and engineering factories in Howrah, even an advanced steel plant in Jamshedpur (about a half a century before Korea set up a steel plant) were all world-class or near that, and capable of holding their own in global markets. Free India went into an autarkic nightmare. We did industrialise, but with the intent of serving only the tiny market of a very poor country, our own. Products and processes were anything but world-class. We set extremely modest goals and our actual achievements were considerably more modest than even these goals. By 1990, the country was studded with inefficient, sub-scale, technologically-backward factories that employed a very small portion of our work force. Liberalisation came to India too late—some 30 years after Korea and some 15 years after China. We have become a nation that habitually and perhaps wilfully keeps missing bus after bus. Tragically, our poor infrastructure (e.g. endless electric power cuts) and our self-imposed restrictions on allowing business flexibility, has meant that instead of industrialising, we have actually de-industrialised quite a bit. One just needs to visit parts of Howrah to understand the meaning of the expression "de-industrialisation".

Our insipid industrial growth combined with over-investment in higher technical education, not only led to a transfer of technical talent to other countries, but to spectacular growth in areas like IT services—businesses which were not strangled by intrusive micro-management by the state and its industrial policies. The usual pattern has been for economies to move from agriculture to industry and then on to services. We seem to have unconsciously leap-frogged one stage. Today, we merrily import manufactured goods on a large scale and export white-collar services. The obvious problem with this model is that organised service businesses are not proving to be employment-intensive enough. This is particularly true for large numbers of our potential workers who are low in skills. It is in this context that our present Government is trying to push the idea of "Make in India". This is a welcome move. In order to rejuvenate India's stunted industrial progress, we need better transportation, more reliable and good quality power, fewer taxes/inspections/controls/registrations and other bureaucratic nightmares, faster clearances and turnarounds at ports—the list is long. Any government which is serious abut supporting Indian manufacturing will have to attend to all these issues before entrepreneurial animal spirits take over.

At a minimum, businesses should not be discouraged from "Making in India".

The point however needs to be made that Make-in-India is not going to be a medicine that can cure all our ills. Firstly, creating the enabling environment of better infrastructure and less bureaucracy is simply not going to happen overnight. Given the stubborn resistance of our bureaucracy to the government's plans at each stage, the latter may not ever fully materialise. Secondly, if manufacturing is meant to absorb large numbers of workers, that too may be difficult. Modern manufacturing is increasingly becoming less labour-intensive—and the few workers required in fact, need to be pretty highly-skilled. One more irony, so typical of all Indian tales is that India's competitive advantage seems to be in high-end, design-intensive products or in high value niches, not in the areas where millions can get jobs.

Is there any silver lining? Without compromising on any of the measures desperately needed to stop discouraging Indian industry, we should actually consider whether our "inadvertent" leapfrog into services, and even the export of talented people, might not be such a bad thing. Services, even advanced ones, tend to be far more labour-intensive than manufacturing. They tend to be less dependent on infrastructure like roads or power. They are more susceptible to our national trait of jugaad. Lastly, if over time, industrial economies any way end up as service economies, should we be risking setting up too many factories that can soon turn into ghost buildings?

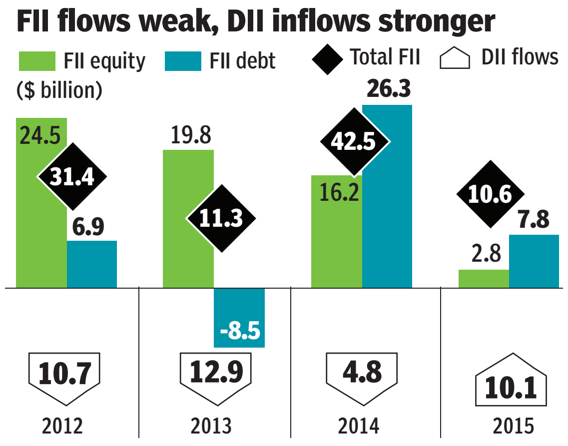
IF OVER TIME, INDUSTRIAL ECONOMIES ANY WAY END UP AS SERVICE ECONOMIES, SHOULD WE BE RISKING SETTING UP TOO MANY FACTORIES THAT CAN SOON TURN INTO GHOST BUILDINGS?

Our ideal approach should not be one of top-down planning. We have had enough of that. Let us just create an environment where manufacturing and service businesses do not face active discouragement or hostility. We can then leave it up to the animal spirits and the jugaad of our entrepreneurs. In this context, the harassment that has already started by greedy Service Tax officials does not bode well for the country. (They take special delight in collecting rents from small businesses and start-ups!).The vulture-like approach of some of our state governments towards the nascent e-commerce sector is also worrisome. The monarchs of the Income Tax Department have already ensured that several hundred thousand ITeS jobs have been lost to the Philippines. My big worry, which is shared by literally hundreds of service sector entrepreneurs, big and small, is that our babus will wilfully misinterpret the government's Make-in-India effort as a signal to stifle the service sector.

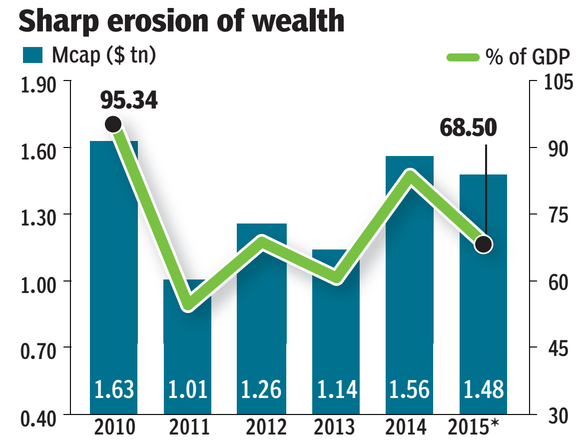
Let us just make India a country where it is easy to do business, not the nightmare which it still remains. Manufacturing and services will both grow organically, and then and only then, can India have any hope of "shining".

DATA DRIVE

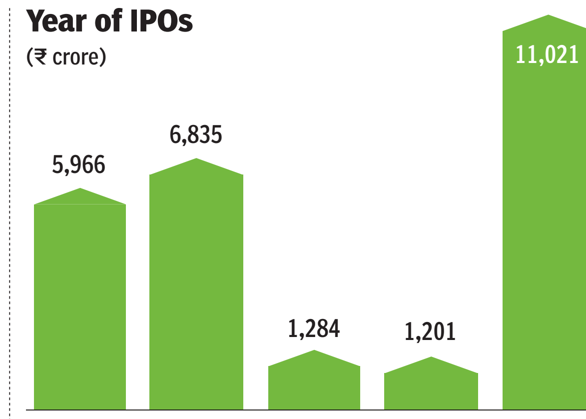
FII flows weak, DII inflows stronger



Sharp erosion of wealth



Year of IPOs



Sensex returns poor