Business Standard

Subir Gokarn: From bottleneck to bottleneck

Alternating periods of fast and slow growth may well be the reality

Subir Gokarn | New Delhi March 10, 2013 Last Updated at 21:50 IST

A drive from north to south Mumbai along the Western Express Highway is an experience that is alternately reassuring and frustrating. Coming in from the north, virtually all major intersections are now covered by flyovers, which, on a good day, provide virtually uninterrupted movement for several kilometres. But then, after having crossed the domestic airport, the Khar intersection, the only major one not to have a flyover, looms. On some days, you can spend more time waiting to get through this intersection than you saved as a result of all the flyovers that came before.

After this, though, there is respite as the approach to the sea-link and the sea-link itself get you to the race course in no time at all. But just when relief is setting in, you get into the backlog from the Haji Ali intersection, a seemingly endless wait, which on many days pretty much kills any chance of making it to your appointment on time.

This may be an apt metaphor for the growth experience of the Indian economy over the past 20 years. After an exhilarating three-year phase of over seven per cent growth per year in the mid-1990s, obviously in response to many of the policy reforms, there was a disappointing and frustrating six-year period of five per cent per year growth. This would have been seen as reasonable, were it not for the seven per cent run that preceded it.

However, even as resignation about an endless trudge of five per cent was setting in, the next five years saw growth accelerating massively to average close to nine per cent per year. Notwithstanding the crisis, this momentum appeared to be sustaining, but the growth numbers for the last two years clearly indicate that it is not. Once again, in what increasingly seems to be a regular pattern, growth has slowed considerably and the frustration about this is all the more because of the high benchmark against which it is contrasted.

The essential question is whether the pattern is indeed regular and repetitive - in other words, do periods of rapid growth alternate with periods of slow growth? The record of the past 20 years suggests that they do. If this record is a valid precedent, then we need to be prepared for the possibility that the current pace is not just a one- or two-year aberration that will correct spontaneously.

The traffic bottleneck metaphor provides a useful way to think about it. The impact of many reform measures can be effectively neutralised by the persistence of a small number of surviving bottlenecks. In this scenario, despite many of the "right" things being done, there is no visible growth dividend. However, when even some of these bottlenecks are removed, there is a very quick and visible pay-off in terms of accelerating growth. Eventually, though, a bottleneck is reached and the pattern repeats itself.

Let's look for lessons in the transition from the five-per cent phase (1997-2003) to the nine-per cent phase (2003-08). In terms of outcomes, the most significant indicator of the phase transition was the rapid acceleration in investment spending. As a percentage of GDP, it went up from about 25 per cent in the slow-growth period to about 38 per cent at its peak in the fast-growth period. But, for this to happen, other factors need to have played a role. First, going into the fast-growth phase, inflation was quite benign. Of course, this was helped by relatively soft international crude oil and other commodity prices, which began to harden a few years into the fast-growth period, aggravating inflationary pressures that were already being exerted by the domestic growth acceleration.

Second, and very importantly, there were two fiscal developments. One was the fiscal consolidation process, concretised by the Fiscal Responsibility and Budget Management (FRBM) Act of 2003. This was greatly reinforced by the introduction of the value-added tax (VAT) by several states in 2005, which contributed to significant improvements in state finances. The second was a reversal in what had been a declining trend in public capital expenditure. The government began to spend more money on asset formation, perhaps the most visible manifestation of which was the National Highway Development Programme (NHDP). While public expenditure in general may "crowd out" private spending, public capital expenditure tends to "crowd in" private investment. I think that the surge in investment activity during the fast-growth period is testimony to this.

All of this took place in a relatively hospitable global environment, which contributed to a dramatic improvement in India's balance of payments position. With rapidly growing exports, particularly with the increasing contribution from the IT/ITeS sector, the current account actually showed surpluses in some of the years in that period. Capital flows surged, pushed by global liquidity and pulled by the attractions of accelerating growth and promising long-term prospects.

An important contributor was the overall increase in productivity. Competitive pressures clearly helped productivity levels in industry and services, but the rapid penetration of the telecommunication-IT combine also made a huge difference in a short period of time.

If all of these - and perhaps more - factors are viewed as growth-enhancing, their reversal must logically be seen as growth-retarding. On the macroeconomic front, there is an obvious circularity between rapid growth and favourable outcomes on other indicators, so it is important to identify the "trigger" correctly. I think the lesson in terms of both fiscal aggregates and expenditure composition is quite clear.

As regards the external sector situation, we have to work with the assumption that global conditions will be at best neutral and, more realistically, somewhat hostile to growth. To shrink the current account deficit in these conditions while ensuring that it is financed more and more by long-term capital flows are both well-recognised but extremely difficult objectives.

On the very critical issue of productivity, telecom may have been the key driver during the last fast-growth phase, but its impact will inevitably taper off as penetration reaches high levels. For growth to move back to the benchmark levels of 2003-08, a productivity boost from another source has to materialise. I think a prime candidate is agriculture, with the objective of boosting availability and moderating prices of key commodities that have been behind persistent high food inflation.

Ultimately, sustained rapid growth will come not from opportunistic reforms, as useful as these might be. It will come when new and emerging constraints are identified and dealt with strategically. Otherwise, we will see growth alternating between fast and slow as we move from bottleneck to bottleneck.

The writer is former Deputy Governor of the Reserve Bank of India. These views are personal