FINANCIAL EXPRESS - 5 APRIL 2014

**INTERVIEW: RAKESH MOHAN**

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# Key issue for India is revival of industry. It does not seem to be getting adequate attention from anyone

*Though India's growth has faltered because of a decline in savings and investment rates, **Rakesh Mohan**, India's executive director at the IMF, told **Raj Kumar Ray** that the country has the capacity to come out of the low growth era. While FII inflows have been on the rise in recent months, the former RBI deputy governor warned that India must remain vigilant as unwinding of easy money policy in the US could result in a significant reversal in capital flows. Edited excerpts:*

**Last year, the IMF chief spoke of a three-stage recovery in advanced and developing nations. Has there been a change in the global growth patterns? Will there be a change in the forecast for India's growth in 2014?**

Compared to IMF's forecasts a year ago, the US recovery has been somewhat faster. Some countries in the European Union have also begun to show signs of recovery. Some EMEs such as China and India have indeed slowed. IMF will come up with its World Economic Outlook in April with its latest forecasts.

**IMF seems to have a different view on the Indian economy.**

I don't think IMF's assessment is very different from what the government view is, except that IMF's growth estimates are slightly lower. India's growth slowdown has been caused by both global and domestic developments.

The global slowdown after the North Atlantic Financial Crisis (NAFC) has affected almost every country's growth rate, including major EMEs such as China, Russia and Brazil. Growth in global trade fell significantly after the NAFC. So there is no doubt that the global slowdown has affected everyone.

In India, we were able to counter the NAFC by coordinated fiscal and monetary policy loosening during FY09 and FY10, which helped in maintaining a healthy GDP growth until FY12. It was only from FY13 that growth has been impacted significantly.

The finance minister has also said that stimulus measures were higher than necessary, and the need for the second and the third fiscal packages is debatable. I agree with him. With the increase in fiscal deficit as a consequence of the fiscal stimulus adopted soon after the Lehman crisis government borrowing increased on a relatively sustained basis since then and crowded out private investment. It also impacted inflation. With the high inflation (CPI inflation averaged around 10% in last four years) that we have experienced, nominal interest rates have had to be high correspondingly.

That has impacted private sector economic activity particularly corporate sector investment has fallen from about 17% of GDP in 2007-08 to just over 9% last year. The government has been trying to address these problems. A significant part of the fiscal deficit was due to subsidies. From 1.4% of GDP in FY08, the subsidy bill had risen to 2.5% by FY13 and was 2.3% in FY14. That is something that the government is aware of and that's why we had decontrol of petrol prices and periodic upward revision in diesel prices. Subsidies on fuel have another impact —when oil prices go up and down, there isn't adequate demand adjustment. If prices are flexible, you would have greater impact on demand.

Continued action on the reduction of energy and other subsidies is essential to bring down the fiscal deficit, and hence government borrowing on a sustained basis. That would have the effect of increasing government savings, reducing government borrowing and hence releasing more resources for the private sector to invest.

The government has also acted to revive investment by setting up the cabinet committee on investment to clear stalled projects. I hope that the impact of this activity will be felt in the coming months, and that the government will continue this pro active stance of promoting investment.

**How has been the fiscal consolidation in India as against other comparable EMEs?**

The one difference we had with other EMEs is that we had high fiscal as well as current account deficits. There are very few countries which had both.

We have gone through this type of growth slowdown before—in 1999 to 2002. GDP growth was low, fiscal deficit was high but the difference was that the CAD was not high at that time. Between 2003 and 2008, we had a very significant fiscal correction.

Between 2002 and 2008, the savings rate went up from 26% to 37% with the reduction in government's fiscal deficit, and huge growth in corporate profits fuelling corporate savings. Coupled with these, growth in household savings was robust which translated into higher investment and growth.

The financial savings of households, as a percentage of GDP, has declined in the last three years presumably because of the gold effect. With the steps taken to curb demand for gold through increase in gold import tariffs, the coincident correction in gold price expectations, household financial savings will also rise if real interest rates can be brought back to positive territory with a sustained reduction in inflation. The question remains whether corporate profitability can be revived and hence private corporate savings.

**India's growth trajectory has sharply come down in the last five years from over 9% between FY06 and FY08 to less than 5% in last two years. Is it because of infrastructure bottlenecks and rigid labour laws?**

The key issue is revival of the industry. Industrial growth is zero now. It does not seem to be getting adequate attention from anyone. You talk of infrastructure bottlenecks. But I presume that these bottlenecks are not worse than before. You talk of rigid labour laws. They do pose problems for industry but are again not any worse than before. You can't aim for high manufacturing growth unless you first acknowledge this is a serious problem.

**Despite US tapering, we are witnessing robust FII inflows. Is it because of the so-called Narendra Modi wave or is it for other reason?**

As a consequence of the US Fed loosening its monetary policy in 2001 after the dotcom crash, huge capital flowed into EMEs from 2001 onwards. We benefitted and managed them (FII inflows) well while we built up forex reserves. Then after the Lehman crisis in 2008, capital inflows reversed, which could be managed because of the availability of forex reserves. The inflows started again in 2010 with the advent of Unconventional Monetary Policy (UMP) by way of near-zero interest rates and quantitative easing. According to some estimates, cumulative portfolio flows to EME fixed income markets since 2009 are around $400-500 billion above their 2002-07 trends. While you will always have ebbs and flows, the writing on the wall is clear – as the UMP is unwound there could be significant reversals as markets react to expectations of decreasing global liquidity and the possibility of rising global interest rates. Therefore, you have to be vigilant about this, in both directions, of capital flows.

**Coming to reforms within IMF, what is holding back the quota reforms?**

In 2010, the membership agreed to reform the IMF in two areas — first, to double the quota resources to deal with crisis, and second, to change the IMF structure according to the changing economic weights of countries in the world. Countries amounting to about 76-79% of voting power in the IMF have already approved the reform proposals. The US administration had in fact strongly supported this reform by which the weights of European nations would go down and the weights of EMEs such as China and India would increase, among others. The US Congress has not yet agreed to approve this reform. Unless they agree, it cannot be done. This week, they were expected to approve it. But the latest indications are that it may not be done. So the IMF reform will remain stymied.