



drishti

Hope with Concerns in 2019

 [drishtiiias.com/current-affairs-news-analysis-editorials/news-editorials/05-01-2019/print](https://www.drishtiiias.com/current-affairs-news-analysis-editorials/news-editorials/05-01-2019/print)

(This editorial is based on the article “Hope with Concerns in 2019” which appears in The Hindu on 4th January 2019.)

2018 has been a mixed bag, with many ups and downs both globally and domestically. Now in the new year countries across the world look forward with hope, whatever the conditions might have been the previous year.

India’s growth rate in 2018-19 is forecast at 7.4% by the Reserve Bank of India (RBI).

But it looks to be a touch-and-go situation. More likely, it will be slightly lower. Looking ahead, 2019 may not show any substantial rise in the growth rate. Even though the Goods and Services Tax (GST) has stabilized, much will depend on the pickup in the investment rate.

The rupee also underwent a severe shock as crude oil prices rose, and abated after a fall in oil prices. While prices fell, agrarian distress accentuated. Therefore, few issues need to be addressed comprehensively if India is to achieve sustained high growth.

The Investment Ratio

Issues

- **The growth rate depends on the investment rate and the productivity of capital or its inverse incremental capital-output ratio.**
- The incremental capital-output ratio is a catch-all expression. It depends upon multiple numbers of factors such as quality of labour, which again depends on education and skill development levels, and technology, which is constantly changing.
- The Gross Fixed Capital Formation ratio has fallen from 35.8% in 2007-08 to 28.5% in 2017-18.

Solution

- **For ensuring a sustained high growth, we need to raise the investment ratio and**

keep the incremental capital-output ratio at 4.

- The journey to raise the investment ratio is not going to be easy. 'Animal spirits' must be revived. A tranquil political and economic environment needs to be nurtured.

Banking system

Issues

- An important factor affecting economic growth is the condition of our banking system. **Non-performing assets (NPAs), including stressed assets, as a proportion of loans of public sector banks, stood at 16.7% as of March 2018.**
- As many as 11 public sector banks are under Prompt Corrective Action (PCA). This restricts the lending abilities of these banks. Added to this, the Non-Banking Financial Company (NBFC) system is also under stress. This is partly a reflection of the stress in the banking system since most NBFCs borrow from banks.
- Today, banks are responsible both for short-term and long-term lending. Their inability to lend affects the availability of working capital as well as capital expenditures.

Solution

- Some have advocated providing more capital to banks outside the PCA framework as that will increase their lending capacity immediately.
- **Recapitalization of public sector banks will partly solve the problem.** It is not clear at this point how much it will help in adding to lending capacity.
- The decision to pump in more capital to public sector banks must be completed soon. The growth rate in the industrial sector will depend on how quickly the banking system comes back to normalcy.

Employment growth

Issues

- There is great concern about the inadequate growth of employment. India does not have satisfactory employment numbers. The employment data in the organized sector are reliable. But the employment in the informal sector is much larger.
- **Growth is around 7%, but there is no corresponding growth in employment.**
- **Growth can occur either as a result of the increase in investment or because of better utilization of existing capacity.**
- It is growth which is led by new investment that leads to a significant increase in employment. But growth caused by improved efficiency of utilization of existing capital can lead only to a marginal (definition box) increase in employment. Much of the growth seen in the last few years is of the latter variety (i.e marginal increase).

- **The increase in employment seen in the period between 2004-05 and 2009-10 was because of the rapid growth of information technology (IT) and financial sectors.** The IT sector has slowed down. The financial sector is under stress.

Solution

- **As the IT sector growth rate is not likely to pick up significantly and industry is undergoing many structural changes,** the revival of the banking system depends on a number of factors (including investment). Thus, even from the point of view of employment, the key factor is the pickup in investment.
- India's external sector has grown and is well integrated with the rest of the world. India's trade in goods and services as a percentage of GDP has grown to 42% of GDP. Therefore, what happens in the rest of the world affects India's growth very much.

Agrarian Distress

Issues

- The future of growth also depends on the performance of agriculture. But, agrarian distress is widespread. **Strangely, the fall in prices of agricultural products is in one sense a reflection of our success in raising output. Some years ago, the concern was a rise in the price of pulses to abnormally high levels. But today the picture is reversed. Similar is the case with respect to vegetables, particularly onion.**
- The need of agriculturists is income in current prices. The solution to the fall in prices lies in government intervening in the market and buying off the surplus over normal levels. The market will then automatically take prices to the normal level.
- The important requirement in this context is not only the financial capacity of the government to procure but also adequate physical arrangements to procure and store. The procured agricultural products can be sold by the government in later years when output is low or utilized in any safety net programme.

Solution

- Loan waivers are at best short-term solutions. There is also another basic weakness that we have to address.
- The average size of landholding is so small that any amount of increase in productivity will not give adequate income.
- Farmers have to think in terms of consolidation of landholdings so that they can get the benefits of larger size outputs. Small farmers will also have to think in terms of higher value-added products like vegetables.
- A combined attack to increase productivity, consolidate landholdings and improve marketing is needed to assure farmers of better income.

Enhancing Export Growth

- India's balance of payment situation has been comfortable since liberalization. However, there are vulnerabilities as seen in September-October 2018, when the value of the rupee suddenly plummeted when crude oil prices rose and there were simultaneously capital outflows. RBI intervention and the subsequent fall in crude prices have restored the value of the rupee.
- In April-November 2018, India's exports of goods grew by 11.6%. However, we need to note that exports growth was 5.2% (2016-17) and 9.8% (2017-18). Strong growth in exports is a must if we have to keep the current account deficit (CAD) at a manageable level.
- The forecast for world trade and output is not encouraging. There are too many uncertainties which include an intensification in the trade war. Along with export promotion, we also need to contain some of our large imports. A watch on India's CAD is critically important if we have to achieve growth with stability.

Way Forward

- **Thus there are five concerns as we stand at the beginning of 2019.**
- These are: raising the investment ratio; putting the banking system back on the rails; employment generation through better growth; enhancing export growth to contain the CAD and removing agrarian distress by increasing productivity and consolidation of small landholdings. These issues need to be addressed comprehensively if we have to achieve sustained high growth.

DRISHTI INPUT

- **The incremental capital-output ratio (ICOR)** is a metric that assesses the marginal amount of investment capital necessary for an entity to generate the next unit of production. Overall, a higher ICOR value is not preferred because it indicates that the entity's production is inefficient.
- **Gross fixed capital formation (GFCF)** is a macroeconomic concept used in official national accounts. GFCF is a component of the expenditure on the gross domestic product (GDP), and thus shows something about how much of the new value added in the economy is invested rather than consumed. GFCF is not a measure of total investment, because only the value of net additions to fixed assets is measured, and all kinds of financial assets are excluded, as well as stocks of inventories and other operating costs (the latter included in intermediate consumption).
- **PCA norms** allow the regulator to place certain restrictions such as halting branch expansion and stopping dividend payment. It can even cap a bank's lending limit to one entity or sector. Other corrective actions that can be imposed on banks include special audit, restructuring operations and activation of the recovery plan. Banks'

promoters can be asked to bring in new management, too. The RBI can also supersede the bank's board, under PCA.
