Read Raghuram Rajan’s full speech:

What I want to talk about today is really where we are in the Indian economy. By the way, I’ve got you under false pretext. I’m only going to talk about how we got here. So, let me talk a little bit about where we are and let me start by saying we are in a very worrisome place in India, today. Growth has slowed considerably, the fiscal deficit is large leaving little room to do something about growth and there’s rising debt levels in many areas in the Indian economy, some of that distressed. So, India’s an economy which for 25 years has been growing at 7 percent. What we see today is much slower growth and if we are to believe Arvind Subramanian’s work, I’ll talk a little bit about it later, perhaps even lower than the headline numbers that we see.

So, what I want to talk about is how we got here, why are we here and what are the things that we’ve done wrong along the way. Both sins of commission as well as sins of omission—things we didn’t do and that have brought us to this parse. So, I want to focus on the next few slides; talk a little bit about growth, talk a little bit about the fiscal and talk a little bit about debt and districts just to give you a sense of where we are and then spend a lot more time on trying to analyse the roots of the problem which then will help us think a little bit about what can be done to rectify it.

So, the first is to show you that in fact we have been slowing. Again, this has not taken into account some of Arvind’s concerns. We were growing really fast before the Great Recession and then 2009 was a year of very poor growth, we started climbing little bit after it but since then, since about 2012, we’ve had a steady upward movement in growth going back to the pre-2000, pre-financial crisis growth rates and then since about early. And then since about mid-2016 we’ve seen a steady deceleration and now the latest numbers were 5 percent for the last quarter.

But when you look at some of the investment bank projections for the next quarter, they’re not very happy. It doesn’t look like there’s going to be a rebound in the very short run. Now, some of the reasons for this—the first two series are the fiscal year 2005 to 2011- sources of growth. First point that one has to make is that his investment has been falling steadily in the Indian economy ever since probably the global financial crisis, but it’s been falling steadily actually from a few years after that. Consumption has been relatively strong and holding up across these two periods but more recently, consumption has also been falling. Net exports were never a strong source of additional growth. So again, continuing on the same theme, what you see most recently is consumption is falling rapidly. If you look at every element of the auto industry; look at cars, look at commercial vehicles, look at two wheelers, two wheelers are a good proxy for rural demand. Commercial vehicles are a good proxy for industrial demand and of course, cars are good proxy for urban demand. You see all of them tanking; tanking to the extent of 30-40 percent levels of negative growth. Now, some of this is because of policy changes that came in. For example, changes in emission requirements. Some of it is because of uncertainty about whether the value-added tax will be changed for these. So, if I think the value-added tax is going to come down from 28 percent for cars, I might say wait and see before buying a car because it does make a lot of difference in the price of a car.

A lot of it is because of a shortfall in credit availability to households as well as households themselves postponing consumption. Finally, when you look at the trade balance— what you see is that in the years of strong growth, India’s exports were growing; in fact growing faster than GDP so that exports rose as a share of GDP. Over the last so many years, they have been growing slower than GDP growth and therefore falling as a fraction of GDP. This is true when you even take out oil— that’s the numbers on the right-hand side are non-oil exports and you see that has been falling. So, India’s investments have been falling, India’s consumption is falling, and India’s exports are not
doing as well as they did in the past when they were growing really strongly especially in the years of strong growth when India became a much more open economy by the usual measures. Today, it’s in some sense closing down relative to the past. Now, I said on the one hand growth has been relatively slow, but the fiscal is also a source for concern. India’s fiscal deficit to GDP is officially 7 percent that’s the sum of the state government’s fiscal deficit and the central government’s fiscal deficit, but the reality is, this fiscal deficit conceals a lot. The headline number again, conceals a lot. If you look at the projections for the coming year, the revenue projections are very optimistic by most counts and we just had a corporate tax cut and estimates of its cost vary but that’s going to add to the burden of the fiscal deficit.

What is less noted but something that the Auditor General has pointed out in India is, there’s a lot of borrowing which is going off-balance and which is not being counted in the fiscal deficit. For example, the food corporation of India is essentially a department of the government. The food corporations borrowing should be thought of as part of the fiscal deficit but is off-balance and you can see that’s skyrocketing over the last couple of years from about 0.7 percent of GDP to 1.1. Point four percentage points of GDP are buried in food corporation of India’s borrowing. Similarly, the National Highway Authority of India- you see borrowing there go up from 0.2 percent of GDP to 0.7 percent of GDP; another 0.5 percentage points of GDP. Now, add these who you get one percentage point of GDP that is not counted in the fiscal deficit but is actually part of the fiscal deficit. To that a whole variety of normal shenanigans that the finance ministry does. I was in the finance ministry so I know exactly what we do. We push, we accelerate any revenues we can find and push any payments we have to make. Well, at some point that catches up with you. So, put all these together add to them the fact that we have rising contingent liabilities in India. The rising non-performing assets means that banks need recapitalisations; some has been done but going forward, there is a question of how much more is needed. You’re seeing the non-bank financial companies- they are in trouble and they may need some state support. You’ve got rising healthcare commitments. We have a whole new healthcare program- Ayushman Bharat which is being rolled out. As it rolls out, it will require more resource. So, these are all contingent liabilities. We don’t account for them well in the budget, but they hit future budgets. So, contingent liabilities are rising which leads respectable investment banks like JP Morgan to put the actual fiscal deficit as somewhere between nine and ten percent of the GDP. That's a large number. It's especially large in India because we brought inflation down. In the past when inflation was available as the inflation tax, you could inflate away your debt and that helped make your finances look a lot healthier. Today, with inflation so low, it's much harder to do that. You actually cannot inflate away your debt that easily and therefore that's a source of concern. Our fiscal is tighter than the similar numbers would be in the past.

Now, let me go on to debt and distress. One of the worrying things about the recent environment is that, household savings are falling. So, households are saving less. Now, Indian households are natural savers and the fact that they are saving less- should be one source of concern. Why aren't they saving more? Because after all, Asian economies grew on the basis of strong savings invested well. So, savings are falling over the last few years but increasingly, you’re seeing that also reflected in higher debt levels. Household debt levels are increasing by about nine to ten percentage points of GDP over the last four or five years. So, households are borrowing much more and saving less. That's a bad combination. That means, they did not have a whole lot of debt earlier, so they started from a low base but they've borrowing quite rapidly and that has to be an additional source of concern. You can see emerging signs of distress. For example on the corporate side, what we see is- if you look at credit rating companies, credit rating companies will give you ratios of the number of credit upgrades to credit downgrades and so the lower this number is, the more stress your corporate sector has. This level of stress is at a six-year high. In other words, the upgrades to downgrade ratio is at a six-year low. We're as bad as we were at that point where we were starting to grow again. So, stress is piling up in the system probably as a result of ‘low demand slow earnings
growth’ and difficulties in serving the servicing debt. So, I’ve talked to you about what we see today and why we should be worried. Let me talk a little bit about what the roots of the problem are. I want to argue broadly that we’ve really had no significant continued reforms in India to propel economic growth since 2004. Now, what is that year? That is the year the last BJP Government - the NDA that won under Atal Bihari Vajpayee - that’s when it lost the election. We had first reforming Congress Government in the early 90s followed by a number of coalition’s followed by the BJP government. That 15-year period or 14-year period from the early 1990s to 2004- was a period of significant reforms where we cut down our tires, become a more real open economy and even did some privatizations under the budget by the Government. That was also a period where growth was not that strong, but it created the environment for really strong growth. The problem with the Vajpayee government was that, even by the end of its term we still hadn't got to the spectacular growth we saw in the next three or four years afterwards. At least the experience of growth amongst the broader people was not that strong and so the Vajpayee Government’s campaign for re-election in 2004 which was based on India rising simply didn’t catch hold and they lost narrowly to the Congress. Congress came in with a coalition government which had the communists in it and really could not continue the reforms that the NDA had started- because simply there wasn't that much consensus within the coalition partners. Nevertheless, there was an explosion in investment and what you can see here is the rise in new projects announced as we go into three-four-five, just before the financial crisis you have a substantial explosion in projects announced. Strong growth and many of these projects were completed on time. Many power plants completed, road building projects completed, the Golden Quadrilateral in India was done in during the Vajpayee regime. So, there was strong infrastructure investment and strong growth. Now, the collateral effect of that sprung growth was, it put a lot of pressure on resource allocation including the institutions to allocate resource. So, a lot more need for land, lot more need for iron ore, a lot more need for coal, lot more need for spectrum. All these pressures rising at the same time as demand for these across the world is rising; iron ore for example, created a strong demand in China. The prices of these things are going through the roof, but we don't have strong systems for allocation because they were never that valuable and so, iron ore really had no system to allocate it. First-come first serve, take it. But as they grew more valuable, the old systems of allocation simply didn't work anymore and we needed a more formal structure but we didn't put those formal structures in place we still had the old informal arrangements and that became the source of tremendous amounts of problems. One of the consequences of the strong growth was a series of corruption scandals which came to light in UPA to the second term of the UPA government. Now, the UPA, the Congress-led United Progressive Alliance got what it thought was a boost at the end of its first term to a massive farm loan waiver. My suspicion as well as of some analysis is that really the boost came from the strong growth they experienced too much of that in their tenure but the belief was, these populist measures were an important factor in their re-election and so when UPA 2 came into power, further reforms were stymied despite their ability to do further reforms by the fact that they really believed it was not from growth but from these populist policies that they had gotten re-elected and the emphasis was much more on populist policies in UPA.

Net effect was right through UPA 1 and UPA 2- they were relatively few of the growth enhancing liberalising reforms especially because in UPA 2, even the reforms they wanted to do like the goods and services tax was stymied by the opposition protests which grew louder and louder as some of these corruption scandals came to light. So, UPA 2 was essentially a period where we didn't have significant growth enhancing reforms- we had a lot more spending especially on distribution of stuff such as the food act, the food security bill and inflation started going through the roof. Inflation started going through roof in part, because of strong demand but in part also because we saw increasing supply bottlenecks being created in the economy. For example, because land acquisition got much harder, many of the bureaucrats because of these corruption scandals became much less willing to put out for fear that they would be held up by investigative authorities. The bankers who were really quite willing to lend in the phase before the financial crisis when projects were doing
really well, now became a little more risk-averse also for fear that if loan went bad, they get hauled up by the investigative authorities. So, essentially, the economy started slowing down considerably post-financial crisis but also it had high levels of inflation. So, macro-stability was a great concern at this time and India had basically all the bats - high levels of inflation, high physical deficits and not-so-strong growth at which point there was a course correction in the Congress government.

It started the process of fiscal consolidation. Chidambaram came back to the finance ministry to focus on that and we had done a little bit when we were faced with the Taper Tantrum. Those of you who remember, that time essentially Ben Bernanke said that he was going to end the process of quantitative easing in the U.S. and that immediately set off a real bout of volatility in the financial markets. Capitals started flowing out of a number of emerging markets and emerging markets that didn't have good macro numbers; among which was India. We are thought of as prime candidates for money to leave. India was one of the fragile five that time and we lost capital very quickly. So, that was a wake-up call and the government listened at that time and transformed to focus much more on macro stability. Bring the fiscal deficit down, try and enhance growth, try to whatever reforms were possible. At that time, I think the RBI also joined in to bring down inflation into making that a focus.

Move forward from the UPA 2- to Modi One. I call it Modi One just to distinguish it from NDA, it came in on the basis that the old government was relatively corrupt. It was going to be much cleaner, it was going to create jobs, it was going to create a run a transparent government and of course there were the traditional BJP elements like Kashmir Uniform Civil Code and the Mandir that they wanted to make. But that was all on the side. The central issues were jobs and lower corruption. As it came in, it started implementing some important reforms on the macro side, on the sectoral side, and to some extent, on the household and populace side. I want to show you this as the fact that during UPA 2 investments started plummeting and stayed low really since then. This is the other platform that the other attempt at macro stability which was to bring inflation down. That has been a success.

We have brought inflation down in India from the double-digit levels that were there but what I want to emphasize is that, in this period, we had the advent of Prime Minister Modi’s government and it started going about macro sectoral and household focus reforms. Unfortunately, it has been a mixed bag. It has been a mixed bag because, on the one hand, as I just showed- we haven't been able to revive investment. We haven't brought investment back. A lot of the promoters who started projects in the past are now highly stressed with high levels of debt. They simply cannot start new projects and banks are anyway not interested in lending to them. Even old projects haven’t been brought down significantly. The reason they are stalled is because promoters have lost interest. Now, one of the successes of both the old UPA government as well as the NDA government was essentially giving the RBI a free hand to bring down inflation. That has been a success. Inflation is low and has stayed low for a considerable period of time. The RBI also undertook a series of reforms- for example, opening up branching, licensing, improving retail electronic payments. We now have a state-of-the-art payment system of retail payments called the Universal Payment Interface which actually is better than many places in the world. These were all small level reforms. But one of the big concerns that was there was that as projects initiated- fell, there were also a whole lot of old projects which were stalled and getting into distress. Bad loans started building up in bank balance sheets. That's what you see here. The NPA's of public sector banks started rising.

Now, the problem with banks when they start seeing bad loans is there's a temptation hide them, to push them under the carpet especially if the bank CEO has a short horizon. 'I'm going to be gone in two years, why do I have to recognize all the bad loans? Now they're going to hit my profitability, why not bury them for the next two years? The next guy can deal with that.’ So, evergreening is a constant feature in banking systems across the world and you really have to force the banks to
recognize the bad stuff because, until they recognize it, they don't do anything about it. So, good money gets thrown after bad in keeping these projects afloat even though they simply need to be restructured if they have to have any hope.

So, what happened here the RBI undertook an exercise to clean up the banks and essentially forced them to start recognising their bad loans. What happened as a result; this was the asset quality review undertaken by the RBI is the NPAs of the banks shot up because there's a lot of stuff they had been burying which came to light at that point.

Now, the classic way of dealing with this is: force them to recognise, force them to start dealing with these loans and working them out with the promoter so that they can be put on track. In the meantime, recapitalize the banks so that they have enough capital to make few loans where lending is necessary. Now, bank recapitalization has been halting. The government has taken some measures but typically been a little behind the curve.

What the government did which was very important was pass the Insolvency and Bankruptcy Act. One of the problems in India in the past is, some of you in India know is that it's very hard for a lender to recover money from a borrower because there's no way of essentially forcing the borrower to pay up. We had a bunch of Acts passed. But every time we had an act passed, it worked initially. For example, what was called SARFAESI Act; an attempt to give lenders the right to cease collateral. But after a little while, the promoters figured out how to stymie the lenders once again. SARFAESI got clogged up in the books along with the debt recovery tribunals. So, the Insolvency and Bankruptcy Act was yet another attempt to try and force the borrower to repay their lenders and not have the lenders go from pillar to post in trying to look for their money. Initially it has worked. Initially it worked in putting the fear of God in borrowers and forcing them to repay. More recently, however it seems as if it's going the way of the old acts. The promoters have figured out how to end-run the banks and the judiciary has also intervened in a way as to make it longer and longer and possibly impossible. So, unless we do something about the Insolvency and Bankruptcy code, it will go the same way as the older reforms. It will be essentially gamed to ineffectiveness.

What also has happened in India and the financial sector is that, we've had the public sector banks getting into trouble. Because they got into trouble, their lending started slowing down significantly. The private banks and non-bank financial companies have lent much more. Now, the private banks have been relatively careful about their loans. A lot of their loans are retail loans. The non-bank financial companies were also generally careful about retail loans, but one source of lending has been a lot more problematic for them- which is they lend to developers who built out some of these projects. Those developers have gotten into trouble because of the slowdown in the retail sector and as a result, the non-bank financial companies also had incipient loan losses on their balance sheet. This came to a head when a big non-bank financial company ILFS essentially imploded in September 2018 and as a result of that, non-bank financial companies found it hard to get credit. A lot of them have gotten into deep trouble since because not only do they have little access credit, but they have loans building up on their asset side which are going from bad to worse.

So, this is broadly legacy problems piling up. We're not able to clean up the projects that are stuck, we're not able to clean up the banks fully but that process is underway, non-bank financial companies have filled the breach but are also starting to get into a little bit of trouble. Now, two big actions also happen over this time which create significantly more problems for the system. The first is, out of the blue, India demonetised 87.5 percent of the currency. Now, essentially what happened was the government said that Rs 500 note and Rs 1,000 note are no longer valid. What happens when you demonetised 87.5 percent of the currency? Basically, people don't have currency to do transactions. Some of it was replaced; but it was replaced slowly. It took 3-4 months to replace...
it entirely. In that period, the informal sector basically didn't have money to do its transactions. These are people who don't use credit cards, don't have checks and essentially a whole lot of them got into trouble. It's hard to measure the damage that was done to the informal sector because we really don't collect statistics of them but the anecdotal evidence is, a lot of people went out of business and there's actual studies which show it now that especially new rural areas; there's a lot more fall in transactions done as a result of the demonetising. In addition, there are sectors which deal primarily in cash for a large part of the transaction or some significant part of the transaction.

Real estate is one sector that is especially focused in cash and this sector was, already as I said, was weakening. With demonetisation, it got further and further into trouble. That also then spilled over to the developers who had built this real estate and then further to the non-bank financial companies. So, that was blue number one and measures of how much the set back growths vary from 2 to 3 percent of GDP for a couple of quarters to 2 to 3 percent of GDP on an annual basis.

Now, this is all using stuff we can measure. What is harder is to think about the stuff we can't measure. Certainly, if you look at employment numbers for example put out by the CMIE, unemployment went up significantly possibly close to demonetising. The second big blow was the Goods and Services Tax. Now, demonetisation was introduced without substantial preparation. I say substantial because we know there wasn't enough currency printed to replace the currency that was taken out. You had to print it full speed for the next four months. Typically, you don't do such things. You typically when you demonetise, have the money ready to roll out on the day you demonetise. That was not done suggesting the timing was chosen for other reasons than everybody was fully prepared.

That leads to the next issue which is, we had the rollout of the Goods and Services Tax. This is a wonderful concept. Demonetisation was misguided in concept. It was not a thing which either affected its aims—which was to bring down black money or what became a later aim which substantially increased the level of electronic payments or substantially formalise the economy. What it did was, create a lot of pain in a very short period of time especially for the poorer informal segments of the economy. It was brilliant politically though-because the government won the UP election soon after demonetisation.

So, it was sold politically very well but it was not an economically well-thought-out idea. The goods and services tax was the next big reform and it is something that the UPA government has been pushing and gone through because the BJP had opposed it then. The BJP took it on and to its credit managed to push it through as a constitutional amendment. It was a sound concept but again, initiated without enough preparation. The computers weren't ready for the volume of transactions which means right off the bat you had to say “Don't do this. Don't do that. We are going to simplify the forms”. There is a lot of back-and-forth which essentially undercut compliance and the constant fiddling with the rates ,I would presume, also created uncertainty. One could argue that some of the recent fall in demand, for cars for example, is because people are still trying to figure out. Are they going to reduce the tax? The goods and services tax on this from 28 percent in order to enhance demand? If so, I don't want to buy now I want to wait till they’ve reduced it.

So, this fiddling back and forth creates uncertainty which eventually has effects on growth. So ideally, you would want everything to be planned out, everything to be rolled out. Nothing in life actually happens that way. You have to roll it out to see some of the problems. But arguably, the goods and services tax had thought less about what would happen than one would want in such a big reform. One could even argue with the benefit of hindsight that one should have run a parallel experiment to see if it worked before running it out on such a massive scale across India.
You could say that you know you never experienced the full volume that would you would experience running it out all over India. Nevertheless, it was an experiment that should have been better planned.

So, let me quickly walk through some of the sectoral reforms. Agriculture—there has been again some reform. Crop insurance has been broadened. There has been a significant increase in the rollout of direct benefits for fertilisers rather than subsidising them. But the reality is, despite some of these changes, agriculture is still a big problem for India. Too much of the population still depends on it and productivity has been abysmally low. Even though India has had some successes in food and agriculture, for example—we are the largest milk producing country in the world. Nobody knows this, but we are and we have done it on the back of a substantial revolution in milk production.

Similarly, yields in a variety of crops have been increasing but not to the extent desirable and this has been compounded in recent years by the fall in the agricultural terms of trade. That is the prices that are obtained by farmers have in fact are not kept up and have fallen relative, for example, to the cost of their inputs. So, there is deep agricultural stress. The way governments across India deal with this is periodically waiving off agricultural loans. The problem there is that the poorest farmers don't get loans. They go to the moneylender. So, the beneficiary of loan waivers typically are the richer farmers and it does create problems in terms of the inequality and who benefits as well as creating massive fiscal issues for the state.

What we really need is much more careful investment in agriculture especially in agricultural extension, seed provision and technology upgradation. India needs to reduce the fragmentation of agriculture. The reason people don’t have high productivity is they don’t have good holdings. So, they can’t use technology they are averse to using some of that. Fragmentation would get reduced if some of these people could lease their land out and go work off the farm. But leasing is also something we haven’t made easy and that holds back some of the increase in size.

Perhaps the most important problem in Indian farming is the price the farmer gets is often very low compared to the price at your table. That's because there's a whole range of middlemen in between who absorb profits. Every politician who comes to power saying, “I'm going to make the farmer get more” but they come up against strong vested interests; many of whom have political connections amongst the middlemen. So, we found it hard to remove that middlemen. There's been initiatives on creating electronic markets, on creating warehouses. We need to do far more of that in order to give the farmer a good deal.

In the meantime, India’s old habits—you saw an example of that just a few days ago when the price of any agricultural commodity gets particularly high, they ban exports of that. Immediately the price falls but the poor farmer who for once was getting some benefit from price rising, gets hurt at that one. So, farmers are protesting in Maharashtra today because of these bans. This is the problem. We don't have a systematic policy of supporting the farmer with either insurance or procurement at reasonable prices across India. Instead, we do it haphazardly but often when it comes to a choice between the farmer and the customer, we choose the customer because the customers’ votes matter a lot. Onion prices are an important political issue in India and with elections coming up, the price of onions in in some of the states the price of onions is extremely poor.

Other places where we have had mixed success: Power. India is in a position to generate tremendous amounts of power today. Enough for the most part, going towards 24/7 supply in different parts of the country.

The problem in India is that we have distribution companies sitting between the consumer and the producer who simply are incapable running themselves efficiently. So, these distribution companies...
essentially make enormous losses, their state-owned distribution companies. So, in situations where there’s plenty of power available, they simply don’t buy it and sell it to the final consumer because they don’t have the finances to buy it. So, distribution companies actually are standing in the way. We do need to restructure these distribution companies. Put them on a sound financial footing. We have done that three times and every time we put them back on a sound financial footing—because we haven’t changed either the fact that they are not charging adequately for power on the revenue side and that they see a lot of theft happening of power which they cannot essentially claim. These companies start making big losses once again.

So, we have restructure them three times and we will have to do it once again. But we don’t seem to learn the lesson that after restructuring that we need to make sure that they are also reasonably profitable. So, India has a paradox of having huge unutilised generation capacity even though the customer wants 24/7 power and benefit from that, we are not able to provide it to them. So, interestingly, power is a success story even despite all this in the sense that we have been growing power consumption about 6.5 percent a year. But much of this is not in the industrial space where power consumption has been relatively bad. But because we are bringing new states into electrification and we are growing in that way. Ideally, what we would want to do is create enough power across the country so that we can benefit from electric power.

Finally, to other sectors, we have had an attempt at banking sector reforms. Remember I told you the public sector banks got into trouble by making bad loans. It is generally recognised that we need to improve governance in the public sector banks and there have been some efforts on this under the Modi government. We have created something called the Bank Board Bureau to make and to recommend some of these public sector appointments. The real problem is that the Bank Board Bureau doesn’t have much power. The recommendations it makes goes up to the Ministry and then to the Prime Minister’s office in the same way as it has always happened. So, it is not an independent agency which can make independent appointments.

Similarly, the public sector bank boards have little power of their own to appoint the chief executive or to take significant decisions and as in the past, they have been politicised. Of course, one of the problems with public sector firms is all public sector firms typically overpay at the bottom because that is part of their social function and they under pay at the top. This is a bad way to run a firm because you don't get much talent to run the firm because you are under paying at the top and this is a problem with the public sector banks also.

I think this has to be fixed because increasingly in the financial system there is a need or really capable people to run these banks. But you simply cannot attract them with the kinds of salaries you pay even if you are willing to recruit from the private sector which historically hasn't happened except for two instances again to give credit to the Modi government; under that government.

What has happened most recently is something that I think was unnecessary and we'll see how it plays out. Recently, what's happened is in an attempt to improve the public sector banks, we have consolidated them. We have picked saying “You three get together, those three get together and, the other three get together.” Largely, I think on the basis of the kind of information technology they use. If they have the common information technology and also the areas they service. The problem is, everybody associated with banking, those mergers take a lot of time and are a big headache. Who occupies which position, how do we merge departments together etc. These bank mergers are coming at a time the banks are already dealing with high levels of NPAs and they are coming at a time that the economy is slowing. It is probably not the right time. It maybe the right move but it is not the right time. And, public sector banks are going to be engulfed in managing the mergers over the next few years instead of actually focusing on making better loans.
Finally, one of the problems with public sector banks is that they have government mandates imposed on them. ‘Thou shalt do this’ and those mandates are generally uncompensated. The latest mandate comes from the Modi government’s emphasis on lending to small and medium companies. There was a whole scheme called the Mudra Scheme which got them to lend. Unfortunately, that experience hasn’t been turning out particularly well. So, what do we do when that experience doesn’t turn out well? Do we clean up the system? I think what we’ve seen now is an attempt to try and not recognise the problem which is, we are going to have forbearance on the MSME loans that go bad. In other words, they will not be recognised and in fact we are going the other way. In order to revive credit, because credit is not flowing, we now have the concept of ‘Loan Mela’ A loan mela is a loan fair- “Come on, come all get your loan”. Now, you wonder how much careful credit assessment goes in when you are supposed to give loans in a loan mela. I think the early signs are the banks are trying to do credit analysis- we will see going forward what kind of pressure they are subject to in order to make these loans.

So, the broader problem is that the public sector banks are in difficulty. The reality is, they need significant governance reform much of what is being done is initially, there was some appetite to do it. Unfortunately, now we are doing stuff which probably takes away from governance, takes away from cleaning up the balance sheet rather than necessarily improving the quality of their balance sheet. One example of this that I pointed to- was the pressure on public sector banks to make some of these MSME loans.

Finally, let me come to the issue of trade and investment. That has been a focus of the Modi government; a good and necessary focus. However, what trade and investment needs really is an increase in the ease of doing business because ultimately, you get more trade if you have more efficient firms who are able to produce both for the domestic economy and internationally. Now here again, what one would want for is a slashing in some of the old regulations that holdback firms and focusing on improving the ease of doing business. Now, there’s been some attention but largely focused on the World Bank indicators of the ease of doing business rather than the actual conditions in India on what prevents businesses from working easily. So, as a result, we haven’t got that significant boost so far in business opening because in fact it may not have become that much easier for businesses to operate in India. One of the recent concerns has been on tariffs and taxes. If you want more trade, you should bring down your tax because today, the way trade happens is through global supply chains moving goods back and forth. In order to move goods back and forth across borders, you need low and stable tariffs. Instead, what we have is high in fluctuating tariffs in certain areas; not all areas but certain areas. And that becomes a concern for business. What will the tariff be next month? If in fact I open a business here, India is not part of any significant global supply chains and that makes it a problem if India wants to increase its exports. Similarly, taxes- the recent cut in corporate taxes is beneficial in attracting firms to India but what firms worry about is not just the level but the changes. Is this going to change? Am I assured that when I put my investment in India, it will stay at 15 to 17 percent? Unfortunately, in India, we have a history of going back and forth, some of which was reflected in the recent budget in taxes on foreign investors. So, we need to have a process where if we stabilise rules and regulations and taxes and tariffs, if we want to attract new companies into India. That is one reason why if you look at the level of foreign direct investment in India, despite the emphasis on ‘Make in India’, you see in the last four years the level of foreign direct investment hasn’t changed very much. We get about $40 billion. In comparison, Brazil gets $90 billion in FDI. I am not even talking about China; China occupies a different space. We have had some successes. For example, in India, let me start with the success. Cell phones; we are starting to assemble more cell phones in India, and this has gone up. If you look at the cell phone imports, they have come down significantly and that's not because we are buying fewer cell phones, but because we’re importing that. And if you look at exports, that have gone up. So, India is starting to export cell phones that it assembles in India. That's good! The problem, however, is, it's largely just assembly because one of the counter parts to the increasing
cell phones is the fact that you look at electronic components, we're importing far more. In other words, we are doing assembly now that's not to be sneezed at we did do assembly before and doing assembly today is a good thing but it's not value-added assembly. It's basically importing the components and putting them together. In places which are more value-added, and this is why I want you to look at textiles. China is moving out of textiles. Who is taking its place? India has moved up from about 3 percent of world exports in textiles to 3.3 percent. That might seem like a reasonable number, but it's over a period of nearly 20 years. On the other hand, if you look at Bangladesh; it's gone from 2.6 to 6.4 percent. If you look at Vietnam, it's gone from 0.9 to 6.2. So, Vietnam and Bangladesh are absorbing the textile market while we have plenty of people to work and we're not getting any of the textile market. That suggests we are still not seen as an export friendly place. Our businesses are not doing as well as they should. What's holding us back; we don't have appropriate logistics, power, land, office space and qualified manpower relative to some of these other countries. Even a comparator that we think is very similar to us; such as Bangladesh. So, that's something to worry about.

Let me end this talk about the sectoral issues and then I'll come to what's going wrong. One place where the Modi government has had a fair amount of success is in people-oriented fields. For example, What Arvind calls Jam, Jan Dhan which is a bank account for everybody; Aadhar, which is the unique ID and mobile phones. You combine these two, you can do direct benefit runs. What the government has been doing increasingly is, do more direct benefit transfers for things like pensions, subsidies, scholarships etc. That’s been a great improvement in the lives of people because instead of going petitioning a government officer to release their pension they now get it directly in the bank account-- that’s something really important. Similarly, Clean India- Swachh Bharat, the signature program of Prime Minister Modi in building toilets for all. Now, there's a lot of complaints that these toilets that are built don't have connections to the to the sewage system and essentially are non-functional but nevertheless, a large number has been built and there is a change to some extent in how these are viewed. So, that is a benefit. India needed to end open defecation and if we've made some progress if not actually achieve that goal, it is an important step forward. Similarly, you know attempts to reduce the burdens on the poor; cooking gas for example for the very poor that’s very beneficial because they don't have to burn wood, which can be tremendously harmful for the housewife as she breathes that wood. So, cooking gas connections for the poor--another positive with the subsidies for that cooking gas being paid to these direct management transfers and finally, Ayushman Bharat. The attempt for health care for all at least for the very poor I think is an important step forward. Now, all these are good steps but clearly there is more need for rigorous evaluation of how they are working and to make sure the work as well as they can. For example, they’re worse investigation of accounts and while a lot of accounts have been opened, some hadn't been used. This is simply because, when you give bureaucrats a number to achieve, they achieve it without necessarily thinking about the larger goal which is accounts need to be opened but also used. Similarly, toilets need to be built but also used. So, we have to work on this to make it much more effective but it's an important step forward. Finally, there are, as with everything in India, accusations of fraud for example with the health care program now there is talk of some of the private hospitals having billed the government and have billed it for things that had not actually happened.

Let me spend a minute on what’s going on and why is India slowing despite all these reforms. I would argue that; there's an attempt to say this is because of the outside. The world is slowing. Well, the world actually was growing more slowly in the earlier period. Sometimes we want to pin it on oil. Oil is actually cheaper now than it was in the earlier period when we were growing strongly. Of course, sometimes we want to pin it on trade. Trade has been relatively weak in both periods. I think looking to the outside, to blame the outside for what’s going on is probably wrong. What is probably a better explanation is really, this is a consequence of not having invested. For nearly 15 years or probably, since the global financial crisis not having picked up the pace of investment,
that’s one. And the second is the lack of reform; of significant reform over the same period and both those have combined with, these are acts of omission in some sense, with acts of commission. The sequence of Demonetisation and the goods and services tax essentially was a straw that seems to have broken the Indian economy's back because it came at a point when the economy was already relatively weak. So, if you look at one investment, we have slowed down relative to our peers. That's one big source of concern but if you look at why things have slowed down, you see that post demonetisation there’s a substantial fall in growth then we had the goods and services tax. I think that just about that time the economy was rebounding from the Demonetisation but that the effects of the goods and services tax plus the NBFC crisis- all those compounded once again to bring these things down. The bottom line is, we need to essentially enhance growth.

Last point I will say is all this is before we even come to Arvind Subramanian’s critique. Arvind argues that even this slow level of growth, he’s not talking about the most recent, but he's talking up to 2016 even that growth may be somewhat mis-measured and essentially this is the slide that he wants us to look at which is in the previous period; pre-2011 growth, we had substantial investment, credit, exports, imports and since then what we've seen is that everything has tanked, except the GDP number. When a country grows richer, the taxes actually go up because people move into higher tax brackets and can pay more and especially with all the reforms this government has done, we should see higher taxes instead real taxes actually have actually fallen as have nominal taxes of this period. So, that's something of concern. Let me end, so basically, signs of deep malaise, growth is significantly lower, the fiscal space is narrowing, debt and distress is growing, India is losing its economic way. I will argue next time that perhaps the reason is because we are centralising power without a persuasive economic vision and if we do this, we risk wasting the demographic dividend.