India Growth - Story or Real?

Vivek Kulkarni
Founder Managing Director
Brickwork Ratings India Pvt.Ltd.

Introduction

India accounted for over 20% of the world GDP three hundred years ago. Now India accounts for just 5% of the global GDP. Will India return to its historic glory? Fortunately, India has been growing 8 to 9% in the recent years when the western world has been reeling under recession. India's growth has now been recognized in foreign media. Earlier, for decades, the Wall Street Journal (WSJ) was happy to cover Indian poverty or visitors observing cows on motor roads. Now the WSJ has been selling its Asia edition aggressively to Indian executives. The Harvard Business School has over 50 cases on India. Can India continue in this growth path? Do we have the right public policies for growth? Can India maintain it's pre-eminence in the knowledge sector? Can we over come domestic challenges like unemployment, poverty and Mao-Naxalism? This article analyses the select factors affecting growth, with particular reference to public finance.

Domestic Growth Story

A decade ago, Indians had to stand in years-long queue for a telephone connection. Our elected members of Parliament used to dispense their quotas of new telephone connections, to their favorite few. Now, India has more than half a billion telephone connections. The telecom industry has grown fifty times in nine years. Education, healthcare, housing, retail and auto sectors have been growing at more than 20%. Some of Bangalore residential schools charge Rs. 6 lakhs a year for a primary school admission. The Indian Institute of Management (IIM), Bangalore offers their executive MBA program for a fee of over Rs 15 lakhs a year. Table 1 shows the growth story across sectors.

Exports Growth Engine

Since independence, India has never come up with any product that would attract the fancy of foreigners. Instead, Indians have been attracted to foreign goods and crave for a Sony TV, a Panasonic two in one, American shirts, or French perfumes and wines. It is only in the twenty first century that India became famous for its Information technology software services. The seeds of success were sown in the liberalization of 1991 that encouraged IT exports, with the creation of STPI scheme. Several small companies took advantage of it and created lakhs of jobs. Almost 50% of job creation in knowledge based sectors was due to small companies. The STPI scheme has been copied by many countries around the world. The mission statement of Jinan, a Chinese province is to be like Bangalore. Table 2 shows how IT has been rapidly growing even in the recession years. We must encourage this export growth engine that provides well paying jobs for our youngsters.

Favorable Demography

India has the most favorable demography with youngest population in the world. Our dependency ratio as of now is just 0.6 and is projected to be even lower over next two decades. Comparatively Japan, France, Italy have been rapidly aging. Many western countries are broke with aged population, high dependency ratio, and huge pension bills. China's youngsters group within working age is expected to decline 30% in the next ten years. However the benefits of demography will accrue only if the young generation is well educated and trained. Many foreign surveys imply that only 25% of Indian graduates are employable. Continued unemployment and under education can nullify the advantages of favorable demography.

How Can India Keep Growth Momentum?

While India's long term growth is unquestionable, it faces medium term challenges, in both domestic and international scene. A few select factors are discussed below. India can keep up the growth if the political leadership takes right decisions.

Increase Infrastructure

India's infrastructure is highly inadequate and will prove to be a major constraint on growth. How one got caught in road traffic, is often topic of small talk in urban cities. India has just 10,000 km national highways. China adds those many in just one year. China is a world manufacturing hub. Chinese roads used by heavy trucks cost more to build and maintain. In India, we need roads just for cars and motor bikes. Unfortunately we have failed to deliver on this simple task. Our delays in airports, ports are notorious. Except for telecom we have no worthwhile progress to show in the infrastructure area. India needs to implement more transparent Public-Private Partnership (PPP) policies to kick start growth in infrastructure.

Spend More On Social Services

More than 200 districts have been affected by the Mao-Naxalism menace. Eradicating this is not an easy task. However, one prescription is to spend more on social services like education, health, family welfare, etc. Governments have to spend most on Social services, because no private player spends any substantial amount.

More Talk, Less Money?

Most politicians talk more and spend less on social services. While the US spends over 45% of their budget on social services the Government of India allocates just 11%. (See Table 3)The budget speech however allocates over 51% para for social services schemes.

Andhra Pradesh allocated just 5% para on general services, but spends over 28% of budget. This is an example of less talk and more money. Most governments spend considerable amount on general services – expenditure on bureaucrats' salaries, pensions, rents, police etc. They however don't mention much about that spending in the budget. For instance, very few come up with plans to minimize the number of staff, improve productivity, reduce corruption levels or promise faster clearance of files. All governments must reduce spending on general services and spend more on social services.

Wake up - Spendthrift Family

Let us consider an example of a family with an annual income of Rs. 5.77 lakhs per year, or Rs. 48,000 per month. Instead of spending within this limit, the family decides to borrow another Rs. 4.14 lakhs and spends the entire amount of approximately Rs. 10 lakhs in a year. This family will have to set apart almost 40% of its annual income or Rs. 19,000 a month just to pay interest. Would you approve of this spendthrift family? The Government of India has been operating in that fashion.

India's fiscal deficit would cross Rs. 414,041 crores, a whopping 6.7% of the GDP. These figures do not fully account for the effects of oil bonds, fertilizer subsidies, agricultural loan waivers, underfunding of pension, health insurance schemes, etc. Then, the fiscal deficit might cross double digits.

Debt Burden

The Indian Government's debt stood at 52% of the GDP as on March 2010 (See Table 4). The large quantum of debt, as well as very heavy interest cost has resulted in large interest payments. As on March 2010, the interest payments claimed 38% of central revenue receipts.

Consider the similar figures for the US. The US shows a 10.6% of the GDP as their fiscal deficit. The US debt of 89% GDP includes the pension liabilities of the government and the net debt figures are slightly lower. With dollar as a safe haven in the world, the Government of the United States has been able to borrow at a much cheaper average borrowing cost. Thus, the interest payments as percent of revenue receipts for the US work out to only 8.7% compared to 38% for India. This gives the US a lot more leeway to counter the unemployment crises by continuing to borrow. The US also has the advantage, of dollar as the only remaining reserve currency, with Euro showing signs of falling apart. Euro – as single currency concept, is likely to fail with some countries lacking fiscal discipline and low labor mobility across countries due to different languages. Greece and Italy are vulnerable with heavy debt. The 3G spectrum auction that resulted in over Rs 100,000 crores will certainly make India less vulnerable. Of all the countries, China has most healthy fiscal status.

Losing India IT Edge?

India is the undisputed IT & BPO Capital of the world. Over 75% of the best software firms are located in India. It's fast becoming the KPO Capital of the world. IT exports have created over 6.5 millions of direct and four times more indirect jobs. Every metro experienced a real estate housing boom. Will this continue? It may not be to the same extent.

I see a possible decline in the sector and eventual loss of competitive advantage. China, Indonesia, Vietnam, Philippines, Russia, Romania and other countries will gradually increase their market share and India might lose its competitive edge in IT for several reasons.

First, China is fast catching up with India in terms of English-speaking manpower. They have 30,000 English training schools. They have made it compulsory for even taxi drivers to learn English or else their license will be cancelled. Our politicians preach one and practice another. They don't want poor children to study English despite their own children going to English medium schools. Once the Chinese acquire English fluency, the jobs may migrate to China.

Second, India lacks the killer instinct and is allowing other countries to get better in software. Consider how China dominates the world in hardware. They have given subsidized loans, low cost labor, and low currency and have captured world market in hardware. China now manufactures Ganesha idols for our festivals. With such substantial market share, China could increase prices say ten years later and extract big amount from all countries. None of the countries will be able to set up production facilities, nor will have skills in those areas in a short period.

Third, India is giving up its competitive advantage in IT. With sustainable market share in off shoring, India could have focused on dominating the entire world. On the contrary the government does not give high priority for knowledge sector. It now feels that IT companies are given too many tax concessions and have decided to withdraw the STPI benefits. In spite of tax concessions, IT industry continues to pay reasonable tax. (See Table 5). IT is employment intensive and salary expenses account for 50% its revenues. Steel is a capital intensive sector and pays just 2.5% of its revenues to employees. Considering the tax paid by employees, the IT industry pays reasonable taxes. The IT industry, led by former middle class educated people, lacks any formidable lobby with the government, unlike real estate players who have profited from building commercial and residential space for IT. Government wants to help these developers and large IT firms with SEZ and the small firms with STPI status would be non competitive due to international pressures. The small STPI companies that account for almost 40% of total employment, might become highly non competitive. That would mean lower purchasing power and low growth over all.

Stock Market Analysts missing the Big Picture?

Can public policy be based on stock market movements? Many stock analysts ignore the implications of knowledge sector. They analyze each sector independently and miss the inter-linkages. For instance their predictions went wrong in 2008, due to missing linkages. Many stock market analysts predicted the Sensex reaching 22,000 levels in 2008. (See Figure 1) Same time the IT companies were experiencing slow demand plus strong rupee. The BSE IT Index was going down since January 2007. The rupee was getting stronger and breached Rs. 39 per dollar mark. The analysts reduced their target price for IT companies but were quite bullish on real estate, commercial space and retail. They felt all these sectors could do well, in spite of IT declining. All these sectors soon fell, when jobs in IT industry declined. Thus many domestic sectors depend on IT sector employees discretionary spending.

How to Kick Start Domestic Growth?

The domestic growth in India will grow, but more slowly. The employees in domestic sector do not have similar discretionary spending power, like the IT and MNC sector. Also domestic growth is slower due to red tape, bottlenecks, tax check posts and no innovative liberalization in real markets. Politicians continue to stifle growth due bureaucratic methods in allotting land, change of land use, countless permission. Our check posts across state and city borders mean that our trucks move at 10 km an hour. When our goods move at average 50 km/hour, domestic growth too will cross double digits with a wide margin.

Summary

India has all it takes to grow. India has the right talent mix and huge domestic demand. Foreign players are attracted to exploit the domestic potential. The Indian English work force can create millions of jobs and provide vital discretionary spending for the faster growth of domestic sectors. Our political leaders have not changed much. The government clearances have got messy and time consuming. Corruption has not been controlled and black money generation now exceeds ten years budget of Government of India. Can our government and political leaders rise to the occasion, effect real liberalization in the economy, encourage small and medium companies and keep up the job oriented economic growth?

Table 1: India Growth Story - Across Sectors

Market Size (Rs. lakh crore)	FY 10	FY 15	CAGR (%)
Funds Management	8.74	23.07	21.4%
Health	2.51	6.79	22.0%
Insurance	2.75	6.45	18.6%
Banking	2.41	6.09	20.4%
Retail	1.23	3.4	22.5%
Education	1.08	2.85	21.4%
Automobiles	1.05	2.52	19.0%
Housing	0.65	1.51	18.3%
Health insurance	0.09	0.62	47.0%

Table 2: IT Dominates

Exports (Rs Crore)	**2009**	**2010**	**Growth** (%)
IT & ITeS	2,16,082	2,77,882	28.60%
Gems and Jewellery	1,17,430	1,20,617	2.71%
Petroleum (Crude & Products)	1,15,597	1,14,277	-1.14%
Manufacturing	2,33,892	1,99,675	-14.63%
Drug, Pharma & Fine Chemical	66,847	67,955	1.66%
Textiles	47,411	47,543	0.28%
Others	1,93,410	1,93,657	0.13%
Total	**9,90,668**	**10,21,606**	**3.12%**

Table 3: More Talk - Less Money?

	Govt. of India		**Karnataka**		**Andhra Pradesh**	
	Para	**Money** (Lakh Crore)	**Para**	**Money** (Lakh Crore)	**Para**	**Money** (Lakh Crore)
BUDGET	59	9.30	305	0.62	62	1.01
Share of (%):						
Social Services	51%	11%	46%	40%	34%	34%
Economic Services	31%	36%	43%	33%	61%	38%
General Services	19%	53%	11%	27%	5%	28%

Table 4: Who is vulnerable?

Year 2010	**India**	**US**	**China**	**Japan**	**Greece**	**Germany**	**Italy**	**UK**
Fiscal Deficit - % of GDP	6.7%	10.6%	3.9%	9.3%	13.6%	3.7%	5.0%	12.2%
Debt as % of GDP	52%	89%	18%	134%	125%	50%	116%	71%
Interest Payments as % of Revenue Receipts	38%	9%	4%	20%	14%	15%	18%	6%

Table 5: IT Pays Less Tax?

In Rs. Crore	STEEL	IT
Market Capitalization	59,600	1,51,100
Total Sales	11,000	22,000
Employee Cost as a % of Revenue	2.5%	50.0%
Taxes Paid		
Excise Duty	1,100	-
Corporate Tax	920	1,680
Employee Income tax	55	2,895
Total	2,075	4,575
Total Tax Paid as a % of Revenue	18.9%	20.1%

Figure 1: Sensex – Realty – IT – Dollar Indices