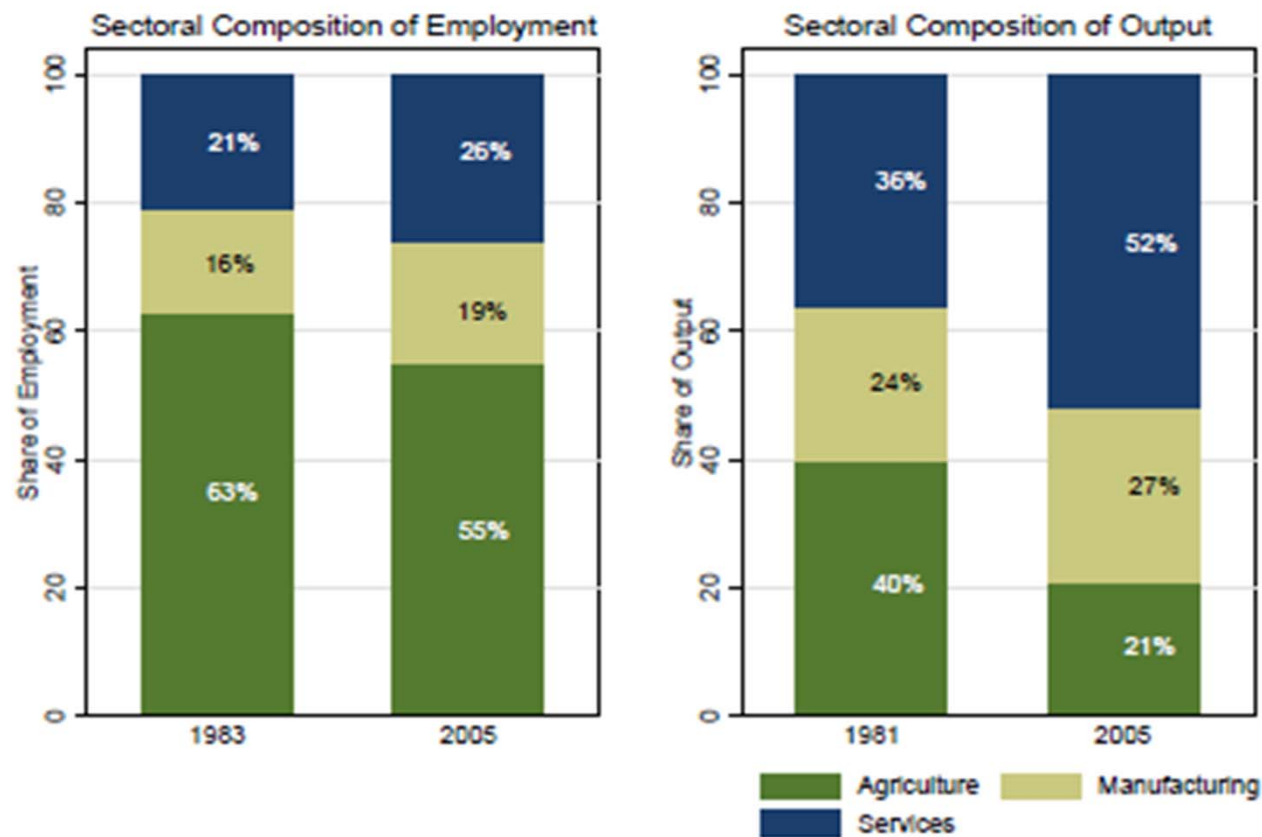

Economic Outlook and Macro Economic Policies

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Carolina at Chapel Hill &
NBER
IIEP Inaugural Conference
on India's Economy

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- ▶ Focus my discussion on India's manufacturing sector.
 - ▶ External sector vulnerability

Make in India: But how?



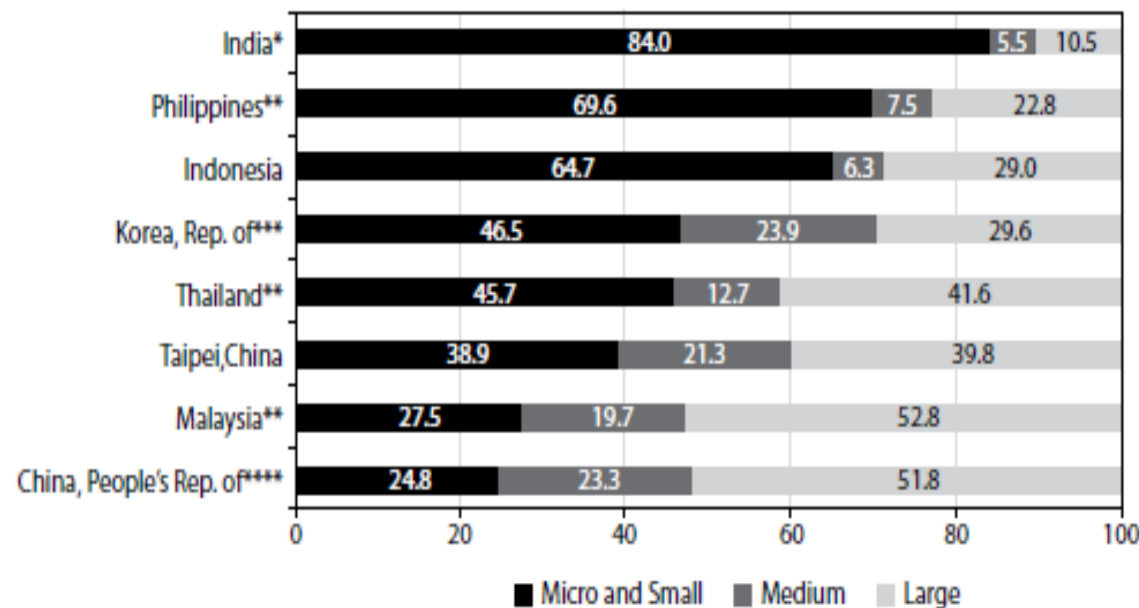
Make in India: But how?

- ▶ Almost the entire decline in the share of agriculture in India's GDP has been picked up by services.
- ▶ The growth in services' contribution to GDP is not accompanied by a growth in employment in the services sector.
- ▶ With manufacturing stagnant in both its output and employment shares, and with agriculture declining in both, this trend is unsustainable in the long run.
- ▶ India has a less than 2 percent share in world exports.
- ▶ Share in manufacturing exports is even lower: petroleum products/agricultural and mining products account for almost half of total exports.

Make in India: But how?

- ▶ A very large share of workers in India's manufacturing sector are employed in enterprises with less than 50 workers.

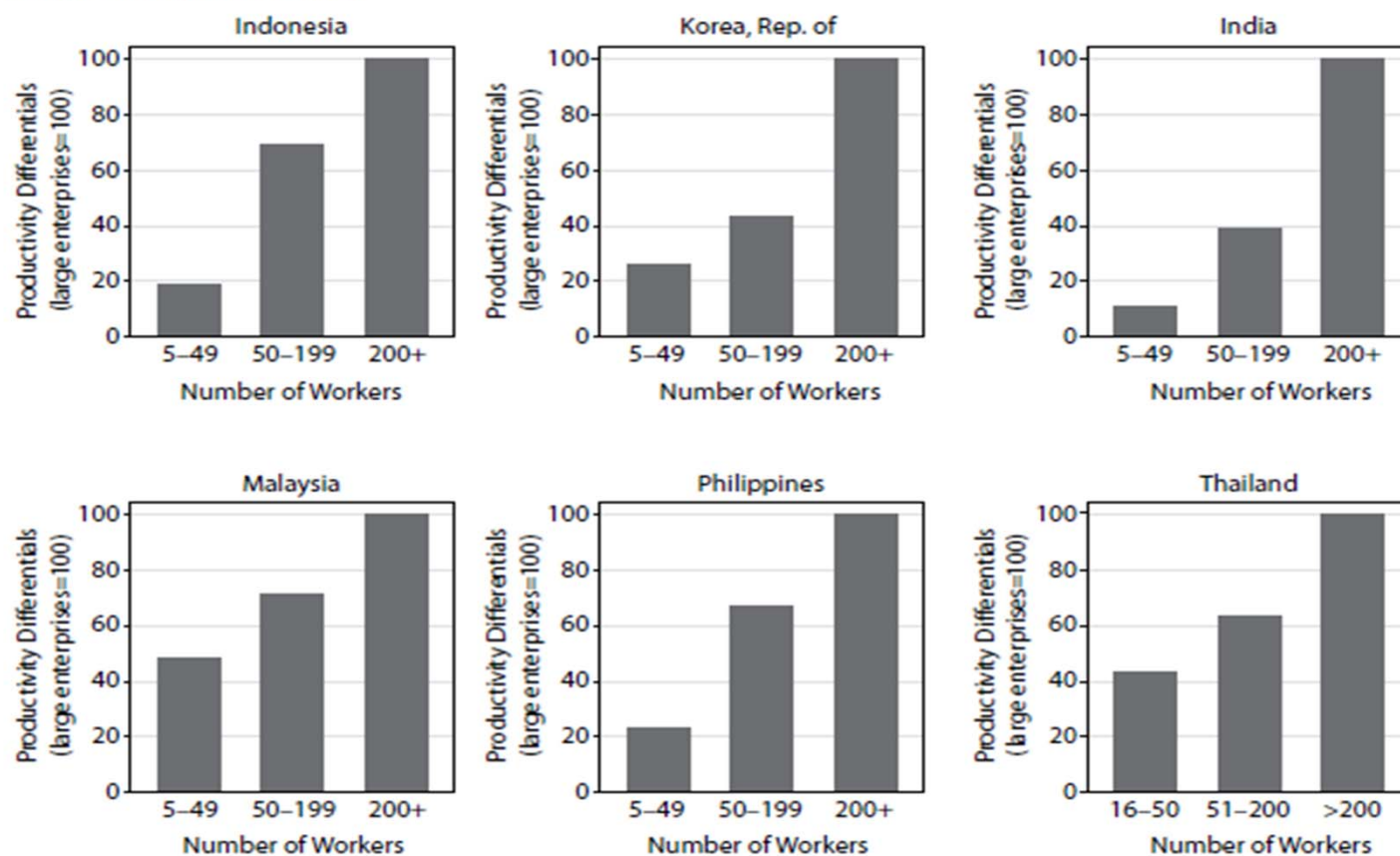
Figure 1: Share of Manufacturing Employment by Enterprise Size Groups (percent)



37.5 mil out
of 44.6 mil in
2005

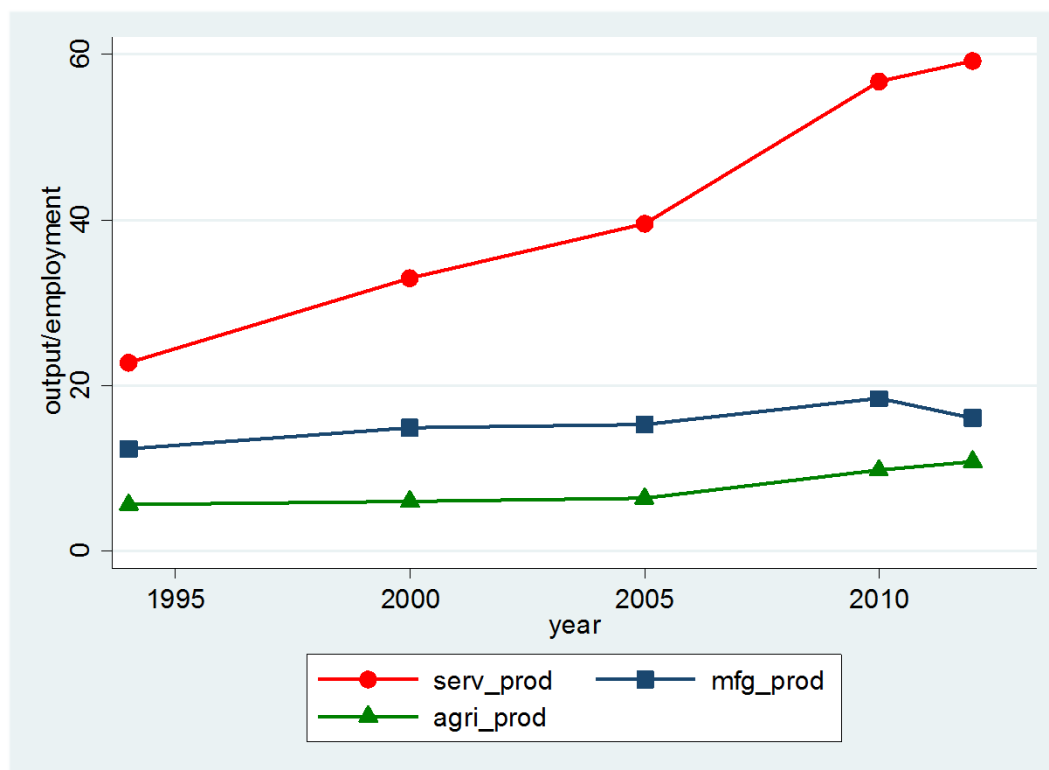
Note: Micro and small: 1–49 workers in all economies except Thailand (1–50 workers); medium: 50–199 in all economies except Thailand (51–200 workers); large: 200 or more workers in all economies except Thailand (more than 200 workers).

Figure 2: Productivity (value-added per worker) Differentials by Enterprise Size Groups (large enterprises=100)



Source: ADB (2009).

Make in India: But how?



**Services take off.
Manufacturing &
Agriculture are
stagnant.**

Make in India: But how?

- ▶ Large enterprises are on average more productive & pay higher wages "Good jobs problem" (Hasan and Jandoc, ADB 2010).
- ▶ Restricting attention to labor-intensive industries, find a greater prevalence of larger-sized firms in states with **flexible labor regulations**.
- ▶ Similar differential not there for partitions of states in terms of indicators of **physical infrastructure** or **financial development**.
- ▶ Labor regulations may indeed be affecting firm size adversely.
- ▶ Complying with labor regulations raises the costs of production and/or adjustment of employment levels.

Make in India: But how?

- ▶ Necessary for firms employing >> 50–100 workers to obtain the permission of state governments in order to retrench or lay off workers (Industrial Disputes Act)
- ▶ Terms & conditions of work → applies to firms employing over 10 workers (20 if the production process does not use electricity) that are legally mandated to operate in the registered sector of manufacturing (Industrial Employment (Standing Orders)).

Make in India: But How?

- ▶ Is this an environment that can promote entrepreneurship?
 1. Labor Market Rigidities
 2. Corruption
 3. Land Laws
 4. Electricity Subsidies
 5. NPLs → slow credit growth

1990-91	2011	2015
High Inflation	High inflation → fears of a hard landing	Inflation has declined. Why?
Iraq war (oil prices (import price shock), remittances dried up)	Middle-East unrest (Oil prices)	WTI Crude (\$52/barrel) For how long? (Scenario analysis?)
High Fiscal Deficit (S_g)	Goal: Fiscal Consolidation	Room for fiscal consolidation?
Export shock (US recession)	Collapse in aggregate demand in US → GFC, export slowdown	Anemic global recovery. Volatility & instability
Political uncertainties (3 govt. changes, assassination)	Political uncertainty?	Policy uncertainty?
Crisis of confidence (capital flows dried up)	Surge of Capital Inflows into India & other Emerging Markets	Taper talk & capital outflows
Huge shortage of FX, even SBI not able to roll-over short term debt	Very comfortable FX reserves position	FX reserves?

External Sector Vulnerability

- ▶ If fundamentals are strong (low fiscal deficit, strong institutions, political stability, high private investment) a CAD to finance growth is less of an issue.
- ▶ Korea ran a CAD of 5% throughout 1970s. Pursued export led growth strategy with very low fiscal deficits.
- ▶ Risk: Policy uncertainty and reversibility with regard to rules and regulations pertaining to foreign investment can undermine investor confidence.
- ▶ Strong fundamentals and corporate governance institutions can serve to strengthen the attractiveness of India as an investment destination.
- ▶ Policies that inhibit the mobility of capital, increase its cost, or reduce its profitability ultimately hurt labor.

Demographic trends....

- ▶ The number of new entrants to the labor force developing countries is projected to rise from 1.1 million per month in 2015 to 1.7 million per month by 2030.
- ▶ China, by comparison, added an average of 1.1 million workers per month during the decades following the onset of economic reforms under Deng Xiaoping in 1978.
- ▶ In order to absorb the rapid increases in the working-age populations from 2015 to 2030, developing nations will need to create jobs at almost **twice the rate** that China did during one of the most extraordinary episodes of economic growth the world has ever seen.
- ▶ Will the population changes afoot yield demographic dividends or will they spell disaster as millions of youth enter the labor force without serious prospects of meaningful work?