

Suman Bery: Anatomy of resilience - Implications for 'exit'

Government response was key in overcoming the recent financial crisis, but the time is now ripe for credible fiscal consolidation

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The forthcoming Union Budget now just two weeks away, will be presented at an extraordinarily interesting moment. Two recent releases of data from the Central Statistical Organisation (CSO) have contributed to the build-up; these are the 'Quick Estimates of National Income, Consumption Expenditure, Saving and Capital Formation 2008-09', released on January 29, and the 'Advance Estimates of National Income 2009-10', released on February 8.

My own awareness of these data releases has been heightened by my recent induction as a Member of the Statistical Commission. This has caused me to take interest in these numbers as they first appear, rather than as and when I need them for analysis.

The first of these releases is significant for the fact that it provides greater statistical authority for numbers that had previously been circulating as estimates, and also because it rebases recent data to the base year of 2004-05 rather than the former base year of 1999-2000. The second of these numbers, equally, represents the first official projection by the CSO of the performance of the current year.

Between the two documents, accordingly, one has a fascinating account of how the economy reacted to the great crisis of 2008-09, how and why the recovery has been so robust, and therefore what this implies for the balance of judgment on the shape of 'exit' from the aggressive fiscal stance that has been adopted over the past couple of years.

Much of the continuing economic crisis in the advanced countries, particularly the United States, has revolved around the saving behaviour of the household sector. In brief, largely because of booming asset markets, American households drastically reduced their saving over the decade leading up to the crash, while simultaneously building up debts. With the crash in asset values, principally homes and to a lesser extent equities, and without a similar write-down in their debts, US households are worried about their long-term financial health and are busy saving again.

As Martin Wolf has repeatedly pointed out in his columns in the *Financial Times*, it has been the willingness of the government to dissave substantially that has saved the US from depression. The issue is how much longer this process has to go, and how much it is aggravated by the additional weakness of the private sector.

The recently released Indian data allow one to piece together a similar narrative for the Indian boom, bust and recovery. In national accounts terms investment, consumption and net exports (i.e., exports minus imports) are the three elements of final demand that exhaust domestic production or output. In turn, investment consists of a discretionary or voluntary element, namely fixed capital formation and a partly involuntary element, which is the change in stocks (or inventories). Investment in turn has to be 'financed' through saving; such saving can either be domestically generated (by the household, government or private corporate sector) or from abroad, represented by the current account deficit.

In India, under ordinary circumstances, it is assumed that output, i.e., GDP, is determined by the supply side of the economy, as supply constraints are usually binding. In contrast in advanced countries, short-term fluctuations are usually ascribed to demand, as individual sectors and agents adapt to the income and borrowing constraints that they face.

However, the last couple of years were not normal, with the source of fluctuations, even for India, emanating from the demand side of the economy. The most striking evidence for this was the sharp reduction in the overall growth rate, from 9.2 per cent in 2007-08 to 6.7 per cent in 2008-09. These are the data at so-called factor cost; at market prices, the concept that is more relevant for the demand analysis that is to follow, the fall was even sharper, from 9.6 per cent to 5.1 per cent. This was indeed a sharp, savage downturn, one much more characteristic of a demand rather than supply-constrained economy.

This 'growth recession', for that was what it was, was caused in a statistical sense, by a sharp fall, of almost 17 per cent, in private corporate investment in 2008-09 compared to 2007-08. A relatively small part of this fall (5 per cent) was in fixed capital formation; a much larger part of the story was, however, the working off of inventories. It should be noted that it is the change in stocks that constitutes 'investment'. While the data for 2009-10 are not available, the data for 2008-09 are quite extraordinary; the growth in stocks held by the private corporate sector went from Rs 1.25 lakh crore in 2007-08 to a mere Rs 27,000 crore in 2008-09. Normally, in a recession, one first expects inventory to grow as sales slow, and only then to be liquidated. It would seem that the agility of the Indian corporate sector, or alternatively the financial pressure it came under, caused it to undertake a massive liquidation of inventory, which accentuated the downturn, but may have allowed a quicker recovery.

Things could accordingly have been much worse but for the public sector, and its contribution to consumption. Total consumption grew at the respectable rate of 8.3 per cent. This was not very different from previous years, largely because of a large jump in government consumption, which is one-fifth the size of private consumption. The share of private consumption in the economy also went up slightly, by around a percentage point of GDP, while that of government rose by 1.3 per cent of GDP.

Accordingly, the main burden of adjustment by the economy to the massive growth shock was in the saving behaviour of the public sector, essentially representing the expansion of the fiscal deficit.

Is it now time for the fisc to draw back? Clearly, unlike the US, there is no serious problem with private consumption. The issue rather is whether private investment is poised for a comeback. Based on the recently released NCAER-Mastercard Business Expectations survey, the answer seems to be yes. Convincing fiscal consolidation would also give the RBI the occasion to take a less hawkish position on monetary policy. Earlier I was more tentative. Now I would add my voice to those who argue that the time is ripe for credible fiscal consolidation.

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