7.2 THE WEAK GROWTH PHASE: POLICY PARALYSIS?

The following Figure 7.a plots growth over the ten year period ending March 2013. This decadal period can be divided into three sub phases. First, the five year 'Goldilocks phase' up to 2007/08 when growth rose to very high levels while inflation remained low. This was followed by the global financial crisis *recession plus recovery* phase. Growth dipped sharply in early 2009 following the collapse of Lehman Brothers in September 2008, but then recovered substantially to above 8% in the next two years. This recovery was due to massive fiscal and monetary stimulus, but at this point, we should ignore the sources of growth and look only at the aggregate outcomes. Then the weak phase set in, with growth dropping to 6.5% in 2011/2012, and further to 5.3% for first half of 2012/2013 (see Figure 7.a).

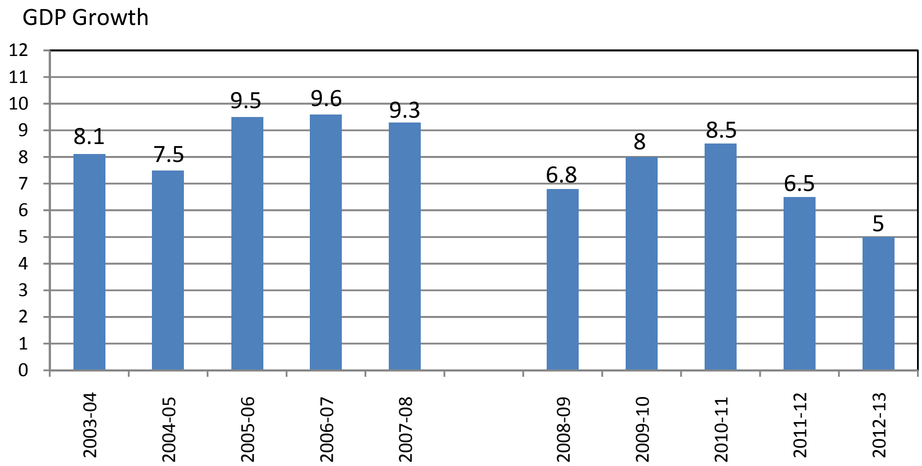

Figure 7.a The Big Drop in Growth

Source: Handbook of Statistics on Indian Economy, GDP at Factor Cost

This weak growth was predominantly attributed to political factors. Due to environmental restrictions, hurdles to land acquisition, often involving the displacement of tribals and other prior inhabitants of the land, the setting up of factories was stalled – as in the prominent case of Tata's automobile plant in Singur in West Bengal. Similarly, it was repeatedly stated by business entities that due to the lack of clear title to land and complicated procedures for real estate transactions, construction projects got mired in the ground. Since the passage of the Right to Information Act in 2005, bureaucrats became reluctant to clear files and sanction projects, lest they be hauled up later on for violations of due process. These factors were undoubtedly present. The following multi-panel chart depicting this situation or some variation or extension, appeared umpteen times in various articles and publications.

The former chief economic advisor Kaushik Basu, in April 2012, characterized India's economic and political situation as one of 'policy paralysis.' The phrase went viral, and the drop in growth was invariably attributed to this phenomenon in policy discussions. Both the phrase and the explanation, when they came out were quite appealing. [4]

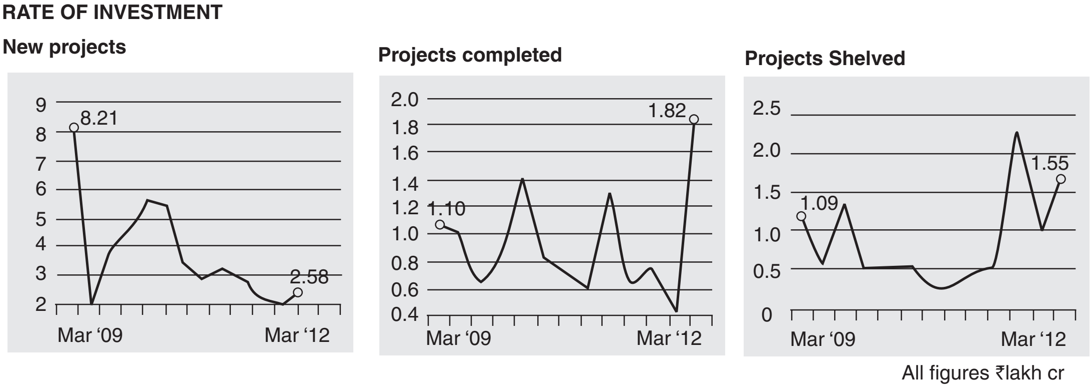

Figure 7.b The Collapse of Investment Projects

Source: Financial Express (2012), from CMIE data.

Some of the drop in growth was undoubtedly due to these factors. However, in explaining overall macroeconomic outcomes, the role of policy paralysis can be questioned. Along with the drop in growth, there was a huge rise in inflation which can be seen in Figure 7.c.[5]

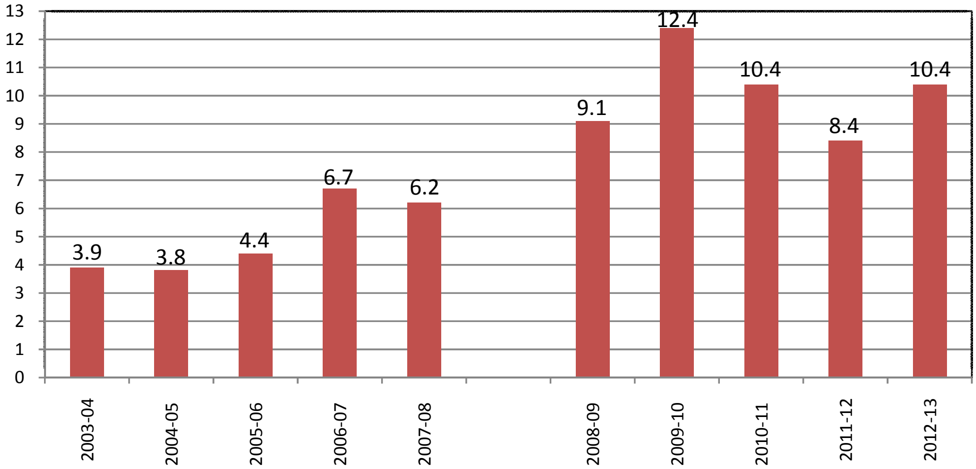

Figure 7.c India's CPI Inflation

Source: HOSIE, RBI. CPI measure for Industrial Workers (Industrial Worker). Inflation is measured on an average basis, i.e., the percent change of the average CPI over the year.

[4] The well-known magazine, "*The Economist*", also espoused this view in its lead article titled, "Losing its magic: Politics is preventing India from fulfilling its vast economic potential" (The Economist, 2012).

[5] A new series for consumer prices was introduced in January 2011, with the corresponding inflation rate from January 2012. Inflation for the new CPI All India (Rural + Urban) has generally been 1 to 2 percentage points lower than the CPI for Industrial Workers. However, this does not make much difference to our analysis.

The summary data below indicate both the drop in growth and rise in inflation from above Figures.

Average Values	April 2003 to March 2008	April 2008 to March 2013	Change
Growth	8.8	7.0	−1.8
CPI (IW)	5.0	10.1	5.1
WPI (not in above Figures)	5.5	7.6	2.1

What needs to be explained is the simultaneous drop in growth **and** the accompanying rise in inflation, which can be called stagflation.[6] This occurred in India and some other emerging economies during 2012 and 2013. Brazil, in particular, has undergone fairly sense stagflation. Its data are worth examining but that is beyond our scope. While the policy paralysis view of the drop in growth may seem persuasive, it can by itself only explain the 'stag' but not the accompanying 'flation'. The enormous rise in the CPI, the most relevant inflation indicator, to above 10%, indicates stagflation.

7.2.1 Real Time Projections of Growth and Inflation

In macroeconomic projections, forecast of growth can easily go wrong and they often do. During the boom years it was not possible to precisely forecast the global financial crisis of September 2008 or how much growth would subsequently slowdown despite the fiscal stimulus.[7] But if the inflation forecast to accompany growth is based on sound analytical foundations, then actual inflation should be lower than what was originally forecast if growth turned out to be weaker. However, if we look in Table 7.B at the GDP and inflation forecasts below made during this time, this was not the case.

In the Table 7.B for 2011-2012 actual growth was 6.2% compared to 8.4%. Simultaneously, WPI inflation the important policy measure at that time turned out to be 7.7%, above the forecast of 6.7%, which we have computed as the rough average. Similarly, for 2012-2013 growth turned out to be well below the 7.3% forecast while inflation was again a percentage point lower than forecast. In short, the stagflation during those two years was unanticipated.

Taken in *isolation*, the policy paralysis view and deteriorating investment climate *might* explain the slowdown – much of the drop in GDP growth over 2012 and 2013, has been due to a collapse of investment. However, a typical slowdown emanating solely from weaker private investment and aggregate demand, should also have led to *less inflation*.

[6] It can be seen from the output based version of the EAPC between the periods D to E, URATE is rising and aftOR is falling, although GDP growth is positive. This can be characterized as mild stagflation. Severe stagflation entails rising or persisting high inflation and falling output, as occurred after the OPEC oil shock. The distinction made between mild and severe stagflation is similar to that between absolute versus growth recession. However, a drop from, say 9% to 5% growth with inflation rising can perhaps be labelled as severe stagflation.

[7] The Chief Economist of IMF, Olivier Blanchard, two week before the global financial crisis had stated that the greatest risk to the world economy was from rising oil prices.