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Globalisation and the Slowdown of the Indian Economy

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Globalisation and the slowdown of the Indian economy: another view

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Summary

The global financial crisis and the 'great recession' that followed had a significant impact on India's growth trajectory. This is particularly true of the relative slowdown in services exports during this period as a result of which trade integration gets dominated by goods trade. It is also the case that the increase in oil prices and the continuing increase in the import of gold and silver had an impact on current account balances. The paper however argues that the oil trade – crude oil imports and petroleum and refinery product exports – overstates the extent of integration and masks important structural tendencies such as persistent deficits on manufacturing trade. Equally importantly neither (increase in oil and gold–silver imports) explain the sharp deceleration in fixed–investment growth nor the contraction in manufacturing output that characterise the slowdown. In our analysis, the centrality of private corporate investment and the manufacturing sector to the high–growth phase and the slowdown is explained by the patterns of integration and its impact on growth dynamics.

The paper argues that in the high–growth phase, the pattern of integration into the global economy created a virtuous cycle of cumulative causation where manufacturing trade, private corporate investment, and manufacturing growth fed off each other. During the slowdown this process reversed itself, creating a vicious cycle of cumulative causation where manufacturing imports displaced domestic capacity leading to a deceleration in private corporate investment through the expected profitability channel. It also argues that import integration during this phase of investment–led growth exacerbated an old structural problem: the inability to produce new capital goods. Finally it argues that in the face of stagnant demand, import competition is recessionary. Our analysis at the very least suggests the need for a reassessment of the growth model. On the contrary the new government seems to have adopted just another version of the same model.

The Government of India has argued that increases in the imports of oil, gold and silver in the context of the “great recession” in the aftermath of the 2008 financial crisis and the consequent volatility of the global economy alongside supply-side bottlenecks within the domestic economy are the main culprits behind the slowdown. This paper has argued that the nature and pattern of integration – particularly of non-oil non gold-silver import integration – is equally if not more implicated. The paper is divided into seven sections: Section I explores the slowdown from the demand side; Section II from the supply side; Section III looks at the resulting current account dynamics; Section IV analyses patterns of integration into the global economy, including the role of oil and gold-silver imports; Section V discusses the role of manufacturing trade in the slowdown; Section VI discusses the impact of manufacturing trade on private corporate investment and growth; finally Section VII concludes.

I: Growth slowdown – the demand side: As is now well established, the first decade of the 21st century saw a sharp increase in average rates of growth of the Indian economy – GDP at constant prices grew at 8.9% p.a. between 2003/4¹–2007/8 as compared with 5.8% p.a. between 1992/93–2002/03. This increase in rates of growth was associated with a significant increases in investment and savings ratios alongside low current account deficits even as integration with the global economy in terms of international trade and capital flows deepened (e.g. see Tables 8.8-8.10 and the associated discussion (pp204-09) in Mohanty (2013)²). Therefore globalisation of the economy has been an important element in the growth acceleration witnessed in the first decade of the 21st century. As Table 1 indicates, this high growth phase gets interrupted as a result of the global financial crisis of 2008 and consequent sharp deceleration in growth – it falls to less than 4% p.a. – in 2008/9.

Table 1: GDP and expenditure aggregates growth rates (% p.a.^a and at constant 2004/5 prices)				
	2003/4–7/8	2008/9	2009/10–10/11	2011/12–13/14
	High-growth	Crisis ^b	Rebound	Slowdown
GDP at market prices	8.8	3.9	9.4	5.5
Consumption	7.2	7.7	8.3	6.2
Gross Investment	18.5	-1.6	13.7	2.1
Gross Fixed–Investment	16.2	-51.4	9.3	4.3
Exports	17.8	14.6	7.5	9.7
Imports	20.1	22.7	6.7	8.4
Source: author calculations on the basis of data from Reserve Bank of India’s Handbook of Statistics on the Indian Economy (15 th September 2014)				
Note: a: p.a. refers to per annum; b: ‘crisis’ refers to global financial crisis of 2008				

However as a result of the Government of India’s stimulus package as a part of the coordinated G–20 response to the 2008 global financial crisis, the economy quickly rebounded and for the next two years resumed a high growth trajectory. ~~The economy~~ It however was unable to sustain this high growth

¹ India’s fiscal year begins on 1st April of a given year and ends on 31st March of the next.

² The English version of Mohanty (2013) is available as Mohanty (2015).

trajectory and decelerated very rapidly, to grow on average at 5.5% p.a. for the period 2011/12–13/14. Official sources (see RBI (2014) and GOI (2015)) suggest that the growth slowdown has ended and the economy has turned around.

But why did the economy decelerate after the rebound, in the first place? GOI (2012: pp20–21) has attributed it to continuing weakness of the global economy. Similarly RBI (2014) attributes the slowdown to an inhospitable global environment and persistent inflationary pressures: “The economy had to face serious challenges to stability in 2013–14 emanating from exchange rate pressures amid capital outflows, persistence of near double digit inflation, fiscal imbalances and a decline in investment” (p1). It goes on to note that it is possible to deliver “sustainable growth of at least 7 per cent in a non-inflationary manner **once global growth normalises**” (p2) (emphasis added). Clearly then in terms of official explanations of the slowdown, the “great recession” and the associated monetary policy of quantitative easing adopted in the aftermath of the 2008 financial crisis and the consequent volatility of the global economy particularly in terms of capital flows are the main culprits along with supply-side bottlenecks within the economy. And surely all of these have some role in explaining the slowdown of the Indian economy.

As Table 1 makes clear, during the slowdown (2011/12–2013/14) whereas growth in all expenditure aggregates slows down, consumption is least and investment the most affected – consumption growth slows to 6% p.a., a decline of less than 15% as compared with high-growth period (2003/4–7/8); fixed investment growth on the other hand drops precipitously, to little more than 4% p.a., a decline of more than 70% as compared with 2003/4–7/8. Actually as is evident from Table1, the decline in gross investment growth is even sharper. But some of the decline in gross investment growth is due to decline in the growth of gold and silver purchases – these fell from 28% p.a. (2003/4–7/8) to 4% p.a. (2011/12–2013/14) – which from the standpoint of the overall economy is a good thing. Chandrasekhar and Ghosh (2013) have rightly argued that gross investment levels are inflated because of the inclusion of valuables (gold–silver). Therefore we focus on fixed–investment which is normally more directly linked with productivity and growth.

Clearly investment, both fixed and gross, has borne the brunt of the growth slowdown. In turn this has meant that the underlying demand drivers (contributions to growth) have changed dramatically. As Table 2 makes clear, in the initial high-growth phase (2003/4–2007/8) at 64%, increase in investment demand (Δ Investment) is the biggest contributor to demand growth (i.e. $(\Delta \text{investment}) / (\Delta \text{GDP}) = 64\%$). Equally importantly for our purposes, it is also higher than consumption’s contribution to demand growth which is 58.5% (i.e. $(\Delta \text{consumption}) / (\Delta \text{GDP}) = 58.5\%$). Indeed not only is it the case that investment’s share in demand growth is very high, most of it came from an increase in fixed–investment – increase in fixed–investment accounted for 80% of the increase in gross investment and 51% of demand growth! As we point out elsewhere (Mohanty and Reddy 2010: p51, 57), in terms of growth dynamics, investment’s contribution to demand growth being greater than consumption’s (i.e., $\Delta \text{investment} > \Delta \text{consumption}$) – what we characterise as investment–driven demand growth – is unprecedented in India’s growth experience.

As a result investment share of GDP at constant prices increased very sharply over a short period of five years – from an average of 26% for the two–year period 2002/3–2003/4 to almost 38% for the two–year period 2006/7–2007/8. Over the same period, the average fixed investment ratio rose from 25 to 33%.

Finally, even though the contribution of exports to demand growth is substantial (almost 35%) the leakage from imports is higher (45%). Therefore net exports makes a negative contribution to demand growth. Which is not to say that high export and import growth do not play a role (e.g., influencing expected profitability by accessing global markets in case of the former and augmenting supply capabilities in the case of the latter) but that growth was largely domestic demand driven over the period 2003/4–2007/8. We will have occasion to return to the issue of net exports.

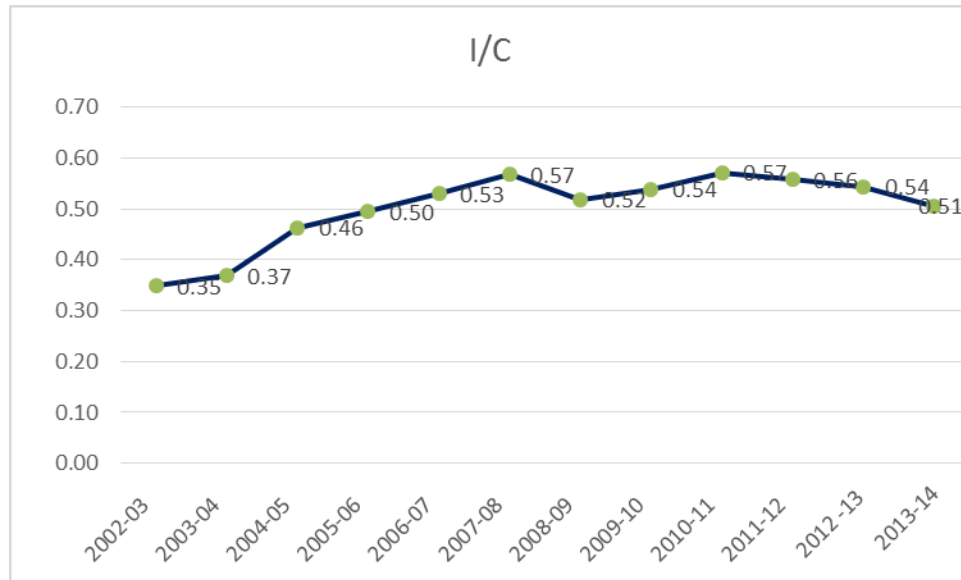
As Table 2 makes clear, this pattern of demand growth gets completely reversed during the slowdown, as a consequence of investment bearing the brunt of adjustment. Demand growth becomes consumption driven, with the increase in consumption demand accounting for 80% of demand growth. Increase in investment demand accounted for only 14% of demand growth – a decline of more than 75% in comparison with the high growth phase! As we have already noted, some of this is due to the decline in the growth of gold and silver purchases. But even the contribution of fixed investment declined markedly to 25% – a decline of more than 50% in comparison with the initial high-growth phase. This sharp decline in contribution meant that investment demand grew (2% p.a.) substantially slower than consumption demand growth (6% p.a.). Even fixed-investment demand grew (4% p.a.) significantly slower than consumption demand (see Table 1). It is also worth noting that during the slowdown the leakage from net exports declined as a result of sharper slowdown in import growth than in export growth. There is one other factor to keep in mind that is germane to our discussion – both in the high-growth phase (see Khanna (2015: pp53–54) as well as in the slowdown (see RBI (2014: p17) investment growth has been driven by private-corporate investment. We will have reason to return to the slowdown in private corporate investment growth later in the paper.

	2003/4–7/8	2009/10–10/11	2011/12–13/14
	High-growth	Rebound	Slowdown
Gross Investment	64.0	54.9	14.3
Gross Fixed-Investment	51.3	33.4	25.2
Consumption	58.5	62.6	80.0
Consumption-private	51.2	51.1	68.7
Exports	34.5	17.0	41.3
Imports	45.1	20.7	43.4
Net exports	-10.6	-3.7	-2.1
Source: same as Table 1			

Returning to the issue of consumption and investment growth, given as we have noted above, that the former grew faster than the latter during the slowdown, meant that the investment-consumption ratio (I/C ratio) declined from 0.57 to 0.51 (see Figure1 below). It is worthwhile noting in this context that during the initial high-growth period this ratio had risen from 0.37 to 0.57. The ratio is metric for the extent of capacity addition **relative** to consumption growth – a rising ratio suggests that there is sufficient capacity

addition to meet increases in consumption growth. A decline in the I/C ratio, as has happened during the growth slowdown, would suggest that relative to consumption growth there is insufficient capacity creation and this could potentially hamper future growth of the economy.

Figure 1: Investment–Consumption Ratio



Source: Same as Table1

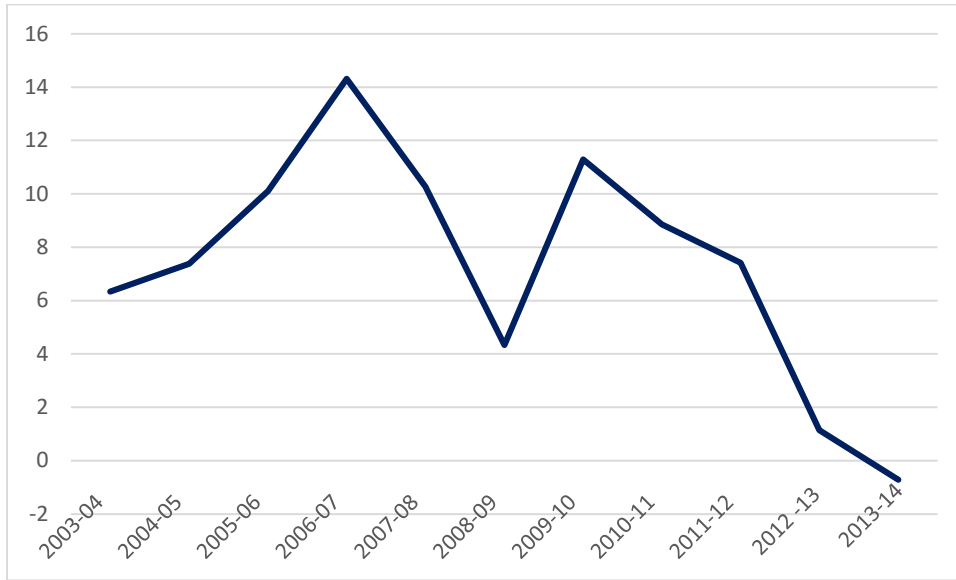
Therefore even though both RBI (2014) and GOI (2015) note that the slowdown of the Indian economy has ended and that the growth rate of the Indian economy will begin to rise given an appropriate external environment, the behaviour of the I/C ratio – itself a reflection of the patters of demand growth – suggests that there might be obstacles in sustaining that turnaround.

Why has investment growth, including that of fixed–investment, slowed down so dramatically? As both RBI (2014) and GOI (2015) note, the slowdown in investment is largely the result of the contraction of private corporate fixed investment which was the main driver of investment growth during both high growth phases. According to RBI (2014) “The weak business sentiment, infrastructure bottlenecks, low public investment, domestic political uncertainty and an uneven global recovery led private fixed investment to contract” (p2).

II: Growth slowdown – the supply side: Whereas each of these has undoubtedly affected private investment sentiment the RBI and GOI view misses out supply side issues and in particular the integration of the manufacturing sector into the global economy and its role in affecting investment sentiment. We turn now to these issues.

Table 3: GDP and sectoral growth rates (% p.a. and at constant 2004/5 prices)				
	2003/4–7/8	2008–09	2009/10–10/11	2011/12–13/14
	High-growth	Crisis	Rebound	Slowdown
Agriculture, forestry & fishing	4.9	0.1	4.7	3.7
Mining & quarrying	4.6	2.1	6.2	-1.1
Manufacturing	9.7	4.3	10.1	2.6
EGWS ^a	7.4	4.6	5.7	5.5
Construction	12.5	5.3	6.2	4.5
THTC ^b	11.1	7.5	11.3	4.1
FIRE&B Services ^c	10.6	12.0	9.9	11.7
Community, social & personal	5.4	12.5	8.0	5.3
GDP at factor cost	8.7	6.7	8.8	5.3
Source: same as Table 1				
Note: a – EWGS: Electricity, Gas and Water Supply; b – THTC: Trade, Hotels, Transport and Communication; c – FIRE&B Services – Finance, Real Estate and Business Services.				

For our purposes, the following conclusions emerge from Table 3: 1) growth during both the high-growth phase and the rebound was evenly spread in terms of sectors, barring 'mining and quarrying' and 'community and personal services' during the high-growth phase; 2) the slowdown however has impacted sectors unevenly and as a consequence growth became very lopsided; 3) mining and quarrying is the hardest hit followed by manufacturing; 4) manufacturing output grew on average around 10%p.a. during both the high growth phase and the rebound but declined to less than 3% during the slowdown – a decline of more than 70%; 5) 'FIRE and B services' seems completely immune to slowdowns and crises – not only did average growth in this sector not slow down but it actually grew faster during the both slowdowns (2008/9 and 2011/12–13/14) than during both high growth phases.

Figure 2: Manufacturing growth rates at constant prices

Source: Same as Table1

Table 3 tells us that the average growth of manufacturing during the rebound after the financial crisis of 2008 was slightly higher (10.1% p.a.) than the initial high-growth phase (9.7% p.a.). But as Figure 2 clarifies, the deceleration in manufacturing growth had started before the slowdown – manufacturing growth has decelerated for four consecutive years. This deceleration gathered pace and by 2012/13 it grew at only 1% and in 2013/14 it contracted by 0.7%. Manufacturing therefore has undergone a protracted slowdown and a contraction in output.

Table 4: Supply-side contributions to GDP growth (%)

	2003/4–7/8	2009/10–10/11	2011/12–13/14
Agriculture, forestry & fishing	10.4	8.2	10.0
Mining & quarrying	1.5	1.7	-0.5
Manufacturing	17.5	18.3	7.6
EGWS ^a	1.8	1.3	2.0
Construction	10.6	5.6	6.3
THTC ^b	31.1	34.1	21.1
FIRE&B Services ^c	18.7	19.2	40.6
Community, social & personal	8.4	11.8	12.8

Source: same as Table1

Note: a – EWGS: Electricity, Gas and Water Supply; b – THTC: Trade, Hotels, Transport and Communication; c – FIRE&B Services – Finance, Real Estate and Business Services.

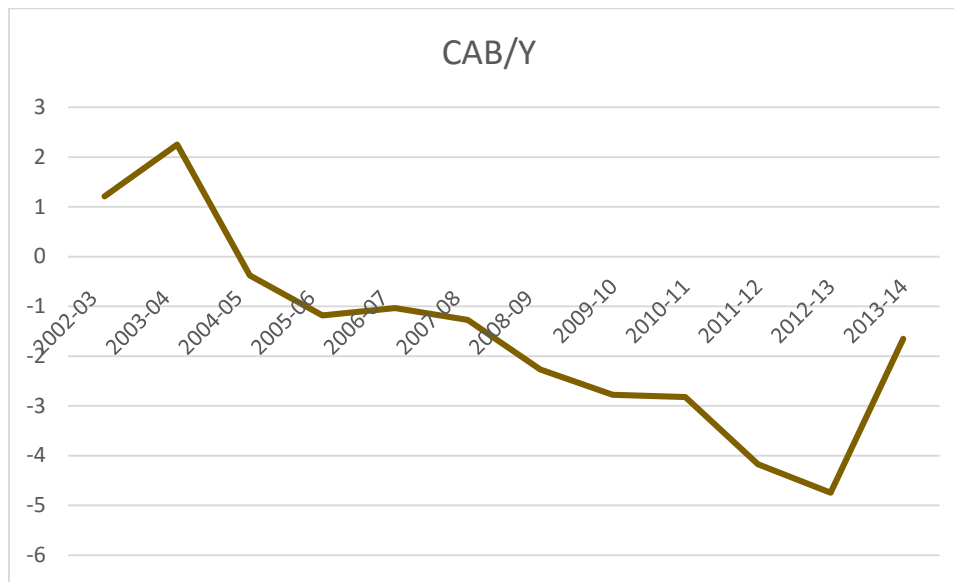
As Table 4 illustrates, changing sectoral growth patterns resulted in changed contributions to GDP growth. In the initial high-growth phase Manufacturing's contribution to GDP growth was 18% (i.e. $(\Delta\text{Manufacturing-GDP}) / (\Delta\text{GDP}) = 18\%$). This is not too different from the contribution of 'Finance, Real Estate and Business Services (FIRE&B Services)' at 19%. The leading contributor to GDP growth during the high-growth phase was 'Trade, Hotels, Transport and Communication (THTC)' with a contribution of 31%. This pattern of contributions remains more or less intact during growth rebound (2009/10–2010/11) with the proviso that the share of Construction's contribution declined. Therefore the manufacturing sector was one of the leading contributors to GDP growth during the high-growth phase and the rebound.

During the slowdown this pattern of contributions to GDP growth is almost stood on its head. During the slowdown the contribution of manufacturing sector to GDP growth declines to around 8% – less than half its contribution during the high-growth phase. The contribution of 'Finance, Real Estate and Business Services (FIRE&B Services)' rises to 41% – more than double that during the high-growth phase – and becomes the leading contributor displacing 'Trade, Hotels, Transport and Communication (THTC)'. Manufacturing goes from being a one of the leading growth drivers to being one of the smallest contributors (along with construction) to GDP growth after 'Mining and Quarrying'.

When we bring the demand and supply sides together, two important drivers of demand and supply growth – gross and fixed-investment and manufacturing – have decelerated very sharply and we have to understand their deceleration to understand the slowdown. The Government of India's position, as reflected in the Annual Report of the Reserve Bank of India and Economic Surveys of the Ministry of Finance, has been that the global economic slowdown after the 2008 financial crisis and institutional failures in the allocation of natural resources including land explain these decelerations. And surely there is some merit in that position. But as we hope to establish it is not quite the whole story.

III: The Current Account Balance and the Investment–Savings Balance

We had noted earlier (see discussion around Table 1) that the economy rebounded very quickly after the 2008 financial crisis and over the next two years (2009/10–2010/11) averaged a 9% rate of growth. However there was one crucial difference – the high growth phase was characterised by low current account deficits, as Table5 makes clear. The rebound from the global financial crisis, on the other hand, saw a sharp increase in current account deficits, averaging almost 3% (see Table5). Not only was it the case that the current account deficit increased during the rebound, it continued to widen over the slowdown as well. As Figure3 indicates it reached almost 5% in 2012–13. Again as Figure3 and Table5 indicate, there was a sharp correction in 2013/14 with the current account deficit reducing to under 2%.

Figure 3: Current Account Balance as a proportion of GDP(Y)

Source: same as Table1

The flip side of the current account balance is of course is the investment–saving balance. During the rebound, as Table 1 and Table 2 tell us, demand–growth was investment driven though not as strongly as in the high–growth phase – rate of growth of investment (both gross and fixed) was greater than consumption but the contribution of consumption (63%) was greater than that of investment (55%)(see Table 2). Particularly, fixed–investment growth was significantly slower than in the high growth phase. The Government of India maintains that the increased demand for gold and silver, most of which had to be imported, meant high gross investment ratios as well as an increase in the current account deficit via the trade deficit.

However, what Table 5 also tells us is that savings ratios declined quite sharply and indeed declined more than investment ratios and thereby contributing to widening of the current account deficit to almost 5% in 2012/13. Therefore an increase in the demand for gold and silver and an increase in the oil import bill due to increase in oil prices cannot be the only reasons for the worsening of the current account deficit. We will not have occasion to go into the reasons behind declining savings ratios but it will be useful to bear it in mind. As Table 5 indicates, in 2013/14 the current account deficit narrowed very sharply to 1.7% (as compared with almost 5% the previous year) but this has come at the cost of a very sharp decline in the investment ratio which of itself is not sustainable. Put differently, had savings ratios not declined in the manner they did it would have required a much smaller drop in investment ratios to close the significant and sustained current account deficit that opens up after the 2008 financial crisis.

	2003/4– 7/8	2008/9	2009/10–10/11	2011/12–13/14	2013/14
Investment ^b /GDP	33.4	35.5	36.4	33.8	30.4 ^a
Savings ^c /GDP	33.3	32.0	33.7	30.0	28.7 ^a
CAB ^d /GDP	-0.3	-2.3	-2.8	-3.5	-1.7

Source: same as Table 1 except where indicated
Notes: a: author's estimates on the basis of 2011/12 base year data from GOI (2015) and CSO (2015); b: refers to gross investment; c: refers to gross savings; d: CAB – Current Account Balance

Returning to the issue of the current account deficit, the slowdown phase of the Indian economy was characterised by three trends: 1) a sharp deceleration and eventually contraction in fixed-investment growth; 2) a significant deceleration and eventual contraction in manufacturing growth; 3) an appreciable and sustained widening of current account deficit, which more than doubles. For the Government of India, the global economic slowdown, institutional failures in allocation of natural resources, increase in the demand for gold and silver and increase in oil prices explain all three trends. And again it is worth emphasising that all these certainly have had some role to play as will be clear in our discussion below.

IV: Patterns of trade integration and the slowdown: In our understanding however all three trends are also explained in part by the nature and pattern of Indian economy's integration into the global economy. We now turn to analyse one element this pattern of integration – trade in goods and services and its impact on growth dynamics.

	1992/93	2001/2	2006/7	2009/10	2012/13
	–	–	–	–	–
	1993/94	2002/3	2007/8	2010/11	2013/14
Goods Exports	7.4	9.5	13.2	13.9	16.4
Services Exports	1.8	3.7	7.5	7.1	8.0
Goods Imports	8.2	11.1	19.9	21.3	25.1
Services Imports	1.5	3.0	4.4	4.5	4.3
Goods Trade ^a	15.6	20.6	33.2	35.2	41.6
Services Trade ^b	3.4	6.8	11.9	11.7	12.2
Total Trade ^c	18.9	27.3	45.1	46.9	53.8
Total Trade less crude oil and g–s ^d imports	16.8	23.4	37.4	38.3	42.6
Total Trade less crude oil and g–s imports and POL ^e exports	16.6	22.9	35.2	36.1	39.3

Source: same as Table 1
Notes: a: Goods trade is defined as total of goods exports and imports; b: Services trade is defined as total of services exports and imports; c: Total trade is defined as goods trade + services trade; d: 'g–s' refers to gold and silver; e: 'POL' refers to petroleum, oil and lubricants (refinery products)

As Table 6a indicates, the speed of integration clearly accelerates in the first decade of the 21st century. In the last decade of the 20th century – the first post-reform decade – integration in terms of total trade in goods and services increased relatively slowly. It increased by a little more than 40% – going from 19% (two year average for 1992/93–1993/94) to a little more than 27% (two year average for 2001/2–2002/3). In the next decade however this ratio almost doubles – going from a little more than 27% to almost 54% (two year average for 2012/13–2013/14).

The doubling of the total trade ratio over the first decade of the 21st century is not consistent over the entire period, neither in its speed nor in its drivers. The bulk of the increase happens in the high-growth phase during which total trade increase by more than 60% – from a little more than 27% to 45% (two year average for 2006/7–2007/8). As Table 6a makes clear, during this period, continuing a trend from the first post-reform decade, the increase in the total trade ratio is driven by both goods and services trade – goods trade ratio increases from almost 21 to 33% and services trade from 7 to 12%.

After the 2008 financial crisis however the pace of integration slows down substantially. During the rebound in growth following the 2008 financial crisis total trade increased by less than 2% with all of it coming from goods trade. Services trade actually sees a small decline in its share. The pace of integration over the slowdown phase of the economy actually quickens again and total trade increases by 7%, to reach almost 54%. Even though there is some improvement in the performance of services trade, the bulk of the increase in integration comes from goods trade – the share of goods trade increases by almost 6.5% and services trade by 0.5%. **It is important to recognise that trade integration result stands even when we strip out oil and gold-silver imports** – total trade less oil and gold and silver imports increases by almost 60% during the high growth phase – rising from 23.4 (two year average for 2001/2–2002/3) to 37.4% (two year average for 2006/7–2007/8). Similarly, during the slowdown, total trade less oil, gold and silver imports increases by more than 4% to 43% (two year average for 2012/13–2013/14).

Therefore the following conclusions can be drawn about the pattern of integration: 1) during the first decade of the 21st century – the second post-reform decade – the pace of trade integration with the global economy increases appreciably; 2) the bulk of the integration happens during the high-growth phase and is driven by **both** goods and services trade; 3) integration continues to deepen during the slowdown but is driven almost **entirely** by goods trade; 4) importantly all of these conclusions hold even when we remove oil and gold-silver imports from total trade.

	1992/93– 1993/94	2001/2– 2002/3	2006/7– 2007/8	2009/10– 2010/11	2012/13– 2013/14
Goods Exports	7.4	9.5	13.2	13.9	16.4
Non-POL exports	7.2	9.0	11.1	11.6	13.1
Goods Imports	8.2	11.1	19.9	21.3	25.1
Non-crude oil imports	8.4	8.2	10.3	13.7	15.1
Non-crude oil non-g-s imports	6.1	7.1	12.2	12.7	14.0
Source: same as Table1					

Given the importance of goods trade in driving integration particularly during the slowdown, Table 6b allows us to explore goods trade in somewhat greater detail. The following conclusions emerge: in the first post-reform decade (1992/93–2002/3) – goods trade integration is driven by both exports and imports, with export ratio increasing by 2% and import ratio by 3%; second, goods trade remains in deficit, but the bulk of the increase in import intensity (2% out of 3%) is due to increase in oil and gold–silver imports; third, therefore in the **first post-reform decade** non-oil non gold–silver import integration is relatively slow and **trade integration is driven by exports**.

The high-growth phase (2003/4–2007/8) saw a sharp increase of 12.6% in the goods trade ratio (see Table 6a) – exports ratio increased by almost 4% while imports ratio by almost 9%. The increase in import intensity remains true even we strip out oil and gold–silver imports which also saw substantial increases – non-oil non gold–silver imports share increases by 5%. Therefore in the **high-growth phase trade integration also driven by non-oil non gold–silver imports**, even as exports share sees an appreciable increase.

During the slowdown import ratio increased by 3.8% of which 1.3% is accounted for by non-crude oil non gold–silver imports whereas good export ratio increases by 2.5%. Actually the two-year average for the period 2012/13–2013/14 understates import integration because in 2013/14 non-oil non gold–silver import growth collapses to 3% (see Table 9 below) alongside a contraction in investment growth in that year as we have already noted above. If we consider averages for the first two years of the slowdown (2011/12–2012/13) the goods import ratio rises by 4.8% of which 1.9% is accounted for by non-oil non-gold–silver imports. The good export ratio over this period rises by 2.3%. Therefore despite a **slowing economy, non-oil non gold–silver imports accounted for a substantial proportion of the increase in imports** – 40% of the increase in goods imports ratio.

Clearly however crude oil imports – and to some extent gold–silver imports – distort the extent of import integration. Oil imports which accounted for 3% of GDP for the period 2001/2–2002/3 (little more than 25% of total imports) increased to 10% of GDP for the period 2012/13–2013/14 (40% of total imports). Gold and silver imports fluctuate between 1–2% of GDP over this period. More importantly, as Table 6a makes clear, without oil and gold–silver imports the Indian economy would run a trade surplus. Therefore the Government of India's position that the deterioration in the current account is on account of rising oil import bill and gold–silver imports is certainly not incorrect. But as we have seen, not the whole story either.

Finally, Table 6a also makes clear that petroleum and refinery product exports have seen an increasing importance in the country's export profile – rising from 0.5% of GDP and a little more than 5% of total exports (average for 2001/2–2002/3) to 3.3% of GDP and more than 20% of total exports (average for the period 2012/13–2013/14). Clearly then in the last decade crude oil and related products have had an important role to play in the evolution of India's foreign trade in goods. But their growing importance perhaps hides more than it reveals.

We noted earlier that trade integration with the global economy was driven by goods trade in the high-growth phase and particularly so during the slowdown. In turn goods integration during both phases has been driven by rising import intensity despite substantially improved export performance. Finally, oil

imports notwithstanding, **non-oil non gold-silver imports have been important drivers of import integration.**

	1992/3– 2002/3	2003/4– 2007/8	2009/10– 2010/11	2011/12– 2013/14
Goods trade deficit	-2.8	-5.4	-8.1	-9.5
Non-oil goods balance	0.7	-1.4	-3.4	-3.6
Non-oil non-gold goods surplus	1.5	1.4	1.1	2.2
Services trade surplus	0.4	2.6	2.6	3.6
Pvt. transfers surplus	2.5	3.2	3.5	3.4
Current Account Deficit	-0.7	-0.3	-2.8	-3.5
Source: same as Table1				

The importance of oil imports in driving India's goods trade deficit is clear from Table 7. The deficit on account of oil imports rises from 4% of GDP during the high-growth period to 6% in slowdown. It is equally worth noting, that the non-oil goods balance has a worsening deficit over the high-growth phase, the rebound and the slowdown. However equally importantly, the non-oil non-gold goods trade has consistently been in surplus in both the first and second post-reform decades (the last decade of the 20th century and the first decade of the 21st). Clearly then gold and silver imports did have some role to play in the worsening of India's current account deficit during the rebound and the slowdown, in line with the Government of India's position in this regard.

V: Manufacturing trade and the slowdown: A more disaggregated analysis of the patterns of integration however allows us to understand the role of manufacturing trade in the slowdown.

As we have noted elsewhere (Mohanty 2013: pp221–22) in terms of global integration the three major sectors are very differently situated. The average agricultural trade ratio for the period 2008/9–2010/11 was 11.9%; over the same period manufacturing's trade ratio was 142%; for services it was 19.8%. Even if we consider the narrower sub-sector 'financial and business services, its trade ratio was 57.8% – significantly below manufacturing.³ Therefore manufacturing – which at 2004/5 constant prices accounts for 15–16.3% of India's GDP (over the period 2002/3–2013/4) – is the economy's most integrated. In addition the manufacturing sector accounts for almost 80% of India's exports (Mohanty (2013: Table8.6 p203)). For manufacturing, both the pace and nature's its integration changed significantly in the first decade of the 21st century – the high-growth phase.

³ As a result of revision of GDP data since the publication of Mohanty (2013) there will be some change in these ratios. The broad magnitudes however and therefore the conclusions do not get altered.

Table8: Manufacturing sector trade ratios (% of manufacturing GDP)					
	1992/93– 2002/3	2003/4– 2008/9	2009/10 ^a	2010/11– 2012/13	2013/14
Manufacturing (X+M) ^b	82.0	134.9	142.5	172.3	201.7
Manufacturing (X+M) less POL ^c – exports	80.6	124.0	128.1	150.8	173.5
Manufacturing (X–M)	10.2	8.5	4.9	13.5	26.8
Manufacturing (X–M) less POL exports	8.9	-2.3	-9.5	-7.9	-1.3
Source: Same as Table1					
Note: a: For India the trade effects of 2008 global financial crisis become visible in the fiscal year 2009/10. Therefore in both Tables8 and 9 the fiscal year 2008/9 has been included in the high–growth period. b: X refers to exports and M to imports; c: POL refers to ‘petroleum, oil and lubricants’					

As Table 8 details, manufacturing’s average trade ratio (as a proportion of manufacturing GDP) for the period 1992/3–2002/3 – the first post–reform decade – was 82%. Manufacturing export and import ratios were at 46% and 36% respectively. The non–POL manufacturing export ratio was 45%. In the **first post–reform period** therefore, both manufacturing export ratio as well as non–POL manufacturing export ratio were greater than the manufacturing import ratio and the sector generated an overall **and** non–POL trade surplus.

During the high–growth period – 2003/4–2008/9 – the average trade ratio rose to 135%, an increase of 65% as compared with the earlier period. Manufacturing’s exports ratio rose to 72%, non–POL exports to 61% and imports to 63%. There are some noteworthy aspects about this phase: first, import integration is much sharper than export integration – the import ratio increases by 75% whereas the overall manufacturing trade ratio increased by 65% and the export ratio by 57%; second, and therefore, during the high–growth phase, manufacturing imports were the driver of the manufacturing sector’s integration into the global economy; third, the non–POL export ratio is lower than the import ratio; finally, therefore, during the **high–growth phase, non–POL manufacturing trade is in deficit**, whereas overall manufacturing trade continues to be in surplus as opposed to the first post–reform decade where both were in surplus (see also Chaudhuri (2013) with regard to the manufacturing trade deficit).

Over the slowdown – 2010/11–2012/13 – trade integration of the manufacturing sector increased further to 172%: the export ratio rising to 93%, the non–POL export ratio to 71.5% and import ratio to 79%. Over this period the increase in the export ratio (29%) was only slight greater than in the import ratio (25%) but the latter continued to increase much faster than non–POL export ratio (17%). Therefore during the **slowdown, the deficit in non–POL manufacturing trade widened even further as compared with the high–growth phase**, as Table 6a clearly indicates. Overall manufacturing trade however continued to remain in surplus.

Therefore it is reasonable to argue that not only has integration increased sharply for the manufacturing sector but that it has also been asymmetric – import integration increasing much faster than exports particularly when we have excluded petroleum product exports as Table 8 makes clear. Put another way, rising POL exports mask an increasing deficit in non–POL manufacturing trade (2% of manufacturing GDP)

that opens up during the high growth period and continues during the slowdown when it widens substantially (8% of manufacturing GDP). As we will see in a moment, this has deleterious consequences for investment growth.

VI: Growth, private corporate investment and manufacturing trade: Before we move on to analyse the consequences of manufacturing trade, it is important to note one particular aspect of private corporate investment as well as overall investment in manufacturing. We have already noted that both the high-growth and slowdown phases were private-corporate investment driven. For the accumulation of the private corporate sector the manufacturing sector is of particular importance. As Mazumdar (2008: p70) notes, “the manufacturing sector absorbs the major part of private corporate investment and [...] private corporate sector dominates the investment in registered manufacturing.” (see also Khanna 2015:pp. 55-56). In addition, manufacturing accounts for a substantial proportion of investment in the economy. Manufacturing accounted for between 33–37% of gross capital formation between 2004/5 and 2007/8 and averaged 34% for that period. In 2009/10, 2010/11 and 2011/12 it accounted for 31.2, 32.7 and 25.7% of gross investment respectively (see Chandrasekhar and Ghosh (2013)). All this to say that what happens in manufacturing has important implications for private corporate investment behaviour as well as overall investment in the economy.

Table 9: Export and Import growth rates (%p.a. in current rupees)					
	1992/93– 2002/3	2003/4– 2008/9	2009/10 ^a	2010/11– 2012/13	2013/14
Imports	18.4	29.3	-0.8	25.5	1.7
Exports	17.6	22.1	0.6	25.0	15.9
Oil and gold–silver imports	22.0	30.8	5.2	30.4	0.0
Non–oil–non–gold–silver imports	17.3	28.4	-4.5	22.2	3.1
Manufacturing exports	18.3	22.4	-1.5	25.2	16.3
Non–oil manufacturing exports	18.0	19.8	-3.5	22.4	16.8
Manufacturing imports	17.1	30.3	-6.3	22.4	2.6
Capital–goods–imports	19.5	31.3	-5.4	18.6	-0.1
Source: Same as Table1					
Note: a: please see notes to Table8 with regard to fiscal year 2009/10					

Putting together data from Tables 6a, 8 and 9 the following conclusions emerge: During the first post-reform decade (1992/3–2002/3), integration was driven by exports of goods and services though the pace of integration was relatively slow. Manufacturing exports grew faster than manufacturing imports (see Table 9) and both overall and non-POL manufacturing trade generated surpluses.

During the high-growth phase that followed however the pace of integration accelerated dramatically particularly for imports – both oil as well as non-oil non gold–silver imports (see Table9). The average rate of growth of non–oil non–gold–silver imports increased by more than 60% whereas that of exports increased at a much slower pace of 25%. As we have already noted during this period the manufacturing sector generated a small non-POL deficit as opposed to a surplus in the previous period. Even though

integration is driven by imports, continued expansion of manufacturing exports saw the commodity composition change towards higher valued added commodities (see Mohanty (2013): Tables 8.5 and 8.6, pp201–203).

We know that in this phase, demand–growth was investment–driven (particularly fixed–investment) and that the manufacturing sector was an important driver of supply–side growth. Investment–driven growth meant, as we have seen, an increase of 8% in the fixed–investment share (at constant prices) over a short five–year period. That this sharp increase was possible was partly due to access to imported intermediates and capital goods. As Table 9 makes clear, in this phase, manufacturing imports and capital goods imports grow faster than overall imports. In addition capital goods imports grows faster than oil and gold–silver imports. Clearly then growth in domestic capacity (manufacturing sector growth) and imports moved together. Access to imported inputs both in the intermediate and capital goods ensured that the investment boom was sustained without domestic capacity or capability appearing as a constraint. But we also know that the period produced a non–POL manufacturing trade deficit. As Chaudhuri (2013: pp46–49) notes, the failure to produce new capital goods was an important reason for this deficit and that the neoliberal policy regime was directly implicated (in the failure).

Be that as it may, the coming together of **increases** in the investment ratio, manufacturing ratio, export ratio (alongside a diversification towards higher valued–added exports) created a virtuous cycle of what Kaldor (1970, 1972) has termed “cumulative causation” – where demand–growth, working itself through manufacturing exports and Verdoorn’s law, triggers productivity growth which in turn leads to more demand–growth. The fact that the leakage – non–POL manufacturing trade deficit – was relatively small, sustained it as a demand driven process with important productivity spillovers given that overall demand growth was investment–driven.

During the slowdown this virtuous cycle of cumulative causation reversed itself. The non–POL manufacturing balance moved significantly into deficit territory – 8% of manufacturing GDP for the period 2010/11–2012/13. Worsening of manufacturing non–POL trade balance was accompanied by decline in gross investment ratio – from 39% during the rebound to 37% for the period 2012/13–2013/14 – and stagnation in the fixed investment ratio as investment growth – both gross and fixed – slowed down sharply (see Table 1). As we have seen, manufacturing growth slowed down significantly, becoming one of the slowest growing sectors of the economy and turned into a laggard sector from being a driver of supply–side growth. As Table 9 makes clear even though import growth slows down across the board, despite the slowdown in fixed–investment and GDP growth, manufacturing imports (as well as capital goods imports) growth remained reasonably robust. Indeed manufacturing imports and non–POL export growth are not very dissimilar. Manufacturing import growth not only led to a non–POL trade deficit, but also, by displacing domestic production particularly in the capital goods sector, adversely affected profitability expectations and led to the slowdown in investment feeding on itself. The virtuous cycle of cumulative causation had turned into a vicious cycle. Manufacturing imports, including of capital goods, working through the harrodian trade multiplier and rising import propensities contributed to the economy’s downward spiral by sparking a deceleration in private corporate investment through the expected profitability channel (see also Mohanty (2012)).

The RBI accepts this. It noted (2012:p19) that , “**Capital goods production also contracted sharply**, though this was partly on account of **substitution by imported capital goods**. Hence, investment decelerated faster than other components of domestic demand. Global uncertainties further worsened the investment climate and also slowed down growth through the net export channel”. [emphasis added]. Just that this view gets lost in translation when it comes to the overall narrative.

Before concluding, there is one other aspect of crude oil and gold–silver imports that we would like to note. As Table 9 indicates, the rate of growth of crude oil and gold–silver imports during the high–growth period (30.8%) is not very different from the slowdown (30.4%). Why is it that in one period this is associated with low current account deficits and in is the other the supposed cause of high current–account deficits? In our understanding some part of the answer to that question lies in savings behaviour, an aspect that we have not touched upon at all in this paper.

VII: Conclusions: Without doubt the global financial crisis and the ‘great recession’ that followed had a significant impact on India’s growth trajectory. This is particularly true of the relative slowdown in services exports during this period as a result of which trade integration gets dominated by goods trade. And certainly the increase in oil prices and the continuing increase in the import of gold and silver had an impact on current account balances. Therefore the international conjuncture and behavioural aspects outside the government’s control have acted as catalysts. But we also argue the oil trade – crude oil imports and petroleum and refinery product exports – overstate the extent of integration and mask important structural tendencies such as persistent deficits on manufacturing trade. Equally importantly, neither (increase in oil and gold–silver imports) explain the sharp deceleration in fixed–investment growth nor the contraction in manufacturing output that characterise the slowdown. In our analysis, the centrality of private corporate investment and the manufacturing sector to the high–growth phase and the slowdown is explained by the patterns of integration and its impact on growth dynamics. We have argued that in the high–growth phase, the pattern of integration into the global economy created a virtuous cycle of cumulative causation where manufacturing trade, private corporate investment, and manufacturing growth fed off each other. During the slowdown this process reversed itself, creating a vicious cycle of cumulative causation where manufacturing imports displaced domestic capacity leading to a deceleration in private corporate investment through the expected profitability channel. We have also suggested that for all the advances in the economy’s technological capabilities, import integration during this phase of investment–led growth exacerbated an old structural problem: inability to produce new capital goods. Finally we have also argued that in the face of stagnant demand, import competition is recessionary. We have argued elsewhere (see Mohanty (2012)) that rapid fixed–investment growth witnessed during the high–growth phase was the result, in part, of an investment subsidy inherent in the under–pricing of land and natural resources. During the slowdown, political economy considerations put a question mark on the continuation of that subsidy, adding another reason for the investment deceleration. Our analysis at the very least suggests the need for a reassessment of the growth model. On the contrary the new government seems to have adopted just another version of the same model.

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