Delivering inclusive growth

PRANAB MUKHERJEE
Finance Minister, India

PRANAB MUKHERJEE graduated in law from the University of Calcutta and holds MA degrees in both history and political science. He began his parliamentary career in 1969 when he was first elected as a member of India's Rajya Sabha (upper house). In 1973 he joined the cabinet as Union Deputy Minister for Industrial Development and went on to hold a number of cabinet posts including Defence Minister, External Affairs Minister and Finance Minister, a post which he assumed for the second time in January 2009.

The global economic outlook could scarcely have looked bleaker when Pranab Mukherjee was appointed India's Minister of Finance in January 2009. Markets were plummeting across the board and capital flows towards India and other emerging markets went into reverse as investors sought the 'safe haven' of the Dollar. Against this background of global recession – and possibly a long and deep depression – Pranab Mukherjee decided it was necessary to take a calculated risk in his first full Budget by increasing government spending "in order to return India to a higher growth path."

Combined with the Reserve Bank of India's loosening of monetary policy and six successive interest rate cuts between October 2008 and April of this year, the government's additional spending is estimated to have produced a fiscal stimulus equivalent to more than 12 per cent of India's GDP. This looks like producing GDP growth of between 6.5 and 7 per cent this year, compared to earlier estimates of nearer 5 per cent.

At the Plenary Session of the Word Bank and IMF meeting in Istanbul last October, Mukherjee said that "the co-ordination demonstrated at the global level has generated hope that we can overcome the worst". Yet he remains cautious, pointing out that from the current perspective "it appears that recovery will be unsteady and long-drawn, with growth in employment lagging behind". For which reasons he believes that "maintaining policy stimulus is crucial for anchoring the recovery."

Mukherjee has described the increase in the scale of India's fiscal stimulus as "a quantum jump". Most of the additional government spending, he says, has been channelled into "investment in rural and urban infrastructure development". Certainly, an acceleration of much-needed infrastructure investments should feed through rapidly into the broader economy.

The focus on projects assisting rural and poor urban populations reflects government priorities of more 'equitable development' and 'inclusive growth'. Such measures are especially needed in developing countries because, as Mukherjee has pointed out, "the lingering effects of the crisis on the poor may continue for many years". As the global economy begins to pick up, he sees the medium-term imperatives as "returning output to pre-crisis levels, recovering jobs, and continuing the fight against poverty."

The combination of higher government spending and selective tax cuts announced last July means that the fiscal deficit is expected to rise to 6.8 per cent of GDP by March 2010. Mukherjee has made plain that the current levels of borrowing and fiscal deficit cannot be sustained in the longer term and that there must be a return to "fiscal prudence sooner rather than later". How this will be done – whether through reining in spending, higher tax revenues, or privatisations and disinvestments of government-owned companies and assets – is yet to be decided. But as an increasingly important and integrated part of the global financial system, India is aware that it will need to co-ordinate its own 'exit strategy' with those of other major economies. As Mukherjee noted in Istanbul, "the timing and sequencing of exit strategies assume importance."

The Prime Minister's Economic Advisory Council recently noted that inflation is expected to accelerate to around 6 per cent by the end of this fiscal year. Food price inflation, resulting from poor monsoons in the north and disastrous flooding in southern India, is the immediate cause, and the government has indicated that it would prefer that the Reserve Bank of India maintain its accommodative monetary policy and not raise interest rates until the recovery is assured. Bond markets, however, are now pricing in an interest rate rise sooner rather than later. As Mukherjee has noted, "balancing the stimulus against the risks of inflation and threats to fiscal viability is a key short-term challenge."

The importance of domestic consumption to India's economy, and its low exposure to 'toxic assets', are two key structural advantages that have enabled India to 'weather the storm' better than most economies. Recent government forecasts are that FDI will reach US$37 billion (bn), while overseas portfolio inflows may rise to US$24 bn this year. Whether there will be a return to moving economic reform further up the agenda – and particularly what should be done to clarify and streamline rules governing FDI in order to encourage further investment – is yet to be decided. But what is clear is that the progress of India's US$1.3 trillion economy now assumes a greater role in global decision-making. At Istanbul, Mukherjee called for parity in vote shares of developed and developing countries in the IMF and that the chairs in the Executive Board be redistributed on a more equitable basis. "The role of developing nations as drivers of future global economic growth", he says, "needs to be recognised." F