

Working Paper

The Indian Macro Policy Playbook: Time for a Fresh Look

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Abstract:

Indian macro policy has been operating under an implicit 2-4-6-8 framework, which are the targets for the sustainable current account deficit, the desired level of retail inflation, the consolidated fiscal deficit target embedded in law and the aspirational rate of economic growth. There is a need to take a fresh look at this macro policy playbook for two reasons. First, the individual targets have been decided at different points of time by different parts of the economic policy ecosystem rather than emerging from a common analytical project. Two, there are reasons to doubt its internal coherence given that India has rarely been able to meet all four targets simultaneously over the past decade.

The tricky political economy decision for the new government elected in May 2019 is whether to ease some of the economic stability constraints such as the fiscal deficit, the current account deficit and retail inflation in a bid to maintain economic growth at 8 percent; or continue to prioritise hard-won economic stability while facing the risk of social unrest as lower economic growth fails to provide the adequate number of jobs in formal enterprises; or put in place policy reforms that can help raise potential growth without creating periodic bouts of macroeconomic instability. This working paper argues in favour of the third option with five sets of policy recommendations, so that economic growth accelerates without putting economic stability at risk.

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The Indian Macro Policy Playbook : Time for a Fresh Look

1. Introduction

A macroeconomic policy framework consists of a set of interdependent goals for the monetary, fiscal, external and real sectors of an economy. Each of these policy goals then needs to be matched with a suitable policy instrument. India may not have an explicitly articulated macroeconomic policy framework, backed by formal econometric models that are in the public domain, but it does have a web of macroeconomic policy targets to help meet the broader national goal of rapid economic growth combined with economic stability. This essay looks at how this macroeconomic policy framework has fared in recent years – and whether the new Indian government that was elected in May 2019 has reason to change it.

2. The 2-4-6-8 Macro Framework

Indian macroeconomic policy has been implicitly operating within a 2-4-6-8 framework, which are the broad numerical targets respectively for the sustainable current account deficit, the desired level of retail inflation, the consolidated fiscal deficit target and the aspirational growth rate for the economy. The underlying assumption here is that the Indian economy can expand at 8 percent a year in real terms, while keeping retail inflation at 4 percent, the current account deficit at 2 percent of GDP and the consolidated fiscal deficit at 6 percent of GDP.

A good macroeconomic policy framework should ideally be internally consistent, in the sense that it should be possible to simultaneously meet all four goals in normal times, to ensure growth with stability. It should also satisfy the Tinbergen Rule that the number of policy instruments available should match the number of policy targets to be met, so that the policy framework is neither underdetermined nor overdetermined in a mathematical sense. A macroeconomic policy framework with interlocking targets also helps anchor the expectations of the participants in any economy.

The implicit targets for Indian macroeconomic policy were not identified as part of a common framework but were decided upon at different points of time by different parts of the policy ecosystem. The lack of coherence is thus not surprising. It is first important to examine the assumptions that these four main macroeconomic policy targets are built on, since it is sometimes

argued that Indian macroeconomic policy goals are either blindly borrowed from other countries or have been plucked out of thin air. That is a mistaken view. The discussion below looks at the analytical foundations of the four macroeconomic policy targets as well as some simple heuristics to understand them.

The sustainable current account deficit: India does not have a formal target for the current account deficit, which is understandable since it is difficult to directly target the external gap in an open economy with an independent monetary policy. The current account deficit is merely the savings-investment gap in an accounting sense. However, exchange rate policies can have an effect on individual parts of the current account balance such as exports of industrial products.

There is good reason for a rapidly growing economy such as India to run a current account deficit with the rest of the world, or borrow capital to supplement domestic savings. Given the periodic episodes of balance of payments stress, Indian policy economists have tried to estimate the level of current account deficit that can be sustainably funded. The first such attempt after the 1991 reforms was by the High Level Committee on the Balance of Payments chaired by C. Rangarajan. The underlying analytical models use an inter-temporal budget constraint to estimate the current account balance that will stabilise the net foreign exchange asset position at some benchmark level. At the beginning of this decade, the RBI estimated a sustainable current account deficit of 2.5 percent of GDP (RBI 2012). C. Rangarajan and Prachi Mishra estimated the sustainable current account deficit at 2.3 percent of GDP, assuming nominal GDP growth of 13 percent (Rangarajan and Mishra 2013).

The sustainable current account deficit is a function of the real GDP growth rate, the inflation rate, the desired benchmark for net foreign assets and changes in the valuation of the latter because of exchange rate movements. A more intuitive way to estimate the sustainable level of current account deficit is by taking a look at the flow of foreign capital from stable sources over the medium term, ie foreign direct investment plus deposits from non-resident Indians. Both methods yield a sustainable current account deficit level of around 2-2.5 percent of GDP.

The retail inflation target: The Reserve Bank of India has been formally given an inflation target by the government through the monetary policy agreement signed in February 2015. Consumer price inflation is the nominal anchor of Indian monetary policy and the RBI is expected to maintain retail inflation at 4 percent with a band of +/- 2 percent.

The choice of the 4 percent retail inflation target can be understood in the following way. The Expert Committee To Revise And Strengthen The Monetary Policy Framework, chaired by former RBI governor Urjit Patel, used an econometric model to estimate the threshold level of retail inflation in India at 6.2 percent (Reserve Bank of India 2014). Economic growth gets hurt whenever consumer price inflation crosses this threshold. So 6 percent became the upper bound of the policy target for the RBI. In an open economy, the domestic inflation rate also has to be sensitive to the global inflation rate. The latter — at 2 percent — provided the lower bound of the target inflation range. The 4 percent mid-point of the range thus became the inflation target for monetary policy.

There are two additional ways to think about the Indian inflation target. First, using the logic of the Balassa-Samuelson effect, the desired Indian inflation rate is 2 percent above the global inflation rate because of faster productivity growth in an emerging market such as India. Second, the Urjit Patel committee argued that the output gap was at zero between Q3 FY 2004 to Q1 FY 2007, when average retail inflation was 4 percent. The sensitivity of Indian retail inflation (and inflation expectations) to food price shocks — thanks to the high weight of volatile food prices in the consumer price index — also provided an argument for having an inflation band rather than a point estimate for the central bank to target.

The consolidated fiscal deficit: Fiscal rules are designed to maintain government borrowing on a path that can help stabilise the ratio of public debt to GDP at a particular level. The fiscal deficit is the operating target of any such strategy, though debt sustainability analysis is more broadly based on nominal growth, nominal interest rates and primary budgetary balances. The Fiscal Responsibility and Budget Management Act of 2003 seeks to anchor the consolidated fiscal deficit of the Union government and the states at 6 percent of GDP — divided equally between the two. In other words, the Union government should keep its fiscal deficit under 3 percent of GDP while the states have to do the same.

The consolidated Indian fiscal deficit target is twice the 3 percent target for the general government deficit in the fiscal rules of the European Union. The committee to draft a fiscal law for India based its recommendation on two considerations — the trend in household financial savings and reducing the debt of the Union government to 50 percent of GDP over a decade (Government of India 2017). Earlier, a technical paper submitted to the 12th Finance Commission

linked the fiscal deficit target to the financial resources available for borrowing (Rangarajan and Srivastava 2004).

Household financial savings at the time were around 10 percent of GDP while the current account deficit was 1.5 percent of GDP. That gave total financial resources of 11.5 percent of GDP. A little more than half of this was assigned to fund a consolidated fiscal deficit of 6 percent of GDP, divided equally between the Union government and the states. The rest was assigned to the private sector for investment activity.

The economic growth rate: India no longer has an explicit target for economic growth over the medium term, but there is an aspirational trajectory of 8 percent a year articulated in recent official documents (Niti Aayog 2018). There are three main ways in which to estimate the rate of domestic economic expansion without severe macroeconomic imbalances putting the growth at risk.

First, using a range of filters such as the Hodrick-Prescott filter to extract the potential growth rate of the economy from recent quarterly time series data. The potential growth rate revealed by these statistical techniques tends to lean towards the most recent data releases (which often give macroeconomic policy a pro-cyclical bias). Filters are more useful in analysing short-term macroeconomic dynamics rather than provide any meaningful clues about the growth path of the Indian economy over the medium term.

Second, constructing a standard Cobb Douglas production function to estimate how rapidly an economy can grow given capital stock, labour force and a technology parameter. Even after ignoring the more fundamental issue of how to aggregate the stock of heterogeneous capital in any economy, attempts to use such a production function is limited by the lack of a credible long term data series on the stock of capital in India.

Third, estimating the sustainable growth rate of the economy using some variant of the Harrod-Domar growth model, where the growth rate is a function of the domestic investment rate and the incremental capital-output ratio (ICOR). The sharp drop in the domestic investment rate over the current decade — the result of a combination of factors such as overcapacity, weak private sector balance sheets and bad loans in the banking system — have perhaps capped the growth potential of the economy.

A fourth analytical tool would be one based on the insights of Anthony Thirwall, that any country that has to maintain a current account equilibrium with a constant real exchange rate should grow at a rate equal to the ratio of the growth of exports to the income elasticity of demand for imports. This model is, unfortunately, almost never used in Indian public policy (Rajadhyaksha 2018). All three main methods of estimating the sustainable growth rate of the economy put it right now at least a percentage point lower than the aspirational growth rate of 8 percent.

3. Indian Macroeconomic Performance since 2010

Any serious discussion on how the Indian economy has performed over the current decade in terms of its four core macroeconomic goals is hampered by several significant problems. One, there is ambiguity about the rate of economic growth because of the ongoing debates about the new method of calculating GDP as well as frequent revisions in the data series. Two, the public sector borrowing requirement (PSBR) tends to be higher than the reported fiscal deficit because of extra borrowing by government agencies such as the Food Corporation of India outside the annual budget presented in parliament (Chinoy & Jain 2019). Three, the Indian economy has had to face two disruptions because of the decision to withdraw high value bank notes in November 2016 followed by the transition to the GST after July 2017, which have impacted both aggregate demand as well as prices.

This essay uses the officially accepted GDP growth and fiscal deficit data since that is what will be used as an input for policy. It also does not engage with the problems arising from the frequent divergence of wholesale and retail inflation on the one hand as well as the divergence between food inflation and core inflation on the other.

The Indian economy recovered smartly from the adverse effects of the North Atlantic Financial Crisis of late 2008 thanks to fiscal expansion as well as interest rate cuts. The average fiscal deficit of the Union government as a proportion of GDP in the three years after the crisis was 2.5 percentage points higher than the average level in the three years before the crisis. The consolidated fiscal deficit of the Union and state governments moved by as much as 5 percentage points over these same two periods. Monetary policy too was in expansionary mode. The benchmark repo rate was cut by 525 basis points immediately after the crisis. The economy was also flooded with liquidity with reductions in the cash reserve ratio as well as the Rs 1.6 trillion released through desequistered market stabilisation scheme (MSS securities).

The stimulus worked. The narrative below is based on a mix of data from the old GDP series at factor cost plus the latest estimates from the Central Statistical Organisation on GVA at basic prices using the new methodology to estimate national income. Growth rebounded smartly in FY10 and FY11. However, the government was slow to withdraw the fiscal stimulus even as aggregate demand recovered smartly. The monetary stimulus was also not withdrawn on time. The RBI also began to increase interest rates from April 2010 but real interest rates remained in negative territory till early 2013 (Mohan and Ray 2019).

The delay in withdrawing the stimulus was one major reason why inflation began to accelerate in the early years of this decade. Price pressures that were first noticed in the food sector later spread to other parts of the economy. The current account deficit also widened. Wholesale price inflation — the informal monetary policy target before the shift to flexible inflation targeting — peaked at 9.6 percent percent in FY11, with food inflation at 15.6 percent. The current account deficit was at a record 4.8 percent of GDP in FY13.

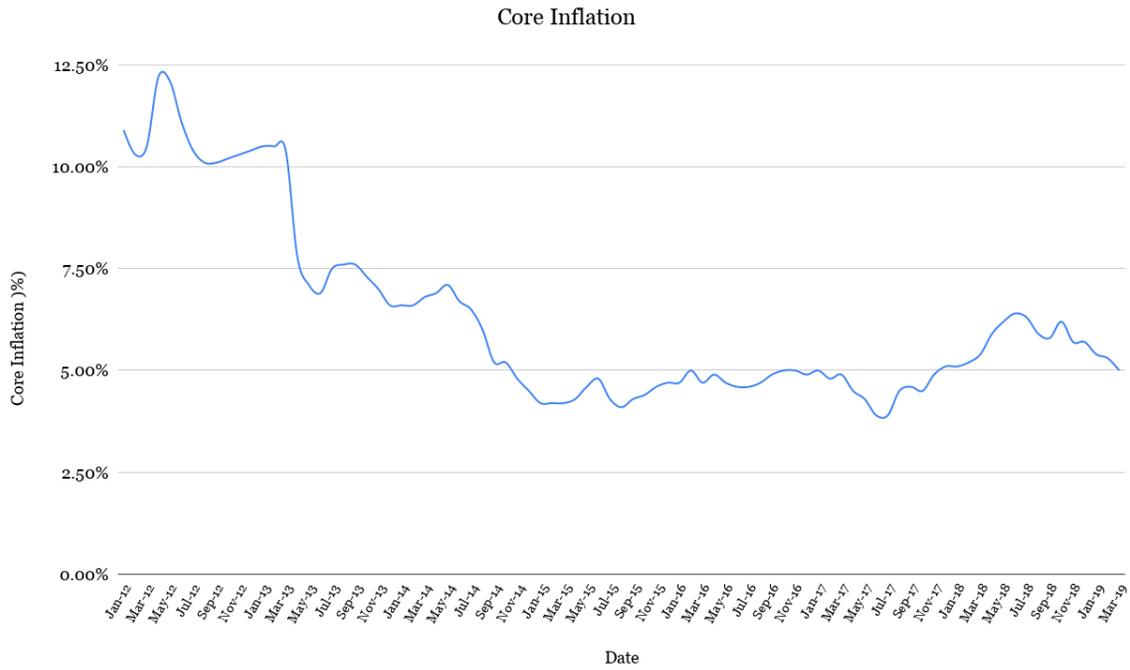
The macroeconomic fragility put the Indian economy in a weak position to withstand a global shock. That moment came in the middle of 2013. The decision of the US to gradually step away from quantitative easing led to fears that India would be unable to fund its record current account deficit as global liquidity ebbed. India got clubbed with Turkey, Brazil, South Africa and Indonesia as the five most fragile major economies in the world. The rupee began to feel the pressure. In response, the RBI began to raise policy rates from September 2013 while the government cut spending to bring down the fiscal deficit. The rupee touched a record low of 66.26 against the US dollar on 26 August 2013, having lost almost a quarter of its value over 12 months.

The focus of Indian macroeconomic policy shifted to stabilisation after the events of August 2013. The government committed itself to a tighter fiscal policy. The RBI made consumer price inflation the nominal anchor of monetary policy. There were a series of administrative measures to curb gold imports on the one hand and increase foreign exchange inflows on the other. The stabilisation was successful without significant loss of economic momentum, since the Philips Curve is a convex rather than linear relationship (RBI 2015). The underlying intuition is that disinflationary policies at high inflation levels entail lower output losses than when inflation is relatively tame.

There was also a stroke of luck. The Indian economy experienced a positive shift in its international terms of trade as global crude oil prices tumbled in the final months of 2014. A barrel of Brent crude that cost \$112 on 12 June 2014 was trading at \$45 by 14 January 2015. The price fell to \$28 on 19 January 2016. This price destruction took pressure off Indian public finances, the external gap and the price level; the sharp improvement in net exports because of lower oil prices also helped economic growth.

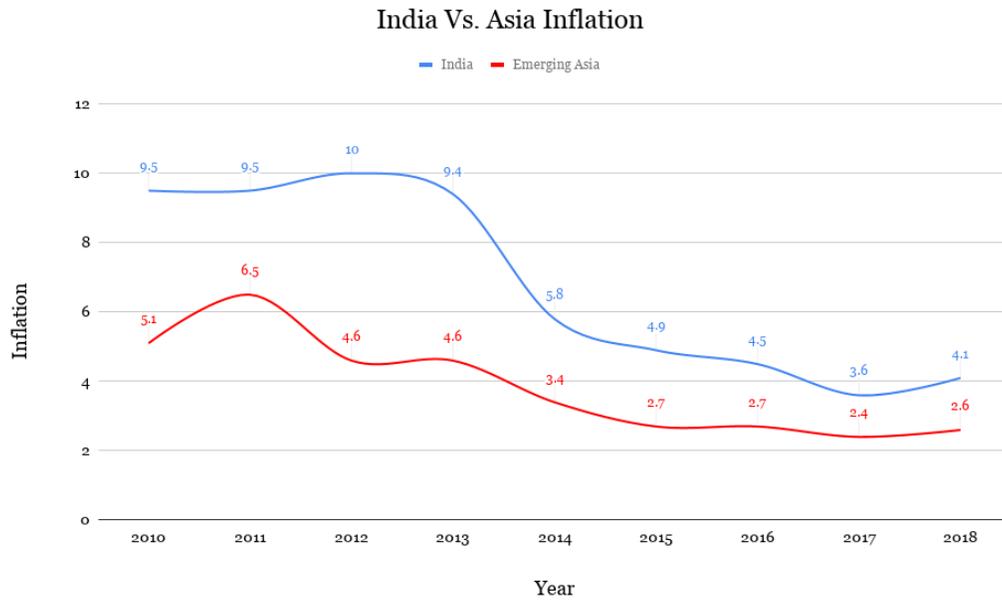
The shift in the terms of trade naturally helped a commodity importer such as India, but economic policy also played a role. Two decisions are worth highlighting here. First, the government decided to save the oil windfall by increasing taxes on fuel rather than fully passing on the benefits to consumers. Second, the RBI officially made consumer price inflation as the formal nominal anchor of monetary policy. The first decision helped the government manage its finances while the second played a part in lowering inflation. One way to understand why the decline in inflation was not just because of the fall in global energy prices is by looking at the trend in core inflation as well as the narrowing difference between Indian inflation and inflation in what the IMF defines as Emerging and Developing Asia. Both these trends show that the disinflation in India after 2013 cannot be explained by food disinflation or global factors alone.

Figure 1



Source: Author's Calculations. Data from Ministry of Statistics and Programme Implementation, Government of India.

Figure 2



Source: Author's Calculations. Data from International Monetary Fund.

How has the 2-4-6-8 macroeconomic policy framework performed over the past ten fiscal years? In other words, has India been able to maintain economic growth above 8 percent while meeting its targets for the fiscal deficit, current account deficit and inflation. The short answer: No.

Take a look at the table below. The data for economic growth here is the latest estimates of the (frequently updated) series on gross value added at constant prices. Inflation data is based on consumer price index for industrial workers (from FY2010 to FT 2012) and the new national consumer price index (FY 2013 to FY 2019). Any single macroeconomic target is deemed to have been met when the actual number is within a range of 50 basis points on either side, since perfect marksmanship is not possible in the real world – giving an effective range of one percentage point on either side of the target.

YEAR	GROWTH	INFLATION	FD	CAD
2009-10	6.9	12.4	9.3	2.8
2010-11	8.0	10.4	6.9	2.8
2011-12	5.2	8.4	7.8	4.2
2012-13	5.4	10.2	6.9	4.8
2013-14	6.1	9.3	6.7	1.7
2014-15	7.2	5.9	6.7	1.3
2015-16	8.0	4.9	6.9	1.1
2016-17	7.9	4.5	7.0	0.6
2017-18	6.9	3.6	6.6	1.9
2018-19	6.8*	3.4	7.0*	2.3

Sources: RBI, CSO, IMF, IDFC Institute estimates

Note: GVA growth and retail inflation are in percentages. Fiscal deficit and current account deficit are as a proportion of GDP

Fiscal year 2013 was the worst in the current decade while fiscal year 2017 was the best, going by the official numbers. However, India has found it difficult to meet its four key macroeconomic goal simultaneously over the past ten years, though the deviations from the individual targets have been relatively modest. Is there a case for a relook at the policy playbook? The next section of this essay deals with this issue in a discursive manner.

4. A new macroeconomic policy playbook

The experience of the past ten years suggests that the growth rate that India can sustain within the constraints set by the other macroeconomic targets is 7 percent rather than 8 percent, or perhaps even lower. The tricky political economy decision for the next government is whether to ease some of the economic stability constraints such as the fiscal deficit, the current account deficit and retail inflation in a bid to maintain economic growth at 8 percent; or continue to prioritise hard-won economic stability while facing the risk of social unrest as lower economic growth fails to provide the adequate number of jobs in formal enterprises; or put in place policy reforms that can help raise potential growth without creating periodic bouts of macroeconomic instability.

The most durable option is the third one. The failure to secure inclusive growth – either because of higher inequality or poor job growth – can lead to redistributive politics that eventually harms growth (Alesina and Rodrik 1994). The most likely political response in India is likely to be fiscal expansion through spending or monetary expansion to support a credit boom rather than redistribution via higher taxes on capital incomes. However, India needs structural reforms that can allow it to grow at a faster pace without high inflation, fiscal stress or balance of payments pressures. Here are five issues that need attention in the quest to increase India’s potential growth rate.

Getting the investment cycle back on track: India has seen weak investment sentiment through most of this decade as private sector deleveraging, weakened bank balance sheets and persistent excess capacity has hindered the ability of companies to invest in new capacity. The investment rate as a percentage of GDP has come down from 39 percent in fiscal year 2012 to 31 percent in fiscal year 2018. The fall in the investment rate directly affects potential growth.

There are now some initial signs of a revival in investment activity though the investment rate is only expected to peak at 33 percent in fiscal year 2013 (Raj, Sahoo and Shankar 2018). A stronger revival will run into the problem of availability of financial resources. The gross domestic savings rate has also been falling since the North Atlantic financial crisis. More rapid growth could address a part of this problem. National savings tend to be pro-cyclical, in the sense that higher tax collections during periods of rapid economic expansion as well as higher retained corporate earnings during profit booms help improve government and corporate savings respectively.

However, the bulk of Indian domestic savings come from households (including unincorporated enterprises). Household savings are usually steady through economic cycles. However, these have also been falling as a proportion of GDP in recent years. Financial savings have come down in tandem. A private sector investment revival will thus be constrained at a time when the total public sector borrowing requirement is already in excess of 8.5 percent of GDP (Chinoy and Jain 2019). The broader challenge is to reduce the cost of capital in India through a combination of lower interest rates, lower rates of corporate taxation and reducing the relative price of capital goods.

Addressing the home market question: An investment revival addresses the growth challenge from the supply side. A more recent theme in India is whether there are demand constraints that could send India into the middle income trap. Economic growth catering to the top 15 percent of the population has its limits (Roy 2019). This home market issue goes back to an older discussion whether anaemic Indian industrial growth in the 1970s could have been explained by inadequate domestic demand (Chakravarty 1979). Both variants of the argument have profound links to the inequality question as well as the internal terms of trade between industry and agriculture.

The problem of a narrow home market is less acute in countries that succeed in exporting to the global markets, so that foreign demand picks up the slack generated by weak domestic demand. India has not had enough success on that score, unlike many Asian countries that have generated jobs by selling to the international market. Global trade is dominated by trade in intermediate goods thanks to transnational supply chains. These supply chains could be reformatted because of two changes in China – the trade war with the US as well as rising Chinese wages. India has an opportunity here to enter the new transnational supply chains, though it seems for now that other Asian countries such as Vietnam and Indonesia are better placed to grab the opportunity (Rajadhyaksha 2019).

Fiscal modernisation for state capacity: The Indian state is fiscally constrained given its constitutional commitments to provide public goods as well as welfare schemes. One reason has been the inability to collect enough tax – especially income tax from citizens. European nations moved from an elite income tax collecting 1 percent of GDP to a mass tax collecting 5 percent of GDP (Piketty and Qian 2019). This transition happened between 1914-1945, when most advanced

European nations were at average income levels comparable to India today. Some of the fiscal modernisation is also explained by the need to collect tax to fund the two world wars (Srinivasan and Mishra 2019). Most citizens in European countries pay income tax.

China has begun making the transition to fiscal modernisation because of rapid personal income growth as well as under-indexation to inflation, as compared to the frequent increases in tax exemptions limits in India (Piketty and Qian 2019). India has failed to increase its income tax base because of this, basing hope on better tax administration to raise the ratio of income tax to GDP. Higher income tax collections will have another advantage. It can create fiscal space for reducing consumption taxes such as the goods and services tax (GST), for which India has one of the highest modal rates.

Removing restrictions on internal trade: The introduction of GST is indeed a transformative moment – India’s free trade agreement with itself. It creates an economic union more than six decades after political union. The creation of a unified Indian market is expected to lead to efficiency gains as companies rewire their domestic supply chains. However, the first version of the GST is messy – a reflection of the messy federal bargaining that preceded its introduction. There is now a strong case for GST 2.0 with fewer categories, a lower standard rate and wider coverage. There have already been moves to ease the onerous compliance requirements that were required when the new tax was introduced. The ideas embedded in the first recommendations about the GST structure are still relevant (Thirteenth Finance Commission 2009).

The internal market also needs to be strengthened by reducing domestic transaction costs. GST takes care of part of the problem. However, there is a whole range of policy action that needs to bolster the impact of the new tax on economic efficiency. This includes better roads and railways for the internal movement of goods, better telecom networks to help smaller enterprises connect to markets, fewer restrictions of land transactions, greater ease of doing business, policies to strengthen urban agglomerations. Each of these has been part of the overall policy debate, but as disparate recommendations. What binds them together is that they have the potential to bring down domestic transaction costs.

Imagining a new financial structure: A dynamic economy needs a robust financial system that allocates capital efficiently. The Indian financial system has faced immense stress in recent

years, and a lot of the policy focus has been on the trifecta of recognition, resolution and recapitalisation. The new regulatory architecture built around the Insolvency and Bankruptcy Code shifts the balance of power from borrowers to creditors – and will hopefully change the credit culture in the country.

However, a broader conversation on the financial structure is needed. India chose the universal banking model after the 1991 reforms, moving away from the specialist financial institutions of the earlier era that had access to subsidised liabilities. Commercial banks were tasked with supporting all types of economic activity – from personal consumption to infrastructure development. The RBI has already begun a modest move away from this model through differentiated licences for payment banks, small finance banks and wholesale banks. The problem is especially acute in the case of large industrial projects as well as infrastructure projects. The task of funding them cannot be left to commercial banks alone. India needs specialist financial agencies to do some of the heavy lifting as well as an active corporate bond market. One possible option is to let commercial banks focus on loans to small and medium enterprises, while larger projects are funded by specialist banks and the corporate bond market.

5. Conclusion

Macroeconomic policy frameworks are not cast in stone. They have to be altered based on changes in the underlying structure of an economy. For example, Lawrence Klein argued that policy models need to be periodically updated, because they quickly go out of date; new types of economic challenges emerge; and there are behavioural changes as well (Bhanumurthy, undated). The same can be said about macroeconomic policy frameworks. What is relevant at one point of time need not be relevant at another point of time, especially in economies such as India that are undergoing structural change. However, the underlying goal of macroeconomic policy should continue to be rapid growth with economic stability. Both are important.

India has emerged as the fastest growing major economy in the world in recent years, even as the Chinese juggernaut has slowed down. The Indian economy is doing well if one makes a comparison with other major economies at this point of time, but the current momentum is less impressive when compared to the growth rates maintained by countries such as China or South Korea when they were at a similar stage of development. Average incomes in South Korea went from \$2180 in 1983 to \$4686 in 1988. Chinese average incomes rose from \$1966 in 2004 to

\$4604 in 2008. On the other hand, Indonesia took twelve years to double its per capita income once it crossed the \$2000 threshold in 2007. Will the doubling of average incomes in India from \$2000 to \$4000 move at Chinese or Indonesian speed?

The Niti Aayog is best placed to catalyse new thinking on the macroeconomic policy framework, without trying to direct investment activity as the old Planning Commission did. As Vijay Kelkar has argued in his Sukhamoy Chakravarty lecture: “The new Niti Aayog will make available to the highest level of policy making knowledge-based advice, and provide national and long term perspective on policy proposals. Today, there is no such advice available to our cabinet. I cannot overemphasise the need for such a perspective as every ministry tends to take a sectional or sectoral view. Equally, individual ministries cannot fully take into account the inter-sectoral implications or the long term implications for the different regions of India” (Kelkar 2018). The need for the Niti Aayog to provide a comprehensive macroeconomic policy framework that combines growth with economic stability — a public good — can be thought about in very similar terms.

India has a rich history of macroeconometric modelling since the advent of planning in 1951 (Krishnamurty 2002). These models are needed for structural analysis, forecasting and policy evaluation. The interaction between economic growth, inflation, public finances and external balances should be understood not just through a formal macroeconometric but also in terms of a broader policy framework to be decided by the political class. Development policy should ideally be focused on identifying the structural constraints to growth — and seeking to overcome these constraints. There is also the need to understand the changing nature of structural constraints such as, for example, domestic savings, productivity growth, energy imports, food production, global growth, capital flows and the import intensity of Indian growth.

The existing 2-4-6-8 policy framework may need to be reconsidered given the changes in the Indian economy, but in an internally consistent manner rather than through a hasty fiscal expansion or a higher inflation target or a greater dependence on volatile capital inflows. The central task is to design a set of policies that can raise India’s potential growth rate to above 8 percent, if not more. A lot also depends on the underlying growth model, and especially if it is led by investment or by consumption. East Asia followed the former path while Latin America followed the latter path. A push for faster growth without taking cognisance of the structural

constraints could compromise economic stability – making India resemble Latin America more than East Asia.

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