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GRAY/21/2663

September 15, 2021

**Statement by Mr. Stephan and Mr. Boehme on India
(Preliminary)
Executive Board Meeting
September 17, 2021**

We thank the staff for this informative report. We would also like to thank Mr. Bhalla and Mr. Goyal for their insightful Buff. We broadly concur with staff's conclusions and recommendations. India had been in the midst of an economic slowdown when it was hit by the unprecedented challenges of the COVID-19 shock, strict lockdowns and million-fold human tragedies in two infection waves. The authorities' economic response has softened the impact and contributed to ongoing gradual recovery. We wish the authorities continued success in their endeavors. The following comments regarding revenue mobilization, lending to MSMEs, fiscal transparency, and structural reforms as well as monetary and trade policies are mainly for emphasis.

We share staff's concern about risks of a more persistent crisis impact straining India's medium-term growth. Boosting high-quality public investment as part of a multi-year strategy while tracking a credible fiscal consolidation path appears warranted, also against the backdrop of dwindled private investment. The authorities are consequently doubling down on revenue mobilization through privatization and asset monetization, which should be underpinned by improving the quality of expenditure and broadening the tax base. We take positive note of the reinvigorated privatization drive and newly created national asset monetization pipeline.

While policy measures have generally mitigated the impact on the corporate sector, smaller companies and service industries seem to bear the brunt of the economic outfall of the Covid-19 pandemic. Micro, Small & Medium Enterprises (MSMEs) still find it difficult to get under the umbrella of these measures, due to banks' reluctance to lend to lower-rated firms or family companies without collateral. Listed corporates, on contrast, have been in a better position to benefit from easier capital market conditions. We acknowledge

the necessity for narrowing such cleavages in access to finance. *To this end, we encourage staff to elaborate on the potential merits of the recently rolled-out Account Aggregator (AA) network, created through an inter-regulatory decision by RBI and other regulators as a digital intermediation platform to facilitate lending on the mere back of borrowers' credit, payments and cashflow history, regardless of collateral. Insights would be welcome into how this innovation might contribute to improving future credit flow and loan access for individuals and lower-rated MSMEs in India.*

We commend the authorities on their efforts to enhance fiscal transparency by shifting off-budget food subsidies into the budget. At the same time, we understand that a transparent and credible medium-term consolidation path is crucial for putting public sector borrowing requirements on a downward trajectory, freeing up resources for private investment and reducing the public interest bill. We consequently encourage the authorities to follow through with their stated goal to gradually reduce the fiscal deficit below 4.5 percent of GDP once the emergency phase of the crisis passes. We also agree with the conclusion that insufficient economic growth is a primary risk for debt sustainability, which buttresses the arguments for continuing the reform drive with a view to boosting India's long-term potential growth in a sustainable manner.

We thank staff for the informative section on RBI's monetary policy and commend the monetary authorities on the broad compendium of measures to reignite growth and maintain financial stability. At the same time, we would like to encourage a more detailed discussion of the challenges posed by above-average inflation pressure, in particular the stickiness of the elevated core inflation in spite of the largest economic downturn ever, marked by a huge quantum of perceived slack. Irrespective of the severe supply-side disruptions as a most important factor, we wonder whether output gaps are eventually lower than believed with SMEs being more impacted by the crisis than supposed. *We would welcome more encompassing inquiries into the nature of actual supply-side disruptions, coupled with a look at the elevated inflation expectations of private households, which have reached a multi-year high. For a future report, we would also be grateful for an elaboration on how the slowdown of total factor productivity (TFP) growth, which has halved over the last 15 years, may have impacted potential growth since the onset of the global financial crisis, and what policy conclusions should be drawn from the findings.*

In line with staff, we underscore the overarching importance of structural reforms and encourage the authorities to keep up the momentum, including implementation of long-warranted labor market reforms. The latter will ease the administrative burden, smoothen job creation and contribute to more labor market formalization. Harnessing India's demographic dividend by putting in place the conditions for more and better jobs for its rapidly growing labor force is becoming an ever more daunting challenge. Labor force participation – in particular the female participation rate – has been trending down for a while and should be the subject of a more thorough inquiry. Reverse labor migration from

urban factories to lower-paid farm and other rural non-farm jobs during the pandemic has contributed to subdued wage bill dynamics, as opposed to buoyant large-enterprise earnings.

We welcome the authorities' concurrence of the macro-criticality of climate change as well as the respective advice in the staff report. Considering the potential of carbon pricing and the reduction of fossil fuel subsidies to reduce GHG emissions and easing public budgets, while recognizing that their introduction can cause strong social opposition due to distributive effects, we recommend to further pursue such approaches in the dialogue with India's authorities. In light of distributive concerns, models with revenue recycling and targeted compensations should be prioritized.

We concur with staff in emphasizing lower trade tariffs on intermediate goods as a facilitator of higher export activity. In line with the recovery of global economic demand, India's exports have turned out to be an important growth engine. We strongly agree that deeper integration into global value chains, supported by continued liberalization, would boost India's export capacity. At the same time, to harbor an ecosystem conducive to export growth, it would be critical to abstain from tariff hikes, which infringe Indian competitiveness through virtually acting as an export tax. We encourage the authorities to maintain their focus on enhancing competitiveness by advancing productivity-enhancing schemes and keeping the real effective exchange rate anchored through containing inflation. While welcoming efforts to ease remaining FDI restrictions, we suggest to further advance policies improving the business climate for international market participants, thereby enhancing India's attractiveness as a trade and investment partner. Trade and investment barriers should be significantly eased. Trade openness paired with investments and efficient financial intermediation would also boost productivity. *Against this background, staff research would be welcome as to how India's economy may benefit from joining free trade agreements.*