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NO EASY ANSWER TO ECONOMIC SLOWDOWN

Relevant for: Indian Economy | Topic: Issues relating to Growth & Development - Public Finance, Taxation & Black Money incl. Government Budgeting

The most keenly watched number in the Union Budget is, perhaps, the ratio of fiscal deficit to GDP. A decline in the ratio is cheered by commentators and the markets. An increase is a seen as a setback to reforms.

This year, the number was of greater interest than before thanks to the vision outlined by the **Economic Survey for 2018-19 a day earlier**. Earlier editions of the Survey had suggested that since private investment was not taking off, there was scope for public investment to pick up the slack.

The latest Survey leaves no room for such ambiguities. It makes clear that private investment is the key driver of growth and jobs. It follows that the government must make fewer demands on public savings so that more of it is available for private investment. In other words, going by the Survey's analysis, there is no escape from an even sharper focus on fiscal consolidation.

It is astonishing, therefore, that Finance Minister Nirmala Sitharaman's Budget speech did not even mention the fiscal deficit figure, perhaps a first of sorts! Nor did it make any reference to a path towards the fiscal deficit target of 3.3% of GDP. The omission reflects the limitations imposed on the Finance Minister by trends in revenue and expenditure.

In 2011-12, the fiscal deficit to GDP ratio was 5.9%. By 2015-16, it had declined to 3.9%. Thereafter, it has got stuck at around 3.5%. The Budget for 2018-19 missed the targets set earlier, for 2017-18 and 2018-19. It outlined a revised 'glide path' with fiscal deficit targets of 3.3% for 2018-19, 3.1% for 2019-20 and 3% for 2020-21. The Budget for 2019-20 shows that the revised targets too have been missed thus far. The fiscal deficit for 2018-19 has ended up 3.4% of GDP; for 2019-20, it is estimated at 3.3%. It would be a brave soul who believes that the target of 3% for 2020-21 will be met.

Nirmala's maiden Budget is all about incremental measures

The government has had some success in reining in traditional items of revenue expenditure. Major subsidies (food, fertiliser, petroleum), which used to claim 2% or more of GDP, have stabilised at 1.4% of GDP. But new items of expenditure have emerged. The PM-Kisan scheme, which provides 6,000 for each farming household per year, will cost the government 75,000 crore in 2019-20. The outlays on the National Rural Employment Guarantee Scheme have crept up with each passing year.

The big disappointment has been in respect of tax revenues. The expectation following demonetisation and the introduction of the Goods and Services Tax (GST) was that both direct and indirect taxes would rise. As a result, the tax to GDP ratio would move to a different trajectory. The Budget for 2018-19 projected the tax to GDP ratio to rise from 11.6% in 2017-19 to 12.1% in 2018-19 and further to 12.4% in 2019-20. The Budget for 2019-20 dashes these hopes. It estimates the tax to GDP ratio at 11.9% in 2018-19 and 11.7% in 2019-20. The shortfall in GST collections in 2018-19 seems to have set the clock back for fiscal consolidation.

How do we balance the fiscal numbers when the tax to GDP ratio is not coming up to expectations? The Chief Economic Adviser has indicated that the government pins its hopes on capital receipts from disinvestment and the sale of land belonging to the government including

public sector enterprises (PSEs). Disinvestment in the sense of strategic sale of PSEs has not really taken off. Much of disinvestment has involved the buying of equity in PSEs by other PSEs. The sale of government land is bound to be a long-drawn-out process and one with fraught with controversy over valuation. Moreover, the sale of government assets to balance the Budget merely defers fiscal problems to the future. It is not the answer to the problem of fiscal sustainability.

In the short term, the government's hopes must rest on the Bimal Jalan committee on the economic capital framework for the Reserve Bank of India (RBI). The government's intention in setting up the committee was to see whether some of the RBI's reserves could be used to mitigate the fiscal position. The report has been submitted, but is yet to be made public. There are reports that the majority does not favour a one-shot transfer to the government, something the government would have liked.

Private investment is constrained not just by the crowding out effect of a high fiscal deficit. Earlier editions of the Economic Survey had identified the twin balance sheet problem, that is, high levels of debt in companies and high non-performing assets of banks, as an important constraint on private investment. The Economic Survey of 2018-19 contends that reducing policy uncertainty can somehow overwhelm the drag caused by the twin balance sheet problem. This is questionable. The broad direction of policy has never been in doubt since the onset of economic reforms, even if the pace has varied in response to the situation on the ground. Had policy uncertainty been a serious issue, it would have surely been reflected in inflows of foreign capital, whether foreign institutional investment or foreign direct investment.

Resolving the twin balance sheet remains the key to reviving private investment. This requires the government to provide adequate capital to public sector banks (PSBs). The Budget's biggest positive is the allocation of 70,000 crore towards capital for PSBs. However, the allocation is meaningful only if it is spent at one go in the current financial year, not staggered over several years. Only then will banks have enough capital to cover provisions for non-performing assets as well as provide loans to firms.

The Budget also makes an attempt to address the liquidity problem at NBFCs. It provides cover for loss of up to 10% on purchase of pooled assets of NBFCs of a total value of 100,000 crore during the current financial year. Many see it as a government bailout of private NBFCs. The apprehensions may be misplaced. The loss cover is only for six months and is intended only for well-rated portfolios and NBFCs. Banks may be incentivised to buy more of the portfolios of the better NBFCs, not those of the weaker ones.

The government expects that by boosting the flow of credit, the recapitalisation of PSBs will help revive private investment. What if it doesn't? Should the government continue to focus on a single number for the fiscal deficit target? Or would it be more realistic to accept a broad range, keeping in mind the fall in the inflation rate and the decline in the combined fiscal deficit of the Centre and the States? The answer to the economic slowdown may not be as simple as the Survey makes out.

T.T. Ram Mohan is a professor at IIM Ahmedabad. ttr@iima.ac.in

The Trump administration's successive punitive actions against Iran can only be interpreted as a desire for direct conflict

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