

Moody's thumbs up to reforms

What happened?

Moody's, an international U.S.-based ratings agency, raised India's sovereign rating earlier this week. For almost two decades, India and the agency have been at loggerheads with each other over the ratings. So, the upgrade, which is the first by Moody's in 13 years, is a significant change in how the agency views the country. In particular, Moody's cited a wide list of economic reforms carried out by the government, from the implementation of the goods and services tax to the recapitalisation of public sector banks, to justify the upgrade. It believes that these reforms will improve the government's ability to repay its debt, despite India's high debt-to-GDP ratio of 69%.

Will it lower borrowing rates?

Many expect the ratings upgrade to improve India's status among global investors. They, however, assume that investors care a whole lot about credit ratings assigned by agencies like Moody's, many of which have been wrong in the past. Hordes of investors, for instance, have invested in countries like India and China irrespective of the outlook of credit rating agencies. In fact, the reaction of the bond market after the present ratings upgrade has been quite lukewarm. The yield on the 10-year bonds issued by the government, for instance, did not show any solid signs to suggest increased confidence among investors in India's sovereign debt. Another touted benefit of the upgrade is that as private borrowing rates are supposedly based on 'risk-free' sovereign rates, it will help companies based in India to borrow at lower rates. This argument, however, ignores the fact that markets arrive at the rates for different borrowers independently. In fact, many private companies have enjoyed borrowing rates lower than those of their sovereigns in the past and the present.

Does it portend higher economic growth?

Moody's expects higher economic growth and a wider tax base, both being the result of the government's wide-ranging reforms programme, to lead to a substantial rise in tax collection. This, in turn, is expected to improve the creditworthiness of the Indian government, which is great news for lenders to the government. But all that is great for lenders need not necessarily be great for long-run economic growth. Some of these reforms may revive growth only for the short term. Other reforms that aim to widen the tax base will do so only by increasing the tax burden on the wider economy, thus imposing a larger drag on long-run economic growth.

The definition of harassment needs to be constantly updated, and the process for justice made more robust

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