The government’s six big economic mistakes

The slowdown in economic growth (5.7%, year-on-year, in the first quarter of fiscal 2017-18), the near-total absence of bank credit growth to industry—small or medium or big—and the lacklustre growth in industrial production, to name a few, have brought many experts out of the woods. There is near-total unanimity on the need for a fiscal stimulus in India. Discussions of solutions must take into account costs and alternatives considered and discarded. Otherwise, solutions could end up becoming the case of committing a second wrong to right the first wrong. Let us examine the mistakes that the government committed and then reflect on whether fiscal stimulus would rectify them.

First, it had not prepared for being in power at all, in terms of using it as an instrument for economic advancement. It inherited the budget projections of the previous government without question. The mid-term economic appraisal of 2014-15 pointed out that the true fiscal deficit inherited could have been of the order of 1.1 to 1.8 percentage points more than the official number of 4.5%. The National Democratic Alliance government thus engaged in a massive fiscal consolidation even as the economy was limping back to normalcy. Had it done its homework and put out a white paper on the economic mess it had inherited in various areas, it would have prepared the ground for a gradual fiscal consolidation. Thus, it could have used the windfall from the oil price crash to recapitalize banks rather than working overtime to legitimize the previous government’s fiscal projections. That brings us to the second mistake.

It did not take the emerging banking sector woes seriously enough. Today, the problem has grown bigger and is even yet to peak. Short of drastic reforms to the banking ownership and governance models, the problem of non-performing assets (NPAs) is likely to persist and remain a big drag on growth. Nor is it any more a question of recapitalizing the banks alone. Governance is a serious issue. After all, without collusion by bank staff, not all banned notes would have made it into bank accounts. Drastic reforms are made infeasible, partly because of resistance from ideologues aligned with the Bharatiya Janata Party and because of the government’s unwillingness to commit political capital to see them through. Above all, the reluctance to confront the problem stems from the facile assumption that economic growth would wash away the sins that lenders and borrowers committed. That brings us to the third mistake.

It was to believe in the economic growth numbers that the central statistical office (CSO) put out. The CSO put out growth numbers based on its new methodology and new base year that bore no resemblance to reality. That was readily apparent because the growth numbers even for the “disastrous” United Progressive Alliance years of 2011-14 were revised higher to appear almost respectable. So, the government felt rather proud that it was able to achieve fiscal consolidation and yet achieve good economic growth. Its mistake lies in not being sceptical enough of CSO calculations and asking them to be thorough and transparent and fix the economic growth calculations methodology especially since many competent economists inside the system had expressed reservations on the numbers. The role of bad economic statistics in India’s current economic plight is a story that has to be told. That would put data collection, methodology, accurate and timely reporting an urgent priority for future governments.

The fourth mistake is its implicit and explicit anti-big bias. India’s economic structure in farms and factories is fragmented, inefficient and primitive. The numbers are shocking and beyond belief. India cannot “make it” with such extremely nano and micro-sized farms and factories. The solution is not to favour the current big firms but to favour potential enterprises becoming big or to encourage firms to start big. There are an estimated 63.4 million non-agricultural unincorporated enterprises (excluding construction) contributing gross value added (GVA) of Rs11.5 trillion only. In contrast, only 189,468 registered (with the Annual Survey of Industries) factories generate

Rs11.6 trillion of GVA. More startlingly, just 4.1% of them have 500 or more workers and they contribute 60% of the GVA of the registered factories. But, the anti-big bias is evident in the fact that the government had stopped (or, been stopped) in its tracks to reform the corporate tax system. Mudra loans without screening and without strings attached will not result in enhanced scale and efficiency but would be a big opportunity cost in a resource-constrained economy.

The fifth big mistake is in continuing with and even strengthening tax terrorism. Economic policymaking has been reduced to one of and only of (tax) morality. That is a slippery slope because it is impossible for politicians to set a personal example and demand reciprocity given how elections are funded. Revenue neutrality is easily achieved in spreadsheets but it happens in reality only when economic activity happens. Note ban has been seen almost only as an exercise in broadening the tax base and not as a transformative exercise from its pigmy sized farms and factories.

The sixth and final mistake could be the wellspring of the other five. Leaders have to surround themselves with advisers who can speak truth to the power. Now, we can decide how many of these mistakes could be possibly reversed by a fiscal stimulus.

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