Bad News in the Good Days*

C.P. Chandrasekhar

The BJP under Narendra Modi has been by and large favoured by fortune. This is reflected not just in the fact that it managed to win 52 per cent (282) of the seats with just 31 per cent of the votes in the parliamentary elections. It has also been helped, for example, by a greater than expected collapse in international oil prices and a marked moderation in food price inflation because of favourable supply side developments in domestic and international markets. While this is good news for the government, there seems to be a real danger of it turning complacent as a result. These developments appear to have reinforced the government's conviction that, besides relying on symbolic programmes pretending to clean up the country or enrich the poor by giving them bank accounts without the jobs and the resulting earnings to deposit in them, relying on Lady Luck is enough to earn a good name.

But luck does fail even the most fortunate occasionally. One instance of such failure is the decline in the quarterly rate of growth of GDP from 5.7 per cent in the first quarter (April to June) of 2014-15, which was one in which the UPA was running the government for most of the time, to 5.2 per cent in the second quarter (July to September). The 5.7 per cent growth rate of the first quarter was encouraging because it was the highest registered since the first quarter of 2012-2013, with the growth in the preceding 8 quarters averaging 4.6 per cent.

Enthused by this recovery the NDA not only attempted to take credit for that performance in a period during most of which it was not at the helm, but to claim that things would only get better. In fact the Economic Survey tabled before the first budget presented by NDA Finance Minister Arun Jaitley projected growth during 2014-15 at 5.4-5.9 per cent, as compared with 4.7 per cent in 2013-14. While the average growth rate over the first six months of 2014-15 exceeds the 2013-14 figure, it is definitely short of expectations.

What is noteworthy is that the shortfall in growth relative to budget-time projections occurred despite the fact that aggregate central expenditures were more or less on track. On the same day when the second quarter GDP figures were placed in the public domain, the government released figures that showed that expenditures during the first seven months of the fiscal year (April to October) were equal to 53.6 per cent of the expenditure provided for in the budget for the year as a whole. If expenditure had been evenly spread out over the year the figure for April to October should have been 58.5 per cent, but that is a shortfall that is not difficult to cover. However, the numbers do suggest that the budgeted level of expenditure was obviously not enough for government spending to drive growth to projected levels.

The level at which expenditure was set was the result of conscious choice. Jaitley's decision to stick to his predecessor's fiscal deficit target of 4.1 per cent of GDP had meant that he had to set expenditures at levels that were in themselves inadequate to revive growth. High average quarterly growth rates of 8.6 per cent and 8.9 per cent respectively in 2009-10 and 2010-11 were the result of enhanced post-crisis stimulus expenditures. The subsequent slowdown was clearly related to a withdrawal of the fiscal stimulus to ensure 'fiscal consolidation'.

In a development that has probably surprised the Finance Minister, the effort at limiting expenditures, while constraining growth, has not helped keep the fiscal deficit within targeted limits because revenue generation has fallen short of budgetary projections. Jaitley finds that, because revenue receipts during April to October 2014 have amounted only to 38.5 per cent of that projected for the full year in Budget 2014-15, the fiscal deficit (or the excess of expenditures over revenue receipts and non-debt capital receipts) over these months is in absolute terms as much as 89.6 per cent of that budgeted.

Thus, if the Finance Minister is serious about sticking to his 4.1 per cent target, only a spike in receipts or a sharp reduction in expenditures can get him anywhere near there. Not surprisingly he has already announced a 10 per cent cut in allocations relative to budgetary provisions for different ministries. Further, according to leaked news that is not officially confirmed, the government plans on a huge reduction in welfare expenditure in a desperate bid to meet the deficit target.

But cutting expenditures further would only worsen the growth record. To cap that reduction while meeting the fiscal deficit target the government is expected to rely on receipts from disinvestment and the sale of resources such as spectrum. The budget, for example, had provided for Rs.63,425 crore in the form of “miscellaneous capital receipts”, which was to come from disinvestment of government equity in profit-making public sector units (Rs.43,425 crore), sale of scarce public resources and the retrenchment of government equity holdings in non-government companies (together Rs.20,000 crore). As of October, receipts under this head are placed at a negligible Rs.217 crore.

So besides expenditure reduction what we can expect is an equally desperate privatisation-and-asset-sale drive over the coming months. Since the receipts from such sale are treated as “non-debt capital receipts”, they would help rein in the fiscal deficit while keeping expenditure on track to meet the budgetary projection. There is a sleight of hand involved here. Even if there are no future liabilities in the form interest and amortisation payments associated with non-debt capital receipts from disinvestment, the latter do imply a loss of a future profile of incomes. In principle they cannot be treated as a form of financing equivalent to revenue receipts and excluded from the fiscal deficit calculation.

Moreover, even an accelerated disinvestment programme can at best help meet expenditure and fiscal deficit targets simultaneously. It would not help raise expenditures, which is what is possibly needed to raise the rate of growth through government agency.

Is it then the case that the government is hoping for a free lunch in the form of higher growth without undertaking the expenditures needed for it? Partly it does, through a pick up in private investment despite the absence of the inducement for such investment that government expenditure provides. Measures aimed at removing obstacles to and disincentives for private investment in infrastructure and industry would, the government argues, revive investor sentiment. So the idea is that like the “feel good” outcome associated with having a bank account is supposed to satisfy the poor, easy environmental clearances, reduced labour protection and easier land acquisition procedures are expected to enthuse private investors (domestic and foreign) and stir up their “animal spirits”.

The government is also trying to divert attention from the adverse consequences of its conservative fiscal stance by calling for a pro-active monetary policy. Statements from the Finance Minister urging the Reserve Bank of India Governor to reduce interest rates, in the hope that it would lead to enhanced consumption and investment spending, have become routine. This has pushed RBI Governor Raghuram Rajan to the wall. Having been chosen for the job because of his conservative credentials, he has been concerned with targeting inflation and ensuring the stability of the financial system. But he is now being told that he should not overstretch his independence and accommodate the government's growth concerns.

With inflation in decline, helped in particular by the fall in energy prices, pressure on the Governor to take over the task of reviving growth has increased. But he still needs to worry about the fact that a loose and cheap money policy has resulted in a steep increase in credit from the banking system and a rise in bad or questionable assets on their books. This then is hardly a time when expanded credit should be chosen as a stimulus for growth, since it could weaken the banking system even more. Reduced interest rates also may not please foreign financial investors, whose presence in debt markets has grown significantly. So the Governor may have an undisclosed objective of avoiding foreign investor exit that may be precipitated by lowered interest rates. And, finally, there is the fact that taking these risks may not deliver the expected results, since there is little evidence that interest rate reduction, especially in small steps, can induce an investment.

Not surprisingly, despite "appeals" from the Finance Minister, the Reserve Bank of India chose to keep interest rates unchanged in its fifth bi-monthly monetary policy statement on 2 December, 2014. It has just passed the buck back to the government by stating that: "the still slow pace of reviving stalled projects, despite government efforts, warrants policy priority, even as ongoing efforts to ease stress in the financial system unlock resources for financing the envisaged investment push." It is Mr. Jaitley's turn now.

*** This article was originally published in the Frontline, Print edition: December 26, 2014.**