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NO EASY ANSWER TO ECONOMIC SLOWDOWN

Context:

- 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.
- The latest Economic Survey 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.
- Going by the Survey's analysis, there is no escape from an even sharper focus on fiscal consolidation.

Issues:

- The Budget Speech 2019-2020, did not even mention the fiscal deficit figure, 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.
- 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.

Tax - GDP Ratio:

- 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 shortfall in GST collections in 2018-19 seems to have set the clock back for fiscal consolidation.
- The major concern is balancing 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 seen as the answer to the problem of fiscal sustainability by many experts.
- 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.

Twin-balance Sheet Issue:

- 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.
- Twin balance sheet problem refers to the stress on balance sheets of banks due to non-performing assets (NPAs) or bad loans on the one hand, and heavily indebted corporate on the other.
- The Economic Survey of 2018-19 contends that reducing policy uncertainty can somehow overwhelm the drag caused by the twin balance sheet problem.
- 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 liquidity problem at NBFCs:

- 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 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.

Conclusion:

- 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.