1. Government should Explore all Avenues to Expand Capital Expenditure.

Background:

- India's GDP growth rate has came down to 5 per cent in first quarter of 2019- 20, from 8.1 per cent in fourth quarter of 2017-18.

Concerns:

- Is this downturn cyclical or structural?
- **Cyclical**
    - Any downturn that happens because of a weakening of demand is cyclical.
- **Structural**
    - If there are fundamental weaknesses in the structure of the economy, these need to be removed to sustain high growth.

Earlier Incidents of Structural Downturn:

- Successful implementation of the structural reforms in 1991 pushed India's potential growth rate to a high level.
- We have successfully tackled structural slowdown in 1991 with high growth rate and structural reforms.

Current Situation:

- What Indian economy is witnessing is a combination of the two.
- Several sectors such as automobiles and housing are facing a sharp weakening of demand.
- There has been a **significant fall in the savings and investment rate**.
- Within household savings, the proportion of savings in financial assets has sharply declined.
- Apart from these, a **significant growth-stifling factor is the weakness of the banking and non-bank finance sectors due to both cyclical and structural reasons.**
- The **saving rate** has fallen from 34.6 per cent in 2011-12 to 30.5 per cent in 2017-18.
- The **investment rate,** which is dependent on the savings rate supplemented by net capital inflows, has also fallen from 39 per cent of GDP in 2011-12 to 32.3 per cent in 2017-18.
- **This persistent downward trend of the saving and investment rates has led to a fall in India's potential growth rate to below 7 per cent.**
- Any additional fall below the potential growth rate may be due to cyclical factors.

Government and RBI Response:

- The central government and the RBI have responded with a number of policy initiatives.

1. Government

- The central government has undertaken a number of steps post the 2019-20 budget which include —
  - Withdrawal of enhanced surcharge on foreign portfolio investors,
  - A public sector bank consolidation plan,
  - Additional depreciation rates for vehicle manufacturers,
  - Additional credit support for housing finance companies and
  - Recapitalisation of public sector banks

2. Monetary authority

- The RBI has reduced the repo rate by 110 basis points since February 2019, reducing it from 6.5 per cent to 5.4 per cent.
- **Issues with Monetary policy.**
  - The monetary authorities have reduced the policy rate but banks have not followed suit due to structural problems against the background of rising non-performing assets.
  - The central banking system is equipped with efficient brakes but the accelerator is uncertain.
  - While the RBI can play a supportive role in expanding liquidity, we must understand the basic limitations.
  - Banks must also be careful while expanding credit. Inappropriate lending can land them in trouble later. Recapitalisation of public sector banks does not "infuse" fresh funds.
  - The mechanism adopted only enlarges their freedom for lending.
  - The bank consolidation plan could have been introduced at a more favourable time.

Better ways to tackle the Situation:

- In the present context of a declining investment rate and declining demand, a good solution will be to **enhance government expenditure, especially capital expenditure.**
- On the scope for increased spending, the bonanza from the RBI will go only to meet the shortfall in revenues.
- A larger disinvestment may help.

What is Capital Expenditure:

- The Union government defines capital expenditure as the money spent on the acquisition of assets like land, buildings, machinery, equipment, as well as investment in shares.

Other Fiscal-Structural impacts on Economy:

- **GST**
  - GST has changed the structure of indirect taxes, affecting the balance between goods and services, formal and informal sectors, and central and state tax revenues compared to the pre-GST period.
  - Since its implementation, the compliance cost has risen considerably for the assesses, particularly the small and medium enterprises.
  - The buoyancy of centre's indirect taxes in the post-GST period has been at low levels — 0.5 in 2017-18, 0.2 in 2018-19 and is budgeted to be 0.6 in 2019-20.
- **New Monetary Framework**
  - The decline in price level in recent years partly because of the new monetary policy framework has affected the nominal GDP growth rate and growth rate of tax revenues.
  - The implicit price deflator has fallen more than 3 percentage points compared to the average of 2012-13 to 2013-14 and 2017-18 to 2018-19.
  - The growth in central tax revenues fell by 3.5 percentage points and that in the states' own tax revenues by 4.7 percentage points during the same periods.
  - **These changes have left limited space for augmenting capital expenditure.**
  - The Centre's capital expenditure is currently languishing at 1.6 per cent of GDP.

What are the Options Ahead?

- **Counter-cyclical policy is primarily the responsibility of the Centre.**
- Given the revenue trends, it may not be in a position to increase its capital expenditure relative to GDP.
- Other available options include **bringing on board state governments for increasing their capital expenditure** relative to their respective gross state domestic products (GSDPs).
- Second, the **Centre may invest through central public sector enterprises (CPSEs)** an additional one percentage point of GDP compared to the present levels.

- Further, **through the public-private partnership (PPP) mode,** the private sector may be induced to supplement the government's investment in select projects.
- The **Amended FRBM Act has a provision for increasing the fiscal deficit by 0.5** per cent of GDP under certain circumstances. The government can make use of this provision.
- **Issue with Export**
    - The present slowdown is happening at a time when industrialised countries are themselves passing through a recession.
    - Boosting export demand in this context becomes difficult.
    - Despite the recessionary conditions in the industrialised countries, it may still be possible to pitch for a higher growth in exports.
    - Allowing the rupee to depreciate steadily may help exporters.

Way Forward:

- One redeeming feature of the current situation is that despite **floods, agricultural production may pick-up leading to a possible pick-up in Rural Demand.**
- The government should also address sector-specific problems and these need not be fiscal in nature.
- A cautious expansion in banking credit can also help.
- It is also the time to look at structural reforms in the banking sector, governance in general and fiscal reforms relating to direct taxes and GST.

Source: Indian Express