1. A Prescription for Revival

Context:

- Government is barking up the wrong tree. Instead of tackling the demand side it is dealing with the supply side of the economy.

Brief Background:

- The root cause of the **present malaise in our economy is the "death of demand".** Growth in any economy depends on the growth in demand, both for investment as well as consumer goods.
- If that demand slackens, then the **installed capacity will not be fully utilised,** fresh investment will not take place, employment will slacken and the economy will get caught in a vicious cycle, as we are experiencing today.
- The basic challenge, therefore, is to **revive demand in the economy** in a sequence where the revival takes place first in the investment goods sector, automatically followed by boost in demand for consumer goods through enhanced employment opportunities.
- This approach is followed when the government were faced with the East Asian crisis and the post-Pokhran global economic sanctions in 1998.

Policy Approach for developing country like India:

- In a developing country like India, there is no dearth of "good" demand. We still **have to provide so many goods and services to our people** in order to **improve their "quality of life".**
- Simultaneously, we have to create new infrastructure and improve the existing ones to reduce the transaction cost in our economy and make it more competitive.
- The emphasis on construction of roads of all kinds, the new telecom policy, the investment in railways, the emphasis on housing construction and development of real estate, the improvement in rural infrastructure and reform in the agricultural sector were all meant to lead to creation of demand in the economy.
- But we also sequenced the creation of demand in such a way that the demand for investment goods picked up first and faster, which created the virtuous cycle of full capacity utilisation, followed by fresh investment for new capacity creation, larger employment opportunities of various kinds — unskilled, skilled and highly skilled — which reached money into the pockets of people leading to a surge in demand for Consumer Goods.

Earlier Policy Approach:

- In the wake of the global financial crisis of 2008 government reversed the sequence, went for strengthening consumer demand first, which in the absence of sufficient supply side measures, led to inflation which in turn forced the RBI to raise interest rates 13 times, making money unaffordable and leading to a collapse of fresh investment. The fiscal deficit, especially revenue deficit, went up steeply.
- Current instance such as instead of wasting a precious amount of Rs 1, 45, 000 crore on tax relief to a limited number of corporates the government had spent that money on rural infrastructure and agriculture and a part of it on railways and highways, it would have led to the creation of demand both for investment goods as well as Consumer Goods.

Misuse of the FRBM Act:

- The basic purpose of the **act was to eliminate the revenue deficit completely within a short period of time and live with a limited fiscal deficit.**
- Revenue expenditure of the government is generally considered to be unproductive expenditure like the huge amount we pay by way of interest on past loans.
- Therefore, if you borrow money from the market to pay for revenue expenditure you will be hard put to repay that loan because that expenditure does not produce any returns.
- On the other hand, if you invest the money you have borrowed gainfully, debt servicing will not pose a problem. In other words, borrowed money should be spent as capital and not as revenue expenditure.
- The original FRBM Act, therefore, mandated that revenue deficit should be eliminated completely and rest of fiscal deficit should be limited to one per cent of GDP.
- Currently the government restricted total fiscal deficit **for this fiscal to 3.8 per cent and for next fiscal at 3.5 per cent of the GDP.** On the other, **the revenue deficit for the current fiscal is 2.4 per cent of the GDP and for the next fiscal it is 2.7 per cent.**
- In other words, minus the revenue deficit the fiscal deficit is only 1.4 per cent of GDP for this year and for the next year, it is 1.7 per se. So, the real villain of the piece is revenue deficit and not fiscal deficit.

Conclusion:

- Controlled fiscal deficit will make more money available in the market for private sector investment and help RBI in reducing interest rates — things which will have an overall benign influence on the economy.

Source: The Indian Express