

Opinion | An inclusive strategy for India to revive its economic growth

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Sudipto Mundle

Putting more money in the hands of the poor, who have a high propensity to consume, should be the aim of our fiscal policy

Topics: Economic Growth | Economic Slowdown

Abhijit Banerjee, Esther Duflo and Michael Kremer have just been awarded the 2019 economics Nobel for their work on combating poverty. Banerjee, Raghuram Rajan, and others have also underlined the seriousness of the growth slowdown in India. There could be no better time to argue the case for an inclusive strategy to revive growth.

From a peak of 8.1% in the fourth quarter of 2017-18, growth in gross domestic product (GDP) has now decelerated to a six-year low of 5% in the fiscal first quarter, with a slowdown visible across all sectors. Particularly important in this context is the compression of government expenditure. Central government revenue grew only 6% last year, more than 11% short of the budget estimate. Accordingly, expenditure growth was compressed to 6.9% last year, down from more than 11% the year before. Weak revenue growth meant devolution to states also fell short, forcing them to cut expenditure. This compression of government spending at a time when all major components of aggregate demand were already slowing has been an important driver of the sharp decline in economic growth.

We now require a macroeconomic strategy to revive aggregate demand in the short-run, while initiating structural reforms to sustain growth over the long-term. Given the grim global economic environment, reliance will have to be placed on internal sources to generate demand. The measures the government has announced are largely in response to demands of specific interest groups such as foreign portfolio investors, real estate companies, automobile companies, etc. These have mostly been piecemeal supply-side interventions, which may help these specific interest groups but won't reverse the collapse in aggregate demand.

The Reserve Bank of India (RBI) has repeatedly cut the repo rate to revive demand and has also taken other measures to ease the availability of credit. However, in real terms the policy rate is still rising and these steps have amounted to pushing on a loose string because the binding constraint on credit flow appears to lie elsewhere—in the lack of credit demand in some segments and credit exposure limits in others. With limited traction for monetary policy, the burden of growth stimulation must fall mostly on fiscal policy. Here, the unrealistic assumptions of the 2019-20 budget are quite worrying. It has been assumed that tax revenue and total revenue will grow by 25.3% and 25.6%, respectively, though they both grew by only 8.9% in 2018-19. The expenditure targets are equally unrealistic. Hence, there will be another large revenue shortfall and corresponding expenditure shock this year, further reducing growth.

Clearly, the 2019-20 budget will have to be substantially revised in the winter session of Parliament or earlier to arrest the crisis. In fact, tax policy has already been revised after the budget, with a large reduction in corporate tax rates. These are likely to have a strong positive impact on growth in the medium- to long-term. In the short-term, though, they will exacerbate the revenue shortfall, as the government itself has pointed out. In comparison, the impact of an increase in government spending would be direct and fast, especially if it puts more money in the hands of poor consumers who have a high propensity to consume. That would have a strong multiplier effect, and this should be the guiding principle for an inclusive fiscal strategy to revive growth.

However, such spending cannot be financed through more borrowing. The total public sector borrowing requirement for the Centre, states and public enterprises amounts to over 9% of GDP, while household financial savings amount to only 7% of GDP. With such severe crowding out, the deficit needs to be shrunk, not increased. So what should be done?

Extraordinary conditions call for extraordinary measures. Deep fiscal reforms could create enough fiscal space to substantially increase pro-poor spending and

revive growth while reducing the fiscal deficit; all this without raising tax rates. If this sounds too good to be true, here is the arithmetic. The revenue shortfall in 2018-19 was mainly on account of a leaky goods and services tax administration based on an incomplete electronic information system—the Goods and Services Tax Network (GSTN). Further, the 2019-20 receipts budget shows the government is foregoing revenue to the tune of 5% of GDP on account of tax concessions and exemptions, whose public benefit is unclear. Another 5% of GDP is typically spent on non-merit subsidies. Further, the Comptroller and Auditor General has estimated that savings due to excess appropriations amount to 1.5% of GDP. Fixing the GSTN on a war footing, paring down tax exemptions and rationalizing subsidies can free up fiscal space to the tune of 6-7% of GDP.

This can be used to finance an inclusive growth revival strategy with three components. First, building on the PM-Kisan programme, Maitreesh Ghatak and Karthik Muralidharan in a paper, *An Inclusive Growth Dividend: Reframing The Role Of Income Transfers In India's Anti-Poverty Strategy*, have made a compelling case for extending the ₹6,000 income support per farmer to all citizens, which would cost 1% of GDP. This income support could be increased to ₹12,000 per citizen per year, doubling the cost to 2% of GDP. This support could grow with the economy.

Second, education, health and infrastructure are all underfunded. Additional funding of 1% of GDP could be provided to each of these. Lastly, the remaining fiscal space could be used to cut the fiscal deficit.

Sudipto Mundle is a Distinguished Fellow at the National Council of Applied Economic Research