Opinion | How will the Modi government leverage its massive mandate?

Livemint Updated: 20 Jun 2019, 11:58 PM IST
Sudipto Mundle

Early indications are that it will focus on growth, employment and income support to help alleviate farmer distress

Following the National Democratic Alliance's landslide win in the general election, there has been a lot of advice from commentators and many open letters to the finance minister on what the economic priorities of the government should be. However, the interesting question is not so much about what the new Narendra Modi government ought to do, but what it is likely to do. The strong mandate enables Modi to take bold decisions on the economic front, but it has also kindled great expectations. It is both an opportunity and a challenge. This is the context which will frame the economic decisions of the new government.

In making those decisions, the government is constrained by a set of challenging external and internal conditions. Externally, global economic expansion and trade growth have both been slowing, and the risk of that downward slide being accelerated by some catastrophic global event has risen exponentially in the past few months. The US-China trade war is rapidly morphing into a bitter war over control of strategic technology. The reimposition of US sanctions against Iran and its confrontation by the US-Saudi-Israeli alliance has greatly escalated tensions in West Asia. Then there is the Brexit imbroglio.

The internal outlook is equally grim. Macroeconomic indicators, hitherto conflicting, are all now consistently reflecting a severe growth slowdown. Growth of the gross domestic product (GDP), agriculture, industry, investment and trade have all declined in real terms. Growth of private consumption remains high, but that too is beginning to slow down. Meanwhile, the Periodic Labour Force Survey results, finally released, have confirmed our worst fears about high unemployment, while severe distress seems to have become the new normal for rural India. Faced with these challenging conditions, early indications are that the government will focus on reviving growth, employment generation and income support to help alleviate farmer distress. Whether it will succeed or not will depend on the measures it takes, beyond the setting up of the high-powered policy committees.

Growth revival will depend critically on the growth of investment and exports. A necessary condition for reviving investment is lowering the cost of money. The

Monetary Policy Committee is moving the needle in the right direction, though the Taylor Rule adopted by many central banks would suggest that the repo rate should be brought down further to around 5%. But lowering the policy rate alone will not transmit to lower interest rates in a world of fiscal dominance. With the government as the largest borrower and state-run banks as the main financial intermediaries, the cost of money will not come down unless the high administered rates on government securities and the National Small Savings schemes are brought down. Furthermore, to effectively revive the credit cycle

and the investment cycle, these interest rate measures will have to be combined with sustained efforts to push the bankruptcy resolution process to clean up the non-performing loans overhang for banks, and also resolve the crisis now being faced by non-banking financial companies. This appears to be a tall order. Regarding exports, there are encouraging reports that Indian producers are finally gaining entry to global supply chains from which they were hitherto excluded. To reinforce this trend, the discretionary tampering with tariff rates in recent years, which destroyed the gains of a quarter century of trade reforms, will have to be reversed, along with an active exchange rate policy to prevent an appreciation of the real effective exchange rate. These economic policy measures will have to be backed by visible improvements in our logistics and communications to level the playing field for Indian exporters. Again, a tall order.
It will be evident from the foregoing that the revival of investment or export-led growth is not going to happen anytime soon. Meanwhile, the government has to deal with the immediate challenges of unemployment and rural distress. Modi's comfort zone is projects and schemes, not abstract policy. So a large boost to public investment in employment-intensive rural infrastructure, especially rural roads, minor irrigation, rural housing, etc., should be high on the government's agenda. But these, too, will bear fruit only in the medium term. To provide immediate relief for rural distress, income support programmes are unavoidable. But in the design of these programmes, the government needs to be mindful that income support linked to ownership of land will exclude tenant farmers and agricultural labourers who are the most distressed.

It is important to recognize that these short-term relief measures are just that and not substitutes for structural reforms necessary to revive productive employment growth over the medium to long term. But even these relief measures and a

boost to public investment in infrastructure will have a large fiscal cost. Where is the fiscal space to meet that cost? In 2018-19, the government compressed its expenditure growth to 9.2%, down from 15% the previous year, to meet its fiscal deficit target. It cannot do the same again if it is to meet its emerging priorities. But together with state governments, most led by the Bharatiya Janata Party, it can restructure public expenditure to cut back at least a part of the non-merit subsidies that add up to around 5.7% of GDP (Modifying The Nyuntam Aay Yojana To Make It Workable, 19 April 2019, Mint). Tax concessions and exemptions that add up to another 5% of GDP can also be pared. The question is whether Modi will use his massive mandate to enforce such fiscal discipline.

Sudipto Mundle is a distinguished fellow at the National Council of Applied Economic Research