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India survey lacks a policy compass

By Kunal Kumar Kundu

NEW DELHI - India released its latest (for year 2012-13) Economic Survey on Tuesday and for the first time under the stewardship of the new Chief Economic Advisor Dr Raghuram Rajan, a former Chief Economist of the International Monetary Fund.

True to its newly evolved status of being a pragmatic report, this survey indeed makes some right prognosis and prescribes appropriate strategies, though at times puts the blame on the wrong actors and makes some forecasts which appear quite optimistic.

Before going into the details though, here are some highlights:

- India's GDP growth for the current financial year 2012-13 is expected to be similar to what the Central Statistics Office (CSO) has projected - ie 5% and for the next year rising to 6.1-6.7%.
- The priority is to rein in inflation, with the March 2013 figure expected to be between 6.2-6.6%. The main reason for high inflation is the existence of supply-side bottlenecks and high food inflation.
- A focus is on harnessing the potential demographic dividend by moving people out of the least productive agriculture sector into manufacturing jobs. The survey also expresses concern about the high incidence of informal employment, which not only constraints GDP growth due to significantly low productivity (as compared to the formal sector) but also leads to significantly lower revenue generation.
- India's fiscal deficit target for 5.3% of GDP for 2012-13 will likely be met despite "significant" shortfall in revenues and the path of fiscal consolidation, as was proposed by the Finance Minister earlier (envisaging a fiscal deficit of 3% of GDP by 2016-17 will likely be met
- Direct cash transfers based on the Unique Identification Number (UID) scheme can help plug leakages in subsidies.
- Widening of the tax base (raising the tax-to-GDP ratio of the central government to 11%) and prioritizing expenditure is critical for sustaining fiscal consolidation.
- On the current account front, the focus should be on curbing imports (including gold import), making oil prices more market-determined so as to be able to rein in the current account deficit.
- Given the global economic conditions, the survey sees little room to increase exports in the short run.
- Foreign Institutional Investors (FIIs) flows need to be targeted towards long-term rupee instruments while restrictions on FDI in several sectors including legal and accountancy services should be removed.

The economic survey expresses concern about rising twin deficits (the fiscal deficit and current account deficit), supply side bottlenecks impacting inflation, falling savings and stalled investments. Also, Rajan seems to be reconciled to the fact that GDP growth for the current year will be 5% (as per the advance CSO estimate) and not 5.5%, which is what he was publicly expecting while contradicting the CSO's estimate. The central theme of the report is that while the worst for the economy may yet be over, there's still uncertainty ahead and the focus should be on improving savings and reviving investment – each of which call for renewed focus on reforms.

The survey correctly points out the need to widen the tax base, as both increasing revenue and containing wasteful expenditure should form the basis for fiscal consolidation and not just a single-minded focus on curbing expenditure, which quite often leads to the compression of capital expenditure.

However, we are none the wiser for the survey, despite some brilliant analysis. To begin with, the survey puts a fairly large dosage of blame for poor economic performance on the external economic environment and tight monetary policy stance rather than faulting the government on its inappropriate policy decisions. The survey does express concern about fertilizer and oil subsidies but ignores other wasteful public expenditure. Even food subsidy is made to appear as a holy cow, given that the government is clearly committed toward introducing the food subsidy bill next year.

On the other hand, the survey appears fairly optimistic (rather toeing the government line) on certain expectations without any specifics about how to achieve those. It's worth pointing out a few:

Diesel prices: The survey rightly talks about mispricing of oil, especially diesel which leads to increased consumption of the motor fuel, part of which is wasteful since inefficient pricing discourages move towards efficient usage. However, the expected diesel price increase will be too gradual to make any dent in the near future and that too is dependent on whether the government can actually garner enough courage to allow that to happen as the next election nears. And, even if that happens, it alone is not going to reduce oil consumption as long as India's energy intensity does not fall significantly or domestic production increases, again significantly.

As per the BP Statistical Review of World Energy 2012, India's oil consumption has gone up by nearly 36% between 2005 and 2011. And, despite being one of the largest importers of oil, we have a bizarre situation of Cairn India waiting for more than 18 months to get a government clearance to double its output in Rajasthan.

Demographic dividend: While the survey does a great job of focusing on issues regarding demographic dividend and the need to create more jobs, there's no plain speaking about how to harness the dividend and what should the government relentlessly focus on to ensure that the needful is done.

Growth drivers: The survey talks about GDP growth rising from 5% during the current year to somewhere between 6.1-6.6% in the next year. However, no specific growth driver have been put forth except for some expectation of fortuitous development i.e. normal monsoon and improved global growth scenario. While the weather God might yet smile on India (surely we don't expect to control nature), global growth may actually surprise on the downside.

Even the expectation of falling inflation may backfire given that one has deal with several headwinds like the increasing diesel price, hikes in freight rates as suggested in the recently released railway budget, a probable increase in the minimum support price (MSP) to ensure the adequate procurement of food grains which is vital for the success of food security bill. However, only if domestic demand continues to remain weak will these factors fail to drive up prices, keeping a check on inflation. But that in itself will mean lower growth.

Fiscal deficit: With the second round of the 2G cellphone auction failing miserably and revenue generation likely to fall short of target given weak economic growth, even an austere government is unlikely to meet the fiscal deficit target of 5.3% of GDP.

Investment: While the survey talks of reviving investment especially of the private nature since the fiscally challenged government will not be able to do much, specific are missing as to how the investment cycle can be revived. The fact is, it is not just that foreign investors are shunning India (as is reflected in abysmal FDI data), even the Indians seem to be more confident about investing abroad than in their own country.

To conclude, the economic survey, while emphasizing on broader themes does not give an indication that the government has specific plans to pull the economy out of the rut. Rather it is hoped that the government would be able to pull some rabbit out of the hat (given the political compulsion of a forthcoming election) to achieve the desired growth, inflation and employment numbers.

***Kunal Kumar Kundu**, a New Delhi-based economist*