RECOVERING ECONOMY

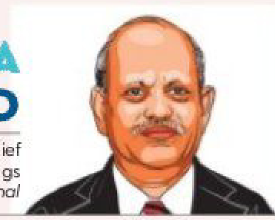
THE ECONOMY SEEMS TO HAVE BOTTOMED OUT, AND BARRING FURTHER DISRUPTIONS, IT SHOULD SHOW A GRADUAL ACCELERATION

India's economy on the mend?

M GOVINDA RAO

Emeritus professor, NIPFP, and chief economic adviser, Brickwork Ratings

Views are personal



THE FINANCE MINISTER'S unveiling of the ₹9 trillion economy-booster plan, involving the ₹2.11 trillion recapitalisation of public sector banks and the ₹7 trillion investments in roads and highways, has not come a day sooner. With mounting criticisms over the slowing down of the economy, in part due to the adverse effects of the demonetisation and glitches in the implementation of GST, it was necessary for the government to focus on the ways to rejuvenate the investment climate. The bank recapitalisation announcement has buoyed markets and PSB scrips have seem sharp increases even as the details of the scheme are yet to be unveiled and full implications of the plan are yet to be understood.

By all accounts, the economy seems to have bottomed out and barring further disruptions, it should show a gradual acceleration. The effects of demonetisation have been devastating on some sectors, and some of the units in the informal sectors could not withstand the disruption and face a permanent closure. The ones which could withstand the onslaught have shown a gradual recovery, but the disruptions caused by the badly-structured and poorly-implemented GST have hit them again. While the flexibility shown by the GST Council in addressing the problems has helped to some extent, the environment for small and medium enterprises has been vitiated. It is very well known that a major tax reform like the introduction of GST would have glitches and would take time to settle down and therefore, the government should have used all the time it had until end-September to dry run the technology platform to smoothen the transition process.

Thankfully, the GST Council has shown remarkable flexibility in correcting some of the problems. While the significant change in the structure—in terms of reducing the number of rates and inclusion of alcohol and, more importantly, real estate and petroleum products—can only be a medium-term goal and much will depend on the revenue productivity. Changes in the operational details and compliance requirements should help to reduce the compliance burden. There is no point in complaining that the taxpayers file the returns only on the last day because the last day is also within the prescribed deadline. It is not the mistake of the taxpayer that the system is not robust enough to deal with that. The Council has done well to respond to the demands in rationalising the rates, enhance the limit for availing the composition scheme and reduce the frequency of filing the returns every quarter instead of monthly. There has been repeated postponement of the deadline for filing returns and hopefully, the glitches will be addressed soon. It is also impractical to cross-verify and match zillions of invoices for self-populating GSTR 2 for availing the input tax credit. Hopefully, with the Council responding to the problems in a positive manner, the new tax regime will settle down over time to reduce the uncertainty element. At the same time, it would be too optimistic to think that there will be substantial revenue gains from the tax in the first year itself. The self-policing aspect has been too much exaggerated for in a predominantly informal economy, the unscrupulous businessmen can move the entire chain of transactions. There can also be disaffection by people for the tax as many compounding dealers may actually charge the consumers the tax at regular rates.

There are indicators that the economy is on the path of recovery. The core sector in October has registered the growth of 5.2% which is the highest in the last six months on the strength of coal, natural gas, refinery products and electricity. The Nikkei Services PMI for October, at 51.7, is a steady improvement over 50.7 in September and 45.5 in August. The corporate results for the second half of the year also show a distinctly better performance. With reasonably satisfactory monsoon, agriculture too may show improved performance There is also the base effect as the economy had substantially decelerated in the last two quarters in the previous year.

In this situation, the decision to recapitalise of public sector banks by ₹2.11 lakh crore over the next two years is timely. In addition to the budget allocation of ₹18,000 crore, the sale of equity by the banks is supposed to yield ₹58,000 crore and the remaining ₹1.35 lakh crore will be raised by the government issuing bonds. The total amount of capital required by the public sector banks is about ₹65 billion and this order of recapitalisation should meet about a half of the requirements to meet the Basel III norms. The details of the package are yet to be unfolded, but the announcement itself has set the shares of the public sector banks soaring. While this is a much needed shot in the arm, it is important to note that there is a moral hazard in these bailouts, and it is important to reform the banking system to enhance their capacity to evaluate loans, eliminate politicisation in decisions and improve the governance in the banks to ensure accountability. The recapitalisation plan will increase government ownership in the banks which has potential dangers and therefore, it should come out with a clear plan to dilute its majority ownership. It is also important to develop the corporate debt market to enable the infrastructure companies to access long term loans.

> **The recapitalisation plan will increase government ownership in the banks which has potential dangers and therefore, it should come out with a clear plan to dilute its majority ownership**

While recapitalisation is likely to free the banks from the shackles of bad debt and propel them to lend, corporate credit may still not take off unless the balance sheets of the corporates show an improvement. This will depend on how soon and effectively the National Company Law Tribunal (NCLT) resolves the cases referred to it. This undoubtedly is going to be a long drawn out and painful process, but is a necessary scavenging operation. Unless this is gone through, the demand for loans will not pick up even as the banks may be willing to lend. Surely, miracles cannot be expected and the country will have to go through atonement for the past sins.

On the whole, it seems the economy has braved the disruptions and is on the mend. There will be growth acceleration and the speed will depend upon how fast and effectively the twin balance sheet crisis is resolved. The initiatives are in the right direction for the current fiscal even though RBI's revised forecast of GDP growth of 6.7% looks too optimistic. The RBI estimate of accelerated growth for the remaining three quarters at 6.4%, 7.1% and 7.7%, respectively, requires a V-shaped growth trajectory which is unlikely. In fact, the quarterly estimates of GDP do not incorporate the impact of the disruptions fully, and that will be known only when annual estimate is available. The more realistic guess would be that the economy is likely to register the growth rate of 6-6.5% during this year. Anything better than that is a bonus.