View: The economic battle, now that the political one's won

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We have a new government and renewed political space to address urgent short and medium-term economic challenges. I offer an aide-memoire specifying these.

With health and education, the central and state governments need to work together to deliver a viable business model so these important public goods are delivered at affordable unit cost and acceptable quality.

IN THE SHORT TERM

The present monetary policy framework is due to be revised in March 2021. While inflation has stayed within the mandated range, we need to consider whether this range is consistent with growth objectives, at what cost the inflation target is secured, and whether it has caused monetary dominance.

In a context where the magnitude and quality of GoI's fiscal deficit constrains its fiscal space, monetary dominance can make it difficult for the government to adhere to its fiscal targets, which, in turn, constrains private sector credit availability. These issues should inform the design of the next monetary policy framework.

The central government has been shrinking in size (share of GDP). This needs to be recognised. To improve productivity and predictability of public expenditure, immediately introduce a medium-term fiscal framework to replace annual budgeting as the operational instrument for the execution of fiscal policy.

This requires GoI to specify a medium-term expenditure ceiling assuming no significant increase in revenue-GDP ratios over the medium term. This would be the baseline to maintain fiscal prudence, such that expenditures only increase when there is more revenue.

The government should also commission a review of three important areas of central expenditure: defence, internal security and railways, and specify resource envelopes for these over the next nine years.

The operation of credit policy is currently unsatisfactory, and ultimately the exchequer bears the consequences. A major reason for this is that the trade-off between the prudential and other objectives of credit policy has not been clearly specified.

To fix this, GoI, in consultation with RBI and other stakeholders, should first specify the volume of reserves RBI should hold for prudential reasons. Second, assign responsibility for the financial burden arising from any regulatory failure between RBI and the government. Third, draft a clear policy that specifies the purpose, cost and time frame of directed credit.

These concrete short-term measures to improve the overall functioning of the macroeconomy are India-specific, and require policy actions that go beyond simply executing generic 'counter-cyclical' expansionary or contractionary measures.

MEDIUM-TERM ACTIONS TO ADDRESS STRUCTURAL CONSTRAINTS

The major structural weakness that India faces is that, so far, growth is spurred by catering to the consumption of the top 15% of the population. Hence, the leading indicators of the economy so beloved to Mumbai are about sales of automobiles, two wheelers, air-conditioners, fast-moving consumer goods, etc.

The goods consumed by all 1.2 billion Indians — nutritious food, affordable clothing, affordable housing and affordable health and education — do not figure. These areas of economic activity, that touch the lives of every Indian, are the indicators of economic progress on which GoI should focus.

An important beginning has been made with the shift in emphasis to doubling farmers' income, as opposed to maximising agricultural output, and with the emphasis on affordable housing.

The task before GoI and the private sector is now to deliver a business model such that both agriculture and affordable housing provide opportunities for those in these businesses to earn at least 15% return, while those earning twice the minimum wage are able to meet the demand for these items without subsidy. (The rest can be subsidised if it is affordable.)

In the case of clothing, there is a huge opportunity to undertake import substitution by locating these industries in the north and east of India where wages are competitive with Bangladesh and Vietnam.

With health and education, the central and state governments need to work together to deliver a viable business model so these important public goods are delivered at affordable unit cost and acceptable quality.

It is also important to recognise that quality economic growth has bypassed northern and eastern India. They have only benefited from remittance income from migration to the south and west.

Some of this has occurred due to new economic opportunities in IT, manufacturing, diamond cutting, etc, but most of these migrants are in low paid, insecure service jobs. It is vital that this imbalance be addressed, as it is the major economic challenge to India's integrity.

The five sectors I mentioned above can deliver such jobs without waiting for a huge increase in existing capabilities in the poorer regions of the country where the majority live.

India's medium-term growth path would now be based on meeting home market demand in these five sectors of importance to all Indians, the spearhead of economic growth. Investments would be judged on how effective they are in securing this objective.

Thus, a programme of import substitution to revive the affordable textile industry would involve fostering units in low-wage areas of northern and eastern India, rather than high wage islands close to the metropolitan regions.

Production of intermediate goods for affordable housing would involve setting up production units that are dispersed to minimise logistic costs; this would mean that employment is created closer to where the unemployed live, rather than involving migration to concentrated urban hubs.

Addressing these questions at the macro level, and assessing their positive impact on growth and employment, would be the principal economic policy task going forward.

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