

AN EXPERT EXPLAINS: N R BHANUMURTHY

Why lower fiscal deficit isn't always good news

THE RE IS growing concern about the slowdown in India's economic growth. Last week, RBI, the country's central bank, cut repo rates by 35 basis points — the sharpest cut in nine years. UDDIT MISRA talked to N R BHANUMURTHY, Professor at National Institute of Public Finance and Policy, to understand what is causing the slowdown and what policy measures are needed.

What is the nature of India's economic slowdown? Is it cyclical or structural?

In any macro time series, there are two components. One is the structural or the permanent component, which is largely determined in the long term by factors such as institutions, productivity, human capital etc., and the second is a cyclical or the temporary component which refers to short-term fluctuations. You have to separate the two and see how they are behaving as well as how it is ex-

pected to move in future. If you can do this, then the prescriptions required to address them would be very clear and different.

My assessment is that in India at present both the components seem to be in a slowdown phase and the projection is that it will slow down further.

Which are the key issues that bother you most on the structural and cyclical aspects in India's slowdown?

Unfortunately, the realisation that the economy is slowing down has come late. Many of us have written that the slowdown started much earlier. The second issue is, when the slowdown is real, we should've gone for a countercyclical measure, at least to address the short-term fluctuation. But by not accepting the slowdown, the fiscal policy followed was pro-cyclical, which has only accentuated the problem.

You have two major policy instruments, one is the fiscal policy, and the other is monetary (interest rate) policy. In a cyclical downturn, it is the fiscal policy that should have been ahead, followed by the monetary policy.

What we have done is the opposite — to such an extent that monetary policy appears to be fighting a lonely battle. I think that sequencing, as well as the response to the slowdown by the fiscal policy, is a serious cause for concern.

What would be your policy prescription to increase economic growth?

The first thing is to increase household savings. Given the declining deposit rates, the banking system is actually recovering its losses at the cost of household savings. The government could have come up with savings instruments (such as infrastructure bonds). In sum, the present macro policies could lead to double whammy — fall in household savings and

increase in household leverage.

Second, we need to correct a structural policy misstep introduced by Finance Bill of 2018 that did away with targeting revenue deficit and compromised on the public capital expenditure. This was the beginning of growth slowdown as well as deterioration of the fiscal situation. Many are happy that the fiscal deficit is coming down, but we don't understand that it squeezes the economy further when there is a cyclical slowdown. It was explained several times that the FRBM Act is not an expenditure compression mechanism; it is an expenditure switching mechanism. I hope that the 15th Finance Commission can correct this mistake. But the low hanging fruit is to quickly recapitalisation of public sector banks (PSBs). There could be resistance for this, because PSBs are considered inefficient, but unlike private banks, public sector banks have large social obligations.

