Coherent set of immediate actions

The government must announce a calendar for implementation of Friday's measures

RATHIN ROY

I have been concerned about some macro-solutions proposed to address the slowdown. Calls for fiscal stimulus are misplaced and would, without much sustained benefit, jeopardise the hard-earned macroeconomic stability attained since 2014. Monetary and credit policy transmission needs fixing, not further rate cuts. Using speculative foreign money for sovereign spending would raise risk without ameliorating the credit and liquidity situation.

At the present moment, the need is for the government to respond to an immediate and exigent situation in which, (1) there are problems of sentiment; 2) the credit pipeline to NBFCs and the banking system is choked; 3) a few low-revenue generating tax measures are negatively impacting public sentiment; 4) the automobile industry which, for better or worse, is a "leading indicator" of economic performance, is being hurt by the misinterpretation of announcements intended to bring the sector in line with environmental best practice; and 5) the most important, structural demand deficiency needs to be addressed.

The package of measures announced by the Finance Minister on Friday has addressed all these concerns. It is a responsive, practical, presentation of a coherent set of immediate actions to ameliorate the structural slowdown without pointlessly expending fiscal firepower or throwing taxpayers' money at special interest pleading.

The taxation measures are concrete and will take effect either immediately or from October 1, 2019. They withdraw contentious but low-revenue generating taxes and allay fears on corporate social responsibility violations. The upfront release of the budgetary allocation of ₹70,000 crore for bank recapitalisation executes the concomitant 2019-20 Budget commitment.

The institutional signal that rate cuts will be passed on to many borrowers in full measure, is necessary and welcome. But there are policy and operational issues that need to be addressed. For example, State Bank of India's current repo linked portfolio covers only 22 per cent of its deposits and 30 per cent of its loans. Banks' credit growth is currently faster than their deposit growth, so cutting deposit rates is not an option to improve transmission; but the bad loan problem still looms large. Banks will, therefore, continue to try and maintain margins, despite moral suasion.

Hence, effective implementation will not happen unless the actions of the government and the Reserve Bank of India are harmonised. There needs to be a joint road map that clarifies which rate (base rate, MCLR or Repo rate) will be linked to which product, and how the overall product portfolio will increasingly link to movements in rates without jeopardising the sustainability of the banking system. But this should not take more than three months to clarify if the authorities work together with this common purpose. There is enough analytical expertise available to them from previous efforts which can be efficiently utilised.

The additional liquidity support to housing finance corporations is also welcome. If there is a case for spending public money, it is most justifiable in the case of affordable housing without subsidy. The National Housing Bank's capitalisation could be further increased and its operational capacity, which is stretched to the limit, significantly bolstered. This, and measures to improve and stabilise rural incomes, would be my ask from the next two tranches of announcements that the Finance Minister is to make. Also, ground feedback from housing finance companies is that the partial credit guarantee scheme is subject to severe delays in processing. Urgent and demonstrable action on this front would be very effective in ameliorating the slowdown.

The measures announced to deepen the bond markets are most welcome. As the Finance Minister said, in the absence of a development banking system, it is desirable that fixed/long-term capital is sourced from debt and equity finance, not bank finance. The measures announced, including those that enable Indian companies to access global financial markets are sound, and will have an immediate impact if implemented properly, as are actions to bring the off-shore rupee market to India (though further reforms will be necessary to achieve results). And it needs to be recognised that issuing sovereign bonds in foreign markets directly contradicts this policy action.

The automobile sector problems have been skilfully addressed. Fears that current inventories would be stranded assets due to BS-VI vehicle norms or an immediate expansion in, and preferential treatment to, electric vehicles (which today means importing them from China) have been put to rest.

There is no timetable specified to implement many of the measures proposed. Administrative delays and hiccups in implementation have typically been the bane of good policy proposals in India. It is critical that the government announces a calendar for implementation of these measures, since their positive impact on the slowdown is crucially dependent on the speed and effectiveness of implementation. In particular, the inter-ministerial task force on infrastructure project pipelines needs to proceed to closure much faster than has historically been the case. The Department of Expenditure needs a concrete timeline to reduce payment delays and needs to be empowered by, and accountable to, the Finance Minister rather than the Cabinet Secretariat. Errant line departments must get a clear political, not bureaucratic, signal that turf wars and excuses that cause payment delays to persist will not be countenanced.

I recognise that this package will not be sufficient to address the structural problems that I have been highlighting, but these actions are a prior necessity to execute structural corrections. It is now up to the private sector to respond positively so that we can, collectively, focus on medium-term structural corrections.

The author is director of National Institute of Public Finance and Policy