

More strategic thinking needed

Budget has a large number of measures, but they are useful in the small



THE BIG PICTURE

AJAY SHAH

Trend growth has been low in 2011-2020. In addition, business cycle conditions are weak. The Budget speech has done well to avoid the calls for a large fiscal expansion in propping up gross domestic product (GDP) growth. Turning around economic conditions requires greater strategic thinking about the relationship between the state and the individual, and addressing the unease of private persons that has manifested itself in private investment. Many measures are visible in the Budget speech, many of which will help in the small, but reviving growth requires something else.

Trend growth in India dropped around 2011. In addition, we are right now in a business cycle downturn. There have been many cries of pain from the economy, asking the government to rapidly change these two things. Some people have advocated vigorous fiscal and monetary policy responses. It is important to emphasise that we already have a large fiscal deficit — of maybe 5.5 per cent of GDP. To impart a stimulus, this would have to go up further. For example, if it went to 7.5 per cent of GDP, this would constitute a stimulus of 2 per cent of GDP.

These tools of macro policy have limited potency under Indian conditions. They can only influence business cycle conditions; they cannot change trend growth. And, fiscal policy is already at fairly large values of the deficit, and enlarging this further would raise concerns about fiscal solvency. I was thus happy to see that the Budget speech does not promise to enlarge the fiscal deficit.



ILLUSTRATION BY BINAY SINHA

How do we get back to higher trend growth? The heart of the problem lies in private corporate investment. Most of the growth in jobs and GDP comes from private firms; GDP and job growth are higher when private persons commit financial capital into business. We got high growth in 1991-2011 because the private sector felt safe in investing in building businesses. In the years leading up to 2011, the private sector has been disenchanted.

Changing this calls for a strategic view of the relationship between the state and the individual, refocusing the state upon addressing market failure, and building a rule of law environment through which private persons will feel safe. The Budget speech has a large number of measures. Many of these measures are useful, in the small. They do not, however, add up to a strategy, and the speech made no attempt at showing a strategic picture, e.g. as was done in July 1991 and in some other Budget speeches.

Economic policy involves many individuals and many steps. If every decision is made based on what is expedient, and viewed in isolation, then there is a lack of coherence between multiple arms of government, multiple individuals in government and multiple actions taken across time. This is why there is a

need for an economic policy strategy, a consistent philosophy that influences and shapes myriad small actions by the government and shapes the expectations of private persons about how government will behave in the future. While many alternatives in communication are available, the Budget speech is a good place in which this overall picture can be articulated and communicated.

To take one small example, the Budget speech is correct in observing that there has been a remarkable flight in activity in the biggest two Indian financial products — Nifty and the rupee — away from India. The speech is correct in aspiring that this activity should be brought back to India. But policymakers have not undertaken the required root cause analysis.

Why do private persons prefer to organise their business activities so that Nifty and rupee trading is done outside India? Because the Indian state has concepts and operations in financial regulation, taxation and capital controls that impose a remarkable burden of cost and policy/regulatory risk upon private persons. In order to change this, we need to undertake foundational work in changing financial regulation, taxation and capital controls in India. Permitting these products to be traded in GIFT, as stated in

the Budget speech, is not a solution.

Similarly, consider the problem of trade barriers. The Budget simultaneously increases trade barriers on some products and cuts them on others. There is a lack of strategic thinking, that trade barriers are bad for productivity and expert performance by India. The big thinking on trade policy is neither shown at a strategic level nor is it put into action with consistent removal of trade barriers in numerous areas.

For a contrast, I remember in the early 2000s, when Vijay Kelkar and Rakesh Mohan rallied the Ministry of Finance around the slogan “Every time we cut tariffs, our exports go up”. That phase of tariff reductions set the stage for the great export boom from 2003 onwards.

In this electronic age, there is a very large audience for the Budget speech. The authors of the speech inevitably need to balance the needs of a political statement versus an economic policy statement. While the need to put out a purely political message cannot be discounted, it appears that there are ways to achieve this while simultaneously articulating and executing a sound economic strategy.

The eyeballs of this electronic age cut both ways. Private persons in India and abroad are also riding the electronic revolution, and are more exposed to the text of the Budget speech than ever before. In terms of visual spectacle, the standards are now higher: we have to now match the quality of an Obama speech. It is useful to visualise how a private person in India or abroad, who has pulled back from investing in India after 2011, would respond to the text of this Budget speech. Does this person feel that the supertanker of Indian economic policy cares about her angst, has now understood the sources of failure, and has a strategy to address this? Perhaps the Budget speech could better be organised as 4,000 words of a political message and 4,000 words of an economic strategy message to private persons in India and abroad.

The writer is a professor at National Institute of Public Finance and Policy, New Delhi; ajayshah@mayin.org