View: Arrested development or attention deficit?

By Chaitanya Kalbag, ET Bureau · Last Updated: Jul 25, 2019, 06:22:00 AM IST

Synopsis
Government's economic policies will combine strident welfarism with tough love for businesses and markets.

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The good news is that everybody – the International Monetary Fund was the latest to fall in line on Tuesday – agrees with the Reserve Bank of India (RBI) that India's gross domestic product (GDP) growth rate will be a modest 7% in 2019-20. The 0.3 percentage point reduction in its forecast is because of "a weaker-than-expected outlook for domestic demand", the IMF said.

The bad news is that nobody I have spoken with is happy about the economy. There is no euphoric surge in sentiment. The market capitalization on the Bombay Stock Exchange has fallen by over Rs 7 tn since Finance Minister Nirmala Sitharaman presented the budget on July 5. Foreign portfolio investors, upset by her 'super-rich' income-tax surcharge, have pulled out over $1 billion so far this month.

Two weeks ago, former Chief Economic Adviser Arvind Subramanian put out his second paper questioning India's growth estimates for the period 2012-13 to 2016-2017 (which covers the final two years of the UPA government and the first three years of the NDA government) after the January 2015 revision of the base year for GDP calculations to 2011-12.

In his paper, Subramanian says he and his team found inconsistencies between GDP data and other macro-indicators, as well as a puzzling divergence between the weak index of industrial production (IIP) and manufacturing-sector growth. “As we continued to investigate the matter, the puzzle only deepened. In 2015-16 and 2016-17, India recorded an exceptionally high GDP growth of 7.5 percent together with weak growth in key indicators, such as credit, exports, and investment. Accordingly, in July 2017, Volume 2 of the Economic Survey devoted a section (Appendix 2) that asked whether any other countries had achieved such high growth with such weak indicators in the post-1991 period. It found that no other countries had done so.”

During the 2002-2011 period, India grew at an average 7.5%, on the back of strong investment growth (13%) and export growth (15%). But between 20111 and 2016, India's economy was hit by a series of shocks. Export growth collapsed to an average 3%. The Twin Balance Sheet crisis struck both stressed companies that had recklessly borrowed for albatross infrastructure projects and banks that were piling up non-performing loans. Credit to industry grew at a paltry 1%. The final two UPA years were mangled by corruption and policy paralysis. Droughts hit agricultural output and consumption in 2014 and 2015. And in 2016, demonetization pulverized the informal and small-scale economy.

Despite these shocks, the revised data said GDP slipped only slightly from 7.7% to 6.9%.

Subramanian's first paper, published in June, was fiercely attacked by critics. The Economic Advisory Council to the Prime Minister published a scathing rebuttal saying India's GDP methodology was robust and in line with advanced countries. Subramanian had followed 'simplistic econometric techniques'. "The author, in the capacity of Chief Economic Adviser in the Ministry of Finance, has presided over the army of government economists and statisticians, and is aware of the enormous magnitude and complexity of the exercise to compute GDP of the continent-size highly diverse emerging economy of India," the EAC said.

Yet, just two weeks before the 2019 election results, one of the economists who wrote that critique, National Institute of Public Finance and Policy director Rathin Roy, painted an alarming picture of India slipping into a middle-income trap, like Brazil or South Africa, "with large numbers of people in poverty (and) rising crime ... It's not panic stations yet; we have five to ten years ... but there is urgency."

Subramanian's questions come at an awkward point for the Modi government: it is about to revise the GDP base year again to 2017-18. At the end of August, it will publish GDP data for the April-June quarter, after the previous quarter's dismal 5.8%. And the National Sample Survey Office is about to publish its 75th survey results on consumption expenditure across India, a crucial measure of poverty in the country.

This is not to say that pro-poor policies have not paid dividends: the United Nations Development Program said earlier this month that India lifted 271 million people out of poverty in the decade from 2005.

Still, some policymakers are jumpy when side-swiped by the slowdown. For instance, RBI Governor Shaktikanta Das has told public-sector banks he is unhappy they are not passing on the central bank's interest-rate cuts to businesses and consumers. As the crisis in the non-banking financial companies deepens, with DHFL about to go belly-up, Das is also irritated at the rising defaults by small borrowers under the MUDRA scheme – this at a time when a committee has recommended doubling the limit of non-collateralised loans to Rs 20 lakh.

Does all this really matter? There is little doubt that this government intends to use its unprecedented mandate to push economic policies that will combine strident welfarism with what can only be described as tough love for groaning businesses and heaving markets.

Sitharaman told the Rajya Sabha on Tuesday that the Modi government aims to bring in "such changes for a New India wherein there is a greater transparency ... and making sure that the redistribution of collective resources happens with an equity principle in mind. So if you were to raise more taxes, more collection is only going to result in more redistribution of funds, thereby bringing in a far more equitable development." We have been warned.