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Economic survey 2020-21: Forget rating agencies, spend without fear

Government spending becomes imperative at the time of excessive risk aversion in the private sector

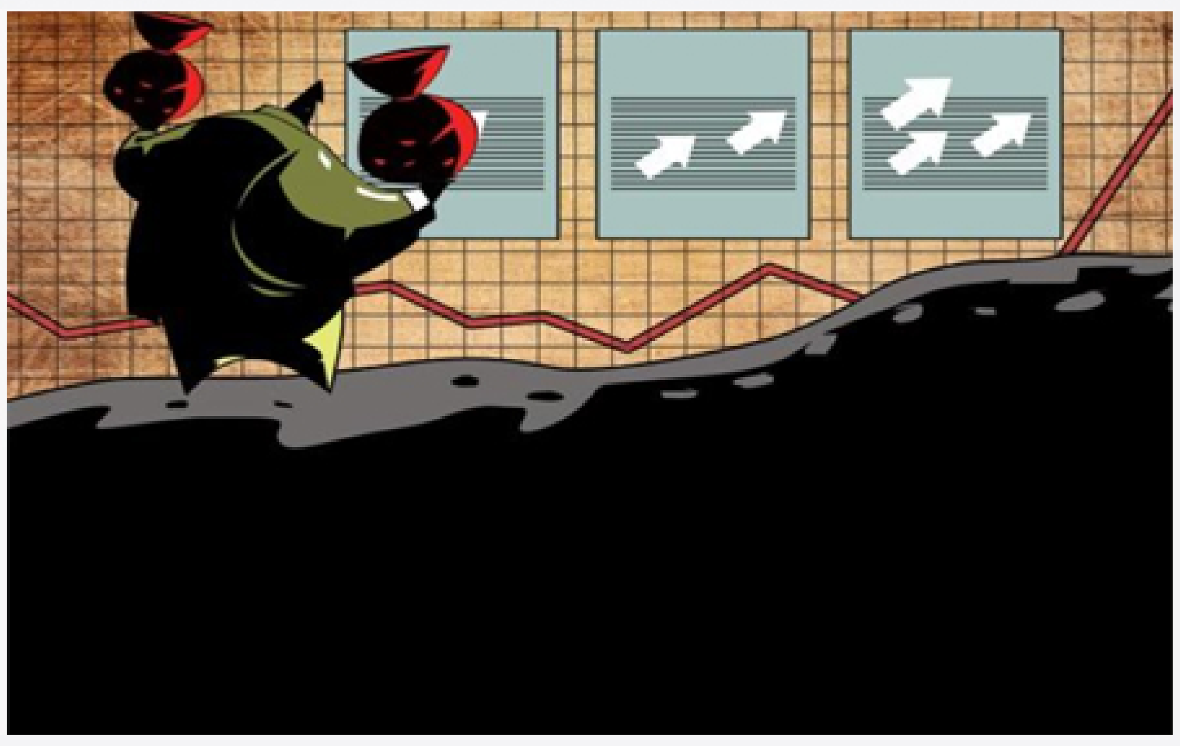


Illustration: Binay Sinha

The Economic Survey endorsed continuation of the expansionary fiscal policy to sustain recovery in demand as the economy comes out of the pandemic shock.

Coming down heavily on global rating agencies, it suggested that India's fiscal policy should not be restrained by 'biased and subjective' ratings and should focus on growth and development. To drive home the point, the Survey quoted Rabindranath Tagore's famous lines "where the mind is without fear".

In the April-December period, the fiscal deficit widened to 145 per cent of the Budget Estimate for FY21. Economists estimate the fiscal deficit to widen to somewhere between 7 per cent and 9 per cent of GDP, against the government's target of 3.5 per cent.

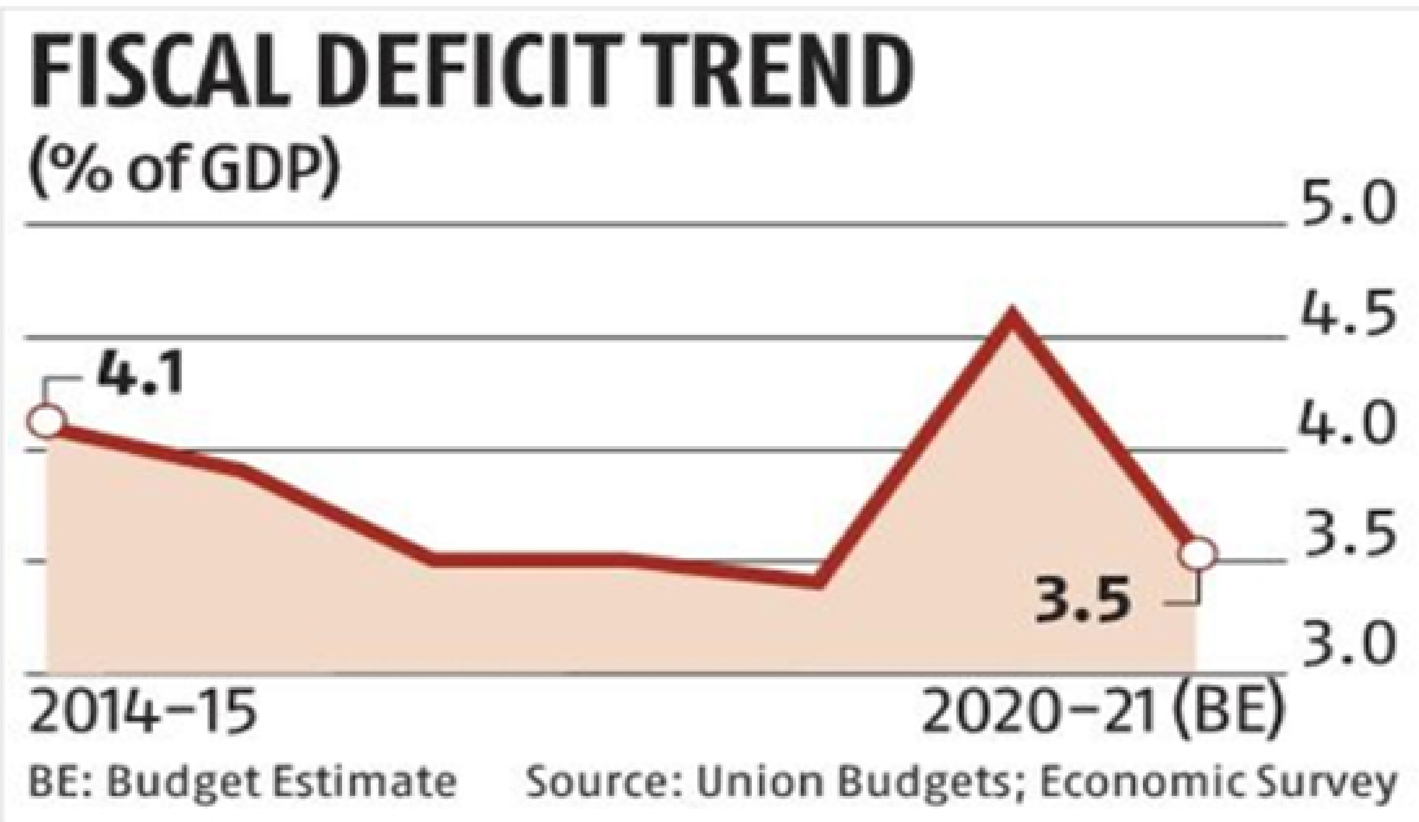
"…There is likely to be fiscal slippage during the year… In order to sustain the recovery in aggregate demand, it is expected that the government may have to continue with an expansionary fiscal stance," according to the Survey.

It added that the expenditure support along with the various key reforms introduced during the year are likely to ensure medium-term growth. "The growth recovery would facilitate buoyant revenue collections in the medium term, thereby enabling a sustainable fiscal path," the report said.

The long-term fiscal policy road map for the Centre and states will be laid down by the 15th Finance Commission. The longer-term fiscal sustainability depends on reviving growth relative to the interest cost of government debt, according to the Survey. Aditi Nayar, principal economist at ICRA Ratings, has estimated the deficit to widen to 5 per cent of GDP in FY22.

Outlining the need for a counter-cyclical fiscal policy, the Survey suggested a well-designed expansionary fiscal policy stance can contribute to better economic outcome, and is necessary to smoothen out economic cycles, which is critical during economic downturns.

Government spending becomes imperative at the time of excessive risk aversion in the private sector. "With the National Infrastructure Pipeline already laying out the agenda for ambitious public spending, a fiscal policy catering to its funding can boost growth, productivity, generate higher-paying jobs and thereby be self-financing."



The Survey called for the methodology of granting sovereign credit ratings to be made more transparent, less subjective and better attuned to reflect an economy's fundamentals.

Pointing out that "noisy, opaque and biased" ratings damage foreign portfolio investments, it suggested countries engage with ratings agencies to ensure correction of the methodology that would reflect economies' ability to pay obligations. "Moreover, the pro-cyclical nature of credit ratings and its potential adverse impact on economies, especially low-rated developing economies, must be expeditiously addressed."

It said India's ability to pay can be gauged not only by the extremely low foreign currency-denominated debt but also by the comfortable size of its foreign exchange reserves that can pay for the short-term debt of the private sector as well as the entire stock of sovereign and non-sovereign external debt.

M Govinda Rao, chief economic advisor at **Brickwork Ratings**, said the government should take a fresh look at the policy of fiscal deficit targets and allow for gentle increases in government borrowings to finance larger public investment and social expenditures.

However, he added the government should be transparent and include off-Budget liabilities in providing the estimates for the deficit.

If off-Budget borrowings were included, the target for FY21 would have stood at 4.36 per cent of GDP instead of the target of 3.5 per cent.

Industry lauded the Survey's counter-cyclical fiscal policy argument.

Chandrajit Banerjee, director general, Confederation of Indian Industry, said an expansionary fiscal policy will result in faster growth and smaller deficits in the future.