E Prime Feed

How to revive growth: Monetary policy has run its course and it's time for fiscal policy to take the baton

September 7, 2021

There is a need for a holistic review of trade policy to energise exports as an effective engine of growth.

The first quarter GDP growth estimate for 2021-22, at 20.1%, is on expected lines, and shows the resilience of the economy. Even after the Covid-19 second wave, there was a turnaround in GVA growth in manufacturing at 49.6% and in construction at 68.3%. Contact-intensive segments like trade, hotels and transport have shown resilience with growth of 34.3%. The official reaction has been euphoric with the assertion that the economy is recording a V-shaped recovery and is poised for double-digit growth during the year on the back of structural reforms, capital expenditure push and rapid vaccination.

A closer examination, however, shows that over-optimism is clearly misplaced, for the impressive growth is recorded on the base of devastating contraction of 24.4% in the first quarter the 2020-21. As has been pointed out by several observers, GDP in the first quarter this year is lower than that of the first quarter of 2019-20 by 9.2%, and even when compared to the last quarter of 2020-21 it is lower by 16%. Relative to the preceding quarter, the contraction in the construction sector was close to 15%, in manufacturing it was 4.2%, and in trade, hotels and transport contracted by over 35%. Thus, the second wave has not only robbed us of GDP by 16.9% from the previous quarter, but also led to significant contraction in employment-intensive sectors like construction and contact-intensive sectors. Much remains to be done to reenergise engines of growth.

Of the four engines of growth, the only one that seems not to have stuttered in the quarter is exports. Merchandise exports recorded a growth of 67% during April-August this year, and as compared to the corresponding period last year growth was 23%. This, to a considerable extent, owes to global recovery; to maintain the tempo, it is necessary to ensure realistic exchange rate, activate trade agreements with Europe and market access with the US. There is a need for a holistic review of trade policy to energise exports as an effective engine of growth.

All other engines of growth have been stuttering. The private consumption expenditure was higher than the corresponding quarter last year by 19%, but lower than the preceding quarter by 17.4% and that of the first quarter estimate for 2019-20 by 11.9%. Similarly, the gross fixed capital formation for the quarter is higher than the corresponding quarter estimate of last year by 55.3%, but lower than the previous quarter estimate by 23.6%. What is of concern is the decline in government consumption expenditure by 7.6% from the preceding quarter.

Not surprisingly, the growth of GVA in public administration was muted at 5.8% on year-on-year basis and by as much as 19.3% lower than that of the last quarter of 2020-21. The government has been far too cautious and this is seen by the fact that the government consumption expenditure declined by 4.8% in the first quarter as compared to the corresponding quarter last year and it was lower by 7.6% as compared to the last quarter of 2020-21. This is also seen from the fact that from April to July, the Union government's revenue expenditure was lower than the corresponding period by 7% and revenue expenditure implemented during the first four months of the fiscal was less than 30% (lowest in recent years).

The analysis of the fiscal data of the Union government for the first four months of the current year released by the Controller General of Accounts (CGA) shows the following:

1. There has been a reasonably high growth of revenues during the first four months in spite of restrictions posed by the pandemic. The government was able to collect 37.4% of budgeted revenues and 34.2% of budgeted tax revenues in the four months, which is highest in recent years, and the increase in revenues is estimated at 194% over the corresponding period last year and 74% increase over the first four months of 2019-20.

2. The government has been cautious in both spending and borrowing. Total expenditure in the first four months is less than 29% of the budget estimate as compared to 34-35% during previous years. Government borrowing was just about 21% of the budget estimate in 2021-22 as compared to 77.8% in 2019-20 and 103% in 2020-21.

3. Fiscal deficit during the first four months of the current fiscal, at 21.3%, is the lowest in recent memory. It was 103% of the budgeted in 2020-21 and 77.8% in 2019-20.

The analysis clearly shows that proactive public spending by the government could have substantially improved growth performance in the first quarter. At the central level in particular, the robust growth performance of revenues permitted larger spending and frontloading of capital expenditures by increased borrowing, and this could have helped revive both public consumption and investment demand. So far, much of the official support for growth has come from monetary policy in terms of lower interest rates, liquidity and credit availability, and in the prevailing environment these can have only a limited impact. The impact of fiscal policy in reviving both consumption and investment demand is immediate and effective; that is the only way the economy can accelerate growth.

The experience provides good guidance on what the government should do. Growth acceleration requires racing on two legs. The monetary policy has run its course and the time is for the fiscal policy to take the baton. While growth is likely to moderate in the coming quarters due to waning base effect, achieving the pre-pandemic level of GDP and acceleration in growth thereafter will depend on proactive government spending as neither private consumption nor private investment are likely to revive quickly. It's time to frontload public consumption and investment expenditure to sustain recovery and accelerate growth. What is now required is racing on two legs!

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