Spurring growth in challenging times

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The economic revival process was off-railed by the second Covid wave. The spurt in cases put severe pressure on health infrastructure. After the first wave, governments had become confident that they can save both lives and livelihoods, but this belief was shattered as lockdowns became unavoidable. The Centre, this time, left the decisions on containing the pandemic largely to the states. As a result, although the severity of the lockdown was much lower than last year's, the pace of the spread forced the states to place extensive restrictions on economic activities.

The first wave saw almost 7.3% contraction in FY21. But recovery was well under way, and the official expectation, both from the government and RBI, was that the economy will register 10.5% growth in FY22 (26.2% in Q1).

However, considering the severity of the second wave, RBI has revised the first quarter growth downwards to 18.5% and the overall growth for the year to 9.5%. Most credit-rating agencies and multilateral lenders, including the IMF and the ADB, have made downward revisions for FY22 growth, ranging from 9% to 9.5%. Although cases have declined since June, the second wave is still raging in some states, and it will take considerable time before activities like travel and tourism can resume fully.

Even if economic activities resume and the economy grows at 9.5%, the size of the economy will be just about the level it was in FY20. The economy was slowing down even before the pandemic (an estimated growth of just about 3% in Q4FY20 and 4% in FY20). Therefore, even when economic activities are resumed, the economy is unlikely to register 7.7% growth, the average rate witnessed over 2003-18. Therefore, it is imperative to address structural constraints.

The government so far has had cautious fiscal management, and much of the stimulus has been in terms of expanding contingent liabilities; the direct fiscal cost of stimulus this year is >1% of GDP. The expenditure increases planned in this year's budget are >1% over the FY21 revised estimate, and the revenue expenditure is actually budgeted to be reduced by 2.7%. Thus, fiscal stimulus for recovery will be limited. Hopefully, the finance minister will revisit the issue and revise the expenditure plans to front-load capex.

The government must address the issue of governance in public sector banks (PSBs). Although the Financial Stability Report shows easing of the NPA situation and many PSBs have turned around in terms of their profitability, commercial lending is still slow. We have a peculiar situation where the corporates are deleveraging and borrowing slow, and banks are unwilling to lend. New investments are not taking place at the level required. The decision to privatise two PSBs is important and, hopefully, should change the culture of banking; but it is important to initiate reforms in the PSB governance, on the lines recommended by the Nayak committee.

Another important measure needed at this juncture is to make the insolvency resolution process timely, effective and reasonable. The two problems plaguing the system are enormous delays in resolution and huge haircuts that lenders have had to take. Delays are because of promoters gaming the system and the acute capacity constraint of the resolution professionals to manage the National Company Law Tribunal.

There have been enormous delays in the admission of the application under the resolution process itself. The immediate need is to strengthen the information utility (IU) system under the Insolvency and Bankruptcy Code (IBC) that was meant to ensure faster admission. The delays have also resulted in low recoveries and lenders incurring large losses.

Since 2017, the government has been in a protectionist mode, although India's history clearly shows this to be self-defeating. "Atmanirbhar Bharat" will not help the country to achieve competitiveness, and will only add to the protectionist stance. Trimming the list of exemptions in the tariff list in October will only add to protectionism. Myopic view of giving protection and subsidising some sectors through PLIs is like creating a scaffolding rather than building walls; it is important to shun such approaches.

GST revenue reached Rs 1.43 trillion in April, though, thereafter, it declined due to the lock down. With relaxations, it is likely to stage a strong recovery which provides an opportunity for the GST Council to initiate reforms—such as merging the 12% and 18% slabs into 15% and reduce the rates on cement and its products, steel, paints, granite and marble from 28% to 15%. This will help in the revival of the labour-intensive inter-construction sector. Note, the contraction in the sector was 8.6% in FY21 and reduction in the rate will greatly help in the recovery of the sector. Similar measure on the automobile sector also will help. There is an immediate need to restore the confidence of the manufacturing, trade, transport and construction sectors.