INFORMIST
Stay Informed

INTERVIEW: AatmaNirbhar plan to hurt econ, says economist Govinda Rao

Informist, Wednesday, Jan 19, 2022

NEW DELHI – AatmaNirbhar Bharat, Narendra Modi government's ambitious plan to make India self-reliant, may actually end up harming the economy as it will make the country protectionist and less competitive in the global market, says economist Govinda Rao.

"Going for AatmaNirbhar Bharat and increasing protectionist stance is not going to help," says Rao in an interview to Informist.

"It will force inferior goods and services on domestic consumers at a very high cost and make the economy non-competitive," Rao says. "Refusal to join competition will condemn you to be non-competitive perpetually."

Prime Minister Modi had announced the AatmaNirbhar Bharat plan in May 2020 as part of a special economic package to make the country self-reliant.

"Since 2017, the government has reversed the trend and has been increasing tariffs and moving towards increased protectionism," says Rao, the chief economist at Brickwork Ratings. "We have learnt from our past that more the protection, less will be exports."

Batting for structural reforms, the former director of the National Institute of Public Finance and Policy says India needs an increase in investments to return to the pre-pandemic growth trajectory.

"Unless and until investment increases, reaching the pre-pandemic growth trajectory may be difficult... we can expect the medium-term growth of only about 6%," says Rao. "If investment cycle picks up, anything could happen – but that would require a lot more structural reforms."

Below are edited excerpts from the interview with Rao:

Q. What is your view on India's growth potential?

A. There has been a steady decline in investments even before the pandemic began. A lot of restrictions at varying degrees are being put by states and this is likely to bring down the growth from the estimated 9.2%. Contact-intensive sectors like trade and commerce, tourism, transport and hospitality are lower compared to 2019-20. Because of the low base, growth will be high, but achieving pre-pandemic growth trajectory would require significant increase in investment. Unless investment increases, reaching the pre-pandemic growth trajectory may be difficult. We can expect medium-term growth of only about 6%.

Investment cycle has not started to revive. I think we need to wait and watch. But then if investment cycle picks up, anything could happen but that would require a lot more structural reforms.

Since 2017, the government has reversed the trend and has been increasing tariffs and moving towards increased protectionism. Now, we have learnt from our past that more the protection, less will be the export.

Going for AatmaNirbhar Bharat and increasing protectionist stance is not going to help. It will force inferior goods and services on domestic consumers at a very high cost and make the economy non-competitive. Refusal to join competition will condemn you to be non-competitive perpetually.

Q. What can FY23 Budget do to address the issue of unemployment in the country?

A. Employment is an issue that relates to both the Centre and the states. All the time, the general focus is on the Union Budget. Of the total expenditure, the actual spending by the Central government is just 40% and 60% of the expenditure is incurred at the state level. How much can it (Union Budget) do in terms of improving employment? It will give money for Mahatma Gandhi National Rural Employment Guarantee Scheme, it will give some money through infrastructure like national highways but I'm not very sure they will create an unemployment insurance sort of thing. That basically is in the realm of the states.

Ultimately, the employment situation should improve by improving the growth scenario and making people employable. It is the economic activity that creates employment.

Q. Government's former chief economic adviser K.V. Subramanian recently said that the 3% fiscal deficit target has lost its relevance, especially with the emergence of the pandemic. Do you agree?

A. If you are talking about a very short-term, yes. But eventually, we have to move towards consolidation, towards 3%. Even the 15th Finance Commission has said, if things continue to improve, we should reach 4% by 2025-26, and if there is some stress, then it would be 4.5%. Finance Minister Nirmala Sitharaman herself, in her Budget speech last year, set the target at 4.5% in 2025-26.

The eventual target is the outstanding debt. In order to control the debt, we need to contain the fiscal deficit.

Q. By when can the government start moving towards the 3% target?

A. If the government reaches 4.5% by 2025-26, as promised, then you can take another 2-3 years to reach the target. Once we reach 4.5%, half a per cent adjustment each year will require three years to reach the target.

Q. Do you believe that the government should continue its stance of being fiscally expansionary in the upcoming Budget? And what should be the focal point of the FY23 Budget, primarily in view of the third wave of COVID-19?

A. With lagging capital expenditures, it is likely that they will stick to fiscal deficit of 6.8% of GDP this year. Next year, I expect fiscal deficit to be contained at around 6.0-6.3%. Buoyancy in revenues is likely to continue and aiming for 6.3% fiscal deficit is eminently feasible.

Much of the work on health infrastructure has been done because of the second wave. And I do not expect that the allocation to schemes like Mahatma Gandhi National Rural Employment Guarantee Act may be reduced.

Of course, there will be an increase in fertiliser and food subsidies. This is because of the upcoming elections in Punjab, Uttar Pradesh, and other states. The farmers' agitation has brought forth a lot of discomfort, and the government might try to placate this lobby.

Q. Is it time for the government to consider direct cash transfer to the public as a form of stimulus measure? And is the Budget a good opportunity to implement plans like universal basic income?

A. That is an attractive proposition but the basic problem is that if we continue to have all sorts of other subsidies and transfers, we won't have money to make direct cash transfer.

We have the Pradhan Mantri Kisan Samman Nidhi scheme, we have MGNREGA and a whole lot of other transfer schemes and subsidies like food, fertiliser, cooking gas, various pensions, etc. When we introduce a subsidy or a transfer, we create strong special interest groups. They would want the universal basic income in addition to the existing transfer schemes. Where do you get the money for that?

Q. Do you think the government should look to increase the standard deduction limit on income tax?

A. I would say that by and large, it is always better to have a broad base and low rate. If you really want to broaden the base, you could increase standard deduction limit, but get rid of all the exemptions and incentives.

There are large number of exemptions in both corporate and individual income tax that we should get rid of. And with a broader base, reducing rates are possible. Now I understand no government could do that in one day, but they can at least try to limit special concessions and incentives.

Q. Do you see the government getting tempted to go back to setting overambitious tax mop-up aims in the upcoming Budget?

A. Both personal and corporate income taxes have shown higher buoyancy partly from businesses as the fear of matching of goods and service tax returns with income tax returns could have improved compliance.

In the case of GST, the technology platform seems to have finally stabilised significantly, reducing the wrongful claiming of input tax credit by producing fake invoices. A realistic target is always a good thing, and I should think they would expect nominal growth to be about 13-14% and obviously the tax revenue growth may also be pegged at 13-14%.

Q. States have been demanding an extension of the GST compensation period beyond June 2022, as the pandemic has hit their finances. Is this a justified demand?

A. The present scheme of applying 14% growth on the base year revenue each year for determining the compensation amount is generous. This needs to be corrected and the compensation scheme should be extended to the period of transition. The growth rate may be negotiated and fixed at 10% and the period of transition may be for another three years. This will provide an assurance of minimum revenue to states and that can help in persuading the much-needed reforms in GST.

It is necessary to bring petroleum products under GST to minimise the cascade effect and improve competitiveness. Reducing the number of rates is also necessary to minimise classification disputes, avoid inverted duty structure, and to reduce administrative and compliance costs. It is absurd to have a 28% rate on cement and steel – building materials used in the labour-intensive construction industry.