GS-III: The policy way out.

News

India is in the middle of a sharp growth slowdown. The debate surrounding the slowdown is whether it is a cyclical downturn or a structural correction. Diagnosing the problem is key for devising policy responses.

Slowdown

- Cyclical slowdowns can be dealt with using temporary fiscal and monetary stimulus.
- Structural problems require long-run policy responses.

The slowdown is structural – Oil imports

- Most of the growth between 2014 and 2017 was sparked by a sharp increase in government spending.
- Given India’s oil imports, the decline in the world price of oil by almost $50 a barrel between 2014 and 2016 represented a windfall revenue gain of 3% of GDP.
- Since the fiscal deficit barely moved, the government effectively used the windfall to finance various government schemes.
- Now that oil prices have reverted towards their previous levels, a stable fiscal deficit demanded a reduction in government expenditures.

Structural slowdown – investment demand

- Throughout the period 2016-2018, there was a criticism of the Monetary Policy Committee’s refusal to cut rates.
- It was argued that high real interest rates, along with the restrictions by RBI on banks’ lending to deal with the NPA problem, were jointly responsible for low investment demand.

Sovereign bonds:

- The idea needs to be pursued for multiple reasons.
- Sovereign bonds would force government debt to be priced in a more competitive setting. Currently, it is priced in a sheltered domestic bond market.
- Issuing sovereign bonds will force greater clarity and transparency of macroeconomic data since international creditors will demand that.
- Things like failure to achieve policy targets or reticence in releasing data will attract rapid punishment by markets. This will provide greater discipline for policymaking.

Way ahead:

The government should revisit the appointments process to key technical and regulatory bodies.

Functions like monetary policy, banking supervision, data collection and dissemination, the audit of government financial accounts need to be independent of government direction.