India has strong economic potential which can be realised by taking tough decisions: Montek Singh Ahluwalia

Deputy chairman of planning commission Montek Singh Ahluwalia feels the government feels the government has established its fiscal credential through some bold measures. In an interview with ET, he says that the twelfth plan has laid down the reforms agenda for the coming years. Excerpts from the interview:

Has the rapidly changing and volatile economic environment post global financial crisis rendered long-term policy making such as five-year plans irrelevant?

There's no doubt that external circumstances have changed but that does not mean that planning has lost relevance. You have to recognise how the circumstances have changed and modify the plan. That is what we have done.

When we started preparing the Approach to the Twelfth Plan in 2010, we considered the range of 9 to 9.5 % growth as feasible but by the time the Approach was presented to the NDC in 2011, we concluded that 9% was the only feasible option because the global economy was recovering more slowly than originally expected.

By the time the draft plan was prepared in the middle of 2012, it was clear that the sovereign debt crisis in Europe was much more serious than thought earlier and also our growth in 2011-12 was lower than was expected. So we scaled growth prospects down to 8.2 %. However, global assessments of growth continued to deteriorate.

A few weeks before the plan was put before the National Development Council in December 2012, there was a further downward adjustment of global prospects by the UN. Europe was expected to show negative growth and remain in recession for some time.

At that time we decided that even 8.2% may be too high so we pegged growth in the Twelfth plan at 8%. This is actually very ambitious since we will be below 6% in 2012-13, the first year of the Plan, and in order to do 8% on average we will have to go above 9% in the last two years. That is quite a big transition.

Medium term prospects of EU and US still look weak which means the domestic effort has to be much stronger. Do you think we have done enough reforms to give that momentum?

We have done some of what is needed but there is much more that needs to be done during the Plan period. In fact we have outlined a very big reform agenda covering each of the major sectors which needs to be implemented if we are to achieve the 8% scenario. But we have also, for the first time in planning history in India, indicated that this is the upper end scenario, which can be realised if we can take strong action to accelerate the growth momentum.

If we fail to implement the policies needed, we may slip to partial implementation scenario which yields 6% to 6.5% growth. If we get stuck in what we describe as a "policy logjam," we may get stuck with 5% to 5.5% growth.

The point we are making is that India has tremendous economic potential but it cannot be realised by just coasting along. We need to take a number of difficult decisions some at the central government level and others at state level to realise this potential.

What should be the reforms agenda going ahead?

We've only just begun. In the next six months or so the most important single thing we have to do is to overcome implementation bottlenecks that are preventing large projects from taking off.

A number projects are held up because of environmental clearances. Protecting the environment is extremely important but we need to take a thorough look at the whole system of clearances and why they lead to delay.

The Cabinet Committee on Investments, which has just been set up, will I hope give a push in the short run. In the longer run, growth will have to be investment driven, and the investment has to come largely from private sector.

If we can resolve implementation issues and also reduce the fiscal deficit which will release resources in the system then I think private sector investment will respond. Foreign investors would also respond and we could expect a larger flow of FDI.

Private investments see high interest rates as a hindrance. Do you think there is sufficient downward momentum in inflation for monetary easing to begin?

I don't want to speculate about monetary easing but the macro economic situation is certainly better than it was six months ago. Core inflation is down though some other elements of inflation, such as food inflation, have not come down. I would have been happier if inflation had come down more but we need to look at the likely trend in inflation over the next six months.

I do not expect a global inflationary thrust through a rise in global commodities prices and that would suggest that the threat of inflation is much less than it was six months ago. On the positive side, the government has gained some fiscal credibility by biting the bullet on diesel prices. These are positive developments which I assume the RBI will take into account.

The brunt of the fiscal consolidation has fallen on plan spending. Does it worry you that the increase this year could not be much?

I am not sure that is correct. There has been no cut in Plan allocations so far for fiscal control reasons. Spending in 2012-13 has been below expectations and if the Finance Ministry applies the normal rules about how much spending is allowed in the last quarter the RE will be lower than the BE. As for the allocation for the next year we have to see what happens.

In any case we should take a holistic view. The planning commission should not be just looking at plan allocations irrespective of spending capacity. I am hopeful that we will get an increase in the Plan allocation which is consistent with the current macro economic situation and the government's spending ability and also the government's priorities.

Is there a case for taxing the rich more especially if the fiscal deficit has to come down and development expenditure cannot be curtailed?

No body can disagree with the proposition that the rich should pay more tax. That's what progressive taxation is all about and we do have a progressive tax system where high earners pay tax at marginal tax of about 33%. It is not the case that rich are paying tax at the rate the middle income people pay. However, there is no doubt that not enough rich people are paying the tax they should be paying.

The number of people declaring income over 10 lakh rupees is very low. A lot more people in professions and commerce are in that range. Whatever we can do to expand that net is absolutely vital and should be done. On the specific issue of tax rate, several suggestions are normally made at this time and the finance minister will no doubt look at them very carefully.

The issue is not so much that of income tax rate but the fact that the richest people do not figure in the list of high tax payers. That is because of the way dividends and capital gains are taxed, at lower rate....

It is true that dividends are not taxed in the hands of the investor. However, the dividend distributing entity pays tax on it at 15 % before distributing dividends. It is true that if dividends were taxed in the hands of investor, then the high income people would pay the higher tax on it.

However the reason this source specific tax was adopted was that it was very difficult to tax dividends in the hands of the investor. Besides the dividend tax rate has been raised from ten % earlier to 15 %. Incidentally, the problem of tax shortfalls is not because of direct taxes but indirect taxes. As I recall, the ratio of direct taxes to GDP has been rising but the ratio of indirect taxes has fallen.

When we make growth centre of reforms focus it runs into criticism it benefits a few. How do you make it more inclusive?

Making growth inclusive is critical for social acceptability. One way of making growth more inclusive is by implementing special programmes aimed at inclusiveness. We are doing this.

But growth also contributes to inclusiveness by generating more employment opportunities and income earning opportunities for a broad range of the population. This is sometimes dismissed as a 'trickle down' approach but its effect can be very substantial. The trickle can become a flood with the right mix of policies.

The policies I have in mind are policies that would generate more rapid growth in agriculture and policies that will stimulate greater growth of employment. These two approaches are mutually supportive.

Faster growth generates more revenues which allows us to finance inclusiveness programmes. Many of these programmes also contribute to the growth potential. Programmes for education and skill development and health all produce a more productive population which raises growth capacity.

How does the entire idea of cash transfer gel with the idea of the food security law? If the idea is to move away from product subsidies to cash transfer of benefits should we be pushing ahead with the food subsidy law?

The direct benefits transfer scheme is a major effort to both speed up the system and through the use of Aadhar to eliminate duplication, which is one of the ways leakages take place. At the moment we are focussing on rolling it out for schemes that are inherently money transfer schemes.

Once we have demonstrated that the system works, it would be logical extension to apply it in cases where subsidised commodities are made available.
I must emphasise that the idea is not to discontinue the supply of these subsidised products through PDS shops. That will continue, but as I see it, the commodities should be priced at the normal price and the subsidy amount should be credited to beneficiaries accounts in a manner where they can use the subsidy to buy specific commodities by themselves paying only the subsidised price. Pilots have shown that people prefer cash subsidies as they empower them more.

The subsidy should go to the account of the woman head of household. So there is on inconsistency between cash transfer system and the food security law the government has in mind.

We have had some issues with private companies surrendering projects in roads sector. Is it because of faulty policies or that we have not found answers to companies over bidding to corner projects in the hope of getting policy changed later?

I have seen the newspaper reports that some companies have exited from road projects. I do not know the details but there could be several reasons. One is that the clearances needed have been delayed and costs have gone up. This is clearly a problem which government has to handle to avoid recurrence in future. It is also possible that companies are faced with a difficult financial situation either internally or because they cannot raise money as easily as they expected and have therefore exited.

This is not something that Government can do anything about. Incidentally we have initiated a large number of road and other projects so it is not surprising that in some cases companies will trigger exit options. The main thing we need to focus on is speedy clearances. I hope the newly established Cabinet Committee on Investments will make a major difference here.

Labour is progressively getting a lower share of corporate profits. Does that make out a case for higher taxes on companies?

I don't think the solution lies in raising corporate tax rates. This trend reflects an underlying trend in our industrial system in favour of capital intensive industry. One of the weak spots in our performance is that manufacturing growth has not been as high as we wanted and the second is that structure of manufacturing, for whatever reason, is moving towards more and more capital intensive areas. That does not fit in with the natural resource endowment of the country, although some people say we have not produced labour with the right skills. We are trying to address that problem.

Industry says our labour laws are too complex and inflexible and discourage hiring of labour. Those opposed to this view say that industry just wants hire and fire policy. No one can agree with simplistic hire and fire and that does not exist in almost any country.

But it is also true that our labour laws are too complex. As a result people are going for capital intensive manufacturing or they resort to employing contract labour, which is kept for a few months and then rotated out. This is not a sensible situation. My view is that we should have more flexibility.

If industries facing difficulty are allowed to shed labour they hire more labour than they otherwise would. This is a politically sensitive issue and the government has said we need to build a consensus with labour interests. We should work more actively towards this objective.

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