

Six immediate tasks for Narendra Modi

Reforms need time but economic revival is possible with some sane steps

Narendra Modi inherits a weak economy. The easy options are closed to him. A demand stimulus is out of the question right now. The fiscal deficit is so large that the new government cannot crank the public spending lever. Persistently high inflation means that the Reserve Bank of India is in no position to bring down interest rates. The Indian economy thus needs structural reforms if it is to get out of the current quagmire.

These reforms will necessarily take time. Meanwhile, here is a list of six policy options Modi could consider pursuing so as to get things moving.

1. The new government should begin by reducing the excess food stocks held by the Food Corporation of India. Agricultural economist Ashok Gulati has suggested that around 15-20 million tonnes of grain stock can be liquidated. Selling food stocks could dent inflation. Rohini Malkani of Citigroup India estimates in a recent report that a 10% reduction in wheat prices will bring down consumer price inflation by 50 basis points.

2. A sustainable economic recovery will be critically dependent on a revival in corporate investments. Business sentiment is glum. New data from the Centre for Monitoring Indian Economy shows that a record Rs.6.26 trillion of projects were shelved, abandoned or stalled in fiscal 2014. At least some of these projects have been held up because of issues such as land acquisition or environmental clearances. The Cabinet Committee on Investments says that large industrial projects worth around Rs.16 trillion were pending resolution. Getting at least some of these projects off the ground through administrative decision would provide a welcome boost to the economy.

3. The Modi government needs to revive the National Investment Fund that had been set up by the Atal Bihari Vajpayee government. This fund was to receive revenue from asset sales. The money would then be used to create fresh assets through public investment programmes. Even money from auctions of radio waves should automatically be sent to the National Investment Fund, rather than frittering it away to fund revenue expenditure as the United Progressive Alliance did. One immediate way to get the National Investment Fund running is to transfer the special dividends from cash-rich public sector companies via the government budget. It could be an important step in the overdue switch of public spending from subsidies to asset creation.

4. Several critics of the interim budget presented by former finance minister P. Chidambaram in February had claimed that the expenditure statement looked better than it actually was because the government had rolled over some of its subsidy payments to the next year. Chidambaram has contested this claim. A clearer picture on this accounting controversy will only be available when the next finance minister presents his budget. But the private companies in some sectors could get some financial relief if these payables are cleared soon.

5. Modi should know by now that India cannot get back to fast growth on a sustainable basis unless the inflation dragon is tamed. He should make it clear soon that he backs the Reserve Bank of India in its fight against high inflation. Modi will undoubtedly get advice from the corporate sector as well as the financial markets on how interest rates need to be lowered, but premature monetary loosening will eventually backfire. He should let Raghuram Rajan do his job.

6. The first budget of the Modi government will be a closely watched affair—not only by domestic investors but by the global credit rating agencies. There is a public finance mess that cannot be sorted out overnight. What the next finance minister should do is announce a credible plan to bring the fiscal deficit down in the medium term, as well as begin moves towards a new version of the Fiscal Responsibility and Budget Management Act that was buried by the previous government after the global financial shock.

Of course, there will be many more difficult battles on the economic reforms front. But some quick administrative decision will be a useful signal that India has a government that means business.

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