Economic

PMEAC Chief Rangarajan Calls for Withdrawal of Fiscal Stimulus
Days ahead of the union budget, chairman of the Prime Minister's Economic Advisory Council (PMEAC), C Rangarajan, has advocated withdrawal of the fiscal stimulus, indicating that indirect taxes could rise in the budget.
Economy ▶▶ 15

PM Panel Wants Stimulus Withdrawn

Push for fiscal consolidation signals indirect taxes could rise in budget

OUR BUREAU
NEW DELHI

An influential policy advisory body has recommended withdrawal of some stimulus measures announced during the global economic downturn, indicating that the government could raise indirect taxes in the Union budget next week.

The prime minister's economic advisory council called for the withdrawal of fiscal stimulus citing the need to boost revenues. "We have to get back to the fiscal consolidation ...this means withdrawal of some of the stimulus," council chairman C Rangarajan said on Monday while releasing a report, 'Review of the Economy 2010-11'.

The report said budgeted levels of fiscal deficit and revenue deficit are still beyond the comfort zone. It suggested that a significant portion of fiscal adjustment will have to come from additional tax revenues.

The council called for continued efforts to reform tax administration, review double taxation avoidance treaties and recommended measures to prevent flight of funds to tax havens.

The fiscal deficit is likely to decline to 5.2% of the gross domestic product (GDP) in the current year as against the budgeted 5.5%, going by an expected 8.6% growth in the GDP, Rangarajan said. He called for speedy implementation of the goods and service tax to boost revenues.

Finance minister Pranab Mukherjee had kicked off the process of rolling back the stimulus measures in his last budget by raising the central value-added tax by 2% to 10% and the minimum alternate tax by 3% to 18%.

Mukherjee is scheduled to present the budget for 2011-12 in the Lok Sabha on February 28.

The council singled out supply constraints as the key challenge in achieving 9% growth in 2011-12. It identified taming inflation, speedy infrastructure building, boost to farm sector and better flow of external investments into the country as the focus areas to sustain 9%-plus growth.

Fiscal deficit is likely to decline to 5.2% of gross domestic product in current year as against the budgeted 5.5%: PMEAC

"To the extent that supply bottlenecks persist to a degree than expected, economic growth may be marginally lower than 9%," the council said. It expects headline inflation to ease to 7% by the end of the fiscal year.

"The declining trend in food prices, particularly that of the vegetables, will result in lower food inflation," Rangarajan said. Considerable care needs to be taken from the policy side to ensure that the manufactured goods inflation remains below 5%, he said. "There is a need to maintain tight fiscal and monetary policy to shield the economy from inflation," Rangarajan said.

Huge investments are needed in the back-end infrastructure to ensure that what is produced in the country is not wasted away, he said. The council called for the strengthening of organised retail, but refrained from commenting on foreign direct investment in multi-brand retail.

"There is a need for increasing corporate investments," said Saumitra Chaudhury, member of the council. He said there was a proposal on FDI in multibrand retail and there were various views on it.

He said it was prudent to depend more on capital flows to finance the current account deficit.

Rangarajan wanted the government to look into the reasons that had led to a decline in foreign direct investment. "Policymakers need to correct misgiving if any that may have led to a decline in FDI flows," he said. However, he said the country had encouraging portfolio investments in the current financial year, part of which was in initial public offers that could be treated as FDI.

The report said adequate attention needs to be paid to ensure that the Indian economy is seen as an attractive destination for foreign investors. It also stressed on speeding up reform in infrastructure with a renewed focus on power sector.

ET Q&A

C RANGARAJAN
CHAIRMAN, PMEAC

'Fiscal Control Needed to Check Inflation'

The council has stressed on the need to take steps to ensure India remains an attractive FDI destination. Is the recent concern over governance and corruption affecting sentiments?
I don't think there is any negativity around. Investors typically look at growth prospects of the economy. We have forecast a growth rate of 9% for 2011-12. Therefore, medium-term growth prospects for the economy remain good, so I think FDI (foreign direct investment) would be forthcoming. There are ups and downs which are due to factors not just operating in India but also elsewhere. You have seen what is happening in the Middle East and what is happening in developed economies. On the whole, I think, FDI inflows should start increasing from next fiscal.

Why have you pegged portfolio investments lower for the next financial year?
This year was an extraordinary year in which FII inflows were very large. We received more than $30 billion this year. Therefore, we are rebalancing it. There's little more of FDI and a little less of FII.

The EAC seems particularly worried about the current account deficit.
Current account deficit (CAD) has been at an elevated level. We need to work towards lower CAD. We have pegged CAD in the current fiscal at 3% and in 2011-12 at 2.8% of GDP. While exports and imports both will expand equally, service sectors are expected to do better next year and will lower CAD. Capital flows would be adequate to finance this. But there is a need to make exports more competitive and moderate dependence of Indian economy on imported fuels to the extent possible.

Is there need for aggressive monetary measures to curb inflation?
There is a need to maintain tight fiscal and monetary policy to protect economy from inflation.

Inflation hurts those at the bottom rung much more. So it is important to contain inflationary tendencies. I think monetary policy is moving in the direction of maintaining tightness in the market.

Indian Economy: A Report Card

PMEAC says demand conditions are ripe for the country to step up to a higher 9% growth next fiscal, but supply & infrastructure constraints pose a challenge. It has listed a series of challenges and a way around them

All-round growth...

OVERALL ECONOMY

Supply Side
GROWTH IN %

	2009-10	2010-11	2011-12F
Agriculture & Allied Activities	0.4	5.4	3
Industry	8	8.1	9.2
Services	10.1	9.6	10.3
GDP	8	8.6	9

Demand Side
GROWTH IN %

	2009-10	2010-11	2011-12F
Gross Domestic Capital Formation	12.2	13.1	13.1
Final Consumption Expenditure	8.7	7.3	7.7

and robust flows...

The country has managed to attract high levels of foreign funds to support growth

FINANCIAL CAPITAL MOVEMENT
(IN BILLION $)

	2009-10	2010-11	2011-12F
Inbound FDI	35.6	27.6	40
Outbound FDI	16	18.2	20
Net FDI	19.5	9.3	20
Portfolio Capital	32.3	38.8	25
Foreign Investment	51.8	48.1	45

but some worries linger...

Unfavourable trade balance and high food prices could upset growth momentum

EXTERNAL SECTOR
AS A % OF GDP

	2009-10	2010-11	2011-12F
Trade balance	-8.5	-7.7	-7.7
Invisibles	5.8	4.8	4.8
Current Account Balance	-2.8	-3	-2.8

2011-12F: FORECAST

FOOD INFLATION
IN PERCENTAGE

Prescription for 9% growth

Contain inflation by focusing both on monetary and fiscal policies & supply-side management

Pace of infrastructure creation needs to be stepped up, with renewed focus on power

Contain current account deficit at 2-2.5% of GDP; encourage foreign investment

Focus on agriculture, including seed development, water and soil management

Key Challenges

The strong volatility of 2010 will continue into 2011. Some unexpected developments possible

Inflation management is the principal challenge in the short to medium term

Supply-side limitations can create high inflation and also excessively large trade deficits

Food prices have crossed the 2008 peak; petroleum prices are at historical high levels

Per capita availability of foodgrain not keeping pace with rise in incomes

The fiscal consolidation targets laid out in the budget may be difficult to achieve

Reform Pitch

Raise fuel prices

The EAC says international crude oil prices are likely to go up further, even as the backlog in the adjustment of prices remains. It has argued for some rationalisation in prices of cooking gas and kerosene, but said prices of diesel need to be raised, in a phased manner

Tighten tax agreements

Significant expansion of the tax base and revenue gains in the short run from the direct taxes code is unlikely. The EAC says increase in revenue productivity will have to come from reform of tax administration and preventing flight of incomes to tax havens

Implement GST

The EAC says implementation of the goods and services tax can improve revenue productivity sharply and is critical for meeting resource needs for food security, education and healthcare. The EAC suggests Centre could start the reforms process unilaterally by pruning exemption list, rationalising rates of excise duty and extending tax to all services. It has proposed a common threshold of ₹50 lakh turnover for both goods and services and a uniform tax of 10%. A separate sumptuary tax can be levied on cigarettes

JAYEETA