It's time for fiscal checks again: EAC

Q A

Rollback not right word

Rolling back the fiscal stimulus is a hotly debated topic in policymaking circles. PM's economic advisory council chairman C Rangarajan says the very term 'rollback' is wrong in the context of tax rates. He talks about the growth prospects of the economy, fiscal consolidation and monetary policy options in an exclusive interview with **ET**. On food, he says inflation will become moderate because the rabi crop is expected to be good. It will be better than even last year. With that information, food prices could moderate in the coming months.

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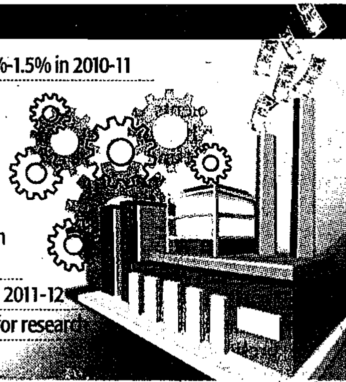
GROWTH **PATH**

- **Start fiscal** consolidation and cut deficit by 1%-1.5% in 2010-11
- **Monetary policy** should return to neutral stance from accommodative
- **GST from** April 1, 2010 not possible, but calibrate excise duty and service tax rates and start it at the Centre
- **Focus on price** management and foodgrain supply to tame inflation
- **Exports recovery** to be slow, to grow only in 2011-12
- **Invest more** in farm with at least 1% of GDP for research
- **Provide** a clear policy on GM crops



SARFARAZ

Our Bureau
NEW DELHI

A WEEK off the budget, Prime Minister's economic advisor C Rangarajan has called for an immediate return to fiscal discipline, as growth returns to normal levels and major economies take small steps to return to neutral policy stance amid whiplashing by bond vigilantes.

The former central bank governor said the GDP growth could be higher in the current year than the 7.2% forecast by the Central Statistical Organisation as agriculture turns out a performance better than forecast. He predicted an 8.2% growth rate for 2010-11, in line with other estimates. It is lower than the 11.4% projected for China.

FOOD TOP CONCERN

PMEAC warns of price instability and says govt must act immediately on cooling food prices.

A potential return of financial instability, inadequate infrastructure creation, fiscal indiscipline and the spiralling of prices could mess up the rosy economic picture, the economic advisory council said.

"The government cannot continue with the kind of large deficits recorded in the last two years and will have to initiate fiscal consolidation in the coming fiscal (2010/11) itself," the EAC said in its review of the economy. "It is necessary to initiate measures towards fiscal consolidation in the forthcoming budget to ensure fiscal sustainability, enable greater flexibility in monetary policy calibration, contain interest payments and to avoid upward pressure on interest rates."

Calls for reducing fiscal deficit are getting louder after investors punished countries such as Greece for its profligacy. While the central bank has raised the cash reserve requirement last month, it is holding back on interest rate action to avoid derailing economic growth. FM Pranab Mukherjee has also been talking about reining in deficit, but the corporate lobby has been against rolling back of stimulus for fear of reduced profits. Without monetary tightening and fiscal prudence, the soaring prices could go out of control and rising bond yields could pressure government borrowings next year.

"Global investors are likely to show greater discrimination and, in general, be more demanding in the coming years," the review said.

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Higher India output may soften global wheat prices

Our Bureau
NEW DELHI

INDIA'S projected healthy wheat crop in the marketing season beginning March and the forecast that the country, besides Pakistan, could emerge as potential exporters in an already well-stocked global wheat market, could keep sustained pressure on prices.

Wheat output in the 2010-11 marketing season is pegged at 80 million tonnes, forcing the PM's Economic Advisory Council (PMEAC), in its report here on Friday, to suggest that more wheat be pumped into the PDS and extensive welfare programmes to cut down rice consumption.

Rice stocks are much lower in comparison to the last year's stock. The PMEAC has suggested that rice imports can be considered if the government's procurement target for rice falls below 27 million tonnes.

While the harvesting season for the winter-sown staple has already begun in Gujarat, it is set to begin next month in other states, including Maharashtra, MP and Rajasthan. Global wheat prices are likely to remain under pressure due to large stockpiles in major growing countries, trading executives and analysts said on Friday.

Given the scenario, top world exporters of wheat, including Russia, France, Ukraine and Canada are currently offering big rebates on older stocks in a market where prices have plummeted to record lows.

BUMPER CROP

- **Wheat output in the 2010-11 marketing season is pegged at 80 million tonnes**
- **PMEAC has suggested more wheat be pumped into PDS and welfare schemes to cut down rice consumption**
- **Top exporting countries, including Russia, France, Ukraine and Canada are currently offering big rebates on older stocks**
- **Some southern mills in India, taking advantage of the rock-bottom prices, have resorted to importing cheap Australian prime wheat since landed prices are cheaper than local wheat**

Agencies have quoted traders to maintain that prices could dip further. Some southern mills in India, taking advantage of the rock bottom prices, have resorted to importing cheap Australian prime wheat since landed prices are still cheaper than local wheat prices. Since October, mills in south India are understood to have purchased close to 100,000 tonnes of Australian wheat at $285/tonne.

According to reports, Ukraine's feed wheat is now being offered at $125-$130/tonne for Asian destinations. The world's largest wheat importer, Egypt, bought Russian and French wheat this week at around $170/tonne, down from $186.5/tonne for Russian wheat in January. Russian wheat is being offered to Asian importers at only $160/tonne in private deals.

Infrastructure cause for worry

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"SUCH large deficits can cause interest rates to go up and constrain monetary policy." Bond yields across the globe, including in India, have surged in the last few months as investors grow cautious about the soaring inflation and governments' inability to repay debts. European Union is coming to the aid of Greece. Portugal and Spain could be in line for bail-outs. The US, China and Australia are winding up easy policies. Indian government bond yields have risen more than 2.5 percentage points from their January 2009 lows while policy rates have remained static. The yield on the 6.35% bonds due January 2020 rose to 7.90%, off its peak of 7.97% touched on February 15.

Fiscal deficit is at a 16-year high of 6.8% of the GDP and if one takes the off-budget items, it could be more than 10%. The government had set a fiscal deficit target of 5.5% for 2011-12. Food prices are driving inflation up and that is fast spreading to manufactured products.

"The 8.5% target for inflation may be breached and it is likely to touch 10% by March. Apart from food prices, fuel prices will also put pressure on inflation. The government must manage food prices to control domestic inflation," said Jyotinder Kaur, economist at HDFC Bank.

With prices becoming a key factor, the EAC suggested measures to boost farm productivity. Rangarajan has set a tough agenda before Mukherjee.

Since much of the fiscal expansion was expenditure driven, the correction must also aim at cutting expenditure, pointing out that it could be cut to the extent of 1% of GDP while maintaining that there was no scope for cutting capital expenditure.

The EAC did not suggest an increase in taxes, but supported the Goods and Services Tax. The council said all the services could be brought under the tax net and there could be a unified threshold and rate structure for Cenvat and service tax.

Though it did not spell out the rate, it implicitly suggested an increase saying that the rate could be between the current rate and the earlier general rate of excise. The current cenvat rate is 8%, down from 14% earlier. Cenvat refers to the median excise rate levied on nearly 90% of the goods manufactured.

"GST needs to be implemented at the Central and state level simultaneously, else the Centre will be able to tax only up to the manufacturing level, while states won't be able to tax services," said Mahesh Purohit, director, Foundation for Public Economics and Policy Research.

Factoring in revenues from disinvestments and auction of 3G spectrum, some revenue increase from tax hikes, and maintaining expenditure and subsidies at current levels, the council said it was possible to lower the deficit by 1.0 - 1.5% in 2010/11 without any adverse impact on economic growth.

DK Srivastava, director, Madras School of Economics, concurred that it was possible to cut fiscal deficit to the extent suggested by the EAC, but felt improving the quality of fiscal deficit was more important than bringing it down. "Revenue expenditure must be reduced so that most of the deficit is because of capital expenditure" he said. The EAC also expects both investment and savings rate to pick up in 2009-10. Further, the annual increase in fixed capital formation is likely to double in the coming years from 5% in 2009-10.

"There's been a decline in government savings, while household savings have been robust. This shows we are positioned for a sustainable recovery," Jyotinder Kaur said.