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India's Economy in 2018: Combating Macroeconomic Challenges[1]

As the Indian government gets set to present its next Budget on 1 February 2018, it is looking at multiple macroeconomic challenges that include maintaining fiscal discipline and containing consumer prices. This paper studies the trend in the central government finances and emphasises the urgency to improve revenues. It also draws attention to the challenges posed by rising consumer prices and the imperative to contain inflation so as to revive investment and preserve fiscal health.

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GDP Growth: Recovered, but Not Robust

The year begun for the Indian economy on a relatively somber note with the Central Statistical Organization (CSO) estimating the gross domestic product (GDP) growth for

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1 The Institute of South Asian Studies (ISAS) at the National University of Singapore (NUS) has undertaken a prognosis of the eight South Asian countries in 2018. This is both opportune and relevant, given significant developments in the region. Although it requires some crystal ball-gazing, such prognosis is important in providing an understanding of the outlook for each country. This paper is part of a series of nine papers on key development in the eight South Asian countries, namely, Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka, this year.

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2017-18 (April 2017 – March 2018) at 6.5 per cent.[3] On a year-on-year basis, this marked a decline of around half a percentage point from 7.1 per cent recorded in 2016-17. Soon after the CSO released its estimates, the World Bank reported that the Indian economy grew by 6.7 per cent in 2017.[4]

An official estimate of 6.5 per cent for 2017-18 indicates the expectations of the economy having overcome short-term growth-hampering effects of demonetisation of the Indian currency in November 2016 and the Goods and Services Tax (GST) introduced with effect from July 2017. Both these measures, arguably, were responsible for the economy having grown by relatively lower rates of 5.7 per cent and 6.3 per cent in the first two quarters of the current year (April-June 2017 and July-September 2017 respectively).[5] Notwithstanding the recovery, the economy is yet to reclaim the seven per cent-plus growth path, which it was on in the last couple of years. The World Bank, though, is bullish about the prospects of the Indian economy and expects it to grow by more than seven per cent in the next couple of years.[6] One must wait for the CSO to come out with its GDP growth estimates for 2018-19 to check if it is as optimistic as the World Bank in this regard.

Fiscal Situation: High Deficit, Low Revenues

All attention is on the Union Budget that would be presented on 1 February 2018. This is the last full-year Budget that Prime Minister Narendra Modi’s government would present before the next parliamentary elections scheduled in 2019. The Budget would be eagerly watched and analysed for both its economic and political content.

On the economic side, it would be interesting to see what the Budget reveals on some key public finance parameters, particularly the indicators for revenue, expenditure and deficit.

3 “Press Note on First Advance Estimates of National Income 2017-18”, Central Statistics Office, Ministry of Statistics & Programme Implementation, Government of India, 5 January 2018. http://mospi.nic.in/sites/default/files/press_release/PRESS_NOTE-Q3_2017-18.pdf. Accessed on 19 January 2018.

4 “World Bank says India's GDP to grow at 7.3% in 2018-19” *Business Today,* 10 January 2018. http://www.businesstoday.in/current/economy-politics/world-bank-india-gdp-economy-growth-at-73-in-2018-19-modi-gst/story/267631.html. Accessed on 19 January 2018.

5 “Press Note on Estimates of Gross Domestic Product for the Second Quarter (July-September) of 2017-18”, Central Statistics Office, Ministry of Statistics & Programme Implementation, Government of India, 30 November 2017. http://mospi.nic.in/sites/default/files/press_release/PRESS_NOTE-Q2_2017-18.pdf. Accessed on 19 January 2018.

6 “Press Note on First Advance Estimates of National Income 2017-18”, op. cit.

The challenges are evident from the latest report on the central government accounts released by the Controller General of Accounts of the Ministry of Finance.[7] The key findings for the central government's accounts for the eight months of 2017-18 (April-November) are as follows.

a) By the end of November 2017, the fiscal deficit had reached 112 per cent of the budgeted estimates. The deficit was 85.8 per cent during the comparable period of the previous year.

b) The first eight months of the year had yielded revenue receipts that were only 53.1 per cent of budgeted estimates. Among these, tax revenue was 57 per cent of the budgeted figure. Both overall revenue receipts and tax revenue were higher during the comparable period of the previous year, at 57.8 per cent and 58.9 per cent respectively.

c) Revenue expenditure till November 2017 had been at 70.5 per cent of the budgeted estimates, compared with 66.1 per cent the year before. Capital expenditure had also been higher at 59.5 per cent compared with 57.7 per cent in 2016. Higher revenue and capital expenditures had resulted in total expenditure mounting to 68.9 per cent of budgeted estimates compared with 65.0 per cent in the comparable period of the previous year.

The above trends point to a situation where revenue collections have been relatively lower in the current year, whereas the expenditure has been higher. The result has been an overshooting of the fiscal deficit. The government would be challenged to maintain the fiscal deficit for the year at its budgeted level of 3.2 per cent of GDP.

At any given point in time, the fiscal deficit reflects the borrowing requirements of the central government.[8] An increase in the fiscal deficit increases the government's borrowings. According to the government's accounts, till November 2017, market borrowing was already

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7 Government of India – Union Government Accounts at a Glance as at the End of November 2017, Controller General of Accounts, Ministry of Finance, Government of India, November 2017.http://cga.nic.in/MonthlyReport/Published/11/2017-2018.aspx. Accessed on 19 January 2018.

8 Fiscal deficit is computed as Total Expenditure – (Revenue Receipts + Non-Debt Capital Receipts). http://www.indiabudget.gov.in/ub2017-18/bag/bag1.pdf. Accessed on 19 January 2018.

at 120 per cent of the budgeted estimates.[9] More borrowings for the rest of the year are unavoidable. These would increase the liabilities of the government by increasing its interest payment obligations – a situation that prudent fiscal management is always keen to avoid.

The revenue receipts for the year, till now, have been lower than expected primarily due to lower collections from the GST. Revenues from the GST would be shared by the Centre and States from a common tax pool. However, the GST collections have been much lower than expected since several items that were initially being taxed at the highest GST rate of 28 per cent have been subsequently shifted to lower rates. Revenue collections are also being affected by the initial hiccups of businesses and enterprises adjusting to the new system of filing returns.

Consumer Prices: Moving North

The macroeconomic situation is becoming more challenging with the hardening of consumer prices. The Consumer Price Index for December 2017 revealed a general inflation rate of 5.2 per cent with food price inflation just below five per cent.[10] This is an inflation rate that would preoccupy policymakers as it is the highest since July 2016 and is induced by higher prices of vegetables and fruits, housing and fuel.

Vegetable and fruit price rises reflect the persistence of typical structural problems, particularly the vulnerability of prices to inefficient agricultural supply chains, which result in price increases at every stage of the grower-wholesaler-retailer-consumer linkage, due to delays in delivery, storage costs and intermediaries. Higher housing costs might reflect a recovery of property prices due to cheaper loans whereas fuel price increases might constrain the government from cutting further subsides on petroleum products.

[9] "Press Note on First Advance Estimates of National Income 2017-18", op. cit.

[10] Press Release – Consumer Price Index Numbers on Base 2012=100 For Rural, Urban and Combined for the Month of December 2017, Central Statistics Office, Ministry of Statistics & Programme Implementation, Government of India, 12 January 2018. http://mospi.nic.in/sites/default/files/press_release/CPI_PR_12jan18.pdf. Accessed on 19 January 2018.

2018: An Uphill Task

As the Union Budget draws near closer, macroeconomic challenges make it imperative for the government to address some major concerns. Foremost among these are increasing revenues to reduce the fiscal deficit and sustaining the fiscal health. The GST issues might continue to hamper central government's revenue receipts, particularly as the Centre is committed to compensating the States for any revenue shortfalls following implementation of the GST.

While direct tax collections might improve, they are unlikely to boost to an extent that would make a dramatic impact on total receipts. One possible way out could be to mobilise capital receipts, which can accrue from the sale of government assets. The Oil and Natural Gas Corporation (ONGC)'s purchase of 51 per cent government equity in Hindustan Petroleum Corporation Limited (HPCL), apart from integrating operations in India's state-owned energy sector, would also fetch much needed revenue for Government[11]. Pressing ahead with the privatisation plan of Air India is also essential as it might fetch the government more funds and compress the fiscal deficit.

Consumer prices would demand full attention of the government. Rising prices can inhibit policy action in various ways. They would hold back the Reserve Bank of India from reducing interest rates, which many experts feel, are essential to revive private investment and generate higher GDP growth. High prices are also inimical for fiscal management as they discourage rationalisation of inefficient subsidies. High prices also have political costs. Containing prices is one of the main reasons for the government progressively reducing the GST rates on various goods and services, so as to cushion the impact on the common man. However, by doing so, the government has jeopardised its own revenue prospects.

Reviving agricultural prospects will remain a major challenge for the Government given the economic and political imperatives of increasing agricultural incomes and productivity. Cooperation with Israel can brighten long-term productivity prospects. But in the immediate future, crop pricing and distribution will remain challenges. Challenges also remain in further

[11] http://www.livemint.com/Companies/gcA2SJaHfRD_gEbZfHDycpM/ONGC-to-buy-government-stake-in-HPCL-for-Rs36915-crore.html Accessed on 21 January 2018

improving investment climate, particularly at the state and local levels, where opportunity costs for businesses continue to remain significant in many parts of the country.

The year 2018 might see the Indian government struggling to manage a complex basket of macroeconomic challenges that include containing prices, sustaining economic growth and fiscal disciplined and reviving farm sector growth. The going is hardly expected to be smooth.

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