

Stay on fiscal consolidation path, cautions Rajan

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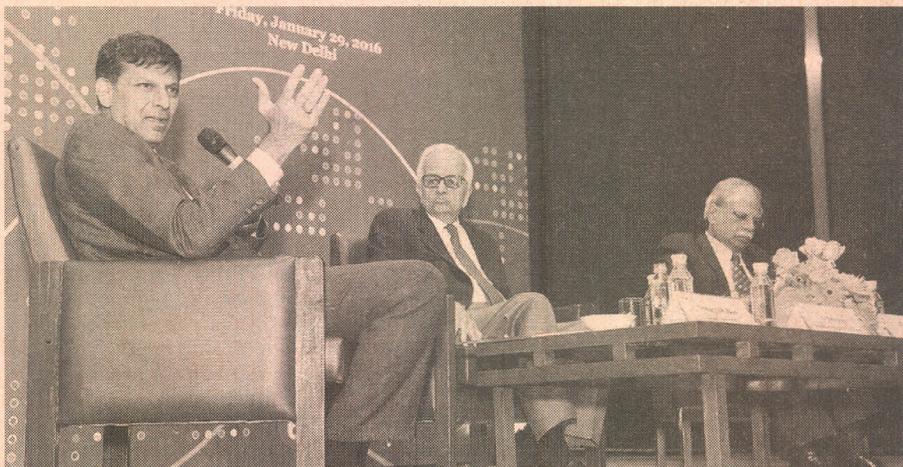
New Delhi, 29 January

Reserve Bank of India Governor Raghuram Rajan on Friday backed fiscal consolidation over "aggressive" policies to boost economic growth, as the finance ministry grapples with a dilemma between economic stability and growth ahead of the Budget.

Delivering the C D Deshmukh memorial lecture here, he also favoured greater competition among banks, saying the government should decentralise decision making in public sector banks (PSBs) after professionalising their boards. Asserting that some stressed loans have to be written down to improve the health of PSBs, Rajan said it will pave the way for mergers and help optimise their resources. "The consolidated fiscal deficit of the states and Centre in India is by far the largest among countries we like to compare ourselves with; presently only Brazil, a country in difficulty, rivals us on this measure," Rajan said.

He cited International Monetary Fund (IMF) estimates saying that the consolidated fiscal deficit of the Centre and states went up from 7 per cent in 2014 to 7.2 per cent in 2015. "So we actually expanded the aggregate deficit in the last calendar year. With UDAY, the scheme to revive state power distribution companies, coming into operation in the next fiscal, it is unlikely that states will be shrinking their deficits, which puts pressure on the Centre to adjust more," he said while adding that it is the IMF figures which investors watch.

The governor questioned arguments by those favouring fiscal expansion on the grounds that it is necessary to generate the growth needed to put our debt to GDP ratio back on a sustainable path. "This is a novel argument. Ordinarily one would think that a government should borrow less, that is, run lower fiscal deficits, in order to reduce its debt. But there is indeed a theoretical possibility that the growth generated by the fiscal expansion is so great as to outweigh the additional debt



RBI Governor Raghuram Rajan (left) delivers the C D Deshmukh Memorial Lecture in New Delhi on Friday

PHOTO: PTI

RAJANSPEAK

It is to the immense credit of the (Indian) government that we have over seven per cent growth, low inflation, and a low current account deficit. But it is at such times that we should not be over-ambitious

Clearly, there are industries in trouble. We should be particularly careful about raising tariffs at a time when costs are falling everywhere

To get sustained growth, we need more competition, especially from new entrants who are in a better position to reach hitherto excluded parts of our economy

It is hard to say it (start-ups) is a bubble. The problem is that everyone is trying to find tomorrow's Amazon

'Never doubted new GDP numbers'

A day after stating that "there are problems with the way we count GDP", Reserve Bank of India Governor Raghuram Rajan on Friday said he had never raised doubts over the GDP numbers and they were broadly correct. "It was not anything about new GDP numbers or the way GDP is calculated. I think it's broadly correct," Rajan said. Observing that there were "no hidden messages" in his lectures, he said: "You do not have to gauge intent. I am direct when I speak."

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that is taken on. Unfortunately, the growth multipliers on government spending at this juncture are likely to be much smaller, so more spending will probably hurt debt dynamics," he said.

"Put differently, it is worth asking if there really are very high return investments that we are foregoing by staying on

the consolidation path?" he wondered.

Rajan said the common man does not really care whether the government stays on the consolidation path or not. "But the bond markets, where we have to finance over ₹10 lakh crore of deficits plus UDAY state bonds, do care. Deviating from the fiscal con-

solidation path could push up government bond yields, both because of the greater volume of bonds to be financed and because of the potential loss of government credibility on future consolidation," he said.

Rajan quoted American strategist James Carville: "I used to think if there was reincarnation, I wanted to come back as the President or the Pope or a 400 baseball hitter. But now I want to come back as the bond market. You can intimidate everybody."

Rajan cited the example of Brazil as a similar developing economy which tried to grow too fast through artificial monetary policy stimulus and paid the price. He said the fellow member of the Brics is now grappling with high inflation and fiscal deficit, with growth having shrunk by 3.8 per cent last year. "As Brazil's experience suggests, the enormous costs of becoming an unstable country far outweigh any small growth benefits that can be obtained through aggressive policies. We should be very careful about jeopardising our single most important strength during this period of global turmoil, macroeconomic stability," Rajan told the audience.

"It is to the immense credit of the (Indian) government that we have over seven per cent growth, low inflation, and a low current account deficit. But it is at such times that we should not be over-ambitious," Rajan said.