

Standing Committee Report Summary

Current Economic Situation and Policy Options

- The Standing Committee on Finance, chaired by Mr Yashwant Sinha, submitted its 59th Report on the 'Current Economic Situation and Policy Options' on August 30, 2012. The Report summarizes the current economic situation, highlights challenges and recommends policy options.

Observations and recommendations of the Committee:

- India's economy has experienced a marked slowdown in growth over the last year. The Committee is concerned that growth will continue to slow despite the Ministry of Finance's optimism about the strong fundamentals of the Indian economy. In particular, the Committee highlight a 'stalemate' in policy reforms and they urge the government to implement better and more balanced reforms.
- The Committee calls for the government to prioritise expenditure on goals of inclusive development, specifically in the areas of healthcare, education and shelter. Citing results from the 68th round of the National Sample survey, the Committee believes that the gap between the rich and the poor is widening.
- The Committee are concerned by the decline in domestic savings, investment and demand in the Indian economy as they believe these are the three primary drivers of Indian economic growth.
- The agriculture component of GDP has diminished considerably since independence while growth in agriculture decreased significantly in 2011-12. While the Committee acknowledges that growth in agriculture can be volatile, they still believe that agriculture growth is falling short of Plan targets and urges the government to invest in the sector.
- Weakness in industry has been the major source of the recent slowdown. Manufacturing has slumped because of a combination of factors like increased borrowing cost, infrastructure bottlenecks, lack of investment and declining exports. The Committee wants the government to address these issues through a time-bound action plan.
- The importance of the services sector in the Indian economy has increased significantly and it has powering economic growth over the last decade. However recent data has revealed a moderation in the sector. To tackle this, the Committee calls for a study group to be constituted to identify the problems in the sector and action required.
- India's trade deficit widened in 2011-12 as a result of a falling rupee, rising crude oil prices and increased imports of gold, coal and fertilizer. With conditions in global economy worsening, the Committee calls for greater diversification of both export markets and products. In addition, the government should introduce measures to provide more incentives for exporters. At the same time the Committee feels that the government should consider promoting alternate fuels to reduce the import bill. They point to the Ethanol blending programme for petrol as a possible area to focus on.
- The Committee believes that India's current account deficit is a serious threat to macroeconomic stability. In particular, the Committee is concerned by the proportion of the CAD being financed by short-term debt flows which they see as a threat to long-term sustainability. In addition, financing the deficit through domestic savings crowds out private investment.
- The Committee sees FDI inflows as crucial in financing India's investment requirement and recommends that the government review FDI policy to improve India's attractiveness for investors.
- According to the Committee, investment has slowed recently because of investor concern over retrospective tax laws and the new General Anti-Avoidance Rules (GAAR). The Committee reiterated their desire to see their original recommendations on GAAR provisions implemented. In addition, the government is urged to enact pending financial reform bills: The Pension Fund Regulatory and Development Authority Bill, 2011, The Insurance Laws (Amendment) Bill, 2008, The Banking Laws (Amendment) bill, 2011, The Prevention of Money Laundering (Amendment) Bill, 2011, The Direct Taxes Code Bill, 2010 and The Companies Bill, 2011.
- Despite the slowdown in growth, inflation remains a challenge for the Indian economy. According to the Committee, a true representative measure of inflation is yet to be evolved and they call for the government to work on indices that better capture inflation. They suggest exploring the RBI's proposal of a Producer Price Index.
- The Committee also highlights a divergence in views between the government and the Reserve Bank on price stability and growth. According to the RBI, inflation cannot be controlled without sacrificing growth while the government calls for high growth even at the cost of increasing prices. The Committee feels that the medium to long terms prospects are more important as price stability is crucial for investment and consumption. They urge the government to take steps to supplement and complement monetary policy with effective fiscal measures.

- At the last policy meeting the RBI reduced the Statutory Liquidity Ratio – the amount of money banks are required to invest in government securities - from 24% to 23%. The aim was to infuse more credit to the private sector but the Committee believes that this is unlikely to happen. In the current environment, they believe banks are reluctant to take on excess risk so they recommend that the RBI review this policy.
- The fiscal deficit of 5.9% of GDP is a source of great concern for the Committee. To achieve fiscal consolidation, the government is urged to formulate a coherent and effective disinvestment policy as specified in earlier Standing Committee reports. In addition, the Committee

recommends that the government prepare a specific action plan which should enhance efficiency in expenditure management; achieve 10% mandatory reduction in non-plan expenditure; rationalize capital expenditure; re-examine the underrecovery calculation methods for oil marketing companies; plug loopholes in the tax system and improve the general quality of public expenditure.

- The Committee also calls for better targeted subsidies as they believe a significant share of subsidized products are being used by richer sections of society.

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