1) What is your assessment of India's current macroeconomic situation?

Virus willing, we will definitely see a huge rebound in growth this year. We have to be careful in interpreting it, though. There will be a temptation to see it as a sign all is well. When the economy shrinks 8%, as it did in fiscal 2021, any rebound because of the end of lockdown coupled with ordinary growth and some pent up demand can make the subsequent growth numbers look extraordinary. However, the true test of our resilience is not 2021-22 but 2022-23, when the numbers will more reflective of our actual situation.

India was in a tough situation before the pandemic because of slowing growth and a tightening fiscal situation, the pandemic has made matters worse by hitting economic activity, worsening our fiscal situation, and worsening the plight of small and medium firms and the poor. I am especially worried about the children of the poor, who have not been to school for over a year, and who are likely to drop out in droves unless we get them back to school quickly and offer them remedial education. I think there is a danger of being complacent here, thinking that they are learning online. My MBA students, equipped with the most sophisticated communications equipment, find it hard to concentrate in online classes, how will the poor child in a bustee, staring at a 3 by 5 inch screen with a poor connection do so? The priority of every government, state and center, should be to get the children back to school, even in the face of a growing second wave.

And that leads to another concern. We risk being complacent about the virus. It is not over. Brazil is experiencing a far worse second wave than the first. We might too, unless we are careful. We need to vaccinate on a war footing – the early rollout is proceeding well, and we need to keep accelerating the pace.

2) Also your comments on the Budget for 2021-22?

Laudably, there is more transparency about the true extent of spending, as well as a degree of conservatism about budget receipts that has not been seen in recent budgets. This is realistic and good. There is also an intent to spend more on infrastructure, which is commendable.
However, the budget is a statement of intent, and as all budgets, has weaknesses as well as strengths. The budget is less clear about revenue raising and the financial sector actions. The slow projected pace of fiscal consolidation could have been made more feasible by credible measures to bind the government, such as a fiscal council and a debt target. A lot of weight is placed on privatization, but the history of the government delivering on this is checkered. Will this time be different? Further, the budget says little about what it will do for the poor and the unemployed. It also continues the process of raising tariffs. At a time when global demand is rising because of the huge spending in the West, we need to be positioned to export. Raising tariffs is not a sensible way to do this.

3) Privatization of the two PSU banks was a big budget announcement. What is your view? Do you expect a backlash?

There is very little detail on how this will be done. Certainly, the government has to talk to the unions and get their buy-in. It also has to improve existing governance mechanisms. I think it would be a colossal mistake to sell the banks to industrial houses. It is politically infeasible to sell any decent sized bank to foreign banks. Perhaps one of our private banks may be in a position to acquire a public sector bank, but I am not sure they have the appetite. That leaves a widely distributed public offering of the government’s stake, with a couple of strategic investors owning 5-10 percent (probably financial institutions) to improve governance. To get there, first we have to reconstitute the PSU bank boards, getting rid of political appointees and professionalizing them. The boards should also be given more autonomy, including over appointing management. That seems like a longer drawn process, not one that will happen in a year. But discussions should already have started with unions, else this will simply stay at the level of intent.

4) How do you think fiscal expansionism will play out with the rating agencies?

What is key is growth. If we can get strong growth, beyond the obvious rebound that is coming, we can keep debt in check and maintain ratings. If we get complacent and settle for the inadequate rate of growth we had pre-pandemic, I
am afraid we are in for tougher times. Sensible spending is not the problem, long-term sustained growth is.

5) What are your views on the proposed ARC, AMC bad bank model? People blame AQR for the surge in NPAs, now CEA K Subramanian has suggested for the fresh AQR, so NPAs are again going to surge if AQR is again initiated. What is your view, should there be fresh AQR?

Blaming the 2015 asset quality review (AQR) for the surge in non-performing assets (NPAs) is like blaming the thermometer for the heat wave. The AQR simply measured the true extent of the bad loans that had built up. We should be concerned about the slow process of dealing with the bad loans, and the new rising levels of forbearance (or more colloquially, “extend and pretend” of bad loans by banks).

With the new “bad bank”, the devil is in the details. If its management has proper incentives, independence, and adequate capital, it can improve the restructuring of bad assets significantly. Poorly designed, the bad bank will just shift bad loans from one pocket of the government to another.

6) The RBI’s Financial Stability Report of December 2020 states that bank’s gross non-performing assets (GNPAs) may rise sharply to 13.5 per cent by September 2021. Do you think present level of NPA is unsustainable?

The economy cannot really get going until credit flows freely, and credit cannot flow until bank balance sheets are cleaned up and banks well capitalized. Whether it needs another AQR to do this, I don’t know, but I certainly think the government should prioritize this issue. The low amounts set aside to capitalize PSU banks in the budget, despite the alarming rise in NPAs predicted by the RBI, indicates it needs to give this issue more weight.

7) The Monetary Policy Framework is coming for a review. Are you in a favour of reviewing the 2-6 per cent target inflation band?

I believe the framework has helped bring inflation down, while giving the RBI some flexibility to support the economy. It is hard to think of what would have
happened if we had to run such large fiscal deficits without such a framework in place. We risk setting upsetting bond markets if we make drastic changes in the framework. I think the framework has been beneficial in bringing down inflation, I don’t think it has been costly in slowing growth, and this is probably the wrong time to make drastic changes.

8) The Modi government aims to achieve USD 5 trillion economy target by 2024-25. Given the unexpected COVID-19 shock, do you think it is a feasible target now?

The target was more aspirational rather than a carefully computed one, even before the pandemic. The Prime Minister can use it to motivate people but policy makers need to base plans on a more realistic sense of where we are. I presume they are doing so.

9) On the farm agitation, has there been a failure of communication? Do you support the Centre's three new farm laws? Given the stand farmers have taken what is the way out?

I think the intent of the farm bills was to create more competition for the farmer’s produce, and to bring more investment to agriculture. I fully support that intent. I don’t think, however, the problem is just one of miscommunication. There has been plenty of time to explain the details to the agitating farmers. I think the farmers genuinely believe they will not be well served by the bills. There is a lesson here – democratic dialogue cannot be dispensed with. It is central to who we are as a nation and to sustainable growth.