IMF’s call for higher public spending in infra not well-timed: Urjit R Patel

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An important issue that monetary and fiscal policy makers alike across the world today are dealing with is the flagging global recovery. The question riveting attention in international policy debate is: will global economic growth pick up if countries ensure an increase in efficient public investment in infrastructure, as suggested by the International Monetary Fund (IMF), at a time when the US Federal Reserve rate hike and global geo-political flare-ups loom large on the horizon? (The Fed has just announced exit from the quantitative easing programme that has been in existence since 2008, expressing confidence that the US economy's revival would nevertheless continue, even as it said interest rates would not be hiked anytime soon). Reserve Bank of India deputy governor Urjit R Patel says the timing of this IMF prescription on infrastructure, as also implied by discussions at the G-20, is not quite right if it coincides with the exit of the Fed from a very loose monetary policy stance. In an interview to Arun S, Patel talked about the practical difficulties that the developed nations could face if they start a publicly driven infrastructure cycle and what such a scenario would mean for India.

Excerpts:

Do you think greater public investment in infrastructure in the current environment can boost global GDP growth?

Increasing fiscal spending in infrastructure is the big bazooka that people are talking about to end secular stagnation in large parts of the developed world. However, starting a publicly driven infrastructure cycle when interest rates are going up does not sound terribly responsible. It will raise the costs for such projects. If this was done five-six years ago when the interest rate was low and expected to be low, then it may have been an idea worth pursuing.

Also, many developed countries think they have the fiscal room to do this, but I don’t think they have.

Given that the US’ government debt is over 100% of its GDP, and if you add on the commitments on social security, medicare, and old age income security for their citizens, and do an overlapping generations calculation, their fiscal elbow room is very limited. I don’t know whether this has been fully worked out. Several large euro zone countries are also on weak fiscal ground. We need to keep sight of “generational accounting” to determine effective, forward looking fiscal space in this context.

The US wants to raise interest rates and that inevitably has to happen because their unemployment is coming down, which will soon create pressure in terms of wage rises and feed into inflation. So to stay close to their 2% inflation objective, they would have to normalize monetary policy which would entail policy rate hikes. Only the timing is not exact.

What impact will it have on countries like India?

We have to be aware that some movement of capital back to these so-called 'source' countries will happen because these countries will now give them a higher rate of interest. We got a taste of it last year and since then we have built up our policy buffers. We have high forex reserves, a lower Current Account Deficit, inflation easing under a tight monetary policy stance and the fiscal deficit is on a path of consolidation. Prices of several of the large commodities that we are net importers of are falling, including that of crude oil, fertilizers and coal. So, in terms of our external situation we are at an almost completely different place compared to the situation last year when the taper talk started.

However, there will be bad news too if global economy growth forecasts keep on coming down. To complicate matters, the ECB is embarking on expansionary unconventional monetary policy. Further, there is an important cautionary tale here for us in the context of the last two years. Specifically how much more do we open our capital account to international arbitrage flows requires careful in-depth analysis before rushing into decisions.

So what should be India's plan for infrastructure given that it is finding it difficult to meet its ambitious target of ensuring investments worth $1 trillion during the 12th Five-Year Plan (2012-17) in the sector?

What we have to think through in infrastructure is that predominantly funding has to be from domestic sources, because infrastructure investment produces services which are non-tradeable, that is, not much by way of foreign currency -denominated revenue. For most of this investment, the entire income stream is in domestic currency. Therefore, it is almost inevitable that much of it is funded domestically.

Secondly, if we get some of our policies aligned in infrastructure, especially on the energy side, we would be surprised on the up side by the outcome that would emerge out of it eventually. This is because the externalities involved in the energy sector are such that economy-wide cash flows capture those externalities and therefore a more viable energy sector would actually "crowd in" investments of all types. The challenges are fixable.

Also, if one goes behind the non-performing assets (NPA) numbers related to the infrastructure sector, what is important to appreciate is that they are not white elephants as such. These assets generate a stream of output that has ready demand. They can quickly start bringing in cash flows for our investors and for our banking system if we fix fuel supply, reduce distribution losses, and address off take agreement design. This should be one of the main tasks going forward.

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