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HARDLY THE BRICK AND MORTAR OF A REVIVAL

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There is no longer any room for doubt on the parlous state of the Indian economy. The automobile industry, seen as a bellwether of activity in the post-liberalisation years, is in crisis, as automakers, parts manufacturers and dealers have laid off about 350,000 workers since April this year, with more job cuts likely. While this could still reflect falling demand only from higher income groups, recently, Parle Products, once the world's largest selling biscuit brands, announced that it may have to lay off up to 10,000 workers (around a tenth of its workforce). The company blamed falling sales due to the Goods and Services Tax (GST) that led to higher prices of the cheapest small packets of biscuits at a time of extreme price sensitivity because of reduced livelihood, especially among rural consumers.

Sales in the fast-moving consumer goods (FMCG) sector as a whole grew at only 10% in the April-June quarter of this year, less than nominal GDP growth. The slowdown in sales is across food and non-food items, with the biggest reductions in salty snacks and biscuits, spices, soaps and packaged tea. These represent the more discretionary element of consumer spending even among the poor — the items more likely to be cut down when household budgets are under strain.

Economists with the government who finally recognised that there is a problem have blamed the current situation on the "financial stress" inherited from the United Progressive Alliance government more than five years ago, which is apparently preventing investment because "no one trusts anyone else". But this isolates only one factor in the current slowdown: the undoubted mess in the credit system, reflecting both the overhang of bad debts of banks (worse today than in 2014) and the erosion of non-banks after the collapse of the aggressive lender, Infrastructure Leasing & Financial Services Limited.

This is a factor, but this explanation completely misses the demand side of the story. It is clear beyond doubt now that the slowdown in mass consumption, combined with falling and then subdued rates of investment over several years, have led to what is undeniably a crisis of inadequate effective demand in the economy.

This scenario has been unfolding for a while because of a medium-term trajectory in which the fruits of growth went disproportionately to a small elite of big capital and rich individuals without translating into broader economic improvement. The increasing inequality associated with jobless growth meant that mass consumption demand did not rise as expected with rapid GDP growth.

The hugely damaging impact of demonetisation in November 2016 was further accentuated by the poor implementation of the GST barely seven months later. These badly managed policy measures served as body blows to informal economic activity, causing major declines in employment and output. At first, they did not affect formal enterprises so much as they gained at the cost of informal ones. But the resulting loss in livelihoods and wage incomes eventually had an effect on demand for formal sector output, which has worsened over time because there have been no counterbalancing moves by the government. Total employment actually declined by more than 15 million workers between 2011-12 and 2017-18, even as unemployment rates reached their highest levels in nearly half a century.

This operated in addition to a medium-term trend of wage suppression, something that was even celebrated by the late former Finance Minister Arun Jaitley as a means of combating inflation.

Rural wages have been stagnant or declining in the recent period. Meanwhile, the continuing crisis of cultivation has obviously affected the purchasing power of the farming community. Urban wage incomes are also apparently not keeping pace with inflation, even as informal activity and “start-ups” in urban areas have faltered.

The government could have countered this adverse impact of declining employment and consumption demand, which in turn reduced the profit expectations of producers in formal enterprises, by providing a fiscal stimulus. It did not do so. Instead, it kept assuming or hoping that using optical measures — manipulating “Ease of Doing Business” indicators and offering further incentives to foreign capital to attract more inflows, however volatile — would somehow attract investment into the economy that would counteract all the negative impulses.

Private investors simply kept demanding more fiscal and regulatory concessions even as they continued to sit on investment plans as they waited for overall demand improvement. More recent complaints of the private corporate sector have been about oppressive tax collection methods of a government desperate to meet its revenue targets. But these along with the greater difficulties of accessing loans from both banks and non-banks are irritants that would have been tolerated in a buoyant economy. They have become serious issues now because of the wider stagnation.

In this context, the Finance Minister’s recent announcements of measures to boost the flagging economy are not a case of “too little too late”; rather, they completely miss the point. They do nothing to address the issue of inadequate demand generation or the underlying tendencies of wage suppression and low employment growth. Instead, they once again reveal a supply-side approach to the problem, which is unlikely to yield much benefit.

Even these measures are mostly cosmetic or affect only a small segment of the economy, not enough to cause any real change in economic direction. The capital infusion of 70,000 crore into public sector banks had already been announced in the Budget; frontloading this inadequate amount is not going to rev up an economy if those whom banks are willing to lend to are hesitant to invest. Giving into demands of foreign portfolio investors with regard to taxation likewise does nothing to increase domestic demand; it simply provides some solace to the stock market. The middle classes repaying home loans may see a minor benefit if banks actually do pass on lower interest rates, but this too will not provide a major boost to the economy. The decision of the government to buy more cars to shore up the automobile industry is bizarre in the extreme, because it undermines the medium-term strategy of shifting to electric vehicles as soon as possible.

What could the Finance Minister have done instead? If the immediate problem is lack of demand, the immediate response should be to increase it — ideally in ways that provide the desired basis for future economic growth.

Rural distress is real and deeper and greater than the much-hyped distress of angel investors and high net worth individuals; so a massive increase in rural public expenditure, including in the Mahatma Gandhi National Rural Employment Guarantee Scheme to provide public works as well as in social spending would provide immediate relief. The multiplier effects of such spending would generate more employment, incomes, consumption and, therefore, investment over time — as well as more tax revenues for the government. There is also both scope and need for increases in “green” public investment for a sustainable future.

But to seize this crisis as an opportunity for progressive change would require more visionary economic policy making, something that this government has been sadly lacking in.

So does the massive transfer of the Reserve Bank of India's surplus amounting to 1.76 lakh crore suggests that this is the government's game plan? Unfortunately, because of the mess in public finances, all that this is likely to do is fill the massive gap left by inadequate tax collection, thereby letting the Finance Minister off in the current fiscal year from another embarrassing situation of budgetary discrepancies. The proposed Budget was not particularly expansionary and did not provide for more spending in the areas required. So this stopgap measure may provide more fiscal space than before, without really addressing the basic problem.

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