The case for a rural stimulus

The fact that the economy is on a downward slide is no longer a matter of debate. It is neither a technical issue nor is it a transient blip which will go away on its own. However, matters are complicated as far as the reasons for the slide are concerned. The real debate is whether it is due to the structural issues leading to a supply shock or it is due to demand deflation in the economy. Any effort at recovery will depend on the correct diagnosis of the problem. Although demonetisation and unpreparedness of the government for the goods and service tax (GST) roll-out contributed to the deceleration in growth rates, the symptoms have been evident for much longer.

In all likelihood the supply issues are not irrelevant, more so after the implementation of GST. The evidence on this based on increasing imports is, however, weak. Although demonetisation and GST have aggravated the supply-side issues, the slowdown started earlier. The economic recovery after 2012-13 had started in 2013-14 and continued until 2015-16, aided by the windfall gain from the decline in petroleum prices. It started declining from the fourth quarter of 2015-16, much before demonetisation and GST had taken place.

The obsession with supply-side issues overlooks the demand-side factors which were showing signs of weakening since 2014-15 itself. A large part of this was driven by what was happening in the rural economy. Wage growth had slumped by the end of 2013. Fertilizer consumption had started declining much before 2014. Growth in agricultural incomes was already decelerating. Construction sector had collapsed. These were clear signs of stress in the rural economy. The rural distress caused by a decline in commodity prices and the drought of 2014 contributed to the worsening of an already fragile rural economy.

It was on the basis of these that I had argued for the need for a rural stimulus (February 2015). The government was also flush with windfall gains from the petroleum price collapse. The government could have acted to stem the crisis in the rural economy. The 2015 drought aggravated the crisis in the rural economy, which was already suffering from depressed incomes. Not only was it ignored, it was allowed to spill over to other sectors of the rural economy, particularly in construction and rural non-farm. The unrest in the rural economy had already spilled over into the Jat, Patel and Maratha agitation, much of it in response to growing joblessness and declining farm profits. This was evident in early 2016, again much before the demonetisation exercise. However, the good monsoon of 2016 did revive hopes for a recovery, which was visible in revival of wage growth and increase in agricultural production. But even this was short-lived with demonetisation taking away the gains of good agricultural production. Since then, it has been a continuous downward slide.

The situation today is vastly different from early 2015 or even 2016 when corrective steps could have bailed out the rural economy. The fiscal capacity of the economy has shrunk, driven by burgeoning farm loan waivers from states and the fact that the government has already spent more than 95% of the fiscal deficit target. Current account deficit (CAD), which had narrowed to less than 1% of GDP in 2016-17, has widened to 2.4% of GDP.

The situation on the demand side has, however, worsened. The first advance estimates of for this year suggest that kharif agricultural output is likely to decline by 2.8% on account of lower sowing of a majority of the kharif crops. This could worsen and impact rabi output as well with live storage in reservoirs down to 66% of the full capacity, compared with 74% a year ago. Reserve Bank of India’s (RBI) consumer confidence surveys show a decline in consumer confidence spilling over to the second quarter as well. Small and medium enterprises are yet to recover from the impact of GST and are likely to see a decline in growth. Even large corporate entities are not showing any

signs of recovery except in commodities and banking. Finally, growth in wage rates, which had accelerated after the good monsoon of 2016, has started declining after demonetisation and is now at the lowest level since May 2014.

Clearly, the downward risk to the economy from the demand side does not suggest any recovery in the near future. While there have been voices demanding fiscal stimulus to increase demand, the government does not seem inclined to it. The argument that this will lead to similar imbalances in the economy as it happened after 2008 are clearly misplaced. The economy in 2008 was already struggling with high food price inflation, unlike now when inflation is well under control and is clearly a signal of demand deflation rather than overheating. Secondly, unlike the 2008 financial crisis, which was accompanied by a deceleration in the global economy, the global economy is now on a recovery path. The fiscal deficit is under control and foreign exchange reserves are at their highest level. More importantly, it has exhausted the monetary policy options for reviving investment without much success. If the government cannot seize the momentum now, it is unlikely to do so at a later stage.

The case of a fiscal stimulus, however appealing, will ultimately depend on whether the government has an idea of what ails the economy. It is clear that not only has the government failed to do anything to revive the sagging rural demand, it has also refused to acknowledge the demand problem. It is only when the government acknowledges that there is a problem that it can begin to analyse the policy option. Unfortunately, the response of the government has been to shoot the messengers as was evident from Prime Minister's speech berating the commentators for spreading the message of pessimism or to blame it on technical issues. While hope may provide succour for the time being, the government should realize that time is running out to do something concrete to revive the economy.

Himanshu is an associate professor at Jawaharlal Nehru University and visiting fellow at Centre de Sciences Humaines, New Delhi.

END