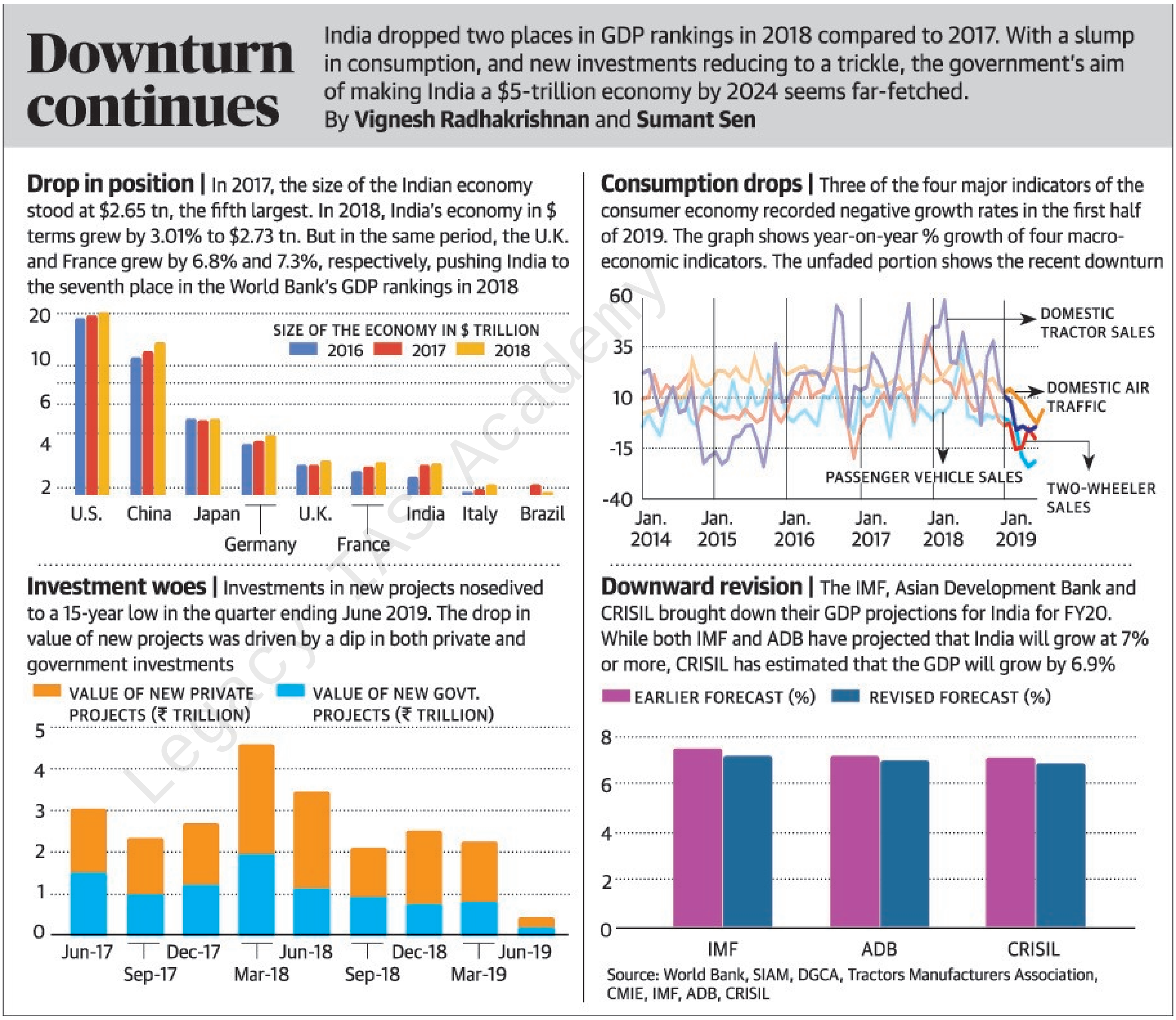
Indian economy downturn



State of the economy: August 2019

The automobile industry, seen as a bellwether of activity in the post-liberalisation years is in crisis as automakers, parts manufacturers and dealers laid off about 350,000 workers within 4 months, with more job cuts likely.

- Reflection of falling demand from higher income groups

- But, Parle Products, once the world's largest selling biscuit brands, announced layoffs too. 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

Home budgets under strain

Sales in the fastmoving consumer goods (FMCG) sector slowed down too: both food and nonfood items.

Pinning down the cause/s

Economists with the government blamed the current situation on the "financial stress" inherited from the previous government more than five years ago, which is apparently preventing investment because "no one trusts anyone else".

However, one outcome can be attributed to the earlier years: mess in the credit system, reflecting both the overhang of bad debts of banks (worse today than in 2014) and the erosion of nonbanks after the collapse of the aggressive lender, Infrastructure Leasing & Financial Services Limited.

Demand side of the story

Slowdown in mass consumption, combined with falling and then subdued rates of investment over several years, have led to a crisis of inadequate effective demand in the economy.

This scenario has been unfolding as 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.

Impact of demonetisation

The hugely damaging impact of demonetisation in November 2016 was further accentuated by the poor implementation of the GST. These 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

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 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

Govt. kept waiting

The government could have countered this adverse impact of declining employment and consumption demand, by providing a fiscal stimulus. Instead, it hoped the “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.

Supply-side approach

The Finance Minister’s recent announcements of measures to boost the flagging economy, do rather less 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 supplyside approach to the problem, which is unlikely to yield much benefit.

- 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 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: 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.