

Official Reforms and India's Real Economy

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The remedial measures announced by the government in and after the 2019-20 budget reflect its limited understanding of the economy as the performance of the financial markets alone. But, to revive the decelerating real economy, the state needs to act upon expansion of public investments towards employment and other basic social goals.

That the Indian economy is currently experiencing a slowdown has been rather evident, both with the deliberations in different private circles and in the official statements signalling a series of remedial measures, mostly focused on the ailing financial sector! However, as we point out, the ailing Indian economy has concerns that go beyond flagging the gross domestic product (GDP) growth and the ailing financial sector.

Downturn in the Economy

As for the downturn, the country's GDP growth rate has plunged into a low of 5% in the first quarter of the current financial year 2019-20. The drop has been accompanied by sharp decelerations in the manufacturing output and a sluggish growth of agricultural output. Matching both, "consumption growth" has also been weak.

But a fact that remains less highlighted in current official concerns includes unemployment, at 7.1% of the labour force during September-December 2018 as reported in the *Labour Force Periodic Review*. Unemployment has been even higher for urban youth during the period, at 23.4% (Gol 2019; Abraham 2017). Information as is available indicates the ongoing spread of job cuts in different manufacturing units and wide-ranging distress in rural areas with farmer suicides, which are of added concern. There are also recent reports of a shrinkage in labour force participation ratio (the proportion of people who are willing to work), indicating tendencies of withdrawal syndromes on the part of the unemployed—which have been largely in response to the grim employment prospects (*Economic Times* 2019). Distress is further manifested in the large number of poverty-stricken people—both in rural and urban areas—ranging from 22% to 29% of the aggregate population according to different estimates.¹

The grim facts relating to unemployment and poverty in the real economy of India make it evident that a drop in GDP growth is not just a matter concerning the dampened financial markets and their volatility. Downturns also speak of the real sector—of the dearth of sustainable jobs and the related poverty.

Looking at the prevailing concerns in India for the stagnating economy, analysts often ruminate on the steep drop in stock prices in India's secondary market, which started with the end of the temporary euphoria when the national election concluded in May 2019. One may recall the shooting up of the Sensex beyond 40,000 on 4 June 2019, far surpassing 37,000 on 13 May. The index, of late, has slumped back, touching 36,855 on 30 August (BSE 2019). The immediate causes cited include net outflows of foreign portfolio investments (FPI) at ₹3,700 crore or above in a single month of July 2019, reversing the usual trend for net inflows in previous months. One also notices the simultaneous drop in India's foreign exchange reserves by nearly \$1 billion between 20 July and 26 July 2019 (RBI 2019).

Announced Policy Measures

Concerns relating to the stagnating GDP growth and financial markets in the country prompted the government to announce a series of measures over the last few weeks of August 2019. Those include the scrapping of surcharges on long and short-term capital gains—as were proposed in the last budget—in a bid to help inflows of foreign portfolio investments.

Among the few stimulant measures proposed, is an investment package of ₹100 lakh crore on infrastructure, a ₹70,000 crore liquidity injection to recapitalise banks and cheaper loans to facilitate property market and auto sector, along with a promise of additional purchases by the government departments in the auto market. Corporates are also assured of a no penalty clause if they fail to comply with the corporate social responsibility (CSR) clause, originally designed to help the underprivileged. Included in the package are also additional rollbacks of taxes on the “super-rich” in the income slabs of ₹2 crore to ₹5 crore and beyond, which were introduced in the 2019 budget declared only a couple of months ago.

Government announcements, in the next round, have relaxed several rules on single-brand retail, contract manufacturing, coal mining and digital media for foreign direct investments (FDIs). Another important measure is the dilution of the current 30% domestic sourcing norms for single-brand retail trading in the country.

The more recent of the official announcements relate to the mergers of public sector banks (PSBs), by combining the “bad” ones with others, thus reducing the total number of PSBs to 12. The move is supposed to coordinate with the promised recapitalisation plan of ₹70,000 crore.

Remedies and Economic Revival

Sops as above can provide tax relief to portfolio investors within and outside the country and are potentially effective in temporarily stimulating the secondary stock market. But these may not work to reverse the tendencies for the stagnation even in the financial sector, let alone in the overall real economy. Thus, contrary to the expectations, the response of the stock market has been rather non-committal. Absence of response is continuing further in the real sector of the economy in terms of output, investment and employment.

The stark realities of the diverse spheres of the real and the financial economy reflect in the low value of the initial primary offers (IPOs) that indicate new physical investments as compared to the transactions of shares in the secondary stock market. A revival of the stagnating real economy demands additional investments in physical terms with related expansions in jobs. Little of those are likely to be fulfilled by a boom in the secondary

market of stocks and the related gains on speculative and short term investments.

Also in terms of simple national accounts, capital gains or losses relating to the portfolio investors in the secondary stock markets are always treated as “transfers” between parties, and as such not even considered in calculating the GDP in their first round. Possibilities, however, remain of injections/withdrawals of demand by agents in markets, who face capital gains/losses, as opposed to their underlying inclinations to further speculate in the market.

The proposed tax benefits for the super-rich will further widen the inequalities within the country, and little of the tax-exempted income will be channelled beyond the speculative zone of stock markets and real estates. Additions to savings, if achieved, again, will not generate real investments unless demand for the latter is forthcoming in the market. This comes as the home truth that Keynes had spelt out more than 80 years ago in the context of the Great Depression of 1929–30! Sops to speculation in the market and the lenient tax breaks for the super-rich may only help to invigorate the current spate of speculation further.

Some concerned measures for the PSBs, as offered, were more than deserving for the banking sector, given the issues with the near bankrupt non-banking financial companies (NBFCs) (or shadow banks) like the Infrastructure Leasing and Financial Services (IL&FS) which availed of the easy access to the formal banking sector. The process also generated the ongoing non-performing assets (NPAs). Also corporates, and not to mention the corrupt/fugitive clients of banks, have made use of credit from banks to make good their earnings on investments in the financial sector and have often taken recourse to bankruptcy while adding on to the NPAs held by banks. Also there remain the corrupt clients of banks who could run away, a process contributing further to NPAs held by any banks. One wonders if the change in governance as suggested by the recent mergers—aiming to combine the weak banks with those that are strong in terms of current performance—will help in lifting the PSBs from the current mess. In our judgment, the vacuum already created with shrinking banking facilities and branches along with the total absence of development banks will continue to provide space to the NBFCs and their malfunctionings.

Incidentally, the soft-peddalling by the Reserve Bank of India (RBI) with four consecutive cuts in the repo rates, while signalling a nod to expansionary monetary policies, will work to lower the lending rates of banks only if there will be a pick-up of credit demand from the public. And, this calls for investment/consumption demand, especially from the real (rather than the financial) sector, because the growth of credit supply is determined by credit demand and not the other way round! This does not rule out possibilities of additional borrowings at the lower rates to finance speculation in financial markets, which will not help revival of the real economy.

Stagnation in Real Economy

As already emphasised in the preceding sections of this article, a country’s GDP growth alone hardly indicates the country’s level of development, which include employment, social security and absence of poverty. Recognising above is important in the context of the ailing Indian economy that is currently subject to more pressing concerns than the plunging financial sector.

The employment situation currently prevailing in the economy includes 90% or more people struggling to eke out a survival in the informal sector, while the organised formal sector of

industry and services offers only 10% or less of jobs, thus pushing the majority of the working population to the dark terrains of the unorganised and informal jobs (EPW 2017). Mention can be made here of the structural changes in the Indian economy, with changing relative contributions of its three major sectors. Those include the share for services moving up to 50% and above since the early 1990s and the respective industry and agriculture shares stalling around 25% and 19% or less since then (Kapoor 2017). As for the sectoral pattern of employment, agriculture has remained the largest provider of occupations, at 48.9% of aggregate employment in the economy during 2011-12.² Almost all of the latter are purely in an informal capacity, thus fetching little of the benefits usual for labour formally recruited.

As for jobs available in the industrial sector, the organised sector (dealing with the registered factories) provides less than 11% of the aggregate employment in the country, of which more than four-fifths are employed on a purely contractual or temporary basis (Kannan and Breman 2013). These offer none of the benefits that normally accompany formal jobs. A recent estimate points at the low employment elasticity of aggregate output at 0.08%, which today is even lower than 0.18% during 2009-11 (Azim Premji University 2014; Suresh and Misra 2014). Much of the above is because of the lower absorption of labour in the production process due to the use of capital-intensive technology. In addition, growth rates are found to be higher for capital as well as the skill-intensive products as compared to the average growth of industry.

The service sector, currently providing more than one-half of the GDP, has only a marginal contribution in employment. Data available from the Labour Bureau indicates that of an aggregate 140-150 million jobs in the services sector during 2015, only 26 million were with the organised sector. The remaining jobs, mostly in petty production units and self-employment in the informal sector, include large numbers, which in our view, reflect of disguised unemployment. However, services in the organised sector also include the “sun-rise sector” of the Information Technology-Business Processing Organisations (IT-BPO). Their contribution to jobs has been rather minimal, as can be expected in terms of their use of capital and skill-intensive technology.

Growth in India’s services sector is concentrated in activities related to finance, insurance, real estate and business services (FINREBS). It needs to be noticed that the FINREBS has a rising share, both in the service sector contribution to GDP as well as in the GDP. In fact, such shares have not only escalated over time, but have continued to rise even with declining GDP growth rates (Bose and Kumar 2018). Thus growth of the FINREBS, as can be expected, while contributing to GDP growth, have failed to contribute much in terms of employment or real activity. This aspect helps one to understand the underlying paradox of high GDP growth with unemployment.

The sectoral contributions as above brings home an explanation of the slow growth in jobs and related poverty—and that too for the majority of the labour force, who are employed in informal sector and denied sustainable wages and benefits as well as job security.

Need for Expansionary Policy

While there is an urgent need for public expenditure as investments, as well as for social sector expenses, the government abides by its self-imposed limits of the fiscal deficit to GDP ratio, which restrains additional public expenditure. The dictum is provided by the Fiscal Responsibility and Budget Management Act (FRBMA) of 2003, which was voluntarily enacted

by the then ruling government. Given that the theory of “austerity” as a measure of investment revival by controlling inflation is much discredited at levels of analysis and policies, there is no reason why the country should continue to stick to such measures (Sen and Dasgupta 2014).

It needs to be recognised that official expenditure remains a prerequisite to stimulation of private spending, especially in the current context of a demand deficient domestic economy. A departure, thus effected, from the ineffective policy prescriptions of the mainstream economic theories of fiscal restraint, can be expected to generate a climate of expansion within the country.

Considering the gravity of the situation, this is the moment for a call to the state to “act” and not just “protect” the interests of stock market speculators, the disgruntled super-rich who threaten to move offshore if imposed by surcharges on higher income slabs, and bankers who misallocate funds in search of quick and illegitimate gains, or “defend” the corporate sector’s negligence towards the only paltry act of benevolence that they were subjected to by their CSR obligations.

It will be a limited exercise on part of the officialdom to view the financial market performance as a true gauge of performance of the economy as a whole. The Indian economy is indeed in the need for an alternate course of action. The state must focus and restore the real economy with channels to revive investment, employment and other social goals for the majority.

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Notes

1 Data.gov.in, <https://data.gov.in/keywords/poverty-estimates>.

2 Statisticstimes.com/economy/sectorwise-gdp-contribution-of-india.php
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