



PERSONALITY TEST PROGRAMME 2019

(Current Affairs Interview Issues)

ECONOMIC SLOWDOWN IN INDIA

Recently, according to the **World Bank's South Asia Economic Focus report**, India's **GDP growth projection has come down to 6% from 7.5%** as projected in April 2019. Quarterly GDP growth slowed for 5 quarters in a row, declining from a peak of 8.1% in the first quarter of 2018 to only 5.0% in the 2nd quarter of 2019, the lowest in over six years. Even the latest annual report of the RBI for the fiscal year 2018-19 confirmed that the Indian economy has indeed hit a rough patch.

Ministry of Commerce and Industry released numbers showing that growth in eight core sectors of the economy had slipped to 2.1% during July as compared to 7.3% during the corresponding month last year. The above numbers make it clear that India is in a middle of a sharp growth slowdown.

What is an economic slowdown?

- The technical term for an economic slowdown is **growth recession**. A recession is defined in economics as three consecutive quarters of contraction in GDP.
- This is the third instance of an economic slowdown for India in the past decade after the ones that began in June 2008 and March 2011, primarily driven by external environment.

Nature of the slowdown

There is an existing debate whether the economic slowdown is a **cyclical downturn** or a **structural correction**. While cyclical slowdowns can be dealt with using temporary fiscal and monetary stimulus, structural problems require long-run policy responses. There are many signs which indicate that the problem is more structural than cyclical. For e.g.:

- The introduction of the 2016 Insolvency & Bankruptcy Code (IBC) and re-capitalization of state-owned banks, though necessary reforms, turned out to be inadequate to resolve the weakness.
- Further, since the beginning of 2019, even the relaxed monetary policy stance and toned-down Prompt Corrective Action (PCA) norms are not push up credit demand.

Reasons

- **Collapse in Private Consumption**
 - The most prominent factor seen as the cause behind the slowdown is **deceleration of the domestic demand**, reducing **Private Final Consumption Expenditure (PFCE)**. Private consumption grew 3.1%, compared to 7.3% a year ago.
 - RBI's annual report points out that significant reduction in sales of motorcycles and tractors during Q1 2019-20 is a clear reflection of the **slowdown in rural consumption demand**.
 - **Low income trap of the farm sector** is believed to be a major contributor to the demand downturn, as evident from Q1 GDP numbers for the agriculture, forestry and fishing segment released by the NSO. The segment grew at 2% in FY20 as opposed to 5.1% in the same quarter of the previous year.
 - Similarly, **urban consumption demand** is also slackened as observed by a strong contraction in passenger car sales, domestic air passenger traffic as well as consumer durables such as TV sets. As demand slackens and consumers begin to consciously reduce their spending, the slowdown that the economy is already experiencing becomes self-reinforcing.
 - If consumption spending falls, the economy would **stagnate** and prices **deflate**. Lower prices, if **unable to recover the costs**, would **halt the operations of any firm** and would **initiate the layoff process**. This, in turn, reduces earnings further. Hence, this **vicious cycle** keeps upon repeating itself until the economy slips into a deeper state of shock.



- **Rising unemployment and layoffs in employment intensive sectors** such as automobiles and construction have not just created utter distress in the labour market but also shaken consumer confidence and choked demand.
- The bargaining power of the working class in industries and services except in the top layer in the IT and finance sectors, has been falling due to **informalisation** and **contractualization** of almost 80% of employment in the formal sector. Share of the labour in value-added formal sector has dropped from 33% in 1990-91 to 23% in 2012-13.
- India's growth numbers were earlier justified through private consumption, with large-scale employment being created in the gig economy, which is not adequately captured in official figures. Yet, recent events like layoffs at restaurant aggregator Zomato indicate slowdown in such sectors as well.
- **Global Slowdown**
 - Consumption demand has fallen in all the major markets including Europe and China. From the early months of 2018, a combination of global spillovers - from attempted monetary policy normalization by central banks (i.e. increasing short-term interest rates and money supply contraction); elevated and volatile crude oil prices; geopolitical tensions; US-China trade war; and Brexit – have not only **contracted world trade** and, in turn, **Indian exports**, but have also triggered **capital flows out of emerging market economies (EMEs)**.
 - Growth is also being weighed down by country-specific factors in **emerging market economies**, and by structural forces, such as **low productivity growth** and **aging demographics** in advanced economies.
 - The deceleration in growth in the context of slowing global GDP and trade growth, as well as an uncertain external environment, bears resemblance to 2008 and 2012/13 when GDP growth in India slumped.
- **Declining private investment**
 - It is unrealistic to expect that the private corporate sector or even foreign investment would invest in an economy with a shrinking market.
 - Absence of investment accentuates the crisis. Investment creates jobs & incomes. As this income flows from one hand to the other, the 'state of confidence' of businessmen to invest goes up, reinforcing the virtuous cycle.
- **Restrained government spending**
 - Government spending, which kept the economy afloat during the last 5 years, was cut back in the last quarter of 2018-19 to meet the fiscal deficit target of 3.4%.
 - Most of the growth during the period of 2014-17 was marked by increased Government spending, allowed by fiscal space due to sharp decline in the world oil prices.
 - Using creative accounting methodologies like such as 'rolling over' a part of the overall subsidy bill & dues to the states to the next financial year; using PSEs like LIC to purchase divested stakes in the disinvestment process leads to understatement of fiscal deficit. This not only makes India's fiscal consolidation numbers appear less attractive to investors and makes Govt. reluctant to spend more.
 - Budgeted schemes such as PM-KISAN, Ayushman Bharat etc. already constrain Government's hand in spending.
- **Structural Issues:** In such a weak economic environment, structural issues, like weak financial sector, are more starkly evident.
 - Despite high economic growth in the last decade, India's banking system still has a significant level of non-performing assets of close to 10% of total assets. This has resulted into a fall in overall credit availability, as the banks are unwilling to lend to overleveraged corporate sector.
 - Non-banking financial companies (NBFCs), which complemented credit availability from banks, were plunged into a liquidity stress post IL&FS crisis. NBFCs financed 40% of car sales, and hence the squeeze contributed to the recent consumption slowdown.
- **Issues with GDP Estimation:**
 - The absolute GDP in the base-year (2011-12) contracted 2.3%, while annual growth rates in the following years increased substantially. For 2013-14, GDP by the new series grew at 6.8% compared with 4.2% in the old series. The growth in manufacturing moved from -0.7% to +5.3%.
 - Such wild swings drew widespread doubts, given that it was out of line with other economic correlates such as bank credit growth, industrial capacity utilisation, exports & imports, Index for Industrial Production (IIP) etc.
 - In a recent published research paper, Former Chief Economic Adviser Arvind Subramanian had concluded that the country's growth has been overestimated by around 2.5% between 2011-12 and 2016-17.
- **Disruptive events** such as **demonetization and implementation of Goods & Services Tax (GST)** are believed to have hurt the supply chains and adversely impacted agriculture, construction and manufacturing, albeit temporarily.

Measures taken by the Government

• Monetary Policy Measures

- **Repo rate cut:** In Oct 2019, RBI lowered the repo rate to 5.15%, lowest in 9 years. This year, RBI has cut down the repo rate by 135 basis points signaling continued accommodative stance.
- **Monetary Policy Transmission:** Despite surplus inter-bank liquidity, however, monetary transmission has been weak and bank lending rates have not reacted much. Linking floating rate loans extended to both retail consumers as well as MSMEs to external benchmarks (e.g. repo rates, yield on 3/6 months treasury bills etc.) might improve monetary policy transmission.
- **Higher flow of funds to NBFC sector:** RBI relaxed liquidity norms to allow more lending to non-banking finance companies (NBFCs) by banks

• Manufacturing Sector:

While monetary policy will continue to act as the main countercyclical tool, the fiscal measure is expected to have a positive economic impact. Government of India has also launched a stimulus package that will support the ongoing expansionary monetary policy.

- It includes **lowering down of effective corporate tax** and **tax holidays** for fresh investment in manufacturing.
- Scope of **Corporate Social Responsibility (CSR)** funding was increased to funding of incubators, contributions to publicly funded universities, autonomous bodies engaged in conducting research in science & technology etc. CSR violations are no longer treated to be criminal offences.

• Exports:

India's share in manufacturing exports is barely 2% and therefore, there is a potential to increase that amidst global slowdown

- **Trade facilitation** by leveraging technology to reduce turn-around-time (TAT) at airports/ports/customs through process digitization and elimination of offline/manual services
- Reducing **GST Refund Period Delay**
- **Special FTA Utilisation Mission** to promote awareness of preferential duties among Indian exporters and facilitate compliance requirements (Rules of Origin/Certificate of Origin etc.)
- Extending **higher insurance cover** to banks lending working capital to exports
- Proper management of **exchange rate**

• Foreign Investments

- Government withdrew additional surcharge on long and short term capital gains earned by Foreign Portfolio Investors (FPIs) arising from transfer of equity shares
- Know Your Customer (KYC) norms were simplified for foreign investors to improve market access
- Government recently opened up FDI in contract manufacturing sector

• Housing Sector

- **Relaxation of External Commercial Borrowings (ECB) guidelines** for affordable housing to facilitate financing of home buyers who are eligible under the Pradhan Mantri Awas Yojana
- Lower interest rates on House Building Advance and link it with 10 year G Sec yields
- Special ₹20,000 cr fund as a last-mile funding for completion of ongoing housing projects that are not classified as non-performing assets (NPAs) or are facing bankruptcy proceedings under NCLT

• Private Demand:

- GST on many consumption items such as automobiles has been cut down.
- Government is trying to address the problem of rural distress & put more money in the hands of poor through income support schemes like PM-KISAN.
- Recently, to increase rural wages & purchasing power and thereby reviving rural demand, Government linked wages under MNREGA to Consumer Price Index for Agricultural Labourers.

Way Forward

• Counter cyclical fiscal response:

Currently, we are facing an unusual situation of low inflation and low GDP growth in nominal terms and hence, there is a need to take the risk of cyclical fiscal expansion.

- State governments must be encouraged to increase their capital expenditure relative to their respective gross state domestic products

• Government Spending: Long-term revival of consumption demand

is predicated largely on the government's ability to create **jobs** and **raise wages** in a classical Keynesian manner. For that, Government needs to spend more.

- Government must continue pursuing its asset sale and disinvestment programme to generate additional fiscal space for spending.
- ₹1.76 lakh cr windfall that the Government received from RBI should be judiciously utilized for **reviving rural demand** primarily by increasing expenditure on rural infrastructure projects.
- Through public-private partnership (PPP) mode, the private sector may be incentivized to supplement government's investment.

- **Redesign MNREGA:** Over the years, due to paucity of funds and untimely disbursal, MNREGA has become a supply-based system from a demand based system.
 - MNREGA must be redesigned back to its original form where people can demand work from the government.
 - Implementing successful social audit models on the lines of states like Andhra Pradesh & Rajasthan would lead to better wage realization for workers in rural areas.
- **Structural Reforms:**
 - Public Sector Banks which account for 75% of the India's banking assets face serious misgovernance issues as evident from increasing number of bank frauds. In the 1st quarter of FY19-20, a total of 2480 cases of fraud involving a sum of ₹32,000 cr were reported from PSBs.
 - ✓ Therefore, there is a need to ensure **transparent and meritocratic appointments to upper management and functioning of Board of Directors independent of the Government**
 - ✓ Additionally, **management** must be made **more accountable to the Board** through proper performance evaluation mechanisms
 - ✓ To avoid the situation of 'regulatory capture' by the Government, the independent functioning of RBI has to be ensured, particularly in case of appointments to the upper management and the Board.
 - ✓ In fact, **domain expertise** and **functional competence** should be prioritized in appointments to all regulatory bodies since functions like monetary policy, banking supervision, data collection & dissemination, audit of government financial accounts etc are all technical jobs.
 - **Increase female labour force participation rate (FLFPR)** (which has fallen from 31% in 2004 to 23.3% in 2017-18) by providing tax rebates/increasing threshold income for zero income tax. This would encourage paid jobs among women and give a definitive boost to consumption.
 - ✓ Such a policy (called "**Womenomics**") **was adopted in Japan** under President Shinzo Abe to get more women into the workforce
 - Moreover, greater Government spending cannot sustain growth for long unless **major supply-side reforms** such as **land and labour reforms** are undertaken.
 - Structural shifts over the long run can be achieved through **additional investments** in the **health and education sectors** that will have multiplier effect on the economy.
- Finally, **international cooperation** is very much required to counter this synchronized slowdown (according to IMF) in the world's economy, which continues to be weakened by rising trade barriers and increasing geopolitical tensions. There must be a decisive and inclusive discourse on issues ranging from free trade, safely adapting to FinTech, implementing the financial regulatory reform agenda, data localization etc.

Therefore, to fend off other risks to growth and to raise potential output, economic policy should involve both monetary and fiscal measures in a coordinated manner. Besides, it is also the time to look at the slowdown as an opportunity to bring widespread structural corrections in the economy, be it in the banking sector, governance in general and fiscal reforms relating to direct taxes and GST. Milton Friedman, a Nobel laureate in economics, once wrote: "Only a crisis — actual or perceived — produces real change. When that crisis occurs, the politically impossible becomes the politically inevitable."

Summary

- Indian economy is going through a **phase of slowdown** which is indicated by- quarterly GDP growth slowing for 5 quarters in a row, dip in the growth in eight core sectors of the economy, and World bank's revised GDP growth rate of India to 6% from 7.5%.
- The inadequacy of fiscal and monetary stimulus like prompt corrective action, relaxed monetary policy, in addressing the slowdown indicates that **it is structural, and not cyclical in nature.**

Reasons for slowdown

- **Collapse in private consumption** as both urban and rural demand are falling, due to low income trap of the farm sector, rising unemployment and layoffs, informalization and contractualization.
- **Global Slowdown** due to increasing interest rates, volatile crude oil prices, US-China trade war leading to fall in consumption demand in major markets like Europe and China, resulting in fall in Indian exports, and out flow of capital.
- Decline in **private investment** due to shrinking market.
- **Restrained government spending** to meet the fiscal deficit target, and due to budgeted schemes, such as PM-KISAN, Ayushman Bharat etc. that constrain Government's hand in spending
- **Structural Issues**, like weak financial sector, evident in rising NPAs (close to 10% of total assets), IL&FS crisis resulting in low credit availability.
- **Issues with GDP Estimation** further raised doubts as it was out of line with other economic indicators like bank credit growth, Index for Industrial Production (IIP)
- **Disruptive events** such as **demonetization and implementation of Goods & Services Tax (GST)** are believed to have hurt the supply chains across the sectors.

Measures taken

- **Monetary policy measures** including lowered the repo rate to 5.15% (lowest in 9 years), better monetary policy transmission, eased liquidity norms to NBFCs.
- **Fiscal measures include** lowering down of effective corporate tax and tax holidays, scope for CSR utilisation in funding of incubators, contributions to R&D etc.
- **Measures to boost exports** including trade facilitation by use of technology, Special FTA Utilisation Mission, higher insurance cover to capital lending banks, proper management of exchange rate, Reducing GST Refund Period Delay etc
- **To boost foreign investments** easing KYC norms for foreign investors, withdrawal of additional surcharge on long and short-term capital gains, opening new areas for FDI etc
- **To boost private demand, relaxation of ECB norms** for housing sector, GST reduction on consumption goods, schemes to boost rural demand like PM KISAN, revising wages under MNREGA etc

Steps to be taken

- Fiscal response by **increasing capital expenditure** including state governments, in infrastructure projects and incentivising private sector via PPP mode.
- **Redesign MNREGA** to make it demand driven and implement social audit system like in Andhra Pradesh, Rajasthan.
- **Structural reforms** like addressing governance issues in public sector banks, bringing in domain experts for technical jobs, like auditors etc.
- **Increase female labour force participation rate (FLFPR)** (which has fallen from 31% in 2004 to 23.3% in 2017-18) by providing tax rebates/increasing threshold income for zero income tax. (Like **"Womenomics" adopted in Japan**).
- **Major supply-side reforms** such as **land and labour reforms** and **additional investments** in the **health and education sectors** that will have multiplier effect on the economy.
- **International cooperation** on issues ranging from free trade, safely adapting to FinTech, implementing the financial regulatory reform agenda, data localization etc.

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