A Candid Assessment?*

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As 2015 drew to a close the Finance Ministry released its Mid-Year Review (MYR), which summarised the official view of the state of play in the economy after a year-and-a-half of Modi-rule. As expected the MYR begins with the positives, which are more in the nature of 'disappearing negatives'. The most obvious of them is the decline of the inflation rate with the CPI pointing to a 5 per cent rate in October and the WPI indicating a negative rate month-on-month for a year now. Interestingly, reflecting its inclinations, the Finance Ministry celebrates the fact that muted "rural wage growth and minimum support price increases" are the principal determinants of this reversal. The other positive is the ostensibly robust 'external position' of the country, with the current account deficit at 1.2 per cent of GDP (thanks to lower oil prices and a recession induced fall in non-oil imports).

But all this merely serves as the preamble to a discussion that cannot conceal the fact that there has been little advance on the development front. In fact, the year gone by has been one in which the euphoria that the landslide victory of the Modi-led NDA had generated in certain circles, especially with regard to its promise of "development", has waned. There were many factors explaining this euphoria, which also vary across sections and interests. Indian big business was happy not just because it was convinced by the Gujarat experience that Modi was pro-business, but because it believed that pro-business reform would sail through given the brute majority of the NDA in the Lok Sabha. Foreign investors had realised that Modi would open his arms to embrace them, and were keen that their own government mend their fences with the new leader, so that they can reap huge benefits. The middle class operated under the belief that the new leader would bring "good governance" so that, not only will the trains run on time, but their kith and kin would be employed in lucrative positions in a hugely successful India. And the Sangh Parivar was convinced that whatever might happen on the economic front, they would have a free hand in the realms of culture and education and the freedom to push their divisive and reactionary agenda.

A year and half down the line all except, perhaps, the Sangh Parivar are disappointed. Modi has faltered hugely and failed on the development front, even though falling oil and commodity prices have kept inflation down, at the expense of small commodity producers. But expectations were kept high for long because of the headline grabbing announcements on issues varying from cleaning India through the Swachh Bharat Abhiyan to transforming India through the Digital India initiative and a host of similar schemes with little substance. Most of them are repackaged versions of initiatives that already existed and had delivered inadequately. But more importantly, there was little by way of additional resources allocated to these, even while financial provision for socially important flagship programmes such as the Employment Guarantee Scheme, the Food Security programme and the Right to Education initiative were drastically cut. While these trends were eroding the government's credibility across the board, what mattered more for many was that when it came to the economy the signals were that nothing had changed on the ground. That is of course true for the poor. But, the NDA's problem is that it is true for business and the middle class as well. Global "branding" focused on a section of non-resident Indians and foreign capital and domestic divisiveness, rather than development, were all that the government has delivered.

Yet the Modi-inspired propaganda wave soldiered on based on just one indicator: GDP growth as revealed by the revised numbers in the new series of national accounts with 2011-12 as base. With that rate placed at well above 7 per cent a year, India was presented as the world's fastest growing economy, ahead of China. Don't mind what you experience on the ground, it was argued, because actually things are far better than anywhere else. But now even that weapon has become difficult to use.

Going by the MYR the truth is now official. India's GDP growth rate may not be reflecting the true state of the economy it admits. The MYR places real GDP growth in the first half of 2015-16 at 7.2 per cent as compared to 7.5 per cent in 2014-15 and also a November projection of 7.5 per cent for 2015-16. But despite that creditable performance "the economy is sending mixed signals with different indicators not always pointing in the same positive direction." Thus while overall tax collections were buoyant during first half of 2015-16, it is indirect taxes which have grown at the same pace as the 2013-2015 average (helped perhaps by new taxes such as the Swachh Bharat cess and recent excise duty increases), whereas direct taxes have grown at a lower rate. The Mid-Year Review attributes this to the fact that "probably … corporate profits have not been buoyant." That is business is not getting what it expected. In addition, industrial credit has slowed dramatically. In fact, much of the credit to industry may have been to stressed sectors, raising the possibility that loans are provided to protect their balance sheets rather than to finance new activity, says the Finance Ministry. The Financial Stability Report that followed the MYR has also pointed to the fact that by September stressed assets stood at 11.3 per cent of total advances and the proportion of bad loans held by large borrowers had touched 87 per cent. Together with reduced profitability this debt burden is seen as limiting capital expenditure by big corporates. And growth in capital goods imports, which is an indicator of investment performance, has declined sharply from about 12 per cent in April 2015 to close to zero.

One consequence of all this is that, while the overall index of industrial production (IIP) has risen moderately faster in the first six months of this financial year than of the last, there is considerable variation in performance across sectors. Power, fertilizers, and cars have registered significant increases in production. But commodities such as steel, iron, aluminium, and cement are not doing well. This does question the robust growth in manufacturing that the national accounts indicate.

In addition, there is some divergence between the production estimates for agriculture and national accounts estimates. The first advance estimate for the 2015-16 kharif season points to a close to 3 per cent reduction in sown area relative to the fourth advanced estimate for 2014-15. This is not surprising given the relatively poor monsoon. As a result, output of crops like rice, groundnut, sugarcane and cotton output during kharif 2015-16 has fallen, resulting in an overall decline in production of close to 3 per cent. National Accounts Statistics, however, suggest that gross value added rose by 2.0 per cent in agriculture, forestry and fishing during the first half of 2015-16, whereas it had declined in the first half of 2014-15. The MYR treats this discrepancy lightly, attributing it to "diversification to non-crop agricultural activities and value addition thereon."

But the Mid-Year Review does elaborate an explanation for an economic slowdown. It argues that the Indian economy now is driven by private consumption, with private investment, government expenditure and exports playing no significant role. But private consumption too is not as buoyant as before. This is in sharp contrast to the boom years, when the economy was powered by all four components of demand.

Clearly, private investment is being constrained by insufficient demand. Besides the persisting poverty of much of India's population, which is unable to provide a mass market for industrial goods, the reason for this demand reduction is the inability of the system to sustain debt-financed private investment and consumption. Through the boom years from 2003-04 to 2009-10, credit provided by India's banking sector, especially the public sector banks rose from just 22 per cent of GDP to more than 55 per cent of GDP. Some of the increased credit went to finance household investment in housing, household expenditure on automobiles and durables like electronic goods, and to finance loans for private education and other private services. Another chunk of the credit expansion went to finance investments in infrastructure in the private sector and in public-private partnerships. A lot of these loans, especially those to power, roads, ports and civil aviation (besides in areas like education) are facing rising defaults, pushing banks to either restructure them at terms hugely favouring private business or to declare them non-performing with little hope of substantial recovery. The consequence is that banks are unwilling to keep pushing credit, resulting in an end to the debt financed private investment and consumption boom.

The Modi government's response to this has been a decision to lean even more heavily on foreign capital, through the so-called "Make in India" strategy. Besides travelling all over the world showcasing himself and presenting a hyped-up picture of India's performance, the PM has made clear that his government is determined to give huge concessions to foreign investors to attract them to India. India, his advisors argue, should replace China as the world's low-cost (read low-wage) manufacturing hub. Besides the fact that this is a strategy that would be highly inequalising and incapable of delivering jobs and improved living standards to the population, it is also largely wishful thinking. Given India's woeful infrastructure, foreign investors are unlikely to rush to India, except to speculate in India's stock and debt markets using cheap capital borrowed abroad. If and when interest rates or the cost of capital borrowed abroad rise, that capital would leave the country, triggering a new form of the 1991 crisis and imposing new hardships on the people. Besides, despite his ambitions, the fact that the NDA has a majority only in the Lok Sabha and not in the Rajya Sabha, has held Modi back from getting legislation passed that serves to favour capital, including foreign capital.

In the final analysis, whether it is to revive flagging demand or creating conditions that would bring in productive capital from abroad, what is needed is public investment. In fact the MYR celebrates the first signs of a revival in public investment, the effects of which it sees as neutralised by a slowdown in other public expenditures. Unfortunately, two factors preclude any significant step up in public investment in the medium term. The first is the unwillingness of the government to tax the rich, especially big business interests in finance and industry. The government has already promised to reduce the highest corporate tax rate even while trying to push through the GST Bill that would impose higher indirect taxes on ordinary people. The second is the government's commitment to hold back and reduce the fiscal deficit by cutting back expenditures, because of the pressure exerted by foreign finance, which for many reasons does not like a proactive state. With tax revenues low, to keep the deficit under control the axe falls on public investment, besides a host of social sector expenditures. The hope that this could be prevented by resort to irrational, large-scale privatisation of public sector assets has also not been realised. With markets not performing well, equity would have to be divested at prices that the government would find hard to justify. The net result is that growth is affected adversely and social expenditures have been curtailed. The only beneficiaries of this economic circumstance are predatory, whimsical and footloose speculators: Indian and foreign.

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