Strangulating the Informal Economy*

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The fact that there has been a slowdown of late in the rate of growth of the Indian economy is accepted by all, including even Narendra Modi in his all-over-the-place diatribe against critics on October 4. The government however sees it as remediable since the economy, it believes, "is on the right track".

The first question to ask however is: why should it matter if the year-on-year quarterly GDP growth-rate has been slowing down for the last six consecutive quarters and is now down to 5.7 percent in the first quarter of 2017-18 (which is the lowest for any quarter in the last three years)? In advanced countries the growth-rate in the level of activity is considered important because, above all, of its impact on employment, a slow growth-rate entailing a lower or even a negative rate of job creation (negative because of labour productivity growth). In India too if the jejune thrill of outdoing China's growth-rate did not bedevil economic discourse, then some concern over employment should have figured in the discussion of economic slowdown.

Such alas has not been the case. The fact that according to Labour Bureau data, the "usual principal status" employment, in the age-group 15 years and above, has declined by 37.4 lakh in absolute terms between 2013-14 and 2015-16, i.e. even before the GDP slowdown began[i] , which could only have become worse because of this slow-down, has scarcely figured in the discussion. And when Modi says that the slowdown of Q1 of 2017-18 will be reversed, he does not at all mean a reversal of the employment drop, which therefore raises the question: what does the economy's being "on the right track" mean?

Nonetheless, while an impressive growth, far from entailing faster employment growth, can even entail an absolute drop in employment, as it has done, a slowing down of growth does mean a further drop in employment, and is undoubtedly a cause for concern. One factor behind this slowing down which is obvious and has affected both China and India is the persistent world economic crisis, whose impact these countries appeared initially to have escaped, but which has finally caught up with them, especially after the counteracting effects of their own local asset price "bubbles" have collapsed. This slowing down began in India during the UPA-II itself and, after a brief interlude (whose veracity too is questionable since the changes in the method of GDP estimation play a considerable role in boosting the growth-rate figures for this period[ii]), has resumed its course, which explains the steady decline in quarterly growth rates for the last six quarters.

The Modi government, however, instead of taking steps to counteract this process, has done the very opposite, in at least two ways. First, in a situation where export growth has been constrained by the world crisis, and imports have risen on account of competition from other countries also hit by the crisis, an increase in the size of the domestic market should have been effected through larger government expenditure (the government in fact is now talking about a fiscal stimulus); instead what we find is a drop in central government expenditure relative to GDP. It was 15.8 percent in 2009-10, was reduced to 13.9 percent in 2013-14 by UPA-II, and has since been

further reduced by the Modi government to 12.7 percent (BE) for 2017-18. The government in other words has gone in for a demand compression at a time of declining growth, when it should have been doing the very opposite.

The second measure is even more drastic, namely a complete strangulation of the "informal" sector consisting of petty production and small capitalist production. Both demonetization and the imposition of the Goods and Services Tax are measures directed against this sector. The objective of these measures is to bring about from above, through the direct intervention of the State, a combination of two processes which had been highlighted by Marx: a process of "primitive accumulation of capital" (the destruction of petty production) and a process of "centralization of capital" (the destruction of small capitalist production).

I am not making an arbitrary ascription here. Spokesmen of the government have explicitly said that their objective is to "formalize" the economy. Now, when this "formalization" is pushed through by State coercion, and is not allowed to occur on its own, at its own pace (if at all), through a prolonged process of self-conversion on the part of the "informal" economy, then it necessarily means that a part of the informal economy will get destroyed by such coercion, which seems to have been the goal of official policy.

But while the contribution of demonetization towards this end, through the sudden withdrawal of the circulating medium used in the "informal sector", is obvious, it may be asked: how does the GST serve such a purpose? It is only a substitution of one tax regime by another, of a supposedly more cumbersome regime by one presumed to be more simple and "rational"; why should it have the effect of destroying the "informal sector"? Even those who recognize this destructive effect have seen it only as a transitory one, a part of the "teething trouble" associated with the birth of a new regime. This however is erroneous.

Since the administrative costs of economic units under a GST regime are largely in the nature of a fixed cost (each unit, no matter what its size, has to submit its returns with the same frequency, using accountants and consultants whose charges vary less than the firm size), the cost per unit of turnover is greater for smaller economic units than for larger ones, which undermines their viability.

A second factor that also contributes towards this end is the fact that small firms tend to be less vertically integrated on average than larger firms (notwithstanding the latter's tendency towards "outsourcing"), so that input tax credit that has to be claimed by the former, which gets "locked up" until it has been obtained, is higher as a proportion of turnover for the former than for the latter. Since such "locking up" is analogous to capital being advanced, it increases relatively the unit costs for the smaller businesses.

These issues have been discussed. But in addition to these, there is a more basic and obvious reason why the GST undermines the viability of small businesses. And this is because the GST has simply raised the average tax-rate on the "informal" sector, a fact that tends to get obscured by the preoccupation with the structure of rates across commodities. A whole range of activities in the "informal" sector that earlier paid no taxes at all or at best meagre taxes are now required to register themselves and pay taxes. The GST is not just a substitution of one tax regime by another that is supposed

to remain “revenue-neutral”; it is an extension of the tax-net to cover a whole range of businesses in the “informal sector”, or an increase in tax-rates upon them, which, if revenue-neutrality is actually achieved, would mean a lower tax-burden on the “formal” sector. In conditions of revenue-neutrality in other words, it amounts a redistribution of the tax-burden from the “formal” to the “informal” sector, i.e. to a process of primitive accumulation-cum-centralization of capital.

A reduction in the level of activity in the “informal” sector under these conditions is to be expected. But why should it cause a reduction in the level of activity generally? And here we come to the crux of the problem.

If the process of primitive accumulation-cum-centralization in the “informal” sector occurs as a consequence of the expansion of the “formal” sector, i.e. as an accompaniment of a process of accumulation of capital in the latter, then the destruction of the “informal” sector, though tragic in itself, provides nonetheless a buoyancy to the “formal” sector. In such a case the reduction of activity in the “informal” sector is accompanied by an increase in activity in the “formal” sector.

But if the reduction in the “informal” sector is not part of such a process but is an ex cathedra action imposed by the State from above, then this reduction, far from stimulating any accompanying expansion in the “formal” sector, reduces, on the contrary, the level of activity in the latter through its multiplier effects[iii]. The activity in the “formal” sector after all is sustained in part by demand from the “informal” sector itself, and if the latter shrinks for independent reasons, having nothing to do with the former’s expansion, then the former too cannot escape some reduction. The entire economy consequently gets caught in a downturn in activity. And this is what the Indian economy is currently facing.

It follows that the claim that the current slowdown is only transitory, that the problems caused by the GST are only “teething troubles”, is unfounded. The setback to activity caused by the GST is not just because of the procedural complications of the current scheme which businesses would “soon get used to”, or which could just be simplified at the next meeting of the GST Council. They have to do with the very structure of the GST itself, with its being used as a coercive instrument by the State to “formalize” the “informal” economy.

There has been some talk of the government providing a fiscal stimulus to boost the economy’s growth rate, though the Reserve Bank of India has pooh-poohed the idea. Any fiscal stimulus however, to be an authentic stimulus, must satisfy two conditions: first, it must entail an increase in government expenditure that raises domestic demand (i.e. is not of the “Bullet Train” variety that would raise demand in Japan), rather than a mere transfer to the capitalists for boosting their “animal spirits”. Such transfers simply get pocketed by them without causing any additional investment in a situation of slowdown in economic activity.

Second, any such increase in government expenditure must be financed through either a fiscal deficit, or a tax, whether on the profits or on the wealth, of the propertied classes. This is because a tax on the working people, who have a high propensity to consume out of their incomes, for financing larger government expenditure, merely implies a reduction of one kind of demand for stimulating another, but no increase in aggregate demand.

With the Modi government being committed to the fiscal deficit target of 3.2 percent of GDP, and having already exhausted 96 percent of the deficit target in absolute terms, and also being reluctant to tax capitalists on whom it depends for realizing its "Make in India" slogan, the scope for any authentic fiscal stimulus is limited. It may of course force public sector companies to spend more by borrowing, but this would only make these companies, and their creditors, more vulnerable in the coming months, compounding the problem of non-performing assets that already afflicts the economy.

There is a further point to note here, namely the opposition of global finance capital to any authentic fiscal stimulus. Even the mere talk of a fiscal stimulus recently caused a fall in the rupee. Such a fall may be considered beneficial for the country's trade balance, but it can trigger an avalanche of capital outflow (as in East and South-East Asia two decades ago), with extremely damaging consequences for the economy.

Indeed even in the absence of any fiscal stimulus, if the Federal Reserve Board in the U.S. decides to raise its interest rates, then that fact alone can trigger such an outflow. Even the current $ 400 billion foreign exchange reserves, themselves built on the basis of financial inflows, would be unable to prevent it. And in such a case, which is not unlikely, the current slowdown will actually become a recession within the neo-liberal regime, as the government will have to adopt "austerity" measures (apart from measures of "denationalization", i.e. letting foreigners take over domestic assets at throwaway prices) to re-establish "creditors' confidence". The past financial inflows which the government has been proclaiming as an achievement, could thus turn out to be a curse: they could play the opposite role of worsening the slowdown and bringing the economy to its knees.

A fiscal stimulus financed by taxes on the rich and used for enlarging government welfare expenditure, in sectors like education and health, could revive the economy; but it would require a willingness on the part of the government to put restrictions on capital outflows if necessary. The Modi government however, hell-bent on inflicting additional willful damage on an economy that is already afflicted by the world economic crisis under a neo-liberal regime, has neither the courage, nor the imagination, nor the humaneness, for adopting such a course.

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[i] Vinoj Abraham, "Stagnant Employment Growth: Last Three Years may Have Been the Worst", Economic and Political Weekly September 23, 2017.

[ii] To give one example, the growth in gross value added in manufacturing in 2015-16 by the new estimates was 10.8 percent, while the growth in the new index of industrial production was 2.8 percent. With such enormous differences what is true becomes difficult to discern.

[iii] Professor Sukhamoy Chakravarty in his book Marx, Marshall and Schumpeterhad argued that primitive accumulation of capital in Europe had the effect of stimulating capitalism because it occurred in response to a set of innovations that were occurring simultaneously.

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