What Can the Government Do to Revive India's Real Economy?*

Sunanda Sen

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 statement announcing a set of remedial measures on August 23.

Downtrends in the economy are visible in the GDP growth rates, declining from 8% to 5% over the last year. A fact which is 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. There have been even higher rates of unemployment during the period, at 23.4% for urban youth.

Simultaneously there are reports of a shrinkage in labour force participation ratio (the proportion of people who are willing to work) indicating withdrawal syndromes on part of the unemployed. Distress is further indicated in the large numbers of poverty stricken people in the country, between 22 % to 29% of the population according to different estimates.

It is apparent from above that a drop in GDP growth is not just a matter relating to a dampened markets, especially for the financial sector, and their volatility. Downturns also speak of lack of growth in the real sector, which in turn deeply affect unemployment and related poverty.

Looking at the current concerns in India for the stagnating economy, analysts often ruminate on the steep drop in stock prices in the secondary market which started with the end of the temporary euphoria at the end of the national election in May 2019. One may recall the Sensex shooting up beyond 40,000 on June 4, 2019, far surpassing 37,000 on May 13.

The 30-share index, of late, has again slumped back, touching 36,701 on August 23. The immediate causes cited include net outflows of Foreign Portfolio Investments (FPI) at Rs 3,700 crore or above in a single month of July 2019, reversing the usual trend for net inflows in the preceding months. One can also notice the simultaneous drop on India's foreign exchange reserves which fell by nearly $1 billion between July 20 and July 26, 2019.

Concerns relating to the stagnating economy and the markets in the country led the government to announce, on August 23, a major roll-back , primarily for the additional taxes introduced in the last budget on the 'super rich' with income slabs over Rs 2 crore and beyond Rs 5 crore.

Also, surcharges on long and short term capital gains as proposed in the last budget, are to be scrapped henceforth to help inflows of foreign portfolio investments. A few stimulant measures are also suggested, including an investment package of Rs 100 crore on infrastructure, Rs 70 crores of liquidity injection for banks and facilitation of property market and auto sales with cheaper loans and promise of additional government purchases in auto market. Finally, corporates are assured of a no penalty clause if they fail to comply with the corporate social responsibility (CSR) clause, which is designed to help the underprivileged.

Emphasis laid so far, both in official and private circles, rests on the financial market as the main symptom of distress.

The remedial measures suggested from official circles prompts us to question the underlying logic behind. As we stressed above, the GDP growth alone hardly indicates the level of development which include employment, social security and extent of poverty in a country. It is similarly a limited exercise to view the financial market performance as a true gauge of how the economy as a whole is functioning. Capital gains or losses relating to the portfolio investors in the secondary stock markets, in terms of simple national accounts, are treated as 'transfers' between parties, and as such are not considered in calculating the GDP in their first round. Possibilities, however, remain of injections/withdrawals of demand, as opposed to underlying inclinations on the part of those with capital gains/losses to further speculate in the market.

In our critique we find it important to point out that the ailing Indian economy has concerns which encompass, beyond GDP growth and the plunging financial sector. Those concern the stark realities faced by unemployed labour, both in the formal and in the informal sectors, with earnings in the latter often below subsistence. We also would like to mention here the changing relative contributions of the three major sectors of the economy as reflected in the share for services at 50% and above since the early 1990s , and the respective shares of industry and agriculture around 25% and 19% or less since then. As for employment growth, a recent estimate from Azim Premji University in Bangalore, points at the respective Compound Annual Growth Rates (CAGR) for GDP and aggregate employment at 6.8% and 0.6 % over 2011-15, while the respective employment elasticity of output has been at 0.08%, which is even lower than the respective elasticity for 2009-11 at 0.18 Figures as above indicate the lower absorption of labour in the production process, much due to the use of capital-intensive technology. Above goes with the fact that growth rates have been higher for capital as well as the skill intensive products as compared to the average industrial growth in the country. As it has been observed, capital-output ratios have moved up in the majority of industries between 1999 and 2012, and the trend has been continuing since then.

As for the sectoral contribution to employment, agriculture has continued to remain the largest provider of jobs, at 48.9% of aggregate employment in the economy during 2011-12. Almost all of the latter are in an informal capacity and fetching little of the benefits for labour formally recruited.

As for the jobs in the industrial sector, the organised sector (dealing with the registered factories) provides less than 12% of aggregate employment in the country, of which more than four-fifths are employed on a purely contractual or temporary basis. These offer none of the benefits that normally accompany formal jobs. Even services, while providing more than one-half of the GDP, have a marginal contribution as provider of jobs. Data available from the Labour Bureau indicate 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, include large numbers facing disguised unemployment.

Services in the organised sector also include the Information Technology-Business Processing Organisations (IT-BPO) whose contribution to jobs has been rather marginal, as can be expected with the use of capital and skill intensive technology therein. Growth in India's services sector is concentrated in activities related to finance, real estate and business services (FINREBS), which, as shares of the service sector as well as of the GDP, not only have escalated over time but continued to rise even with declining GDP growth rates. Thus growth of the FINREBS, as can be expected, failed to contribute much in terms of employment or real activity.

Facts as above on the sectoral contribution to employment explain the slow growth in jobs – and that too for the majority of the labour force employed in informal sector and denied of sustainable wages and benefits as well as job security. It unfolds an underlying paradox of high GDP growth with unemployment, underemployment, and the related poverty.

While the government's recent measures seek to arrest the tendencies for stagnation by offering sops to portfolio investors within and outside the country, they while potentially effective in temporarily stimulating the secondary stock market, may not work to reverse the tendencies for the continuing stagnation in the real economy of output, investment and employment.

The stark realities of the diverse spheres of the real and the financial economy reflects itself in the low value of the initial Primary Offers (IPOs) which indicate new investments as compared to the transactions of stocks in the secondary 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.

Limits self-imposed by the government on additional public expenditure (which remains a pre-requisite to stimulation of private spending) in terms of the Fiscal Restraint and Budget Management Act (FRBMA) of 2003 has very many valid reasons to be foregone in the current context of a demand deficient domestic economy of India as at present . A departure, thus effected, from the ineffective policy prescriptions of mainstream economics can be expected to generate a climate of expansion within the country.

Drawing attention to the remaining gestures in the official measures, which are supposed to draw attention to real expansion, say with automobile industry or housing and auto loans, little of net demand, if any, for automobiles can be expected with such moves for replacing old cars by new ones.

Thus, the replaced old cars may even crowd out the markets for second-hand cars. In addition, subsidy on loans may not work to revamp auto sector demand until employment and related income of the potential car buyers get an uplift.

Considering the gravity of the situation, this is the moment for a call to the state to act and not just to protect the speculators who operate in stock markets, the super-rich who are disgruntled and may move offshore to avoid the newly imposed surcharges on higher income slabs, to provide relief to the bankers misallocating funds in search of quick gains, or even to protect the corporate sector for their negligence to the little benevolence they were subject to so long in terms of the CSR.

Indeed, the Indian economy is in need of an alternate course of action. The state must focus and revive the real economy.

Sunanda Sen is a former Professor of Economics at the Jawaharlal Nehru University. She can be contacted at (mailto:msunanda.sen@gmail.com)

*** This article was originally published in The Wire on September 1, 2019.**