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Policies responsible for the economic gloom

Political Economy

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The Modi Government is completing a year in office this month but there is gloom all around. Shopkeepers say sales are down by 20 percent. Property dealers say prices are down by 30 percent. This despite a huge reduction in corruption at high places. The Government has also garnered huge revenues from the auction of coal blocks and spectrum, Global oil prices are low. Yet there is no growth, except in statistics. The problem lies in the policies that are being implemented by Modi.

The first problem is that there is no thrust on public investment in infrastructure. We must use the opportunity provided by low global price to jumpstart investment in infrastructure. The Finance Minister has increased allocations for roads by 14k crores, and for rail by 10k crores in this year's budget. These figures are deceptive. The allocations should increase more than the rate of inflation to be effective. An allocation of Rs 100 crores last year should be increased to Rs 107 crores this year to maintain the same level of actual expenditure, if the rate of inflation is seven percent. The increases in allocation for road and rail are less than the rate of inflation. As a result, the real expenditures on these heads is declining. Former Governor of Reserve Bank of India C Rangarajan has estimated that the capital expenditure of the Government this year will remain at the same level as that last year. It is necessary to increase expenditure in roads, drip irrigation systems, net connectivity and other infrastructure to jumpstart the economy.

The Government is making efforts to encourage domestic and foreign companies to make big investments in manufacturing in India. The problem is that the global market for manufactured goods is down. China already has over-investments in manufacturing. They are unable to sell their goods in the global market. There is a glut. Multilateral agencies, too, have reduced their forecasts for global growth in the current year. Trying to penetrate the global market in such circumstances is a difficult proposition.

Moreover, this thrust on manufacturing is leading to a slowdown in the economy. Manufacturing by big companies with automatic machines is killing jobs as well as small and medium enterprises. I was recently in Varanasi. A sari manufacturer told me that ninety percent of the weavers have already lost their jobs. Cheap duplicates of Banarasi Saris from Surat have virtually taken over the market. The same process is taking place in other areas like paper envelopes and soft drinks. The result is that jobs are getting lost and small enterprises are closing down. This is leading to lack of demand in the market and a decline in sales and property prices. If weavers in Varanasi do not have jobs how will they purchase shoes and clothes? Modi does not recognize the loss of jobs due to Make in India. He is hooked to the 1000 jobs created by the textile mill and oblivious to the plight of one lakh weavers that lose their livelihood.

Big scale manufacturing cannot deliver for another reason. India does not have the land, water or power to become the global manufacturing hub. On the other hand, we have the mind. Our culture such as applying tika on the forehead invigorates the mind. The correct policy was to import goods and export services like software, translations, health tourism, and designing.

It is difficult to fathom the reasons for Modi's stress on manufacturing. It is true that manufacturing sector provides many opportunities to the ministers and bureaucrats to collect bribes in allotment of land and licenses, and in regulations such as those of labour, factory act, weights and measures etc. But I hesitate to attribute Modi's penchant for manufacturing to opening routes for collection of bribes. Modi has shown determination to weed out corruption by Ministers and bureaucrats alike. It seems he is blindly trying to copy China, not realizing that China's growth is down precisely because it is focused on manufacturing.

Modi has sought to take the Goods and Services Tax (GST) forward. Indeed, its implementation will streamline movement of goods and add some momentum to the growth. At what cost, though? GST aims to impose the same rate of tax on a rubber slipper worn by the poor and a designer shoe worn by the rich. GST is also contrary to Modi's commitment to state autonomy. The authority of the States to vary the rates of tax as per their requirements will be taken away. The Government keeps on harping on the benefits that will accrue to the economy from smooth movement of goods. But the Government is not taking into account the loss of growth from lesser incomes to the poor and lesser autonomy to the states. The poor will have to pay more for the goods under the GST regime. This will reduce their purchasing power. They will buy less from the market. On the other hand, the increased incomes in hands of the rich will not translate into demand. The reason is that the poor spend nearly 95 percent of their income on consumption while the rich spend about, say, 50 percent. Let us say Rs 100 is transferred from the poor to the rich on account of GST. This means that demand from the poor will decline by Rs 95 while the demand from the rich will be generated by Rs 50 only. There will be a net loss of demand in the market. The benefits from smooth movement of goods will be cancelled by this reduction in incomes of the poor. Remember that the European Union was formed precisely on these considerations but that has not helped them much.

Another possible reason for stagnation in the economy is the remittance of large amounts for defense purchases. Think of the economy as a bubble. It collapses if air is let out. The same holds good for the economy. It collapses if money is leaked out to foreign countries. This leakage was taking place in form of hawala remittances by politicians and bureaucrats in the UPA regime. The same leakage is taking place in Modi regime when it comes to purchase of defense equipment. The demand for steel and engineering consultancy will be created in France if India buys Rafale Fighter Jets. That demand would be created in India if the money was spent in making highways. The recent decline in value of the rupee points towards large official remittances made from India. I am not opposing these purchases. But there is a need to put in place compensatory policies. Modi could have printed money and continued to invest in highways. That would have led to price rise but the economy would have chugged along.

The author was formerly Professor of Economics at IIM Bengaluru