The Informal Sector Needs Credit

What is the issue?

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- The 2018 economic survey had recommended an urgent prioritisation of investment revival to arrest its impacts on growth.
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- As the slowdown is particularly centred in the informal sector, policies need to be recalibrated to specifically address this problem.
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What is the current investment scenario?

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- While investments in the economy peaked 11 years ago, a slowdown started 5 years ago, and has currently become severe.
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- The slowdown in private investments in India is now well recognized and is visible chiefly in the informal sector and lesser felt in the corporate sector.
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- Notably, financial stress on company balance sheets and the severe bad debt problem hindered big ticket corporate investments only briefly in 2014-15.
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- Subsequently, corporate investments had picked up but private investments in the informal domain have been largely stagnant.
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- **Informal Sector -** It has been estimated by NSSO that about 6.34 crore unincorporated non-agricultural enterprises exist.
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- These often operate out of homes, typically employ less than 10 workers and do contribute a considerable chunk of the private investments
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- As informal enterprises are one of the principle engines of growth, the slowdown in the sector is delaying a full economic recovery.
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- The fall is so severe that the government’s macroeconomic stimulus by

increased public investments hasn’t been able to compensate for it.
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Why is the informal sector more vulnerable?

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- Consuming households tend to be net savers, while the government, corporates and unincorporated enterprises are net debtors.
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- **Competition for Funds -** A major chunk of saving are held with banks, insurance companies, from which the net debtors borrow from.
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- When government borrows considerable sums to finance its deficits, it reduces the lending potential of financial institutions due to a smaller fund pool.
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- Hence, while the big corporates can still access capital from the remaining or through the bond/share market, the informal enterprises get left out.
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- Notably, informal sector does not have the resources required to access credit from diverse sources and is left to depend on extoritionist money lenders.
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What caused the present situation?

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- The government had increased its spending in the aftermath of the global economic slowdown to provide an economic stimulus.
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- This saw a surge in fiscal deficits, which had to be serviced by borrowing.
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- Concurrently, banks that were already stung by the bad loan problem, have been played safe by lending generougly to government projects.
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- Along with all this, the recklessness of some states governments also seems to have crowded out the informal sector from formal credit avenues.
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- As a consequence, there has been a cut back in private informal sector investments due to lack of sufficient credit.

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What needs to be done?

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- Given the anatomy of the private investments slowdown, a macroeconomic stimulus may not be the best policy choice.
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- Urgent fiscal deficit reduction, quick clean-up of the bad loans mess, and restoration of banks' health are more likely to revive private investments.
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- The current credit policy seems skew in favour of the visible and large organised enterprises, which needs to be corrected.
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- Recognising the credit needs of the unorganised sector is hence crucial.
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Source: The Hindu

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