

## **Transfer of the RBI's surplus - Only a stopgap measure**

### **What is the issue?**

- The Reserve Bank of India (RBI) Board recently approved a transfer of Rs 1.76 lakh crore to the government.
- This transfer is only a stopgap measure which may not address the key problem of a lack of demand.

### **What are some examples of the uncertain state of the Indian economy?**

- The automobile industry is in crisis as automakers, parts manufacturers and dealers have laid off about 350,000 workers since April 2019.
- Recently, Parle Products announced that it may have to lay off up to 10,000 workers (around 10% of its workforce).
- The company blamed falling sales due to the Goods and Services Tax (GST) that led to higher prices of the cheapest packets of biscuits.

### **Why are home budgets under strain?**

- Sales in the fast-moving consumer goods (FMCG) sector as a whole grew at only 10% in the second quarter 2019, less than nominal GDP growth.
- The slowdown in sales is across the food and non-food items, with the biggest reductions in salty snacks, biscuits, spices, soaps etc.
- These are more discretionary element of consumer spending which are more likely to be cut down when household budgets are under strain.
- Economists with the government finally recognised that there is financial stress.
- They also say that the current situation was inherited from the United Progressive Alliance (UPA) government more than 5 years ago.
- This is apparently preventing investment. But this isolates only one factor in the current slowdown, the undoubted mess in the credit system.
- This is a factor, but this explanation completely misses the demand side of the story.

### **What is the demand side story?**

- The slowdown in mass consumption along with the falling and subdued rates of investment over several years have led to this crisis of inadequate effective demand in the economy.

- This scenario has been unfolding for a while because of a medium-term trajectory in which the fruits of growth went disproportionately, without translating into broader economic improvement.
- The increasing inequality along with jobless growth meant that mass consumption demand didn't rise as expected with rapid GDP growth.

### **What is the impact of demonetisation?**

- The damaging impact of demonetisation in 2016 was further accentuated by the poor implementation of the GST.
- The resulting loss in livelihoods and wage incomes due to these policy measures eventually had an effect on demand for formal sector output.
- This effect worsened over time as there have been no counterbalancing moves by the government.
- Total employment actually declined by more than 15 million workers between 2011-12 and 2017-18.
- Rural wages have been stagnant or declining. The continuing crisis of cultivation has affected the purchasing power of the farming community.
- Urban wage incomes are also apparently not keeping pace with inflation, even as informal activity and "start-ups" in urban areas have faltered.

### **What the government could have done?**

- The government could have countered this adverse impact of declining employment and consumption demand.
- This could have reduced the profit expectations of producers informal enterprises, by providing a fiscal stimulus.
- Instead, it assumed that manipulating Ease of Doing Business indicators and offering further incentives to foreign capital would attract investment into the economy that would counteract all the negative impulses.
- Private investors simply kept demanding more fiscal and regulatory concessions even as they continued to sit on investment plans as they waited for overall demand improvement.
- Recent complaints of the private corporate sector are about oppressive tax collection methods of a government.
- But these along with the greater difficulties of accessing loans from both banks and non-banks are irritants that would have been tolerated in a buoyant economy.

### **What is the supply-side approach?**

- In this context, the [Finance Minister's recent announcements](#) of measures to boost the flagging economy completely miss the point.

- They do nothing to address the issue of inadequate demand generation or the underlying tendencies of wage suppression and low employment growth.
- Instead, they once again reveal a supply-side approach to the problem, which is unlikely to yield much benefit.
- These measures affect only a small segment of the economy and not enough to cause any real change in economic direction.
- **Solution** - If the immediate problem is lack of demand, the immediate response should be to increase it in ways that provide the desired basis for future economic growth.

### Why the rural should be focused?

- Rural distress is real and deeper than the much-hyped distress of angel investors and high net worth individuals.
- So a massive increase in rural public expenditure to provide public works and in social spending would provide immediate relief, is required.
- The multiplier effects of such spending would generate more employment, incomes, consumption and, therefore, more investment and tax revenues for the government.
- But to seize this crisis as an opportunity for progressive change would require more visionary economic policy making by the government.

### Is transfer of the RBI's surplus a game plan of the government?

- Unfortunately, because of the mess in public finances, all that this is likely to do is fill the massive gap left by inadequate tax collection.
- This will thereby let the Finance Minister off in the current fiscal year from another embarrassing situation of budgetary discrepancies.
- The proposed Budget was not particularly expansionary and did not provide for more spending in the areas required.
- So this stopgap measure may provide more fiscal space than before, without really addressing the basic problem.

**Source: The Hindu**