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

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