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Addressing structural issues in the economy

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Economic restructuring comes at a cost and yields results with a lag but there's no gain without pain

India Inc is facing an economic slowdown due to weakness in private consumption. Consumption expenditure grew only by 3.1 per cent in Q1FY20, a 17-quarter low compared to 7.2 per cent in Q4FY19. Private consumption is a key driver of growth in India, constituting around 59 per cent of GDP.

Unemployment rates are at a three-year high, at 8.4 per cent in August, as per the Centre for Monitoring Indian Economy (CMIE). Additionally, the rupee depreciated following slower trade growth, volatile global economic conditions (US-China trade wars and oil price uncertainties), and fluctuating foreign capital inflows.

The RBI's forward-looking surveys continue to point to feeble demand conditions and the central bank now expects the economy to grow by only 5.3 to 6.1 per cent in Q2 2019-20, compared to the earlier forecast of 6.9 per cent. Weak demand is expected to keep CPI inflation around an average of 3.4 to 4 per cent in 2019-20, well within the target.

What do these numbers suggest?

India is going through a low growth-low inflation phase. While some part of the slowdown is cyclical in nature, the economy needs a boost of major reforms to restore growth to the former levels of 8 per cent and higher, while maintaining inflation within the target.

To tackle this issue, the central bank and the government have taken several steps. They cut the the repo rate from 6.5 per cent to 5.15 per cent between February and October, slashed the corporate tax from 30 per cent to 22 per cent for domestic companies, and reduced GST brackets. It is hoped that the lower tax burden will either help companies pay off debt or prune product prices, while lower interest rates would motivate individuals and households to borrow and spend or invest.

Conscious consumers

Let's address the cyclical issue first. Take the recent Amazon and Flipkart Big Festival sale as an example. Although the current sale generated higher revenues compared with previous years ($3 billion in 2019 vs $2.3 billion in 2018 vs $1.3 billion in 2017, according to RedSeer consultancy), the growth has slowed this year, from 72 per cent to 30 per cent, despite witnessing an increase in buyers from tier II and III cities. Hence, consumers appear to be conscious of their spending.

On the investment side, while the RBI has cut the repo rate five times, it has not fuelled investment demand, given that many industries are witnessing excess capacity because of low consumption demand. Further, though the repo was cut by 135-basis points, banks made a less than 50 per cent basis point reduction on fresh loans, on an average. Also, lower interest rates alone cannot raise retail demand for credit, in the absence of a stable income growth and good job prospects.

The fiscal space to boost demand directly by raising government expenditure however, is limited. The Centre's earnings have fallen, especially the GST revenue which was only ₹92,000 crore in September, the lowest in 19 months. The decision to reduce corporate tax will further widen the fiscal deficit. Also, an increase in government expenditure may lead to higher interest rates in the economy which will impact private demand for funds. In short, it is a Catch-22 situation for the government at present.

Managing deficit, farmers' income

The government needs to focus on urgently solving the structural problems in the economy. The banking system, which forms the backbone of the economy, has clearly been in trouble for several years now. Its profitability is low, despite banks levying one of the highest spreads (difference between deposit and lending rates) among emerging and developed economies. And massive NPAs have restricted the banks' ability to pass on RBI rate cuts to their customers.

For the financial markets to recover their money stuck in NPAs and stressed assets, the efficient implementation of the Insolvency and Bankruptcy Code within a minimum time-frame is crucial. Inadequate infrastructure, handling the vast backlog of cases and legal procedures, however, have often delayed the recovery procedures (often beyond the mandated 270 days).

Further, the ambitious privatisation process is yet to kick-start. In another vital area of the economy, the massive troubles of unstable and unviable incomes for a large majority of small farmers remains to be tackled.

Addressing structural issues will come at a cost, be it in the form of job losses arising out of privatisation, a cautious banking sector as it goes through mergers, or lowering the cap on public spending to manage the fiscal deficit. As it is said, there is no long-term gain without short-term pain. Restructuring an economy is a massive task which yields results with a lag. This is something that the government needs to communicate to the people.

(The writer is a PGDM student at Great Lakes Institute of Management, Chennai. Views are personal.)

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