Understanding India's Economic Slowdown

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India has experienced a dream run followed by an economic slowdown over the last two decades. The author, R Nagaraj attempted to explain the reasons for both the dream run and the economic slowdown in this paper. With an annual growth rate touching 8-9% between 2003 and 2008 and a large inflow of foreign capital in form of FDI, FPI, and external commercial borrowing, India was being hailed as one of the fastest-growing economies. However, the author pointed out that this growth was a debt-led one.

The Global Financial Crisis of 2008 which followed the boom period had an impact on India by the middle of the second decade with lower output growth translating into significant job loss for the citizens, affecting the earnings of private corporate houses. This made it difficult for them to service the debt they had accrued during the boom. As a result many of these loans became NPAs which restricted the banks' ability to offer new loans.

To resolve the problems, the newly elected government adopted the motto "minimum Government, maximum governance" and introduced policy reforms such as a new tax system (Goods and Service Tax; GST) and demonetization. India's ranking in the World Bank's Ease of Doing Business (EDB) improved under the new administration, rising from 42nd in 2014 to 63rd in 2019. There was a large rise in real GDP in 2016-17 as compared to 2011-12, but the increase in GDP was said to be overestimated. The primary sector was seriously harmed, rural incomes remained stagnant, and overall, all three sectors' employability suffered. This period was termed job-less growth since the GDP growth was accompanied by mass unemployment and serious poverty. The disaster triggered by demonetization and improper implementation of GST is cited as the primary cause of the economic slowdown.

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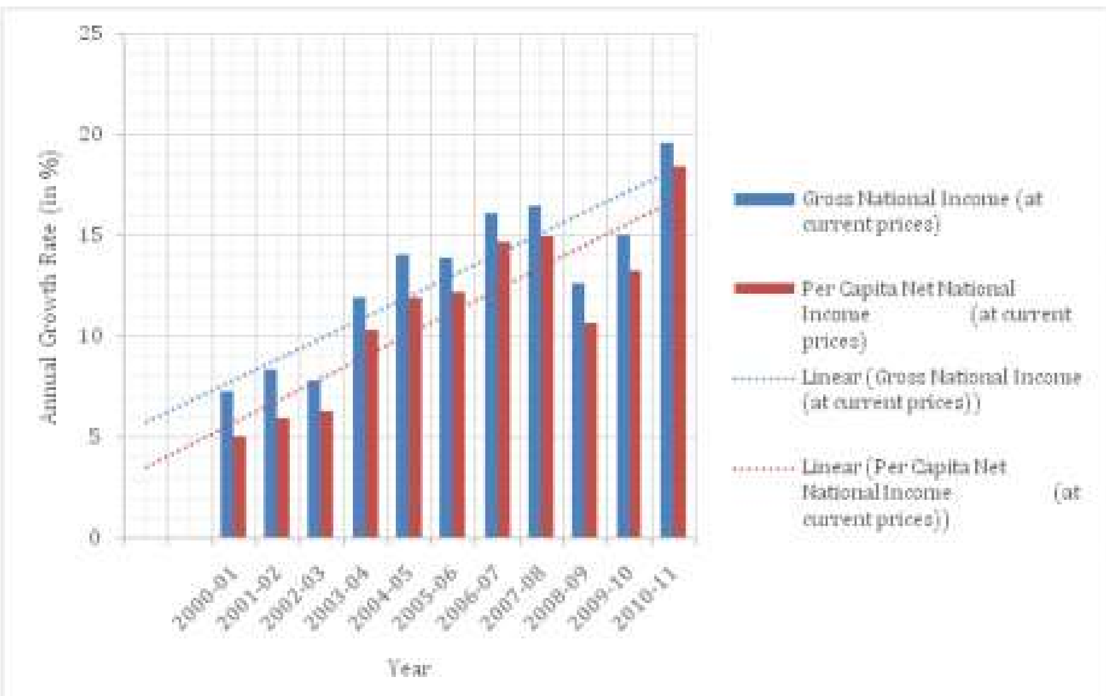
From the macroeconomic point of view, the slowdown in output growth is from the demand side and a high level of debt. A major policy that could help India recover from the slowdown is the revival of investment growth and public infrastructure improvement (creating productive assets). R Nagaraj concludes by illustrating that the slowdown is not a mere short-term phenomenon. If it is not dealt with implementing a proper policy targeting the areas that need the most attention, loss in economic welfare is inevitable, thereby worsening India's position in the global economy.

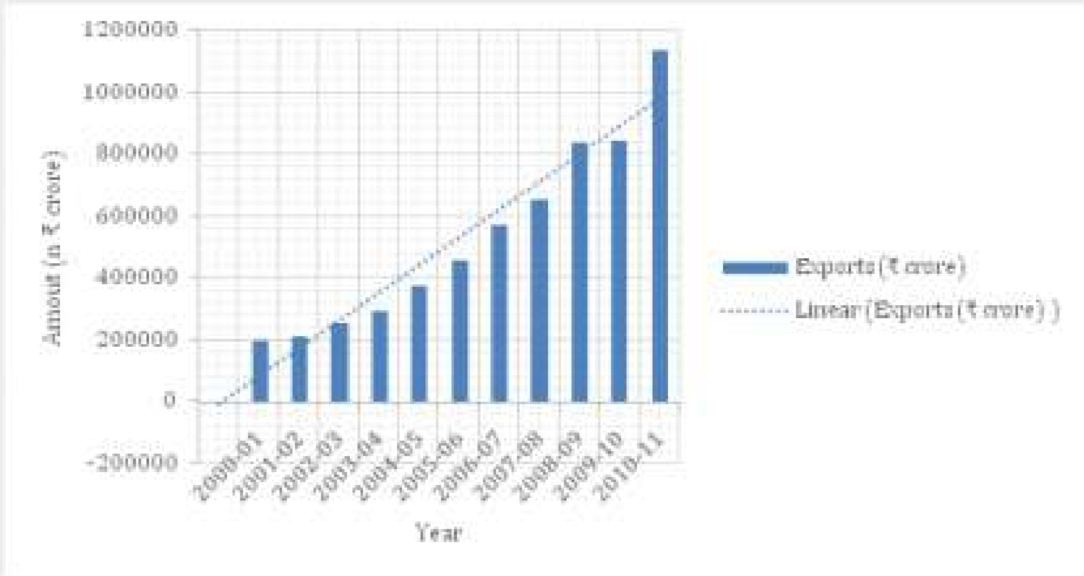
During 2000-2008 India witnessed a rise in the annual growth rate of gross national income and per capita net national income (both at current prices) along with a continued rise in exports and foreign exchange reserves. The following graphs obtained from the Economic Survey 2020-21 (Statistical Appendix) supports the author's observation:

Table 1: Increasing Annual Growth Rates of Gross National Income (at current prices) and Per Capita Net National Income (at current prices) during 2000-2010



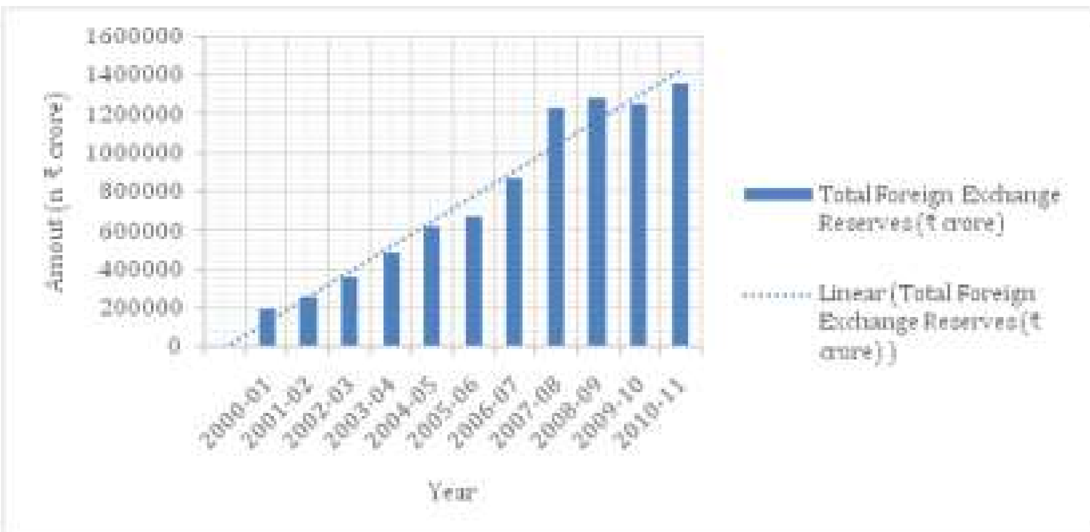
Source: Table A4, Statistical Appendix, Economic Survey 2020-21

Table 2: Continuous Rise in Exports during 2000-2010



Source: Table A95, Statistical Appendix, Economic Survey 2020-21

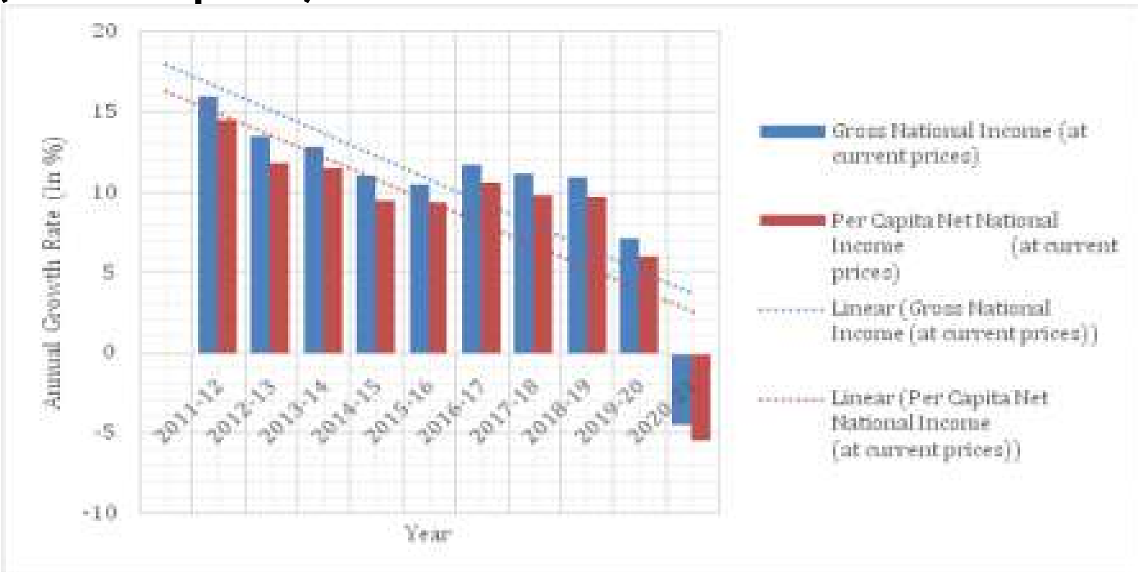
Table3: Rising Total Foreign Exchange Reserves during 2000-2010



Source: Table A81, Statistical Appendix, Economic Survey 2020-21

The above graphs depict the rising annual growth rates of national income (gross and per capita net), export, and foreign reserves during the 2000s and that despite a brief dip in 2008-09 due to the Financial Crisis of 2008; India was able to recover and flourish. However, during the second decade India experienced a fall in annual growth rates of Gross National Income (at current prices) and Per Capita Net National Income (at current prices) and experienced fluctuations in the volume of exports (in Rs. crore) as observed in the graphs below:

Table 4: Decreasing Annual Growth Rates of Gross National Income (at current prices) and Per Capita Net National Income (at current prices) from 2011



Source: Table A4, Statistical Appendix, Economic Survey 2020-21

Table 5: Fluctuations in Exports of India from 2011

Source: Table A95, Statistical Appendix, Economic Survey 2020-21

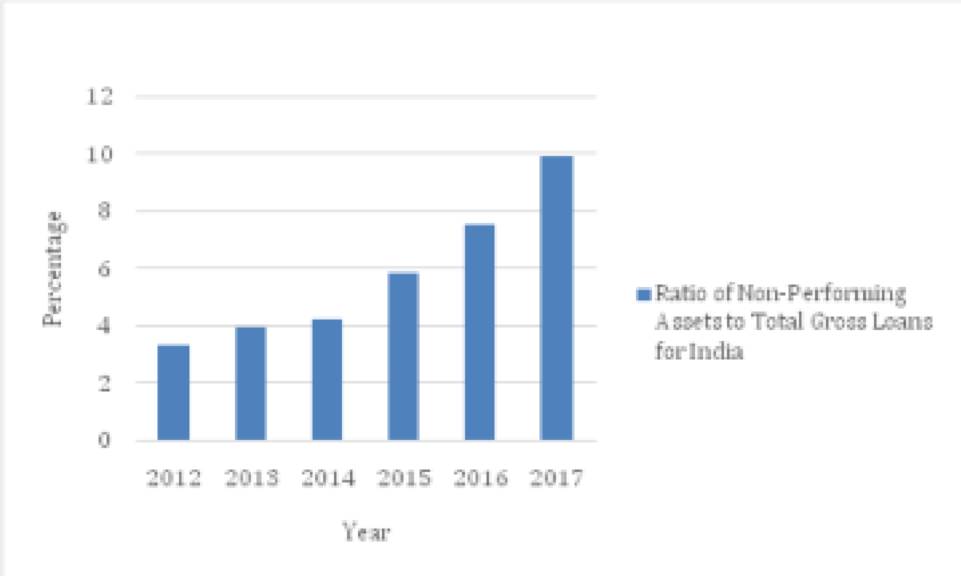
Demonetization imposed by the new Government in 2016, came as a macroeconomic shock, devastating the informal sector, which employed nearly 90% of the workforce and contributed nearly half of the domestic output. The introduction of GST in 2017, replacing various indirect taxes came as a second shock to the nation, which not only affected the small enterprises but also the Government finances and sharing of revenue between the Centre and the states. A key reason behind introducing GST was to improve the ease of doing business in India by eliminating the inconvenience of paying multiple indirect taxes. This would further motivate the citizens to set up new businesses thereby creating more jobs and contribute towards GDP growth. The higher output and subsequently higher income of such businesses would also ensure that they regularly pay taxes to the government leading to the rise in tax revenue and elimination of the problem of tax evasion. Hence a tool to measure the effectiveness of GST is the Tax Revenue (as a percentage of GDP). Table A58 of the Statistical Appendix of Economic Survey 2020-21 shows that after the introduction of GST in 2017, the Tax Revenue (as a % of GDP) decreased from 7.3 in 2017-18 to 6.9 in 2018-2019 and further to 6.7 in 2019-2020 thus showing that GST did not help to bring India out of the economic slowdown. Table A57 of the same survey shows that during this period the Revenue Deficit (Revenue Expenditure-Revenue Receipts) of the government increased from ₹316381 crores in 2016-17 to ₹667511 crores in 2019-20 coupled with a rise in borrowing from ₹535618 crores in 2016-17 to ₹935635 crores in 2019-20. Thus the tools of GST and Demonetizationimplemented by the Government of India were not very effective to deal with the issue of economic slowdown.

In such a scenario, the Government believing that a fiscal stimulus would result in considerable improvement, implemented nationalist projects like 'Make in India' to create a plethora of manufacturing sector jobs, targeted to increasing welfare for the women, poor and unemployed sections of the society. By promoting import substitution and export promotion, this project helped India become self-dependent and redirected investment back into the Indian economy which would have otherwise flown outside the country.

The author explains that from a macroeconomic view, the slowdown in the growth of output is from the demand side, which fell due to a fall in gross capital formation, which principally occurred due to the decline in the private corporate sector. Irrespective of India being a consumption-led growth country it should be understood that for achieving higher economic growth, stepping up domestic investment is extremely crucial.

However, reviving the private corporate investment was constrained due to rising bank non-performing assets (NPAs) as a proportion of total bank advances. A study by Das and Ghosh (2007) revealed that at the macro level, GDP growth and at the bank level, real loan growth, and bank size play an important role in influencing the problem of NPAs. Misra and Dhal (2012) highlighted the positive relationship between a bank's size and its share of NPA by showing that large banks are more likely to have relatively more NPAs, due to balance sheet constraints. The following graph obtained from the annual report of Bangladesh Bank (2006-17) highlights the significant rise in NPA in India during 2012-17 through the tool of 'Ratio of Non-Performing Assets (NPA) to Total Gross Loans'.

Table 6: Rise is the ratio of Non-Performing Assets (NPA) to Total Gross Loans for India from 2012 to 2017



Source: Annual Report of Bangladesh Bank (2006-2017)

Some of the causes for such a rise in NPA are:

1. Legal impediments and time-consuming nature of asset disposal process.
2. Banking sector's inefficiency in loan screening and lending practice along with deep-rooted crony capitalism.
3. Loan sanctioning procedure in favour of politically exposed persons (PEPs) made the loan vulnerable. Sometimes managers were under great pressure to disburse loans to the PEPs. In that case, a loan had been disbursed without proper or adequate credit assessment or sanction procedure either in terms of the viability of the project or the proper valuation of collateral which ultimately became defaulted.

Some mechanisms which can be used to tackle this problem are:

1. Strengthening of legal rules and regulations and aligning prudential norms with international standards.
2. Proper monitoring by the loan issuing bank to prevent clients from diverting funds from other activities.
3. Legal mechanisms including the creation of ARCs(Asset Reconstruction Companies) to help recover the debts