The Roots of Economic Pessimism*

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The Indian establishment's obsession with GDP growth and stock market performance to the exception of all else, especially economic and social deprivation, is coming home to roost. Recent media reports on the state of the economy have highlighted three supposedly 'troubling' features of recent Indian economic performance. First, according to the World Bank, India is losing rank in the league table of economic size, with its rank according to dollar GDP slipping from position five to seven in 2018. There are also indications that the Indian economy is not as 'big' as it was thought to be, making the Prime Minister's promise of taking it to $5 trillion by 2024 look even more implausible.

Second, doubts expressed by a number of economists and statisticians for some time now about the validity of the official rate of growth based on a new and substantially revised series of national income figures have intensified. India, it is being argued in a wider circle, grew at a significantly lower pace than official figures suggest. Talk of high growth, and even of being the fastest growing economy globally, was clearly misplaced.

And, finally, even that growth is slowing. GDP growth is officially estimated at 5.8 per cent in the first quarter of 2019, and projections for financial year 2019-20 are being trimmed. The slowdown is reflected not just in the inflated GDP figures themselves, but in the perceptions of leading industrialists and bankers. Individuals such as Larsen and Toubro's Naik to HDFC's Parekh, who had remained silent when others were espousing growth pessimism, have also suddenly turned pessimistic. Some are sounding alarmist. Representatives from different segments of the automobile industry, which had been one of the drivers of growth, are demanding tax relief and other sops on the grounds that the slowdown is steep.

Parallel to this growing growth pessimism is the rise of "market" pessimism leading to a reversal of the post-election euphoria in the stock market. After having risen from just above 37,000 on 13th May 2019 to above 40,000 on 4th June 2019, the Sensex has fluctuated and slumped back to around 37,000 by 1st August. In other words, the huge and largely speculative spike in stock indices in the run up to and immediately after the announcement of the election results, has been completely reversed, principally because foreign portfolio investors (FPIs) are booking profits and heading back. Net outflow of FPI capital which amounted to Rs. 2,986 crore in July as a whole, totalled Rs. 2,881 crore in the first two days of August alone. How far this would go is anybody's guess.

Earlier, such behaviour could be attributed to nervousness regarding monetary policy in the advanced nations, with central banks threatening to reverse the easy and cheap money policies they had adopted since the crisis. Risky bets that could be taken when capital was cheap had to be abjured when capital was not merely becoming expensive but hard to come by. But that environment no more prevails, with most advanced nation central banks, including the Fed recently, indicating that a return to interest rate cuts and quantitative easing is what is required. Nor could it be said that the trade and technology war unleashed by Trump against China would hurt India adversely. If

anything, it could help India by making it a potential alternative source of imports into the US. So, if foreign portfolio investors are pulling out from India, it must be due to developments in this country.

Part of the problem is that perceptions on the basis of which growth optimism and market euphoria were built are now proving wrong. Principal among these perceptions was the view that if a business-friendly BJP and its supposedly decisive leader Modi are returned to power, there can be no holding back the Indian economy. Rapid reform and aggressive government support for the private sector, it was believed, would raise profits and rouse the animal spirits of private investors and accelerate growth in what was already the world's fastest growing economy. That the BJP received almost all of the corporate donations provided to political parties through the electoral bonds route was proof that it was the private sector favourite. And so was the euphoria that had overcome the market even before the results were out. Not everybody cherished such hope necessarily, but the euphoria that had overtaken some players provided an environment where well-chosen speculative bets by asset managers could yield large returns. That accounted for the speculative boom in the stock markets before and after the elections.

Seen in that light, both the stock market collapse and the newly expressed growth 'realism' are evidence that these expectations have been belied. Because the economy was 'not doing as well as it can', and given the huge victory the BJP had won, quick and strong action was expected. But all the budget could offer was a celebration of the achievements of the previous Modi government, with nothing that suggested the new government would catch the economy by its scruff and send it running. Moreover, it is becoming clear, especially after the budget, that despite the rhetoric and the hype, Modi wields no magic wand that can make an economy that is tanking suddenly boom.

The change in mood became clear as the nitty gritty of what the budget revealed and, more importantly, concealed, came to be discussed in the public domain. The picture that emerged is of a government caught in a neoliberal trap. Tax forbearance and the GST misadventure have significantly sapped its resource mobilisation capabilities. While revenue growth is sluggish, the government cannot increase its borrowing significantly as its constrained by the demands of global capital and its own commitments to rein in the fiscal deficit. If it cannot borrow, its expenditures are capped. If it cannot spend, it cannot spur demand for the private sector or put in place the infrastructure needed to support private sector growth, however fast that may be. It also cannot outlay the large resources needed to recapitalise financial institutions, so as to set right the visible crisis in the banking sector and the less visible crisis in the non-bank financial sector. That precludes a credit surge that can drive demand and support private investment. To top it all, even though it cannot do all this, to the extent that it has chosen to spend, it is dependent on special resources from the central bank's reserves, large and ambitious privatisation plans and, disconcertingly for the private sector, a surcharge on the super-rich. The private sector cannot stomach the last.

This neoliberal bind that the government has put itself in has implications for the growth story. India is still an economy in which demand is driven not primarily by mass incomes that create a wide market or by large exports to global markets, but by the demand generated by government spending and credit expansion. If the

government cannot spend to drive demand, growth would be indifferent or slow. And if the government cannot provide the resources to revive a sick financial sector, credit will remain sluggish, restraining demand and growth even further. So, the problem is not just the evidence that growth is slowing, but that it is likely to decelerate even more.

Realising that the government was not doing and possibly cannot do what they thought it would, stock market players are choosing to book profits or cut losses and exit. The intensity of the decline triggered by disappointment only matches that of the climb driven by misplaced expectations. But there are other players, in industry, banking and the trade who cannot exit unless driven to bankruptcy. They are the ones who are now waking up to slow growth and chosen to speak up and say things are going awry, perhaps with the hope that they can get the decisive leader to somehow break out of the tentacles of neoliberalism.

It is important here to see the difference in the nature of the new demands. The clamour earlier was for “more reform”, based on the belief that it was reform and the animal spirits it would unleash and not state support and easy credit that was crucial for growth. The demand now implicitly and explicitly is for a stimulus: more spending, more infrastructural investment, more tax cuts, and the like. In fact, interestingly, the chief executive of the Niti Ayog is reported to have declared that growth is slowing because of too much reform. That, if true, is definitely a turnaround.

Meanwhile, in a turn reminiscent of the emphasis on non-economic issues in the election campaign, the “decisiveness” of the new government is focussed on other fronts. The race to amend the Right to Information Act and the Unlawful Activities Prevention Act, among others, points to a trend where it is not economic revival that leads to legitimacy that is the government’s focus, but the ability to quell any dissent that a loss of legitimacy would lead to. That is what the push for “minimum government and maximum governance” is proving to be. But that unfortunately is not a matter that seems to concern India’s business leaders.

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