Sops that are no Stimulus*

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The government has finally admitted that the Indian economy is on a steep downturn. For some time now, even the business community, which tends to shower all praise and disapprove any criticism of the reformist Modi dispensation, has expressed concern about deteriorating economic conditions and the absence of any decisive action on the part of the government. This was seen as a signal that the 'business friendly' government had to act, though there appeared to be no clarity in the policy establishment of what needs to done.

It was only after experimenting with a range of half-hearted measures, including a partial withdrawal of surcharges on capital gains made by portfolio investors and on incomes of the 'super rich', that Finance Minister Nirmala Sitharaman finally announced what she claims to be a major stimulus package. Principal components of the package include a reduction in the corporate tax rate from 30 (or an effective rate of 34.61 per cent after surcharge and cess) to 22 per cent (or an effective rate of 25.17 per cent) for domestic companies that do not avail of tax incentives or exemptions. New domestic manufacturing companies incorporated on or after October 1, 2019 will pay corporation tax at the reduced rate of 15 per cent (which is an effective rate of 17.01 per cent) so long as they do not avail of incentives and exemptions. And the minimum alternative tax (MAT) applicable to companies that do avail of incentives and exemptions has been reduced from 18.5 per cent to 15 per cent. This is a huge bonanza, which is expected to account for much of the revenue foregone to finance the stimulus, estimated at 1.45 lakh crore or around 0.8 per cent of GDP.

The handout implicit in these tax cuts for business firms, especially the larger and more profitable amongst them, has cheered markets, leading to a spike in the Sensex. But there is reason to believe that the measures would not deliver the needed results. The slowdown, as a response to which the Finance Minister's stimulus has been announced, is the result of a shortfall in demand in sectors as diverse as automobiles and biscuits that comes from three sources. The first, is the long-term tendency for sluggish demand growth resulting from agricultural stagnation, agrarian distress, rising unemployment and stagnant or declining real incomes. Second, is the absence of any demand stimulus from enhanced public spending, which is constrained by limited resource mobilisation because of a lenient, business-friendly tax regime and an obsessive adherence to fiscal deficit targets in central and state budgets inspired by neoliberal fiscal reform. And, third, is an inability to sustain the artificial boost to investment and consumption spending that had been provided by a surge in credit offered by banks and non-bank financial corporations over the decade since the mid-2000s.

Given these factors underlying the weakening demand trend that led to the slowdown, the options before the government were limited. There was no way in which the structural factors resulting in the agrarian crisis, rising unemployment and stagnant real earnings could be addressed in the short run. Reversing those trends to revive demand would take time. Continued reliance on credit as an artificial stimulus to growth, when the incomes and profits to service the resulting debt were absent, was not possible, as the debt defaults and accumulating non-performing assets in the financial system made clear. When the Finance Minister announced plans to force credit out of the banking system at lower interest rates linked to the now-falling repo rate fixed by the Reserve Bank of India, observers and analysts were not impressed. That left only public expenditure, to enhance which increased taxation and larger deficit spending were needed. The Modi government's neoliberal mindset and pro-business inclinations prevented both of these.

The aversion to public spending persists, as is evident from the kind of stimulus package that has been chosen. The package announced by the Finance Minister consists not of increased public expenditure, especially capital expenditure, that can inject much needed demand into the system and improve capacity utilisation and induce private investment. Rather, the perspective underlying the stimulus seems to be that cuts in corporate taxation would revive business sentiment and automatically lead to increased economic activity, including investment.

That expectation is bound to be belied. If instead of reducing revenues, expenditures had been increased to enhance wages paid under and widen the scope of the National Rural Employment Guarantee Programme, to improve farm incomes, and to add to infrastructure spending financed from the budget, the contribution to a revival of demand would have been immediate. As compared to that, allowing business to retain more of the profits it makes by offering it tax concessions would not impact demand significantly. With demand still depressed the tax cuts will not translate into increased investment as the government expects. The possibility that lower corporate taxes will attract investment in production for world, as opposed to domestic, markets, is also foreclosed by depressed conditions in world markets and the intensifying protectionist turn in many countries.

What is also striking is that, when designing the package, the government has decided to ignore the implications the move has for the size of the fiscal deficit and the magnitude of government borrowing. With the reserves of the Reserve Bank of India having been tapped to the maximum extent possible and disinvestment proceeds already estimated at a huge Rs.90,000 crore, there are no sources other than borrowing left to cover the loss of revenues resulting from the tax concessions that amounts to close to one per cent of GDP or a 25 per cent addition to the budgeted fiscal deficit. The government is expecting that since the increased deficit is going to pay off business and finance, it will not receive the adverse response it would have got if it was diverted to employment generation or raising farmer incomes. If the deficit was used to finance the latter, the stimulus package, though more in keeping with its objectives, would inevitably have been labelled 'populist' and been subject to attack, especially by market spokespersons and the mainstream media.

These characteristics of the so-called stimulus suggest that the real intention of the government was not one of stimulating demand, but of buying out business opinion that had turned mildly critical. This is no real solution to the problem at hand, but only a means of buying time, during which business criticism is silenced, and the problem, the government hopes will go away. It will not.

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