Jagdish Shettigar
Professor, BIMTECH

THE HINDU

MARCH 23, 2018

Is the economy back on track?

Disturbances on account of demonetisation and GST were purely short term

Looking at various indicators such as an increasing trend in the Index of Industrial Production (IIP) and GDP growth rates, there is a clear signal that the economy is back on track. Disturbances on account of demonetisation and the goods and services tax (GST) were purely short term, and short-term disturbances were only to be expected. Employment-generating sectors like construction, the worst hit by demonetisation, have already started reviving — demand is picking up because of falling prices and this is obviously due to minimum exposure to black money. There are indications that the government is realising the need to move towards the ideal GST by addressing the glitches experienced at present. Moreover, with the revival of India's major markets such as the U.S., Eurozone and Japan since September 2017, exports have started picking up, accounting for about 15% of the GDP.

Fixing the rural economy

However, a major challenge is the worsening rural crisis. It is worth recalling that India was insulated from the sub-prime crisis in 2008-09 mainly because of the rural economy. The rural economy's contribution to GDP may not be significant. But in terms of aggregate demand, the rural population impacts more than 50% of the market base. What I mean is, when you talk about markets, you talk about population. And in terms of purchasing power, half the population is still in the villages and is very crucial for the growth we are looking for.

On the agricultural front, while the increasing input costs have to be borne by the farmers, when it comes to reaping the benefits of market prices for agricultural produce or rise in minimum support prices (MSP), they are deprived as they do not have direct access to the market. Unless these fundamental problems are addressed and corrective steps initiated, there is no point in simply raising the MSP which benefits middlemen.

Similarly, farmers should be enabled to play their role as an effective supply force in the market and be in a position to sell their produce at a competitive price. That is possible only when adequate infrastructure support is built for them. Unfortunately, the wisdom of both the government and the opposition does not extend beyond traditional approaches like MSP or farm loan waivers.

Three major challenges

On the external front, the government faces three major challenges: the Federal Reserve's approach, rising crude oil prices, and the move towards protectionism by India's major export market, the U.S.

It is reported that the Federal Reserve is in for three hikes in the next one year. This may upset not only the stock market but also rates of exchange. Withdrawal by foreign institutional investors in response to federal hikes may weaken the Indian currency and end up in a higher import bill, especially on the crude oil front, if exports do not pick up. The government has to bring about strong reform measures. However, it may not take the risk during an election year. Against this background, policymakers should not venture into countering FIIs' withdrawal by forcing domestic institutional investors such as LIC, UTI, or public sector banks to enter the market as it may lead to the creation of a bubble economy.

Rising crude prices is another challenge, especially in terms of imported inflation. Another negative signal is the U.S.'s initiatives in terms of protectionism.

As told to Anuradha Raman

Jagdish Shettigar is professor at the Birla Institute of Management Technology