



ECONOMY UNDER MODI



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Narendra Modi ✓
@narendramodi

...

Economy is in trouble, youth want jobs. Devote more time to economics not petty politics. Chidambaram ji, please focus on the job at hand!

3:46 PM · Nov 30, 2013 · Twitter Web Client

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Economy is in trouble, youth want jobs. Devote more time to economics not petty politics. Chidambaram ji, please focus on the job at hand!

- Tweet by Narendra Modi, 30 Nov, 2013



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2014

The people of this country made a very clear choice in making the decision to elect Modi, in him, they chose development.

In the run-up to the 2014 General Elections in India, three distinct candidates campaigned on three distinct platforms. Narendra Modi was undoubtedly the development man, while Arvind Kejriwal rode the anti-corruption wave. Rahul Gandhi, the face of the Indian National Congress (INC), seemingly did not cling on to an idea like his counterparts did, and chose instead to rely on the track record of his predecessor, Dr Manmohan Singh. Modi won that election in a historic landslide and was granted the largest ever mandate seen in Indian politics up until that point in time.

Modi's resume in 2014 looked quite impressive. He had been Chief Minister of Gujarat for 13 years and was the architect of the so-called 'Gujarat Model'. The state had witnessed a sharp acceleration in its growth rate thanks to the development of infrastructure and the inflow of corporate investment. Modi provided a number of incentives and subsidies to help make this happen, and the numbers showed that Gujarat was amongst the best performing states in the country. His record in his home

state acted as a precursor to what was to be expected from him as Prime Minister and this was evident on the day that he was elected when the markets reacted with great optimism.

It has now been more than 6 years since the Modi-led BJP took the reins. The National Democratic Alliance (NDA) has enjoyed at least a 67% majority in parliament for almost all of its tenure, meaning that it has faced little to no opposition when it comes to getting its policies enacted. They criticised the INC for rolling back the reforms of liberalisation and for promoting rent-seeking activities during their tenure, while also making promises regarding economic prosperity if they were to be elected. Any government will need time to pass bills in order to make their vision a reality; they need time to allow these bills to manifest tangible results.

However, we are now at a point where judgements can be formulated.



NEOLIBERALISM

The resurgence of free-market capitalism

When India gained its independence from the British, it employed an economic philosophy that revolved around Socialism, inspired by the then Soviet model. Nehru himself was a Fabian Socialist, which is an ideology that believes in bringing about change via democratic socialist principles through reformist means rather than through revolutionary tactics. These ideas were illustrated in India's GDP growth rate over the first four decades since independence where the country averaged a mere 3.5%.

In the early 90s, India was facing an economic crisis brought about by a severe fiscal deficit. The then government, led by PV Narasimha Rao and aided by his Finance Minister, Dr. Manmohan Singh decided to embark on a journey of economic liberalisation which was characterised by deregulation. The 'License Raj' was done away with along with reductions in the State's control of the economy and on import duties. This move essentially opened up India's economy to the world and has since produced positive outcomes in terms of poverty reduction and income growth.



PV Narasimha Rao: The Outsider Who Dared, PR Ramesh, OPEN, 7 Mar, 2016

India's economic philosophy shifted from that of a socialist one to becoming more capitalist in nature. This shift in ideology was very much a part of the trend seen around the world in the 80s and 90s. This is where the term neoliberalism comes in and it refers to the resurgence of free-market capitalism. Capitalism was unbridled and unchecked for much of the period leading up to the Great Depression in the late 1920s.

The extent of that economic collapse forced world leaders to rethink their outlook on the economy, which eventually

led them to the conclusion that the market can not be left to its own devices. Regulatory authorities began popping up in economic ministries all around the world as governments sought to oversee and exercise control over the functioning of their respective economies.

For the next two to three decades, these actions produced healthy results. In the 1970s, however, a global oil crisis led to a stark increase in inflation which brought with it an economic recession. Elite members of society lamented the move away from classical economic liberalism and sought to use their influence to bring these ideas back into the mainstream. This reemergence of classical liberalism is what is now called 'neoliberalism'. Ronald Reagan and Margaret Thatcher were the champions of the ideology in the 80s and since then it has been at the center of global economics.

With respect to the Indian context, there is not much difference between the economics of the left and that of the right. Both the INC and the BJP subscribe to neoliberal ideas, although the BJP might do so to a larger extent. Where the INC might believe state support is needed, the BJP will likely disagree. This is evident in the recently passed Farm Bills of 2020 where the BJP is attempting to move away from the system of minimum support prices and Mandis and towards a free market. The INC, on the other hand, remains a staunch supporter of the status quo.

Let's evaluate some of the major policies introduced by the Modi led BJP government, over the past 6 years.



DEMONITISATION

99.3% of the demonetised currency was back in circulation by 2018

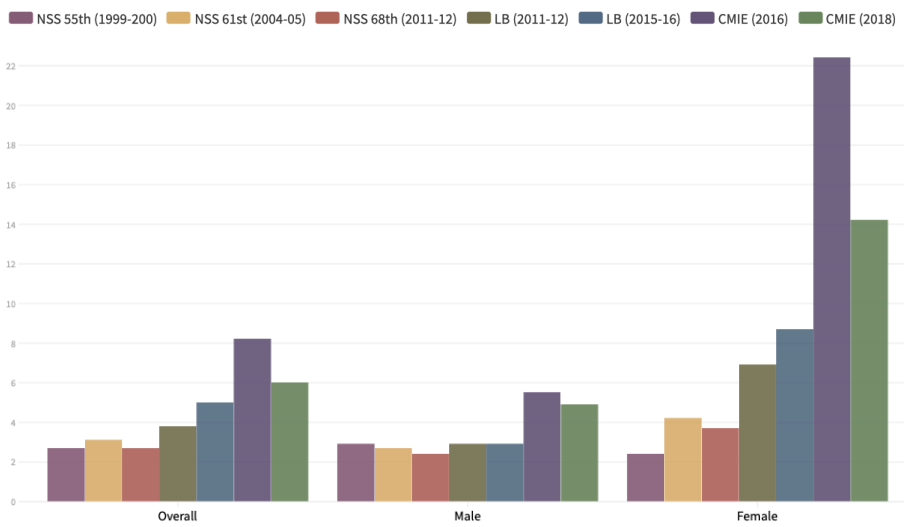
One of the BJP's most consequential economic policies has been the demonetisation of Rs. 500 and Rs. 1,000 bank notes in November of 2016. The aim of the move was to tackle corruption and the presence of black money in the economy, and to do this the decision was announced a mere four hours before the policy went into action, giving people little to no time to prepare. Individuals were required to go to banks to deposit their old Rs. 500 and Rs. 1,000 notes in exchange for the new Rs. 500 and Rs. 2,000 banknotes. Queues were long and the ordeal went on for weeks as the policy was rolled out in a less than impressive manner. As India is primarily a cash based economy, the economy at large took a hit, especially in rural areas.

With respect to its aim of tackling black money in the economy, the government estimated that around 20% of total currency demonetised would not return to circulation. It later emerged, however, that 99.3% of the demonetised currency was back in circulation by 2018.

The effect of the policy on the economy has been most noteworthy, and not in a positive way. Many analysts believe that lacklustre GDP growth seen under the BJP's regime thus far has been largely brought about by demonetisation. The unorganised and informal sector took the biggest hit as there was a loss of jobs and a decline in wages as well. Immediately after the policy took effect, there was a loss of 1.5 million jobs as reported by the Center for Monitoring Indian Economy (CMIE). Some estimates are as large as 5 million.

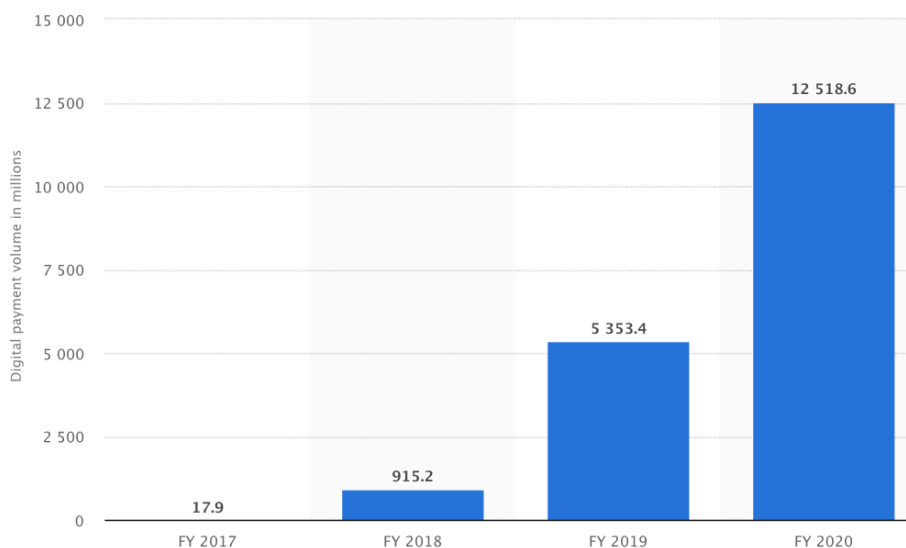
By 2018, the unemployment rate had risen to its worst numbers since record keeping had begun in the early 70s.

Unemployment rate in India



TheWire, Five Million Indian Men Have Lost Their Jobs Since 2016, 17 Apr, 2019.

On the other hand, one of the main positives that emerged out of the whole situation was the growth of digital payments in the country. India has become one of the highest adopters of digital currency transactions around the world, with the growth in value of transactions being consistently high year-on-year. This was one of the stated aims of the policy, and in this area the move was successful.



Volume of digital payments across India, in millions, **statista.com**

Looking back on the whole event, it is difficult to understand why the decision was taken in the manner that it was. The Governor of the Reserve Bank of India at the time, Raghuram Rajan, had met with the BJP's establishment and advised them strongly against the policy. The fact that it was done with no warning also deeply unsettled the economy.

Given that its main goal of seizing black money and tackling corruption was not achieved, along with the long term effects to the Indian economy, it becomes apparent that the move was a failure. Yes, it did help boost digital payments and the FinTech industry has benefited, but it acted more as a catalyst for a change that could have likely happened even without the government's interference.



GOODS & SERVICES TAX

Not a single large state has achieved 14% year on year growth.

In a much needed effort to simplify India's overly complex tax regime, the BJP government in July of 2017 decided to implement the Goods and Services Tax (GST). GST was officially launched on the 1st of July during a historic midnight session of both houses of parliament. The only other occasions when parliament had met for a midnight session had been when India won its independence, and during the silver and golden jubilee anniversaries of the same.

The idea of GST had been floating around since the Vajpayee government in the early 2000s. Even after his surprising loss in 2004, the Manmohan Singh government continued to work on the reform. When the bill entered parliament in 2011, it received immense criticism from the opposition with the loudest voice being that of Narendra Modi's. As a result, the bill failed.



Narendra Modi ✓
@narendramodi

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On GST, I made it clear that BJP has never been opposed to GST. But, without proper IT infrastructure GST will be difficult to implement.

7:14 PM · Feb 27, 2014 · Twitter Web Client

406 Retweets **53** Quote Tweets **297** Likes

After the BJP won the general elections in 2014, it decided to reintroduce the bill, and this time it passed through smoothly, as the BJP had a clear majority in parliament. The whole idea was to bring the entire Indian market under a unified tax code, as opposed to the previous system which had a number of indirect taxes at both the state and central levels. GST brings goods and services under one umbrella, which helps solve the conundrum regarding whether a particular transaction is a sale of a good or a provision of a service. It also allows for claims of input tax credit (ITC), which is when a manufacturer can claim back the taxes paid on the inputs they have purchased to build their final product.

GST has also helped businesses simplify their supply chains by allowing them to centralise their operations, This is due to the fact that GST is applicable all over the country, and has done away with the barriers to the interstate movement of goods. Ease of doing business has improved.



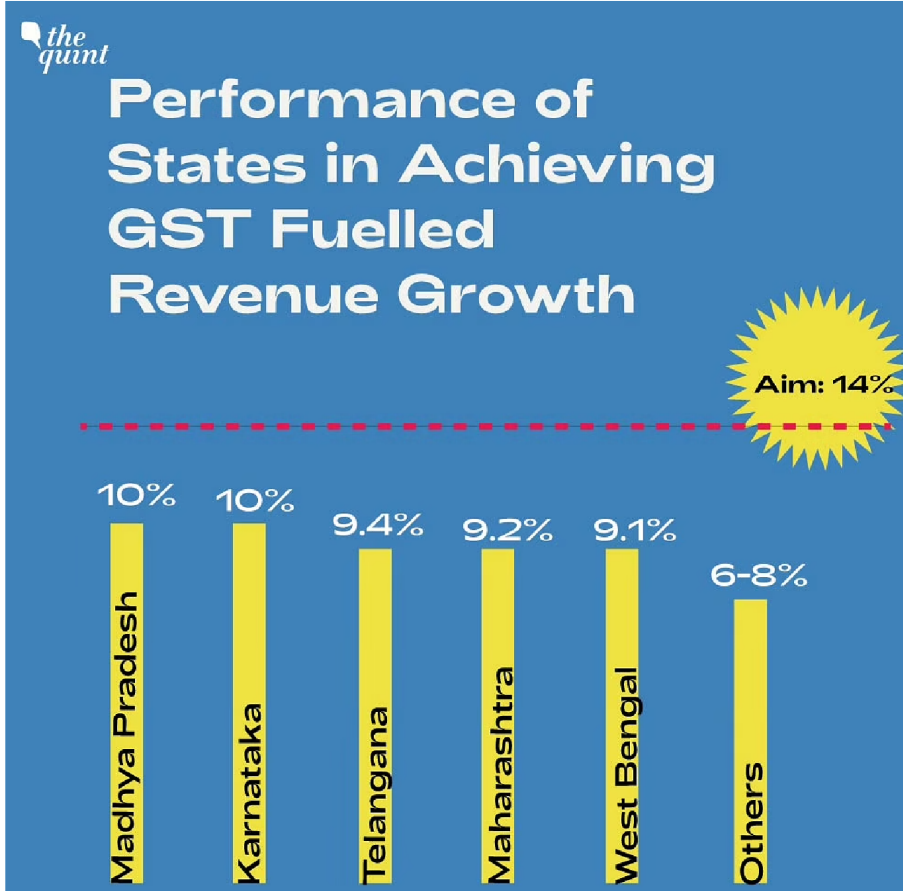
Since the whole system is online, on the GST Network (GSTN), taxpayers can register, make payments, file refund claims, and returns, all through one portal and in person interactions with tax authorities is minimal. The problem with this, however, is that there are many small businesses in remote parts of the country who do not yet have the IT infrastructure or necessary personnel to use the GSTN. The government too has thus far been unable to implement all the features of the GSTN due to IT-related issues. Internet coverage is increasing but there is still some way to go before every business in the country sets up the infrastructure and figures out how to use it.

One of the main problems with the GST is the way input tax credit is handled. A company can only claim ITC if the supplier that it purchased its inputs from has already deposited a certain amount of tax with the government. This law has been relaxed to some extent due to the COVID-19 situation however there is still a requirement that the supplier has to at least file their GSTR-1 before ITC claims can be made. The problem with this is that a number of small businesses, as described above, do not yet know how to access or use the GSTN. The reason the government has put this requirement in place has to do with fraudulent claims that can be made, however, it is currently discouraging manufacturers from sourcing out inputs from small businesses, which is detrimental to the survival of these entities.

When the implementation of GST was being discussed, many of the opposition states took issue with the



government's initiative. These concerns were however set aside when the government promised the states that their revenues would go up by 14% of what they were earning the year before GST came into being (2015-16). They also assured the states that any shortfall with respect to this figure would be compensated by the government itself. It has been almost five years and not a single large state has achieved that 14% increase, which means that the government has had to find a way to raise money to pay the states in order to make up the difference.



How does it do this? Well, normally through imposing additional taxes on luxury goods and 'vices' (tobacco, alcohol). The problem here is that spending on luxury goods and vices has not been as high as the government has hoped, which has left it in debt to a lot of the states. For the financial year 2020-21, the government says it owes states around Rs. 3 lakh crore, but can only afford to pay around Rs. 65,000 crore.

Since GST has been rolled out, the government has had to make a number of changes regarding its structure due to a lot of confusion in terms of understanding how it works. While the policy as a whole is a positive move, its roll out has been questionable to say the very least. It will take a few more years before the issues can be corrected and the positive effects of the policy can be felt.



OTHER POLICY MATTERS

Nearly a quarter of infrastructure projects are on course to be completed on time

- Almost as soon as Modi assumed office, he decided to liberalise India's foreign direct investment (FDI) policies. Since doing so, FDI into India has grown substantially & under his regime, foreign exchange reserves have grown by more 16% between 2014 and 2019
- Modi also made several changes to the labour laws of the country during his initial years but these changes were met with a lot of criticism, some even coming from his own supporters. Now, in 2020, after much deliberation the new set of laws were announced. He simplified the system by consolidating the 29 central laws into 4 main codes that pertain to wages, working conditions, social security, and industrial relations. The new laws make it much easier for businesses to hire and fire workers, which is something that labour unions have expressed discontentment over. The government also reserves the right to exempt certain industries from the new codes

- The BJP government has also done quite well when it comes to infrastructure development. It has ramped up spending and has set in motion, construction of nearly 1,500 projects, with many more supposedly planned for the next few years. Nearly a quarter of these projects are set to be completed on time or even ahead of schedule, while at the same time another quarter are going to be delayed. The total spending on these projects has been around Rs 22 lakh crore thus far, while Modi himself has pledged to spend another Rs. 100 lakh crore over the remainder of his term.
- Spending by the Modi government on social and welfare programmes declined notably in the initial years. It fell from 14.6% of GDP to 12.6% in the first year alone. Spending on health and family welfare declined by 15%, while spending on primary and secondary education fell by 16%. Spending on the 'Sarva Shiksha Abhiyan' or 'Education for All' programme fell by a massive 22%.
- While this has been the case, the government launched a number of its own initiatives in the following years. 'Ayushman Bharat', which is a healthcare programme that provides insurance upto Rs 5 lakh for 10 crore families was launched in 2018. Targeted spending was more than Rs. 6,000 crore but only half of that has actually been achieved.
- It also launched the PM Kisan programme in 2019 wherein it promised farmers Rs. 6,000 annually and set aside Rs. 75,000 crore but only managed to spend

around Rs. 54,000 crore. Another scheme launched for the farmers was the Pradhan Mantri Fasal Bima Yojana, which provides insurance for crops. The government met its spending target and plans to increase spending next year, but reports claim that the programme itself has not been very effective as insurance companies have failed to pay nearly 40% of claims.

- Pradhan Mantri Awas Yojana is a housing programme undertaken by the government wherein it aims to build 20 million houses by 2022. It has met targeted spending and will increase spending next year, and has also already built nearly 8 million houses in rural and urban areas.
- The Mahatma Gandhi National Rural Employment Guarantee Scheme is one that guarantees employment for at least 100 days for unskilled workers. Spending under this programme has been disappointing and has even led to protests by activists.
- Modi's attitude towards agriculture has been called into serious question with the passage of the Farm Bills in 2020. The new laws that have been put forward essentially deregulate the agricultural market in totality. Farmers will face no restrictions in terms of selling their produce and can enter into private agreements at their own will. This freedom, however, comes at a cost as it will also mean that the government will withhold support. The 'Minimum Support Prices' will still be available, but they need the Mandi's to exist. The Mandi's can only

function if they witness traffic, for without sales being facilitated on their premises, they will not receive any commissions, which is the main source of their revenue. If there are not enough farmers selling their produce at the Mandi's, then the Mandi's will not be able to offer the support prices.



Rakesh Tikait, Leader of Farmer Unions, after his hunger strike.

Entering into private agreements will only really benefit the wealthier farmers who have large holdings, as they will possess a certain amount of negotiating power. The majority of the farmers in the country have very small holdings (less than 2

hectares), and as such might find themselves being exploited by private interests.

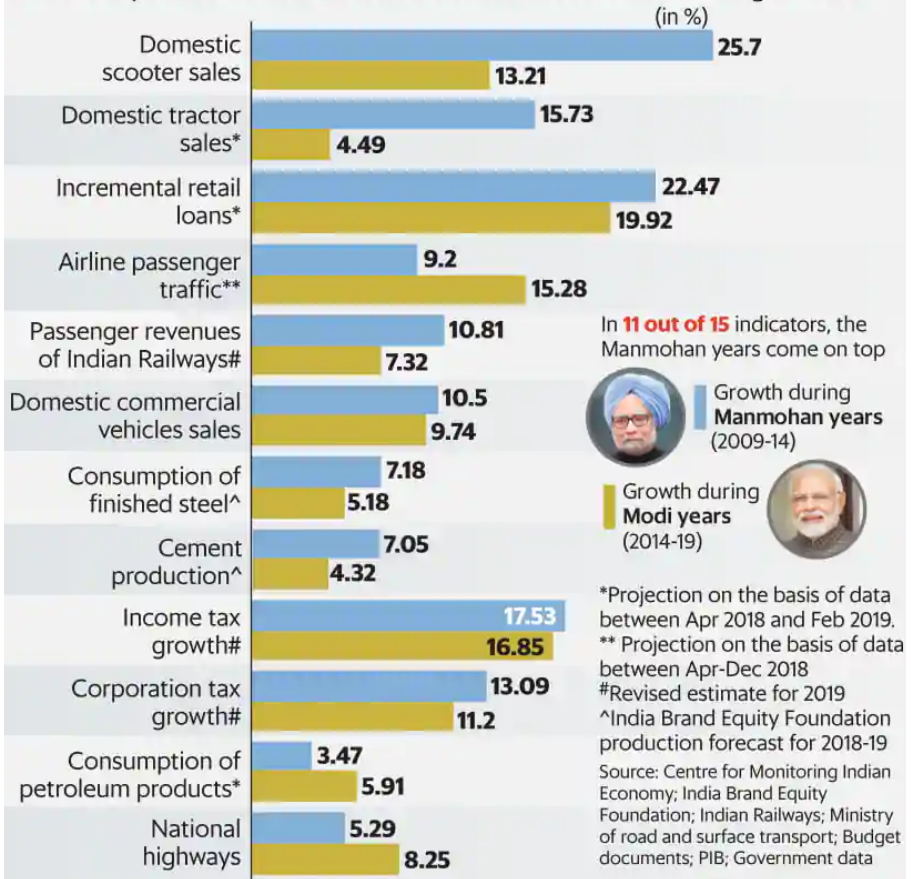
Many academics have come out in support of the laws, but they also contend that it is merely a step in the right direction as there is still much work left to do on the government's part. China implemented a similar system in the 1980s and 1990s but their version included a risk-mitigation framework that put their farmers at ease, something that does not exist within the Indian context.

Farmers across the country have reacted to the laws with some of the largest protests ever seen, anywhere. The protests began at the start of December and as of mid-February, are still going strong. They have forced the government to suspend the implementation of the laws for 18 months and have made several demands which include the promise of a minimum support price from the government's end. The government, for the time being, looks like it is trying to ride out the storm and is hoping that the farmers will retreat eventually. With growing international pressure, it will be interesting to see how firm the government can remain on its stance.

CONCLUSION

THE GROWTH PUZZLE

Based on most high-frequency indicators that measure consumer sentiment, the Manmohan years seem better than Modi's term. What's with the GDP figures then?



LiveMint

A simple analysis of the above listed high frequency indicators shows that the second Manmohan Singh government performed better than the first Modi government in almost all areas. Airline passenger traffic has been better under Modi, thanks to growing number airports under his tenure (more than 23%) and reduction of airfares (down by 25%). National highway construction has also been higher under the Modi government largely due to his increased spending on infrastructure.

Earlier we spoke about how FDI under Modi has been higher than that of Manmohan Singh's government. This is true, but it is important to note that foreign portfolio investment under Manmohan Singh was much higher than it is under Modi currently. Why is this noteworthy? The problem with too much FDI is that Indian companies end up being controlled by foreign interests, which is not necessarily the case under portfolio investment.

One of the major problems that the Indian economy is currently facing has to do with the banking sector. Loans are being defaulted on at an alarming rate and big banking institutions have faced periods of crisis, wherein they have had to have been bailed out. This was an issue under the Singh government but as we can see the growth of non-performing assets has exploded under the Modi government. This is an issue that has to be dealt with immediately if India is to avoid a major economic crisis.

Being the party that positioned itself as the 'pro-development' party and generally being business friendly,



one might have expected big improvements in India's economy as a whole. In many areas, the BJP have been better than their predecessors (infrastructure, FDI) but in a lot of other areas they have been quite disappointing (GDP, employment, NPAs). It can not be understated just how much of a negative impact demonetisation had on the Indian economy. Looking back it was a policy that the government really did not have to follow through with, and it will be something that will always be a question mark on its record.

If Modi had decided against it, it is entirely possible that his economic record would have been clearly superior to that of Manmohan Singh's. The only positive that came out of it was the emergence and adoption of FinTech in India, which has been a good thing for the Indian economy. The cost, however, could have surely been avoided. Demonetisation and GST will be the hallmark economic policies passed by Modi and while one was a failure, the other was a step in the right direction.

