Syllabus subtopic: Indian Economy and issues relating to planning, mobilization of resources, growth, development and employment.

Prelims and Mains focus: the ongoing economic slowdown and its impact on India’s GDP; measures to be taken in the upcoming budget

News: As per the government's first advance estimate, gross domestic product (GDP) growth for FY20 is likely to be 5%—the lowest since the global financial crisis of 2008-09, when it fell to 3.1%.

Why is GDP growth likely to fall to 5%?

Private consumption expenditure, the money people spend on buying things, has comprised 56-57% of India’s GDP (in real terms, adjusted for inflation) over the past few years. In FY20, it is expected to grow at 5.8%, after growing at over 7.4% in each of the last four fiscals. This can clearly be seen in the fall in sales of cars, two-wheelers and tractors, and the slower volume growth of FMCG companies. People are not spending as much money on buying things as they used to, given the lack of confidence they have in their economic future. This is reflected in slow growth of private consumption expenditure.

What is investment’s part in the fall?

Investment is a key driver of consumption. Investment growth in FY20 is expected to collapse to 1%, the lowest since FY06 (i.e., as far back as growth data for the current GDP series goes). Without proper investment growth, jobs can’t be created. And without jobs, there won’t be a source of income for the million Indians entering the workforce every month. Only when people earn can they spend. Also, one man’s expenditure is another man’s income—creating a cycle. Hence, a slowdown in investment growth is bound to affect private consumption, which, in turn, will slow down GDP growth in FY20.
What is the state of government expenditure?

Government expenditure—growing 9.3% in FY19 and 15% in FY18—has driven growth between 2017-19. In FY20, it is expected to grow 10.5%, the fastest among all constituents of GDP (others being private consumption expenditure, investment and net exports). This fiscal, the government’s share in the economy will reach 11.3%, the highest in a decade.

What about the non-govt part of economy?

If we leave government expenditure out of the GDP, what remains is the non-government part of the economy. This part is expected to grow at 4.3% in FY20—the lowest since 2008-09, when it had grown 2.2%. This is hardly surprising given the slow private consumption growth and plunging investment growth. The non-government component forms around 90% of the economy, and it’s this part that needs a boost if the overall economy is to be revived. Higher government spending can only do so much.

So what can the government do?

In the short run, consumption growth needs to be revived, without which investments are unlikely to improve. Companies invest when people consume. To ensure this, the government can put more money in the hands of people via a personal income tax cut, and spend more on social schemes, such as MGNREGS. Also, the GST Council needs to stop fiddling around with the goods and services tax and go for a comprehensive overhaul.