
**IS KEYNESIANISM A PANACEA FOR THE PRESENT
AILMENTS OF OUR ECONOMY?**

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ABSTRACT

At present the national income numbers is a matter of controversy. There is no unambiguous picture of income in our country. No serious policy decision is possible without a clear idea of income and expenditure. Even if the new income calculations are assumed to be correct, the fact is that growth is slowing down. The revised new estimates show that the growth rate in 2016-2017 was 8.2% and that in 2018-2019 it was 7%. Therefore, accelerating economic growth must be on the top of agenda of the new government, at least to keep the minimum pace of the economy which satisfies the minimum expectations and dreams of 1.3 billion of people in this largest democracy. For realizing this, higher investment rate is required. It is true that for a short period, growth may be realized out of better utilization of existing capacity. But in the long-run the ratio has to go up substantially for remarkable growth.

Keywords: Keynesianism, Economy, Irrigation, GNP, Households

INTRODUCTION

During the second half of the 20th century, in spite of India's richness in natural resources and manpower, and her excellence in philosophy, metaphysics and fine arts, which can be matched only by a few civilized countries, India had been labeled as a country with structural stagnation and a poor country in the midst of plenty. This ominous labeling was, however, against many indices of development, mainly because India had taken great strides in the fields of industry, agriculture, and animal husbandry. Our irrigation, power, transport and communication sectors also achieved remarkable progress. The existing concept of development, emanated essentially from an uncritical application of growth models which considered the rate of growth of per capita GNP as the most important variable of development, is a post-war phenomenon. The identification of development primarily as economic progress reveals the euro centricity of the concept, although Marx had incorporated institutional variables in his analysis of development and progress, not to forget that even Marx looked beyond Europe with artificial opacity because

he looked beyond Europe only to classify the underdeveloped areas as being dominated by an unchanging and static Asiatic mode of production. In the post-war period, the conception of development was circumscribed by the tenets of Keynesianism, which focuses on the rate of growth of national income and employment. The main concern of this research paper is to analyze the prospects and challenges of the present Narendra Modi government at the centre with special focus on current economic situation in India on the basis of GDP growth rate and employment opportunities.

WHAT IS KEYNESIANISM

J M Keynes in his “The General Theory of Employment, Interest and Money” gives three models of income generation. The first model which is also popularly known as the Simple Keynesian model is a two-sector model. It consist only households and businesses. The second model, in addition to the above sectors, considers government spending and taxing to produce a three-sector model. The third model adds foreign trade to produce a four-sector model.

The Simple Keynesian model simply says, although insane in the present international order, that in an economy consisting only households and businesses and operating below full employment, price level is determined entirely by the supply of commodities. The equilibrium level of income in such an economy is determined solely by aggregate spending and investment, sum total of consumption spending and investment spending. In simple words, this model lays down that equilibrium level of income and output depends on the economy’s aggregate spending for output. If aggregate spending is not sufficient to call forth the level of output that requires the employment of all available workers, unemployment results, and production and services falls below its potential. On the contrary, if aggregate spending is just sufficient to call forth the level of output that requires, full employment results and production reaches its sufficient level, and too much spending leads to inflation.

The three-sector model extends the theory of income determination to include the effect of government spending and taxation on income. The action of government in varying the spending and taxes are called its fiscal policy. How the fiscal policy affects income level is explained by three fiscal models. The first model assumes that all government spending is for goods and services and that tax receipts are fixed. In other words, tax does not vary with income level. In spite of its unreality, this model provides the basis for the well-known balanced budget theorem. The second model allows for transfer payments as well as government purchases. It shows that changes in these two types of government expenditures have different effects on the income level. The third model makes a variation from the first model by assuming that tax receipts are a direct linear function of the income level, a clear aberration from the fixity of tax receipts irrespective of the income level.

The effect of government spending and taxation on the income level and output depends on how much government injects into the spending stream through its purchases and on how much it withdraws through net tax collection (total tax collection minus the cost of tax collection which forms part of government spending). These decisions contribute to the attainment of certain income goals. Appropriate fiscal policy is very important for meeting situations of stagnation, depression and inflation. If the economy is operating at a level of income and output below that at which there is reasonably full utilization of its resources, the appropriate fiscal policy is an expansionary one. If on the other hand, if the economy is at a level of income and output at which there is not only full utilization of resources but strong upward pressure on prices, the appropriate fiscal policy is one of contraction. During the time of stagnation, the government policy should be one of encouraging investment slightly by means of incentives of low rate of interest for loans both by investors and households, reduced taxes, deficit financing etc., because a minimum level of inflation is required for increase in investment, which in turn leads to increase in production, increase in employment, increase in income, increase in saving and thus for continuing the cycle of development. In the four sector model, otherwise called open economy, aggregate spending is measured by adding the spending of the three domestic sectors with the foreign sector, because income level is affected by spending by foreign consumers, foreign business and foreign governments. In other words, the net import or export balance affects the economy's income level.

The government in a mixed economy influence income levels through taxation and expenditures. The tax and expenditure policies together constitute, as we have noted, the fiscal policy of a government. The impact of government expenditures can be measured in two ways: one by considering the impact of tax change and the other by neglecting the change in the tax rates. The effects of an increase in taxes will differ from an increase in government expenditures accompanied by a raise in taxes. Similarly, taxes independent of income will produce different effects from taxes related to income.

PRESENT INCOME LEVEL

At present the national income numbers is a matter of controversy. There is no unambiguous picture of income in our country. No serious policy decision is possible without a clear idea of income and expenditure. Even if the new income calculations are assumed to be correct, the fact is that growth is slowing down. The revised new estimates show that the growth rate in 2016-2017 was 8.2% and that in 2018-2019 it was 7%. Therefore, accelerating economic growth must be on the top of agenda of the new government, at least to keep the minimum pace of the economy which satisfies the minimum expectations and dreams of 1.3 billion of people in this largest democracy. For realizing this, higher investment rate is required. It is true that for a short

period, growth may be realized out of better utilization of existing capacity. But in the long-run the ratio has to go up substantially for remarkable growth. When this fact is linked with the ambitious expectations of the ruling elites, the efforts become more hazardous, not to share the pessimistic ideas of professionals in our country. In 2007-2008 the investment ratio was as high as 35.8%. But in 2018-2019 it showed only a dismal ratio of 28.9%. Making matters worse, the fourth quarter GDP numbers showed a dismal growth rate of below 5.8%. However, waking up our development plans, in the first quarter of 2019-2020, it is estimated to 7.5%. The picture is not so dismal as it was when Narendra Modi assumed office as Prime Minister in May 2014. But there are causes for worry, especially because the new government has laid down the big dream of making our economy a 5 trillion one in five years and the government has to move quickly. We have promises to keep before we sleep.

It is in this context Keynesian economics becomes significant, according to which when an economy is suffering from the paucity of sufficient investment to make use of the available resources, the government should take initiatives to stir the economy with new investments, both private and public.” It is only a fast growing economy that will generate the surpluses which are necessary to address many of our socio-economic problems and to provide social safety nets.” For faster growth, higher investment rate is required. In current prices, the ratio of Gross Fixed Capital Formation to Gross Domestic Product has stayed low at 28.5% between 2015 and 2018. Several studies show falling corporate investment. Depending upon data provided by banks and other financial institutions the RBI forecasts corporate investment. The March 2019 bulletin of the RBI says that in 2018-2019, the capital expenditure of the corporate sector were estimated at rupees 1,487 billion, a steady decline of about 500 billion rupees from 2014-2015. A survey conducted by industry chamber FICCI has shown that around 41% of the respondents in the survey covering over 300 manufacturing units, with a combined annual turnover of over 35 million rupees, expected a 13% point drop since the March quarter of 2019. Of the 12 sectors covered by the survey, automobiles, metals, medical devices and leather and footwear were seen to be most pessimistic and pointed to low growth expectations. What is needed in this situation is the governmental intervention to boost public expenditure. Most public investment occurs outside the budget estimates, because the bulk of public investment comes from public sector enterprises. The standard idea of macroeconomic stimulus is to implement a large increase in government spending without raising taxes. This will certainly raise the deficits.

WHAT ARE THE IMPORTANT POLICY REQUIREMENTS?

The budget proposals for the fiscal year 2019-2020 has, however, committed a path of deficit reduction, announcing that the government is committed to a long term macroeconomic framework. In this fiscal year, capital expenditures of the Central Government to GDP shows no

much change from the past, around 1.6%. In this context, what is needed is interaction of the government with all public sector units and ensuring increase in public investment. Increase in public investment will automatically bring more private investment because increase in the former will prepare a fine ground for the latter. If the government is vigilant to remove bottlenecks that impede private investments, the initial increase in investment can bring multiple effects in the economy.

Our economy shows a sharp decline in the demand for consumer durables and fast moving consumer goods for the last few months. Sales of commercial vehicles showed negative trend due to a drop in freight volumes. Passenger car sales fell by 17% in April 2019, which had only a sluttish movement of 2.7% in 2018-2019. Similarly, Two-wheeler sales fell by 17% in the same period. Even domestic air traffic growth fell for the first time in April this year. Falling consumption spending is a bad omen. In an economy like India, depending heavily on consumption spending, the Keynesian solution of pushing consumption spending is highly recommendable. The best means to do this is to pump more money into the economy in a way that enables the poor and the middle income group to purchase more. In other words, purchasing power of those who would purchase goods should be enhanced. The best way to increase the purchasing power of the middle class is reduction of tax rates because it is the middle class which will spend the extra money in its hands.

The easiest and effective way to enhance the purchasing power of the poor, who have more or less cent percent marginal propensity to consume, is the enhancement of welfare programmes and employment guarantee schemes. Allowances for the unemployed, aged, disabled, widows etc. should be established and the existing ones enhanced. The new budget appears to be a continuation of the last budget with an emphasis on social welfare. This includes a bank overdraft facility for women members of Self Help Groups (SHG) and an identification with the poor. The hike in the allocations for women (10%) and the Scheduled Castes (30%) and Scheduled Tribes (25%) also points towards the government's commitments to put money in the hands of the poor. We have welfare schemes including the National Social Assistance Programme and the Mahatma Gandhi National Rural Employment Guarantee Programme (MGNREGA). But the allocations for these schemes are not up to the mark. The revised estimates for the current fiscal fall short of the previous year. During 2018-2019, RS.84,3610 millions was allocated. In the current budget, the allotment for this is only Rs.818,630 million, a curtailment of 3%. If this cut for welfare schemes is adjusted for inflation, the real cut is more than the 3% direct cut. The budgetary allocation for MGNREGA in particular for 2019-2020 is RS. 6,00000 million. This amount falls short of the even insufficient allocation of Rs. 6,10840 million for the year 2018-2019. The allocations for Pradhan Mantri Awas Yojana also shows decline, while allocations for Pradhan Mantri Gram Sadak Yojana shows no change.

The problem of unemployment is another core area to be addressed to find solutions for the paucity of demand. There is no doubt that the increase in the employment opportunities offers a huge potential for India's future economic growth. Employment and growth are closely interlinked. The famous *Okun's law* establishes this relation*. To realize the so-called "demographic dividend" investment in education and human development is an imperative. The only solution to the problem of unemployment is faster growth and faster investment. Recently, there has been some shift of employment from the unorganized to the organized segments. But this does not give any solace because unemployment does not confine to the educated youth only, it also means unemployment of all those who have capacity and willingness to work. Improvement in the construction field can find solutions to the job problems of the uneducated. But the solution for job problems of the educated youth lies in the growth of service sector, especially in the financial system. Here lies another important task of the government. Although banks have shown signs of recovery from the non-performing assets issue, the non-banking financial sector seems to be in trouble. It has been hit by one problem after another and the common problem threatening this area is liquidity crunch.

The new budget seems to have a clear vision of the problems of the banks and NBFC's. It comprehensively addresses the important issues of liquidity, solvency and poor governance in the NBFC sector. The lost confidence and credit capacity of the institutions in the sector can be regained. The big Rs.700000 million capital infusion in banks will definitely spur lending to growth sectors in the economy. The decision to provide one-time credit guarantee to banks for purchasing high rated pooled assets of financially sound NBFCs has the potential to increase credit flow to the economy. Above all, the government has announced that it would invest Rs.1000 million in infrastructure over the next five years. These are notable macroeconomic measure to push the economy to speedy paces. These and other measures in the budget can solve job problems in the service sector to a large extent.

The new government's agenda for long-run growth is clear in its decision to bring all companies having turnover up to Rs. 4000 million under the 25% corporate tax ambit from the former limit of Rs. 2500 million. This will have positive impact on investment. Similarly, interest subventions for Micro, Small and Medium Enterprises (MSMEs) and electric vehicles (EVs) will boost the economy. Increased tax deductions for interest paid on loans for houses up to Rs. 45 lakhs, construction of 19.5 million rural houses and finalization of a model tenancy will augment the march forward off this sector. Further, in order to provide a further impetus, the budget proposes an additional deduction up to Rs. 1.5 lakh for interest paid on loans borrowed up to March 31st, 2020. "Therefore, a person purchasing an affordable house will now get an enhanced interest deduction up to Rs. 3.5 lakh. This will translate into a benefit of around Rs.7 lakh to the middle class home buyers over their loan period of 15 years". All these sound well. But these measures

are not sufficient to push forward the economy to double its GDP within five years. Although the macroeconomic measures taken by the Finance Minister point toward a long-run growth with stability, there is an important weakness inherent in the budget which is contradictory to the overall objective of the government. The efforts of the government to increase spending should be supplemented by a simultaneous reduction of tax rates of the middle class. This will certainly enhance deficits. But the government seems to be working with an assumption that some stimulus is possible without raising deficits. This might be the rationale behind the policy of stringency in taxes. In this respect, the present government, like the previous Narendra Modi government and the UPA governments sticks to high tax rates and refuses to cut them. Actually no tax cut is harmful to the growth of the economy. Lower taxes not only boost revenues but also bring about economic growth**.

Notwithstanding pessimistic notes from various quarters, the report of the UN'S World Economic Situation Prospects (WESP) 2019, reports that India's GDP growth is expected to accelerate to 7.6 per cent in 2019-2020. According to the UN sources, India will continue to remain the world's fastest growing economy in 2019 as well as in 2020, much ahead of China. The growth rate of China may go down from 6.3 per cent in 2019 to 6.2 in 2020, due to negative impact of trade tensions. Growth in India continues to be underpinned by robust private consumption, a more expansionary fiscal stance and benefits from previous reforms. However, the WESP reminds that a prolonged escalation of trade tensions could severely disrupt the global economy. Directly impacted sectors have already witnessed rising input prices and delayed investment decisions. These impacts can be expected to spread through global value chain, particularly in East Asia. Slower growth in China and the United States could also reduce the demand for commodities.

To conclude, the present position of Indian economy does not raise any cause for worry. But we are living in an open economy. We have to consider the rest of the world while looking for our development and growth. The macroeconomic measures or suggestions of Lord John Maynard Keynes unambiguously laid down in the new budget of the government are well-thought ones. At the same time, it should be noted that such measures are to be accompanied by their augmenting mechanisms. In spite of initiatives for investment boosting measures, the budget is lacking demand stimulating mechanisms. The robust private consumption has to be retained and if possible increased, especially when we have to go a long way in terms of growth. Negligence of farmers, welfare programmes for weaker sections and high rate of tax rates of middle income group will cause irreparable damage to the future growth of the economy.

NOTES

*A relation between real growth and changes in the unemployment rate is known as Okun's Law, named after its discoverer, the late Arthur Okun of the Brookings Institution, former chairman of Council of Economic Advisers. Okun's Law says that the unemployment rate declines when growth is above the trend rate of 2.25%. Specifically, for every percentage point of growth in real GDP above the trend rate that is sustained for a year, the unemployment rate declines by one-half percentage point.

**Well-known economist Arthur Laffer theorized that lower tax rates not only boost revenues but also spur economic growth.

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