RECESSION IN INDIAN ECONOMY

ITS CAUSES AND CURE

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> "People must come to accept private enterprise not as a necessary evil, but as an affirmative good."
>
> —Eugene Black

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By

DR. R. *C*. COOPER*

The problem emerging from recessionary trends in industries has raced ahead of many others of economic significance both in terms of importance and, urgency. The subject is of an extremely complex nature and it is, therefore, not easy to determine1 the remedial, measures both in the short run as also over a period of time. The matter has been discussed again and again in meetings, conferences and seminars. The recession and the remedial measures appear to assume a pattern differing with the perspective with which one looks at them.

Recession in industries was taken seriously only when it became widespread and began to manifest itself in bolder hues in terms of a steep decline in production, lay-off and retrenchment. Nonetheless, it is not as if it has overtaken the economy by surprise. There has been a continuous slow-down in the indus-

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trial production. The index of industrial production was on an average placed in 1965 at 186.9, which represented an increase of 5.4 per cent as compared to 1964. Last year, the index reached an average of 191.5 representing a much smaller increase of just 2.5 per cent, over that recorded in 1965. The rupee was devalued in June 1966. Following the same, many steps were taken to give an impetus to industrial production. For example, the import policy was liberalised to permit industries to import raw materials and other essential items in adequate quantities. Many industries were freed from the licensing provisions of the Industries (Development and Regulation) Act, 1951, and it appeared for a while as if production would pick up, but these hopes were belied and the index of industrial production dropped p ecipitately from 200 in December 1966 to 197 in March and to 186 in April this year.

The consequence has been that a growing portion of the capacity remains unutilised. Official figures culled from the Report of the, Ministry of Industrial Development for 1966 show that the idle capacity as percentage of installed capacity was disturbingly high in several of the industries such as steel castings, railway' wagons, steel forgings, heavy structurals, welding electrodes and machine tools. The situation has further worsened during the last few months, with an alarming Pall in production and the rapidity with which other industries are affected by the phenomena.

Industries in the private and public sectors have been

equally affected. The engineering industry has been most severely hit. Production in many units in the western region has been at a low level and there have been reports about closure of a number of units. The textile industry in the western region iq also in a sad plight. At such a stage, there is no time to be lost in discussions on whether the present economic situation represents recessionary conditions or a slump. Suffice it to say that a crisis of vast magnitude is threatening to take over' the economy. The manifestations are becoming clear as time passes on. What is, therefore, urgent and essential is to consider the matter in all objectivity, to identify the problem and seek a solution for the same on a realistic basis.

The immediate causes are by now well known. With the persisting inflationary pressures and the prevailing high level of prices, the purchasing power of the people has gone down and with the continuous droughts during the last two years, the available purchasing power has been used up in buying foodgrains at high prices. There is hardly anything left for purchasing cloth and such other essential consumer requirements. Again, the demand has fallen off, mainly because of cut-backs in orders! on industry from Public Sector organisations, or from industries in the Private Sector which generally help sustain their manufacturing activities. Faced with real shortage of resources, both internal and external, there has been a slow-clown in the tempo of development, the level of public investment has been reduced and this has entailed a corresponding cut in the demand for the products of the industry such as for wagons. Similarly a slack in demand for products of industry such as cotton textiles has affected the fortunes of the textile machinery manufacturing industry and so on. If the tapering demand for its products is the immediate cause of a slow down in production in some cases, in others it is the non-availability of finance to sustain its day-to-day operations. Under the high level of taxation,, there is very little that can be saved. Such working funds as are available have been used up in importing goods against import licences without in all cases the justification provided by urgency of requirement. The Reserve Bank's progressive tightening of the credit closed the normal avenues on which an industry could rely for securing its requirements of working finance in adequate measure and on reasonable terms. It is clear that such funds as are available from banks are not only not adequate but costly.

All these factors have contributed in giving rise to the present recession. The more important factor, although more distant in point of time, is that there has been an over-licensing of capacities in industries most affected by recession. Accepting the estimates of demand as projected by the Perspective Planning Division of the Planning Commission, the Government continued to licence capacities and entrepreneurs, encouraged by buoyant conditions then prevailing, rushed in

to set up industries. These capacities, after considerable effort, hard work and deployment of scarce resources, are today coming to production just at the time when the demand, due to various reasons, seems to be contracting. The Government, however, seems to be yet planning to expand capacity such as that in the steel foundry industry in the Public Sector, when a considerable portion of the existing capacity in the Private Sector remains unutilised.

There are, thus, varying factors that have caused recession. Some have had their immediate effect but others, of the latter category, have had, even if slow, inexorable decisive impact on industries. I have attempted to draw this distinction, as very often, in the anxiety to find remedies based on a study of the short-term causes, one tends to overlook the fact that essentially what is required to remedy the malady of recession does not differ from what is necessary to arrest the stagnation in the economy and put it back on the wheels of progress.

Having examined the causes, it is natural to turn attention to the possible measures that could be taken to combat recession. It is necessary to guard against the tendency to over-simplify the issue and to suggest that one or the other measure is bound to prove effective in relieving the impact of recession. The problem is a complex one and it cannot lend itself to a simple solution. It has to be attacked from various directions.

No single measure by itself can hope to take care of all the consequences of recession. A simultaneous action by way of a series of measures have to be implemented in a coordinated manner to ensure that industry is successful in getting over the adverse effects of recession.

In this connection, it is a matter of some satisfaction that the earlier tendency noticeable in Government quarters to ascribe the present ills to the drought conditions and to rely on a good monsoon for beneficial results is slowly giving way to a more positive thinking on the steps necessary for reviving both production and demand. The Government has announced a series of steps to help industries on an immediate basis in fighting recession such as, the selective liberalisation of the credit policy to help industries in the priority sector and for facilitating exports and evolving arrangements for hire purchase and deferred payments so as to stimulate a larger demand for products of industries both here and abroad. The measures taken by the Government are useful and welcome but are they adequate? A point that has often been made is that the departments of Government show a preference, for the products of the Public Sector undertakings with the result that units in the Private Sector do not get the opportunity to participate in the purchase programme of the concerned departments and this affects the off-take of the industry.

I will now refer to some of the remedial measures

that have been constantly suggested in the recent discussions on recession. The first of this is the possibility of increasing the demand for the products of industry through a price reduction. It is obvious that reduction in prices must necessarily have some effect on the extent of the demand. But is the demand so flexible as to be amenable to a price reduction? Even if this is so, is there scope for a significant decrease in the price of the products? It is well known that a good part of the cost and, therefore, of the ultimate price of industrial product is represented by the high level of indirect taxation, made up of excise and sales-tax. It is now known that the burden of the excise levy has increased from Rs. 67 crores in 1950-51 to Rs. 1,030 crores in 1966-67. It is also known that of the price of, an industrial product nearly 30 to 40 per cent represents the tax component by way of such indirect levies, both in the products as also on items of raw materials and components that go into the manufacture of such products. So long as the burden of taxation remains high, so long as there is inbuilt cost inflation of such a high order, is it possible ta expect a significant reduction in prices as an effective remedy for stimulating demand for the products of industry?

In the context of the fall in demand' in the internal market, it is being widely recognised that the industry must endeavour to find an outlet for its products in the export market. This, it is said, will yield results advantageous to the industry. Firstly, it will help to build up a permanent market in the foreign countries and thus secure valuable foreign exchange earnings for the country. This in turn will also help industry to become increasingly less dependent on the changing import policies from time to time in conformity with the overall foreign exchange position confronting the country.. Here again, it will be necessary to examine whether what is desirable is also feasible. Export markets cannot be built up overnight. They have to be nursed over a long period of time with products of good quality and standards, offered at competitive and reasonable prices. But what are the prospects of our goods being produced at lesser costs and being sold at competitive prices in foreign markets?

An answer to this question is linked up with larger aspects of policy in the sphere of labour productivity, efficiency and scientific management, scrupulous effort to adhere to standards, specifications and quality of goods and what is most important with the fiscal and taxation policies of the Government. All of them have a bearing on the question of considering export promotion as a way out of the difficulties caused by recession.

I have referred to the prospects of export promotion over a long-term basis. There does appear to be a possibility, on an immediate basis, of the industry being able to dispose of its accumulated stocks in export markets. If the prices that can be offered to foreign buyers are not competitive, the industry, it is suggested, must be prepared to sell its products for some time on a no-profit-no-loss basis. It must be satisfied if it can recover the prime costs, i.e., the cost of raw materials and wages.

Another direction in which it has been suggested that the industry should seek solution of its difficulties is that relating to rationalisation of multi-purpose manufacturing capacities. That there is some scope for such diversification cannot be gainsaid. But what are the minimum additional facilities that are required to help a change-over in the manufacturing programme of an industrial unit? Would the Government be prepared to permit import assistance, if necessary, for the purpose, by way of securing balancing equipment for the industries?

To the extent that there is scope for rationalisation, it should be fully explored but that should not lead to a general impression that diversification of manufacturing programmes is all too easy and simple. As for example, in the capital goods industry, such a changeover is not always readily possible because it involves so many changes affecting the standards, quality and detailed specifications of the goods produced. These obvious facts are often overlooked. Was it not suggested the other day that HMT, if it cannot find market for the machines that it produces, should take up the small car project for implementation without pausing to consider if the HMT does have the necessary wherewithal to produce small cars?

In discussing cures for recession, stress is laid on the possible action that the Government could take to soften its impact, but is it not appropriate that the industry should consider what part it could and should play? I have referred earlier to the possibility of industry trying to promote exports. Can industry not persuade itself to export a specified portion of its production in the overseas markets? It is true that the demand for export products cannot constitute a large portion of the productive capacity in any of the new industries. Even so, an endeavour to maximise exports would be justified. If that is so, should the industry not make an effort to improve the quality of the products? How important the aspect of quality is, will be clear from the fact that even in the home market, when the demand is falling, a product of good quality finds comparatively little difficulty in securing a market. Should the industry not concentrate on increasing its efficiency through a proper control of inventory built-up, a close look at its administrative expenditure, a rational planning of sales programme and proper tax planning and thus help lower the costs of production? Further, it has often been stressed that fragmentation is the bane of Indian agriculture. Is it not time to consider this aspect in relation to industry? Should the need and necessity of amalgamation and merger of marginal and weaker units not be examined so as to

facilitate formation of viable units? Whatever happens at Government level, the industry must in the sphere in which it has influence, endeavour its utmost to bring down costs.

To the extent that recession in industries is directly attributed to the over-licensing of capacities in the past, perhaps, an immediate solution to the difficulties of industries affected cannot be found. In that case, the industry will have to learn to live with the problem and to continue to struggle to exist as best as it could by adjusting its programmes in one or the other of the directions indicated above, all the while hoping that the demand will pick up in the years to come and make its vigorous functioning possible.

The hope for such a change is inextricably linked up with the hope for a change in the approach and! attitude to economic policies and procedures followed in the past. That there is a close relation between the two is quite clear. When economic conditions were buoyant, the national income was rising; the demand for capital goods industry continued to rise. When the same policies led to a slowing down of the tempo of development, the capital goods industry has begun ta experience a falling off of the demand for its products. It is necessary, therefore, to examine if there is a possibility of a real significant improvement in the situation unless there is a radical change in the overall economic policies.

The defects and drawbacks of the economic policies have been pointed out to the Government again and again. There has been undue stress on heavy industries. We have stressed the need for deploying the available resources on schemes which have a small gestation period and which can yield return in a foreseeable period. Unfortunately, a large part of the investment has been laid on projects with a very long gestation period. The yield from the projects, when they come into being, has been extremely poor. At the same time, the resources raised through a high level of direct and indirect taxation have been locked up in investments which yield a meagre return, not to speak of a diversion of a good part of such resources towards wasteful expenditure of a non-plan and non-developmental character. The non-development expenditure has grown since 1960-61 from Rs. 953 crores to Rs. 3,623 crores. The result has been the emergence of inflationary pressures which have continued to be with us with an increasing impact since the middle of the Second Five-Year Plan, a continuing foreign exchange crisis during the last so many years, necessitating devaluation of the Rupee last year, which instead of helping the economy as it was expected to, has made the position still worse and the economy has now on its hands the recession to contend with.

We are confronted with the simultaneous operation of forces of high prices and lessening demand for industrial goods. Ultimately, the remedy can only be

in the direction of evolving production-oriented policies and efficient utilisation of the available resources in pursuing developmental programmes, particularly those which are already half-way through. Votaries of large-sized plan may see in this unfortunate development a justification for the hopes that they have pinned on larger investments. True, developmental investment on productive schemes have to be continued and if possible, enlarged; but resources for the same should only be found by effecting strictest economies in expenditure. The Union Minister of Works and Housing, Mr. Jagannatha Rao, stressed the other day this point when he observed that in construction alone, (which represents nearly 40 per cent outlays in Five-Year Plans), if economies of the order of 10 to 20 per cent could be effected, the resulting savings in the current plan might be between Rs. 600 crores to Rs. 1,200 crores. The remedy certainly does not lie in the direction of increasing plan investments on a general basis for that would only give rise to the emergence of all the maladies, that have afflicted the economy in the last few years, with yet greater adverse impact.

Recession is an intricate problem requiring complex treatment. It is a symptom — perhaps a dangerous symptom — of the basic illness from which the economy is suffering, namely, the inflationary situation. How shall we counter this development? Is it of a transitory nature or has it emerged from deep-rooted causes? Is it amenable to solution through **ad hoc** measures designed to stimulate demand for industrial products or does it indicate the need for an overall review of the fiscal, monetary, credit and taxation policies? Will a selective reduction in excises not be conducive to stimulate demand? Will a review of the taxation in the corporate sector not be helpful at the present juncture? Will a relief in corporate taxation not enable the industry to be in a better position to face recession and help the capital market? Will an easier availability of finance at comparatively lesser cost not be appropriate for stimulating demand? Does recession not stress the importance and urgency of a greater scrutiny of non-plan and non-development expenditure? Should the funds so released be not utilised for adjusting outlays on the higher side on a limited number of developmental programmes without resorting to the facile expedient of fresh measures of taxation for raising additional resources? Above ail, shall we not learn by experience to free ourselvec from dogmas and ideological considerations and fashion our policies on a realistic and pragmatic approach to problems of economic development? What should be done to instil a greater degree of cost-consciousness in

industry? The Union Minister for Steel, Mr. Chenna Reddy, put the point succinctly when he observed the other day that in the initial enthusiasm for development, we did not bother about the cost of production, expansion and other economic implications. Shall we now learn from experience of the conditions of crisis in which the industry has had to function? What role should the industry play in seeking a solution to its present difficulties? Should it not look upon the present situation as a God-sent opportunity'? Should it not take stock of the situation, turn the search-light inward and fathom deep into the possible remedies which it should attempt, minimising the reliance upon Government help and guidance?

The continuing foreign exchange crisis had earlier stressed the need for import substitution. Subsequently, the import policy was liberalised and in the process, it is said in many: cases indiscriminate imports were allowed, which hurt the indigenous industry manufacturing similar products. The Government will, of course, undertake a review of the import policy, but should not the industry endeavour to secure a greater degree of import substitution and thus subserve the larger objective of conserving foreign exchange resources and giving a fillip to the indigenous industry9 A radical change in the approach and attitude of the

Government to problems of planning and economic development is, of course, indicated. Is it not necessary that simultaneously there should be attempts of a fresh look on the approach and attitude to the problems of sustaining growth and development?

The views expressed in this booklet ore not necessarily *the* views of *the* Forum of *Free* Enterprise.

"Free Enterprise was born with man and shall survive as long as man survives."

— A. D. Shroff
(1899-1965)
Founder-President,
Forum of Free Enterprise.

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