Recession in Indian Industry —Causes, Consequences & Prospects

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"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

Recession in Indian Industry

I

Causes and Consequences

D. R. Pendse*

At long last, there is no more a verbal debate, whether or not, there are recessionary tendencies in Indian industry. The broad affirmative agreement is a good starting point to examine the more important question: How did these tendencies emerge and what will they lead to?

Recessionary tendencies were first seen over a year ago in such industries as textiles, cars, steel and air-conditioners. Since then, they have been spreading fast and now engulf a significant section of Indian industry, which covers the so-called luxury goods or the consumer durables like T.Vs., radios, refrigerators, cars, plastics, dry cells, electrical appliances, furniture, office equipment, etc; basic industries like steel, aluminium, steel tubes, pipes, commercial vehicles and a host of other engineering industries; and such high priority industries like fertilisers, tractors, chemicals like soda ash, etc. Indeed, industries which in the last one year have not felt even the first signs of a slackening demand for the product of their industry, are now more of exceptions rather than the rule. Two such exceptions are, power generation, and, the mining equipment industry.

The roots of this spreading recession are manifold, but the most important of these can be identified fairly clearly: e.g. (i) The generally inadequate purchasing power of individuals and the Government alike, (ii) overlicensing, (iii) the sharp increase in prices, (iv) the crack-down on black money,

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(v) imbalances in plan performance, etc. It is necessary to dwell briefly on some less known aspects of these factors.

The generally inadequate purchasing power of the consumer is of course the most common cause. When prices rise all round, but incomes remain stagnant, consumers are compelled to spend a larger share of their incomes in buying the basic necessities — particularly food, etc. — and less remains available to be spent on all other goods and services together. So, purchases of some goods are postponed, of others, altogether done without. This is the primary agent of recession in textiles, consumer durables, aluminium (for utensils), plastics, etc.

This factor applies equally to Government as a consumer. On the one hand, there has been considerable pressure on Government to reduce its expenditure, with a view to keep deficit financing and inflation in check. On the other hand, due to acute inflation, Government and its undertakings had to spend a larger share of its revenues on such "committed" items of expenditure as salaries, dearness allowance, interest burden, and maintenance and replacement of equipment, etc. As a result, the cut-back had to come sharply on the only remaining area, viz., development outlays.

These lagging public sector outlays have affected the resources, e.g., of the State Electricity Board and through them the demand for cables, aluminium, etc. Similarly, through inadequate financial provisions for Railways, demand for wagons and a host of engineering goods was curtailed; and through a cut-back on civil works, demand for steel, cement, etc., became slack.

Overlicensing is another important factor at work. In 1974, when the production of T.V. sets was barely 74,000, there was a licensed capacity to produce over 3 lakh sets. Similarly, the licensed capacity for electric lamps is 204 million, against production of 145 million. For dry cells, capacity is 1,521 million, as against production of 635 million. Available reports indicate that for 1975, thanks to the accumulated stocks and poor offtake, production is likely to be lower than in 1974; but licensed capacity may, if anything be higher, thus widening the gap. This means an increasing competition for a stagnant market; and each productive unit experiences a slackening in demand.

At times, recession is simply the effect of too high a price: In some cases, cost escalations, price decontrols or high taxes have been responsible for the price rise; e.g., after the price hike in July 1975, aluminium prices have shot up by 50 per cent from about Rs. 8,000 to Rs. 12,000 per tonne. A good quality truck chassis now costs over a lakh of Rupees, even when costing is strictly on Government's formula. In some other case, that the producers agreed to charge the highest price that the market can bear, is also in evidence. Whatever be the reason in any particular case, and irrespective of whether the increase is justified on economic criteria or not, when consumers' purses are already squeezed, such high prices inevitably tend to reduce demand further.

Next in the list is the crackdown on black money. Several factors (the curb on inflation, the raids, to name only two), have combined to cut the importance of black money to size. Not only less of it is being generated, but the velocity of circulation of the existing stock is also reduced. This in itself is most welcome. But, a large range of the proverbial luxury-oriented industries (such as refrigerators, air-conditioners, cars, furniture), as also service industries (such as air and first-class railway travel, hotel industry, etc.) have in the process, got into difficulties. What is particularly sad is that quite few of these units had come up and prospered in the Small-Scale sector, or were promoted by new entrepreneurs, either of whom the Government wanted to encourage through its industrial policy. In a sense, this paradoxical phenomenon has really brought to surface a basic weakness in our planning.

An unbalanced performance in meeting plan targets has also contributed to the current recession in certain industries. Take the example of power generation: The Fourth Plan target in this area failed by as much as 49 per cent. Several down-stream industries, such as, electrical lamps, appliances, cables, etc., depend on power generation, and their demand is worked out on the presumption that power targets would be fulfilled. Industrial licences were then issued keeping these demand estimates in mind. Now we find that the licensed units in these down-stream industries are ready for production; but since power generation has lagged behind, they find themselves in the midst of recession.

Finally, high maintenance costs have shied away consumers in many cases. The demand for cars, received the first set-back with a sudden three-fold rise in petrol prices in November 1973. Similarly, with rising prices of dry cell batteries, maintenance costs of a transistor radio have increased; indeed they increased so much, that consumers now seem to prefer a battery eliminator, which in turn aggravates the recession in the dry cells industry.

Even this long list of the causes is not exhaustive. The moral of the story is, however, clear that the situation is far too complicated and does not admit simplistic statements. But why show surprise about it? Even a year ago, it was obvious that certain undercurrents present in the economy could not but lead to recessionary pockets. Not only did the very process of inflation and scarcities have seeds of recession, but the various anti-inflationary measures, such as the immobilisation of incomes through the Additional Emoluments (Compulsory Deposits) Act, the anti-black money operations, and most important, the sharp cut-back in Government expenditure also had distinct recessionary overtones. I myself had argued and warned so at that time. ("The Recession Debate: The Wood and the Trees", *Indian Express*, January 30, 1975).

By now, as anticipated, the evidence of recessionary tendencies is all over the place for anybody to see. If, until recently, some of the best economic brains were still quarrelling over definitions, and were unwilling to accept even the fact of recession, the reason for this reluctance was not that they did not see the recessionary tendencies; but perhaps that they thought there was nothing wrong with a "little" recession; which of course is another issue altogether.

So, let it be said straightway that recession has indeed its own plus points. Recession is a sort of purgative that cleanses the digestive system of an overheated economy. It weeds out the inefficient in industry, for whom life is much easier with scarcities and inflation. Scarcities and inflation, by boosting figures of sales, assets, dividends, stock exchange quotations, etc., without any significant increase in physical production, create a mirage of prosperity and lull corporate managements and shareholders into complacency. Recession shakes them off their complacency.

Similarly, recession in some sectors can make the rest of the economy more manageable; e.g. instead of 20 incomplete factory buildings whose construction is delayed because of shortages of power, steel, cement, etc., there would perhaps be ten buildings whose construction is proceeding according to schedule.

Finally, as pointed out earlier, recession helps reduce the generation of black money and this, in course of time, could bring about a healthier shift in the pattern of industrial production.

The concern about recession is, however, voiced because its debit side is also glaring. In the first place, it leaves considerable portions of industrial capacity unutilised. Most machines and equipment are installed at great financial and real cost of scarce national resources. To see them remaining idle when the bulk of the nation remains at or below the poverty line, is too big a national waste to be shrugged away.

Secondly, an economy in the midst of recession is not a very encouraging backdrop for holders of industrial licences to proceed with implementation enthusiastically; or for entrepreneurs to want to start new projects. The smaller and the newer the entrepreneur, the less enthusiastic he would be! Thus the process of economic growth which has been faltering for the last two or three years, will be further delayed, exactly at the time when it is overdue for a restart on a top-priority basis.

But by far the most unfortunate result of a recession is the set-back it gives to the creation of employment opportunities. The frustrations involved in being thrown out of a job, or in not getting one despite all efforts, all the skills and all the education one may have had, have to be lived through to be imagined. Even ignoring the psychological tensions, which indeed are enormous, the adverse economic impact on the nation feeds on itself. Thus, while recession leads to lower employment, lower employment in turn leads to a shrinking national purchasing power, and aggravates recession.

The question whether the debit side is more weighty than its credit side, remains open; and can result in much fruitless debate, which is best avoided.

II

Is the Recession on the way out ?

In connection with the recessionary tendencies in the economy, several questions are repeatedly discussed. The most controversial and confusing among them are four:—

(i) Even with relative price stability, why is demand not picking up?

(ii) Will a reduction in excise duties and other taxes help ward off recession?

(iii) How come that in a recession-hit economy, one after another, companies have turned out highly encouraging results for 1974 or for 1974-75?

(iv) When will the recession come to a halt?

Price Stability: When prices are rising sharply, it is understandable that consumers have to spend a larger and larger share of their stationary income on the very basic necessities, reducing the demand for industrial goods on which the residual portion is to be spent. But with a negative rate of inflation and all that, why is demand not picking up?

The answer seems to be reasonably clear: Consumer prices have not really come down to any noticeable extent. During 1975, the All-India working class cost of living index (1960 = 100) has been fluctuating within narrow limits from 328 to 321. As against 326 in January 1975, it was 321 in August. The variation is thus less than 2 p.c. Hence, at best, prices can be said to be stable. (Incidentally, this in itself is an undoubted achievement, for which the policy-makers deserve praise). On the other hand, incomes are not increasing (a) because the rate of the net increase in employment is low, and (b) because, for those that are employed, in many cases, dearness allowance payments are not increasing proportionately and the payment of dues are also delayed. These facts may be justified on other grounds, but the inevitable result is that in the absence of increasing incomes whatever pattern of consumption and demand was established when consumer prices were rising to their peak, is manifest even now.

For demand to pick up, at least one of two things must happen: Either, consumer prices should fall and continue to fall, because then some surplus purchasing power will be released for purchases of other goods and services. Alternatively, incomes should rise, either by higher money emoluments or by increased employment.

In the absence of either of these two factors, all that the so-called price stability can mean at best is that demand will not be reduced further. Even that is not assured because growing unemployment means reduced purchasing power of the nation as a whole. Moreover, people may just get used to doing without particular goods. And of course, price stability, inspite of falling or static production, is a sign of a stagnant economy. In a healthy and growing economy, price stability is achieved, as a result of increasing incomes and purchasing power on the one hand being matched by an increasing production of goods and services on the other.

Tax Reliefs: Frequently, a demand is made for relief from high excise duties and other taxes on the products of some recession-hit industries, on the ground that the high tax-components are the cause of high prices of these products; which in turn lead to recession: If taxes are reduced, prices will be reduced, and this will help a pick-up of demand.

A selective approach to this problem seems necessary; in respect of several products, tax component in the final price has certainly been high for quite some time. (To cite two extreme cases, in petrol it is over 220 per cent and in cigarettes over 125 per cent). If, even with a high tax component, there was no recession in some industries until last year, it only implies that the demand and production pattern had got used to the high level of taxes and duties. In such cases, if recession develops later, it cannot really be said that the high tax component is the cause of recession. Secondly, when in some cases, tax reliefs were announced, (like the sales tax relief to cars in Bengal), there has been no evidence of any immediate pick-up in demand. (In such cases, of course, the argument promptly advanced is that the relief is not enough and more of it is called for!) Finally, one wonders how tax reliefs can be given on any wide front, without Government having to cross the safety limits of deficit financing.

This does not imply that high taxes and duties is not a cause of recessionary tendencies in many cases. There are probably some cases, where a substantial jack-up in the excise duty (*e.g.* in the supplementary budget of July 1974) has directly resulted in the tapering off of demand. It is in these cases, that the case for tax reliefs as a counter-recessionary move is the strongest.

A point that has not received due attention in this connection is the increasing tendency on the part of the Government to change over from specific to *ad valorem* basis of duties. *Ad valorem* duties create almost a vested interest for the Government to benefit from high costs and prices; while, with specific duties, Government revenues stand to augment only with increasing production. The *ad valorem* nature of duties has in many cases become a contributory factor to reduced demand via higher prices.

Corporate Prosperity? It is true that financial results of many companies for the year 1974 and 1974-75 have been very encouraging, and, to the uninitiated, this fact does not seem to fit in with the fact of recession.

In this connection, it bears stating that recession simply implies a decline in demand even when other things are equal. Thus, vanishing black market premia (cement, steel), the shortening queues of customers (trucks, scooters, chemicals, etc.), or the accumulation of stocks (fertilisers, textiles and steel) are all first symptoms of a decline in demand, *i.e.*, of recession. Corporate balance-sheets will not be affected by these symptoms in the first round, more so if prices of finished products were controlled or kept artificially low, *e.g.*, despite the recession, steel output in 1974-75 was not less than in 1973-74. Ditto with, say, fertilisers.

The balance-sheet results will be affected, if the declining trend in demand continues and forces the company to cut back on production, and/or to reduce prices. But good corporate managements should not, and do not, let themselves into this quandary. Rather, they adopt a number of strategies to avoid such an eventuality *e.g.*, exports, diversification (which Government has wisely permitted in certain cases), changes in the product-mix, cost reduction programmes, adjustments in schedules of maintenance shut-downs of plants, etc. Very often they succeed. So, if the financial performance of a company producing a recession-prone product is not adversely affected, it does not, by itself, prove that there is no recessionary trend in that industry. It probably suggests that the company's management is efficient and awake, and is tackling the problem adequately.

Moreover, during recession, the efficient units are generally hit last. During days of scarcity, when the waiting period for a recognised quality product is too long, helpless consumers buy even second-grade products. But when recessionary trends emerge, these helpless consumers prefer to switch over to the recognised product, so that, that producer suffers last. This phenomenon is perhaps already at work in industries like cars, trucks, tractors etc. But success stories are known, become famous, and are talked about; while failures are unknown or forgotten. The continued good financial results of some company in an industry is, therefore, poor evidence to argue that there is no recession in that industry.

Thirdly, the balance sheets for 1974-75, more so for 1974, cover only a few months of the post-recessionary period. And the "total" corporate performance of that year is more a reflection of a previous longer period of inflation and scarcities. Perhaps the 1975 or the 1975-76 performance may not be equally encouraging.

Finally, quite often, the "encouraging" corporate profits are only paper profits in depreciated currency. Deflate the accounts by inflation accounting methods, and the resultant picture would almost certainly be a more sobering one!

Prospects: When will the recession come to a halt? Three emerging factors seem to indicate that by the turn of the year, recession in some of these industries would be past its worst. Or, to put it even more cautiously (as an economist should characteristically do), these factors indicate that there would not then be fresh additions to the "recession casualty" list.

First, Government spending is going on at quite a high rate. For the economists, a good indicator of deficit financing is the net bank credit to Government. During the period end-March to end-September 1975, this increased by Rs. 997 crores as against by Rs. 588 crores during the corresponding period last year. Even discounting the seasonal factor, the increase in Government spending has been sizeable, and with a time lag, it would enter the purchasing power stream. The spending would be distributed over such areas as higher outlay on plan projects, a stepup in administrative, defence, debt servicing, flood relief, payments for imports of food, fertilisers, etc. The exact distribution is, however, not known, and is difficult to judge. If we had a more detailed break-down, it would have been possible to indicate the areas that will be affected earlier or later.

Secondly, a good kharif crop outlook coupled with Government's perfectly understandable desire to avoid any significant fall in agricultural prices indicates that additional Rs. 700 to Rs. 800 crores would be in the hands of the rural people on account of only the *additional* agricultural produce likely to be marketed. Unlike deficit financing by the Government this source of new purchasing power will not have any inflationary impact in the first round, but should create demand for a host of industrial goods.

Finally, the Government has already started stepping up Public Sector outlay, though during the current year 1975-76, the step-up, rightly, is selective. It is concentrated on two areas, *viz.*, agriculture and energy. The Government can afford to be, and is likely to be, more bold in stepping up the outlay, because with a larger kharif crop, and with larger foreign assistance receipts, the inflationary potential of a high public outlay, is somewhat less this year.

These macro-economic factors should help in halting recession in certain industries. The time likely to be taken for the impact of these factors to be felt by particular industries may indeed vary and vary widely. For some, the impact would be almost immediate, for others the time-lags may be considerable.

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— Eugene Black

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