Our View

Stimulus package – consumption or investment led?

Popular ancient Indian economist Chanakya repeatedly asserted that a strong economy is the foundation of a powerful and successful state. Indeed, he went on to say that it is from the "strength of the treasury" that an army derives its strength.

Earlier this week there was an indication that the Government is working on another stimulus package to support the economy. Relative to the economy's productive potential there has been a severe shortfall of spending by households and the government, and the package is expected to enhance demand in the economy. This demand shortfall and the resultant impact on growth has had a negative bearing on both jobs and wages. Demand generation through increased spends by consumers can be achieved in multiple ways – first, by way of reduced taxes leading to reduced prices of goods and services and more money in the hands of the people to consume more; second, by providing direct grant/ support to certain sections of the society so that they spend and consume more; and finally, as a medium term strategy, by investing in the economy and creating infrastructure in the country. Which route to follow has been a big dilemma for the policy makers.

Consumption-led demand creation is shallow and may only last till the pent-up demand is satiated and the inventories are replenished. Data shows that the demand propelled by tax incentives is short lived – it creates just a one-time demand which does not sustain in the long term. Direct transfer of money again does not necessarily result in spending – it is human psychology that unless the future is secured, one does not like to spend. Anecdotally, the total amount just lying in the 410 million JanDhan bank account is a large sum of INR 1.31tn. This implies that people need other comforts like a full-time employment before they start spending. There is a saying that, "Do not give me money, give me the ability to earn money". Therefore, direct transfer of money to certain section of people, while easy to roll out, costs the exchequer and yet does not necessarily achieve the objective of creating demand in the economy.

The most appropriate solution would be to invest in infrastructure creation which in turn will generate employment. Our experience of 1999-2004 confirms that when for the first time India focused on investment in infrastructure, it indeed had a long-term positive impact. Infrastructure investment has the potential to propel economy for a long term. A study conducted by global rating agency S&P indicated that the investment in infrastructure has a direct multiplier effect. For India, the multiplier effect is a minimum of 2x of the investment and it can create ~13.4 million direct full-time jobs with every 1% GDP spent on infrastructure. Evidence also shows that infrastructure can create significant economic stimulus even compared to other forms of spending. It could be an extraordinarily useful tool for macroeconomic stability.

Like the large strides undertaken in taxation, electricity, agriculture, labor and digitization reforms, the government should immediately focus on infrastructure creation on a war scale. And there cannot be a better time than now for investment in the infrastructure sector – the time is very conducive for the various reasons:

- First, most commodity prices are unlikely to move up in the short time given the global economic situation and muted demand from China. Looking at oil, both NYM WTI Crude and ICE Brent Crude are down by ~25% and ~28%, respectively. Similarly, metals such as Aluminum and Steel are also range bound. Cement Production is back to almost normal levels and prices are unlikely to move up
- Second, labour – another important component for construction – would be available in plenty given the current situation
- Finally, the most important aspect, financing, should be easier and cheaper to tie-up with the present low interest rate scenario, very high liquidity, and low credit growth. Further, the all-time high forex reserve, would help borrow more from the global markets. Several global funds and our own NIIF are looking at India to invest significant amount of capital in the long-term infrastructure projects. The tax concessions to global SWFs and pension funds on the income from investing in infrastructure projects, announced by the government in the last budget, make these investments attractive for them. The significant liquidity in the global market would also lower the cost borrowing

In my opinion, we have all ducks in a row to kick start the economy and to create demand by infrastructure investments. The government should simply follow-up on its plan of investing INR 100tn in infrastructure, as originally envisaged in its election manifesto.

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