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ASIA MAIOR

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Asia in the Waning Shadow of American Hegemony

Edited by

Michelguglielmo Torri, Elisabetta Basile, Nicola Mocci

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Articles meant for publication should be sent to Michelguglielmo Torri (mg.torri@gmail.com) and to Nicola Mocci (nmocci@uniss.it); book reviews should be sent to Oliviero Frattolillo (oliviero.frattolillo@uniroma3.it) and Francesca Congiu (fcongiu@unica.it).

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India 2017: Still no *achhe din* (good days) for the economy

Michelguglielmo Torri

University of Turin
mg.torri@gmail.com

In 2017 the Indian economy appeared to be on a declining trend up to Quarter 1 (Q1) 2017-18 (April-June 2017). The data for Q2 of 2017-18 (July-September 2018) – the last available at the closing of the present article – were better, but insufficient to conclude that the negative trend had been reversed. In turn, this declining trend was the result of long-term causes, going back at least to Financial Year 2012-13, which are briefly analysed in the present article. However, its main thrust aims at analysing the two main economic reforms implemented by the Modi government - demonetisation and the Goods and Services Tax. The following analysis shows that, they, far from improving the situation, worsened it, in particular causing the contraction of the informal sector of the economy, without bringing about any development of the formal sector. As shown by a plethora of journalistic enquiries, this adversely impacted the Indian economy although, because of the way in which data on the economy are collected, at the closing of the present article the actual dimension of this negative impact was not yet visible in the official statistics. What was clear was that, in spite of Modi's promises during the 2014 electoral campaign, job creation was lower than during the UPA governments.

At the closing of the period under review, the government started to react to the worsening economic situation not only at the rhetorical level, but by taking some sensible economic decisions such as reviving the Economic Advisory Council and trying to tackle the NPA-induced crisis of the banks.

1. The performance of the economy in 2017: an overview

The Indian economy in 2017 was characterised by a declining trend up to Quarter 1 (Q1) 2017-18 (April-June 2017), when the GDP rate of growth fell to 5.7%, compared to 7.9% in the same quarter of the previous year (see table 4). Q2 of 2017-18 (July-September 2018), namely the last quarter for which data were available at the closing of the present article, saw an improvement vis-à-vis the previous quarter, with a growth rate equal to 6.3%. However, this was still a sharp decrease when compared to the same quarter of the previous year (when GDP growth was equal to 7.5%). Also, at the closing of the year, it was too early to decide if the improvement in the rate of growth for Q2 2017-18 signals a positive inversion in the declining trend after March 2016 (when it stood at 9.2%). One needs to wait at least for the data of Q4 (due in March 2018).

Table 1
GDP growth in the Modi years
Year-on-year percentage at 2011-12 prices

Quarterly		Yearly
Q1 2014-15 (April-June 2014)	7.47	7.18
Q2 2014-15 (July-September 2014)	8.34	
Q3 2014-15 (October-December 2014)	6.56	
Q4 2014-15 (January-March 2015)	6.71	
Q1 2015-16 (April-June 2015)	7.56	7.93
Q2 2015-16 (July-September 2015)	7.26	
Q3 2015-16 (October-December 2015)	7.26	
Q4 2015-16 (January-March 2016)	9.2	
Q1 2016-17 (April-June 2016)	7.2	7.11
Q2 2016-17 (July-September 2016)	7.4	
Q3 2016-17 (October-December 2016)	7	
Q4 2016-17 (January-March 2017)	6.1	6.5
Q1 2017-18 (April-June 2017)	5.7	
Q2 2017-18 (July-September 2017)	6.3	
Q3 2017-18 (October-December 2017)	n.a.	

Sources: *Statistics Times*; miscellaneous Indian newspapers

It is clear that 2017 was not a good year for the Indian economy. According to most analysts, the causes were the adverse consequences of two policies: the 8 November 2016 demonetisation and the 1 July 2017 launch of the Goods and Services Tax (GST). However, the slowdown of the Indian economy had begun *before* the implementation of these two policies.

Below, first the root causes of India's economic difficulties are analysed and the impact of demonetisation and GST implementation is discussed; finally the belated reaction of the government to the economic slowdown is highlighted.

2. Economic slowdown

According to Pronab Sen, former chief statistician of India, the economic problems affecting India in 2017 «started with the reversal of rural growth».[1] Rural growth had remained high during the 2004-12 period, with farm output growing at 3% and farm income at 7.5% per year. As 70% of

1. Asit Rajan Mishra & Gireesh Chandra Prasad, 'Indian economy looming as Achilles' heel of Modi govt', *Livemint*, 29 September 2017. For an analogous analysis on the long-term causes of the economic slowdown see also Nitin Sethi's interview to JNU professor Himanshu: 'Interview: «This is a kind of economic collapse. The first step to tackle it is to acknowledge it»', *Scroll.in*, 14 September 2017.

India's rural households still depend primarily on agriculture for their livelihood, any variation in rural growth is bound to have a cascading effect on the whole Indian economy.[2]

In 2013-14 the positive agricultural trend reversed itself for several reasons: while global food prices came down, the Reserve Bank of India (RBI) continued to keep a restrictive monetary policy;[3] under the new NDA government, the minimum support price (MPS) of many farm products started to grow insufficiently; in the same period, the Mahatma Gandhi National Rural Employment Guarantee Act (MGNREGA), which was supposed to assure 100 days of work to one member of every rural household, became resource driven instead of demand driven; finally, two consecutive drought years (2014-15 and 2015-16) worsened the situation.

The steep rise in farmers' suicides between 2014 and 2015 was a glimpse of how bad the situation was. According to official data farmers' suicides jumped from 5,650 to over 8,000, namely a rise of some 40%.[4]

In 2016-17, the drought spell was interrupted by good monsoons, but this was insufficient, as shown by the persistence of peasant agitations.[5] All this triggered the outset of deflation in agriculture, with its negative cascading effect on the whole economy.[6]

The downturn in agricultural production was coupled with the problem of Non-Performing Assets (NPA), which weakened both the banking system and the major Indian corporations. An NPA, or bad loan, is defined by the RBI as a loan from a financial institution «on which interest or instalment of principal remains overdue for a period of more than 90 days from the end of a particular quarter».[7]

2. Food and Agriculture Organization of the United Nations [FAO], *India at a glance* (without date but, from internal evidence, 2015).

3. For a hard hitting criticism of the RBI policy of high real rates of interest see Prem Shankar Jha, 'How the RBI Destroyed the Indian Economy', *The Wire*, 31 October 2017. This is only one of the most recent among the many articles on the same topic, written by Jha in recent years.

4. Amiya Kumar Bagchi, 'Even the Optimism of Official Economists Cannot Ignore the Warning Signs', *The Wire*, 27 October 2017.

5. As many as sixteen states saw large-scale rural protests during 2017. Mridula Chari, 'Explained: Behind the farmer protests in 16 states are bumper harvests and low prices', *Scroll.in*, 18 June 2017.

6. E.g. Asit Rajan Mishra & Gireesh Chandra Prasad, 'Indian economy looming …'; Harish Damodaran, 'Distress in farms: GDP data confirms deflation is here', *The Indian Express*, 2 September 2017; 'Nitin Sethi's interview with JNU Professor Himanshu', *Scroll.in*, 14 September 2017; Business Line Bureau, 'Poor MSP growth led to farm distress, says Crisil', *Business Line*, 3 October 2017; C.P. Chandrasekhar & Jayati Ghosh, 'The Crisis in Agriculture', *Business Line*, 23 October 2017.

7. However, in the agricultural sector, an NPA is such if it is not paid for 2 crop season in the case of short duration crop agriculture or for 1 crop season in the case of long duration crops. Gudipati Rajendera Kumar, 'Understanding the NPA's [sic] and their impact', *The Hans India*, 11 October 2017; 'NPA issue in India: An Analysis', *Ias Score*, without a date.

In the early 2000s and up to 2013, large corporations actively promoted major project proposals. In turn, banks willingly financed such projects, «often without sufficient evaluation of risks and returns».[8] Things started to change dramatically during the concluding years of the UPA 2 government, following the 2G spectrum and coal mining scandals. NPA – which in September 2008 amounted to 2.11% of the total loans – ballooned to 5.08% by September 2015 and reached 9.3% the following year.[9] At the end of March 2017, corporate debt rose to a seven year high. In turn, all this brought about the banks' decision to reduce lending and the Indian business decision to cut back on new investments.[10] Then, «investments abandoned by their promoters [rose] from Rs. 8,60,000 crore in March 2013 to the mind-boggling sum of Rs. 11,40,000 crore in 2016, that 40 of India's most courageous (and possibly foolhardy) entrepreneurs [entered] bankruptcy court, and that almost half of the [US]$ 20 billion of foreign direct investment [which came in 2016] [went] into the purchase of distressed assets by international speculators».[11]

Both the agricultural crisis and the NPA bubble manifested themselves before the swearing in, on 26 May 2014, of the Modi-led NDA government. But, once Modi was in power India's overall macroeconomic situation suddenly started to improve. This was the by-product of two developments. The first was the change in the methodology for measuring the GNP, which, adopted in 2015, inflated the figures of its rate of growth by 1.5 to 2.2%.[12] This made India's GNP the fastest growing among those of the biggest world economies. Unfortunately, most other indicators characterising the Indian economy looked pretty bad.[13] The second development – totally unrelated to

8. Gudipati Rajendera Kumar, 'Understanding the NPA's [sic] and their impact'.

9. Dinesh Unnikrishnan & Kishor Kadam, 'Explained in 5 charts: How Indian banks' big NPA problem evolved over years', *First Post*, 10 February 2016.

10. Kranti Kumara, 'Indian economy in a downward spiral', *World Socialist Web Site*, 11 October 2017.

11. Prem Shankar Jha, 'No «Achhe Din» here: The Modi bubble has now burst', *The Wire*, 29 September 2017.

12. The former evaluation is by Vijay R. Joshi, Emeritus Fellow at Merton College, Oxford, (see 'India's national accounts on economic growth wrong: Expert', *DNA*, 3 June 2017); the latter is by Mohan Guruswamy, head of the Centre for Policy Alternatives, New Delhi (see his 'This Russian joke helps explain the persistent government euphoria on the economic front', *Scroll.in*, 3 June 2017). For a discussion of the doubts which, since the beginning, were expressed on the validity of the new methodology see Michelguglielmo Torri & Diego Maiorano, 'India 2015: The uncertain record of the Modi government', *Asia Maior 2015*, pp. 357-361.

13. As noticed by Vijay R. Joshi: «If you look at exports and imports, they have been flat […]. If you look at employment in the organised sector it's at a standstill. […] And especially if you look at investment, it has collapsed. The investment ratio which was 34 per cent of GDP in 2011 is now 27 per cent of GDP». Joshi unambiguously stated that he, «along with many other economists» did not believe the national accounts and, instead of accepting the official rate of growth of 7%, estimated it equal to 5.5%. 'India's national accounts on economic growth wrong: Expert'.

the Modi government's economic policies – greatly favoured the Indian economy. This was the halving of the price of Brent crude, which plummeted from US$ 114 per barrel in mid-June 2014 to US$ 54 by the end of March 2015. The decline continued and, by the end of March 2016, the price of Brent crude had plunged to US$ 39.[14] This should have offered the Indian government the space for some game-changing economic reforms, but this golden opportunity was not used and, by mid-2016, the oil bonanza tapered off.[15]

3. Modi's major reforms

The game-changing reforms of the Modi government were implemented after the oil dividend had started to dwindle away. These reforms were demonetisation and GST.

3.1. Demonetisation

Demonetisation – the transformation by political fiat of Rs. 500 and 1000 notes, namely 86% in value of the Indian currency into «worthless pieces of papers» – was announced on 8 November 2016 and became operative after a four hour time lag. [16]

As enunciated by Modi on 8 November 2016, demonetisation had spectacularly failed to reach its main objectives: curbing black money, taking out of circulation counterfeit notes and choking terrorism by causing its financing through counterfeit notes to dry up.

With reference to the former objective the RBI annual report, released on 30 August 2017, made official that nearly 99% of the banknotes demonetised on 8 November 2016 had legally been deposited in bank accounts and had returned to the RBI by the end of June 2017.[17] This means that either

14. Manas Chakravarty, 'What went wrong with the Indian economy?', *Livemint*, 17 October 2017.

15. *Ibid*.

16. The launching and the consequences of demonetisation up to the close of 2016 have been analysed in Michelguglielmo Torri & Diego Maiorano, 'India 2016: Reforming the economy and tightening the connection with the US', *Asia Maior 2016*, pp. 320-26. Here, however, some of the demonetisation features must be highlighted once again and analysed by making reference to the additional data which became available in 2017.

17. The Wire Staff, 'Demonetisation: Nearly 99% of Scrapped Notes Came Back into System', *The Wire*, 30 August 2017; Manojit Saha, '99% of demonetised notes returned, says RBI report', *The Hindu*, 31 August 2017. The above figure (98.96%) does not include cash held in district cooperative banks and in Nepal, where the India rupee has a wide circulation. As it is possible that some of this cash will eventually find its way to the RBI, this means that may be less of 5% of the demonetised cash would remain unreturned. Suyash Rai, 'The Vast Difference Between What Demonetisation Achieved and How it was Perceived', *The Wire*, 8 November 2017.

the supposed black money owners had found a way to break through the government demonetisation net by making use of *benami* accounts,[18] or that black money was only a tiny share of the illegally held wealth (the bulk of it being made up by gold, land properties, real estate and foreign accounts in hard currency).[19] Both causes were at work in frustrating the Indian government's effort. The direct consequence of all this was that, while the Modi government had expected a conspicuous amount of de-notified money to disappear, giving the RBI the possibility to make use of the corresponding financial value to fund new economic activities, that simply did not happen.[20] Also disappointing was the result of the hunt for counterfeit notes. The value of those netted by the RBI was a paltry Rs. 41 crore.[21]

Similarly preposterous, appeared to be the claim that demonetisation would be a blow to terrorism, by impeding its financing. Claiming this, Modi was referring to the Indian government's oft-repeated assertion that the ongoing trouble in Kashmir was the work of miscreants, paid by Pakistani agents with (counterfeit) Indian money. But, of course, quite apart from the disappointing results of the hunt for counterfeit money, the problem is that the Kashmir troubles have deeply ingrained causes, most of them related to the dishonest, arrogant and unfeeling policies implemented by successive Indian central governments, particularly from the 1980s onward.[22] Although Pakistan has undoubtedly fished in Kashmir's troubled waters, the reasons why Kashmir's waters are troubled have little to do with Pakistan's meddling.

As, in spite of the government's effort to present it as a success,[23] demonetisation had failed, the government and the economists who supported

18. Benami indicates any transaction, contract or property made, held, done, or managed in the name of another person.

19. On this see Michelguglielmo Torri & Diego Maiorano, 'India 2016', p. 325, and the sources there quoted.

20. The value of the demonetised notes was Rs. 15.44 lakh crore. See Manojit Sinha, '99% of demonetised notes returned'. The government was expecting that Rs. 4-5 lakh crore would be «neutralised»; a figure that was later scaled down to Rs. 3 lakh crore. Eventually only Rs. 16,000 crore did not return to the banking system. Karan Thapar, 'After demonetisation', *The Hindu*, 1 September 2017. See also 'Shifting goal posts: Demonetisation has totally failed to curb black money', *The Hindu*, 1 September 2017.

21. According to a 2015 enquiry by the National Investigation Agency, at any given point of time the value of counterfeited money in circulation was anyway limited, amounting to Rs. 400 crore, namely 0.028% of the total currency. But, according to a CNBC report, only one tenth of it, namely forged notes for Rs. 41 crore, were taken out of circulation thanks to demonetisation. Karan Thapar, 'After demonetisation'.

22. For an overview of this problem and some relevant sources see Marco Valerio Corvino, 'A brutal and violent year in the Kashmir Valley', *Asia Maior 2016*, pp. 369-84.

23. On the demonetisation fiasco and the Government's attempt to present it as a success, see R. Ramakumar, 'One Year After Demonetisation, Modi's Government Claims About It Have Clearly Proven False', *The Wire*, 8 November 2017.

it came out with two additional justifications: (a) demonetisation had favoured the passage to a cashless economy, and (b) had caused a rise in the number of new tax payers (by forcing people to deposit their money in the banks). The truth is that, whereas there was a steep increase in the employment of no-cash media of payment (such as credit cards, debit cards, e-wallets) in the closing months of 2016, by mid-2017, with the circulation of the new Rs. 2000 notes, digital payments went down, approaching the pre-demonetisation value.[24] Official data show that 1.26 crore (12.6 million) new tax payers had been added in 2016-17, a number not significantly different from that of the new tax payers in the two previous fiscal years.[25] This means that the rise in the number of tax payers was mainly due to the crossing, because of demographic reasons, of the taxable income threshold (which has not changed since 2014-15) by an increasing number of people. According to Suyash Rai, from the National Institute of Public Finance and Policy, the role of demonetisation in increasing tax collection was modest, although «non-trivial».[26]

It is equally true that demonetisation-related losses piled up. The major one was the savage blow to the informal sector, a sector which works on cash only, where some 90% of the Indian labour force is active, historically responsible for the creation of most new jobs, and from where almost 50% of the national income evolves originates.[27] Here, the sudden drying up of cash caused a major economic contraction.

At the closing of the present article it was not yet possible to quantify this contraction with accuracy. Gathering official data related to the infor-

24. In value terms, digital payments amounted to Rs. 94 lakh crore in November. They shot up by some 50% to Rs. 149 lakh crore by March, but tumbled down to Rs. 107 lakh crore in July, namely an increase of less than 14% when compared to the November transactions. Karan Thapar, 'After demonetisation'. As far as the «single most unambiguous indicator of a shift towards a digital economy», namely «a sharp increase in the number of outstanding credit cards», the story is much the same. Debit and credit cards, after a small surge from 829 million in October 2016 to 886 million in March 2017, sank back to 853 million in September 2017, an increase of only 3.1% over 11 months». Prem Shankar Jha, 'While Supporters Clutch at Straws, Demonetisation Balance Sheet Is Awash With Red Ink', *The Wire*, 8 November 2017. See also Amitabh Dubey, 'Seven Little Lies the Government is Still Peddling About Demonetisation', *The Wire*, 5 September 2017.

25. Suyash Rai, 'The Vast Difference Between What Demonetisation Achieved and How it was Perceived', *The Wire*, 8 November 2017. The reference to the two previous fiscal years is due to the fact that the definition of «new taxpayer added» was changed from 2014-15.

26. *Ibid*.

27. A. Srija & Shrinivas V. Shirke, *An Analysis of the Informal Labour Market in India*, Confederation of Indian Industry. Special Feature, without date but October 2014 (http://www.ies.gov.in/pdfs/CII%20EM-october-2014.pdf), for the dimension of the informal sector and its contribution to the Indian economy; Government of India, Ministry of Finance, *Economic Survey 2015-16*, vol. I, chr. 1, for the informal sector contribution to new jobs.

mal sector takes up to two to three years; meanwhile informal sector-related data are simply inferred with reference to the formal sector.[28] But if in normal times this methodology is acceptable, this is not the case with dramatic and unexpected events such as demonetisation.[29] The formal sector, being able to function by making use of no-cash media of payments, was affected only marginally by demonetisation (through the decline in demand caused by it); conversely, the effects on a sector, such as the informal sector, which functioned almost exclusively on cash, could not but be catastrophic. While official direct data are not yet available, a surfeit of journalistic enquiries has clearly exposed the gravity of the situation. Also, a survey by the Centre for Monitoring Indian Economy pointed out that over 1.5 million people lost their employment between January and April 2017, as a consequence of demonetisation.[30]

The introduction of the new Rs. 2000 notes in the first part of 2017 eased the situation. However, as late as 28 April 2017, only 90% of the currency withdrawn had been replaced by the new notes,[31] while the adverse consequences of the 8 November decision continued to manifest themselves for the whole of 2017.[32]

3.2. The Goods and Services Tax

Generally regarded as the most important tax reform since 1947, the GST had been in the making since 1999.[33] As implemented in India, the

28. Prabash K Dutta, 'GDP growth falling for 6 consecutive quarters: Why India slipped after overtaking China', *India Today*, 1 September 2017.

29. Arun Kumar, 'India's Troubling and Official Growth Numbers are Only the Tip of the Iceberg', *The Wire*, 3 October 2017.

30. The Wire Staff, '1.5 Million Jobs Lost During First Four Months of 2017, Says CMIE', *The Wire*, 13 July 2017. See also Shreya Shah, 'Three years of Modi govt: Job-creation promise falls short as unemployment rate up', *Hindustan Times*, 23 May 2017; Sanjay Kapoor, 'The great Demonetisation botch-up', *HardNews*, 1 September 2017.

31. Prem Shankar Jha, 'While Supporters Clutch at Straws, Demonetisation Balance Sheet Is Awash With Red Ink'.

32. Pronab Sen, interviewed in December 2017, flatly stated that: «My view is that demonetisation effect is still playing out». See '«The current GDP data doesn't say much about economic reversal». 'Pronab Sen speaks to Pawan Bali on the GDP data for the second quarter released on Thursday', *The Asian Age*, 3 December 2017. See also: Abhishek Dey, 'Revisiting demonetisation: «If the notes have come back, why not the lost jobs?»', *Scroll.in*, 11 September 2017; Arun Kumar, 'India's Troubling and Official Growth Numbers are Only the Tip of the Iceberg'. For an analogous evaluation by India's largest consumer packaged goods firm Hindustan Unilever Ltd, see Soumya Gupta, 'HUL: Rural growth yet to recover from demonetisation, farm crisis', *Livemint*, 27 September 2017.

33. For an overview of the history of the GST see, e.g., Manu Balachandran & Itika Sharma Punit, 'India's 16-year wait for the mother of all tax reforms: the Goods and Services Tax', *Quartz*, 3 August 2016; Prabhash K. Dutta, 'GST: 17-year-journey of missed deadlines and shifting political goalposts', *India Today*, 27 March 2017.

GST is a value added tax on the manufacture, sale and consumption of goods as well as services at national level. It takes the place of a plethora of indirect taxes previously levied by the single states and by the central government, and is paid by final consumers. The GST should prevent the inclusion in the final price of the taxes on physical and immaterial inputs. To this goal, at each step of the production chain, the refund of the taxes paid on the physical and immaterial components hitherto employed is allowed. Accordingly the GST should lower the amount of taxes paid on any given goods.

Moreover, the GST aimed at discouraging tax evasion and widening the number of taxpayers: it «essentially privatised tax enforcement»,[34] as those who paid the GST could receive the reimbursements to which they were entitled only if their suppliers had already paid their own taxes. This caused the major operators either to switch from suppliers which did not pay taxes to suppliers who did, or induced them to put pressure on those suppliers who did not pay taxes to make them do it.[35] In this field, the introduction of the GST was successful.[36]

Although the GST was supposed to cover all goods and services, «various essential goods, constituting 50% of all items», were left out of it,[37] at least for the time being, among them, basic foods, books and newspapers, alcohol, real estate and petrol products.[38]

The adoption of the new tax system had been slowed down by several factors: technical problems (due to the complexity of the GST);[39] political opposition;[40] the reluctance of the states due to fear of depriving management of a considerable source of wealth. However, in 2016 the states had been

34. Mihir Sharma, 'India's Great Tax Tangle', *Bloomberg View*, 27 September 2017.

35. 'Goods and Services Tax (GST) Bill, explained', *The Indian Express*, 19 October 2016.

36. By mid-September nearly 8.5 million traders had registered for the GST. This included some 2.3 million new taxpayers. Raghu Krishnan, 'Infosys gets a month to fix GSTN glitches', *Business Standard*, 17 September 2017.

37. Arun Kumar, 'With Prices Rising Post-GST, Has the Government Taken the Public for a Ride?', *The Wire*, 20 September 2017.

38. 'Will petrol, power, real estate come under GST soon? It seems likely', *Business Today*, 15 January 2017. From taxes on petrol products both the states and the central government net 40% of their revenues.

39. Arvind Subramanian, the government's chief economic adviser, had warned that the GST was bound to be «fiendishly, mind-boggling (sic) complex to administer». 'In a Victory for Modi, India Overhauls Its Tangled Tax System', *The New York Times*, 3 August 2017. On the same topic, see Soutik Biswas, 'Why India's GST is one of the world's most complex tax reforms', *BBC News*, 4 August 2016.

40. Accordingly, when it had first been conceived, the new tax had been opposed by congress; the situation reversed itself when the Congress was in power (2004-14), with the BJP leading the resistance to the GST's adoption. Things reversed once again, once the Modi government assumed power.

convinced to accept the new tax system,[41] and congress opposition relented. This made possible the change to the constitution, giving the state governments the exclusive right to tax goods and services, leaving to the central government only the Central Sale Tax on goods transported across the Indian states' borders. [42] The adoption by mid-August 2016 of the constitution (One Hundred and Twenty Second Amendment) Act, 2016, opened the way to the implementation of the centrally administered GST.[43] After the necessary steps, the GST system was implemented starting on 1 July 2017.[44]

Business communities and traders would have liked a further postponement.[45] And their doubts were soon to be proven right, as the glaring inadequacies of the new tax regime soon became apparent. First, the GST rates were too numerous: four rates on goods and services,.[46] Second, the GST rates were too high, with too many items in the 28% and above categories, and the insertion in either the luxury or «sinful» categories of certain items.[47] Also, the tax on services – which had previously been 15% – was raised to 18%. Instead of lowering prices, the introduction of the GST increased them.[48] Third, the extreme complexity of the GST returns obliged most companies to complete *three returns each month, every month*. Fourth, to receive the refunds, the buyers and sellers had first to upload their tax returns in the GST portal, and these tax returns had to duly correspond.[49]

41. Michelguglielmo Torri & Diego Maiorano, 'India 2016', pp. 321-22.

42. E.g. Kranti Kumara, 'India imposes regressive nationwide sales tax', *World Socialist Web Site*, 18 August 2017.

43. The 122nd Constitution Amendment was finally adopted by the Rajya Sabha on 3 August 2016 and by the Lok Sabha on 8 August 2016. After being ratified by 20 out of 28 states, it received President Pranab Mukherjee's assent on 8 September 2016, being notified in The Gazette of India on the same date.

44. The introduction of the GST was made possible by the passing of four GST-related bills first in the Lok Sabha (29 March 2017) and then in the Rajya Sabha (6 April 2017) and by the states' adoption of ad hoc GST bills.

45. E.g., 'View: It would be wiser to put off implementation of GST till September', *The Economic Times*, 30 March 2017.

46. 'List of GST Tax Rates 2017', *Deal4loans*, 19 December 2017. Apart from the goods which did not pay the GST, the main tax slabs were 5%, 12%, 18% and 28%. But, for several «luxury» or «sin» goods, on top of the 28% tax, cesses of 1%, 5%, 15% and 31% were added. To make things more complicated, some of the goods or services subjected to the GST were not allowed the Input Tax Credit (ITC), namely the tax credit offsetting the collection of the GST.

47. E.g. air-conditioned venues, readymade garments and *pan masala* in the former case, *beedis* in the latter case.

48. Arun Kumar, 'With Prices Rising Post-GST, Has the Government Taken the Public for a Ride?'.

49. Apart from India, among the countries adopting a GST system, the matching of invoices was followed only by China. Indira Rajaraman, 'GST features contributing to GDP growth slowdown', *Livemint*, 6 October 2017; Chetan Bhagat, 'GST a modern reform implemented with archaic sarkari attitude, here are five ways to set it right', *GSTIndia*, 29 October 2017.

All these problems were compounded by the malfunctioning of the GST portal through which the taxpayers[50] had to register, make payments and file returns. For the whole of 2017, the GST portal, built by Infosys, appeared slow, unreliable, and liable to crash. The uploading of a single tax return could take up to 12 hours, and mails sent to the provider often bounced.[51]

These technical «glitches» were the responsibility of both Infosys and the central government. Sources related to Infosys blamed them on the plethora of government requests in the run up to the GST launch, on the unreasonableness of many of those requests, and on the stubbornness of the government in making the new tax regime operative on 1 July. Moreover, the continuing changes in the rates and the uncertainties of the taxpayers on how to measure the amount of taxation caused the rejection by the GST portal of a very high number of tax returns. This affected the functionality of the GST portal.[52] By contrast, according to government sources, Infosys made «basic errors».[53]

That the Modi government had arrived so unprepared was also shown by the behaviour of the GST Council,[54] which kept changing the collocation of the various items from one tax slab to another. This was a necessary exercise, given the lack of accuracy in the allocation of the various goods to different tax slabs before the rolling out of the GST regime. But, it was often done while the system was already operative, enhancing the uncertainty of tax payers on how to fulfil their obligations, and adversely impacting on investments on new products and technology.[55]

Some of the problems of the GST system were in the nature of «teething problems», bound to disappear with time, as with the malfunctioning of the Infosys-managed GST portal, which resulted in the slowing down in production

50. Initially estimated to include some 7.5 million businesses, they had grown to 8.5 million by mid-September. Soutik Biswas, 'Why India's GST is one of the world's most complex tax reforms', and Raghu Krishnan, 'Infosys gets a month to fix GSTN glitches'.

51. According to the President of the Confederation of All-India Traders (CAIT): «Even after four months of GST implementation, the portal which was supposed to function properly from July 1 is still working like an experiment project causing much harassment and mental concern to traders across the country». Venkatesh Ganesh, 'GST glitches: Infosys blames frequent changes', *Business Line*, 2 November 2017.

52. Jochelle Mendonca, Kunal Talgery & Surabhi Agarwal, 'Can We Do this Yesterday? GSPs Get New Test', *The Economic Times*, 26 September 2017.

53. *Ibid*.; Sankalp Phartiyal & Rahul Bhatia, 'Government ignored warnings over GST roll out - sources', *Reuters*, 15 December 2017.

54. The GST Council consisted of the Union Finance Minister, who chaired the Council, the Union Minister of State in charge of revenues and a Minister for each state, nominated by the related state government. 'Goods and Services Tax (GST) Bill, explained'.

55. This was the charge made by Hyundai Motor India on 12 September. 'Frequent changes in tax rates to impact investment: Hyundai', *The Economic Times*, 12 September 2017.

caused, in mid-2017, by «destoking» (the decision not to restock their inventories «because of the confusion and uncertainty around the new tax regime»).[56]

Other problems were of a more long-term nature. Some economists argued that the GST system was affected by a structural flaw, owing to two main problems: (a) the request to most businesses of filing tax-returns three times a month, every month[57]; and (b) the decision to allow refunds only once all the invoices related to the production chain of a given product were inserted in the GST portal and corresponded correctly with one another, which translated into inordinate delays in the reimbursements, with a major impact on exports.[58] Moreover, the filing of tax returns with the requested frequency entailed the investment of conspicuous resources and the employment of much time in fulfilling bureaucratic obligations.

Yet, the main and crucial problem with the GST system appeared to be that the system itself was structurally flawed and inadequate for its main aim: to formalise the informal economy. As argued by well-known economist Prabhat Patnaik, whereas the formalisation of the informal economy is a worthwhile target in principle, the only sane way in which this goal can be attained is through the growth of the formal sector, which gradually absorbs the informal part of the economy.[59] On the contrary, the new tax system adversely impacted on the informal system, while there was no expansion of the formal sector. The contraction of the informal sector, while there is no expansion of the formal sector was bound to adversely impact on the latter, which is organically related to the former.[60]

56. Radhika Pandey, Amey Sapre & Pramod Sinha, 'Analysis: Did pre-GST destoking of goods contribute to India's GDP slowdown?', *Scroll.in*, 1 October 2017.

57. Businesses with a turnover of less than Rs. 20 lakh were exempted from GST, while those with a turnover of between Rs. 20 lakh and 75 lakh had to meet less stringent obligations than business fully under GST. Arun Kumar, 'India's Troubling and Official Growth Numbers Are Only the Tip of the Iceberg'.

58. In the new tax regime, exports were free; however exporters were required to pay straight away GST for the inputs bought from their suppliers. The government had promised to proceed to reimburse 90% of these payments «within a week, of the receipt of the refund application» while the remaining 10% was to be paid within 60 days. However, the difficulty in filling the refund applications «in the right manner» had caused a delay of several months, resulting in «a sharp liquidity crunch» for the majority of exporters. Mayank Jain, 'No tax refund, no working capital: How GST is hurting Indian exporters', *Scroll.in*, 24 September 2017.

59. Of course, this statement by Patnaik is contentious, as many economists argue that informal capitalism is the new face of today's capitalism. This being the situation, there would be no way to re-absorb the informal sector into the formal one. Symptomatically international organisations such as WIEGO and ILO are striving to implement new strategies aimed at protecting the workers in the informal sector, accepting the fact that the informal sector cannot be formalised.

60. Prabhat Patnaik, 'Strangulating the informal economy', *Frontline*, 27 October 2017. On the connections between the formal and the informal sectors of the Indian economy, see Elisabetta Basile, *Capitalist Development in India's Informal Economy*, Abingdon: Routledge, 2013, *passim*.

Patnaik's thesis is supported by the experience of other states which have adopted the GST, and shows that this kind of tax is weighted against small businesses.[61] In the case of India, hundreds of thousands if not millions of small economic operatives, such as shop owners and small entrepreneurs were now forced by the GST to become both computer-literate and proficient in English, the language of the GST portal,[62] and had to fall back on the services of English-speaking, computer-literate accountants or accountancy firms. Small- and micro-firms unable to afford this additional cost were obliged to fold their business. [63] The new tax system, while oppressive for all taxpayers, was particularly so for small businesses. As with demonetisation, the GST was bound to negatively impact particularly on the informal. The final data on the GST-caused contraction of the informal economy were not yet available at the closing of the present article. Nevertheless, a spate of journalistic analyses coincided with the hypotheses of some economists as well as the evaluation of the secretary general of the Federation of Indian Micro and Small and Medium Enterprises Anil Bhardwaj, in showing that this contraction had indeed been conspicuous. [64] It contributed to an increment of the diminution of jobs caused by demonetisation. To the 1.5 million jobs lost between January and March, a further 400,000 could have been lost by August.[65] As a consequence, despite the promises made by Modi that the BJP would create 10 million new jobs, job creation reached an eight-year low in the year under review.[66]

Rahul Gandhi's jibe that demonetisation and the GST were like a commando-style «double tap», killing the Indian economy,[67] was no doubt an exaggeration. But certainly, at least in the informal sector, if not dead

61. This is brought out by a study on the working of GST in Australia. Girish Shahane, 'Why the current economic slowdown is worse than the one during Manmohan Singh's second term', *Scroll.in*, 5 October 2017.

62. Mandar Oak & Peter Mayer, 'India adopts a national Goods and Services Tax … sort of', *GSTIndia.com*, 8 December 2017.

63. E.g. Shreya Roy Chowdhury, '«No hope of recovery»: Varanasi sari weavers are abandoning their looms as GST rips business by 50%', *Scroll.in*, 2 October 2017; M. Rajshekhar, '«This government is killing our business»: What small, medium enterprises think of GST Revisions', *Scroll.in*, 9 October 2017.

64. On this topic it is eye-opening the interview to secretary general of the Federation of Indian Micro and Small and Medium Enterprises Anil Bhardwaj. See Ajaz Ashraf, 'Interview: «Demonetisation and GST accelerated the slowdown India was already experiencing»', *Scroll.in*, 26 September 2017.

65. As referred by senior journalist Karan Thapar, while interviewing Montek Singh Ahluwalia. See 'Raghuram Rajan's Note Advising Against Demonetisation Should Be Made Public: Montek Singh Ahluwalia', *The Wire*, 19 November 2017.

66. 'One crore jobs if BJP comes to power: Narendra Modi', *DNA*, 21 November 2013; Nupur Anand, 'Four charts and a table: more proof of India's job crisis', *Quartz*, 31 October 2017.

67. 'Note ban, GST «double tap» killed economy: Rahul', *The Hindu*, 27 October 2017.

because of the «double tap» represented by demonetisation and the botched introduction of GST, it was nevertheless badly wounded.

4. Coping (sort of) with the downward turn of the economy

The performance of the Indian economy in 2017 was far from brilliant. However, the government denied the difficulties of the economy and that they had been worsened by its own policies.[68] This does not mean that it did not try to redress the economic situation. However, even in the first months of 2017, the Modi government either did not realise the full import of the ongoing economic crisis or adopted counter measures which were inadequate or downright wrong. This undervaluation of the problems besetting the Indian economy was evident in the 2017-2018 budget.

4.1. The budget for 2017-2018

The budget for 2017-2018 was presented on 1 February 2017,[69] when the slowing down of the growth rate and the adverse consequences of demonetisation were fully apparent. In his presentation speech, the Union Finance Minister Arun Jaitley, after claiming that India stood out as «a bright spot in the world economic landscape», assessed demonetisation not as a problem but as an asset: «the surplus liquidity in the banking system, created by demonetisation, will lower borrowing costs and increase access to credit».[70] This, in turn, was bound to «boost economic activity, with multiplier effects».[71]

The problem with this optimistic assessment was that it did not take into account the problem of the banks' increasing NPA, which made them unwilling to lend and a growing number of entrepreneurs unable to borrow. This situation was worsened by the depression in demand, to which demonetisation was a powerful contributor.

While the government could have borrowed from the banks to finance a programme of substantial investments, this went against the neoliberal

68. The most glaring example of this state of denial was BJP president Amit Shah's invitation not to «rely on statistics», but «travel the country» to see the actual development of the Indian economy. 'Don't rely on statistics: Amit Shah', *The Hindu*, 10 September 2017.

69. This represented a change in the established custom to present the budget on the last day of February. According to government sources, the change aimed at initiating revenue mobilisation and capital expenditure measures right from the beginning of the fiscal year (1 April). 'Union Budget may be advanced by a month to 31 January', *Livemint*, 22 August 2016.

70. Budget 2017-2018, Speech of Arun Jaitley, Minister of Finance, 1 February 2017 (http://indiabudget.nic.in) [hereafter BS 2017], § 14.

71. *Ibid*.

ideology guiding the economic policy of the Modi government. Therefore, remedial measures to the deleterious effects of demonetisation were conspicuous for their absence.

In the 2017-18 budget speech, the finance minister announced the decision to bring down the budget deficit from 3.5% in fiscal year (FY) 2016-17 to 3.2% in FY 2017-18. He went beyond the recommendations of the FRBM Committee, namely the Committee in charge to verify the adherence of the government's policies to the Fiscal Responsibility and Budget Management Act, 2013.[72] Despite the reduced financial space allowed by the chosen budget deficit target, Arun Jaitley was confident that the Indian economy was certain to grow. This would be the result of three factors: economic reforms, particularly demonetisation and the implementation of the GST; the increase in public investment in infrastructure and development projects; the expected export growth.[73] Other characterising aspects of the budget were the diminution of direct taxes on medium and small enterprises[74] and the rise in the funds for welfare schemes in support of the weakest sectors of the population. In particular MGNREGA received the highest allocation ever.[75]

Jaitley's optimism on the benefits of reforms was misplaced. But even the claims related to increased allocations in infrastructure investments and welfare schemes appeared dubious. As argued by well-known economist C. P. Chandrasekhar, «implicit in the budget's numbers and arithmetic» was the continuous diminution of the ratio of government expenditure to GDP. This means that, if the global expenditure of the government was steadily diminishing, the rise in the allocation for infrastructure investment, even if fully implemented, boiled down to a redistribution of diminishing resources, favouring a particular sector at the cost of others. Also the rise in the allocation for welfare schemes was such only for some of them and, even in the case of the most favoured among them, namely MGNREGA, such a rise limited itself to a slightly upward rounding of the revised estimates for

72. The FRBM Act 2013 mandated to bring down the Indian budget deficit to the magic figure of 3% by 2008, a target that successive Indian governments had been missing, causing the wailing and complaints of the neoliberal ideologues. As is well known, there is no scientific reason why a nation should maintain its budget deficit at 3% rather than 4% or 5% or 2% or any other figure. In January 2017, the FRBM Committee, while recommending a 3% fiscal deficit for the next three years, had also provided for «escape clauses», to be applied in case of major economic reforms, allowing for deviations up to 0.5% of GDP, from the stipulated fiscal deficit target. BS 2017, § 135; 'Budget 2017: Government pegs FY18 fiscal deficit aim at 3.2% of GDP', *Moneycontrol.com*, 1 February 2017.

73. BS 2017, § 14.

74. BS 2017, §§ 155-56.

75. BS 2017, § 36, and Annex II-B to Part A.

FY 2016-17.[76] Finally, the advantages related to the much welcome decrease in the direct taxation on medium and small enterprises was bound to be undone a few months later by the adverse consequences of the disastrous implementation of the GST.

4.2. Reviving the Economic Advisory Council and trying to revive the economy

The budget 2017-2018 was a missed chance to redress economic problems, which were soon compounded by the hasty implementation of the GST.

The government remained in denial on the adverse consequences of its economic policies. However, the announcement, on 31 August, that the quarterly GDP growth for the April-June period had fallen to 5.7% – the lowest point in a declining trend since March 2016, when GDP quarterly growth stood at 9.1% – shook the government out of its complacency. At least, this is what one can reasonably infer from the decision – taken less than a month later – to bring back to life the Economic Advisory Council to the Prime Minister. Created on 29 December 2004, the Economic Advisory Council had given its advice to then Union Prime Minister Manmohan Singh. However, once Narendra Modi became prime minister, the Advisory Council was disbanded.[77] Eventually, on 25 September 2017 – in an avowal as clear as any of being in need of all the economic advice that he could get – Modi revived the Council.[78]

The revival of the Economic Advisory Council can be seen as the turning point at which the Modi government started to make an effort to take some sensible economic decisions. This it did by tackling the NPA problem, launching a massive road building programme and closing a loophole in the important bankruptcy law approved the previous year.

One of the major problems ailing the Indian economy even before demonetisation and the GST «double tap» was the NPA-related crisis of the banks. When presenting the 2017-18 budget, Arun Jaitley had taken a couple of limited remedial measures by allowing the banks some tax relief on the NPAs and by allocating the limited sum of Rs. 10,000 crore for the recapitalisation of banks.[79] It was only on 24 October that the Modi government confronted the problem by announcing the decision to inject Rs. 2.11 lakh crore into the sector over the next two years. This measure was to be implemented through three different measures: the government was to buy

76. C. P. Chandrasekhar, 'Budget 2017-18: Blinded by neoliberalism', *Macroscan* (originally published in *Frontline*, 3 March 2017); Id., 'Budget 2017-18: The macroeconomic perspective', *Macroscan* (originally published in *Economic & Political Weekly*, Vol. 52, Issue No. 9, 4 March 2017. See also IBS, Annex II-B to Part A.

77. Puja Mehra, 'Crash-landing the Indian Economy', *The Hindu Centre for Politics and Public Policy*, 20 September 2017.

78. 'What ails the Indian economy?', *BBC News*, 26 September 2017.

79. BS 2017, §§ 157 and 107 respectively.

bank shares to the tune of Rs. 18,000 crore; it was to encourage the banks to raise an additional Rs. 58,000 crore from the market; finally and most importantly, the government planned to raise Rs. 1.35 lakh crore through recapitalisation bonds.

Recapitalisation bonds are a financial instrument consisting of bonds to which banks can subscribe. Although the mechanism related to the creation and use of recapitalisation bonds still remained imprecise at the closing of the present article, it is clear that the government was counting on the banks making use of the excess deposits accrued to them following the demonetisation to buy up the recapitalisation bonds. According to the RBI, the banks' excess deposits were between Rs. 2.8 and 4.3 lakh crore, more than enough to finance the subscription of the requested value of recapitalisation bonds.[80] Which meant that the launching of recapitalisation bonds, if successful, would have the serendipitous effect of somehow redeeming the demonetisation fiasco.

The second economic decision aimed at reviving the economy was the approval, on 24 October, of a massive road building programme (under consideration from at least early April).[81] This move, being part of the effort to make a common market of the different Indian states, was presented as complementary to the GST. The project involved an outlay of Rs. 6.92 trillion for building a km 83,677 road network over the next five years.[82] This impressive infrastructural plan was bound to have a greatly positive consequence on the economy. However, as pointed out by former Finance Minister P. Chidambaram, the implementation of the programme necessitated a long and complex set of preparatory steps, which suggested that nothing was likely to start for at least 18 months.[83]

Finally the third sensible economic decision taken by the Modi government in 2017 was the closing of a main loophole in its bankruptcy law of 2016. In its original format, this law – «one of Narendra Modi's true

80. Scroll Staff, 'Explainer: How will the Indian government's bank recapitalisation bonds work?', *Scroll.in*, 25 October 2017. See also Bhupal Singh & Indrajit Roy, 'Demonetisation and Bank Deposit Growth', Reserve Bank of India, Mint Street Memo No. 01, 11 August 2017 (https://rbi.org.in/scripts/MSM_Demonetisation.aspx).

81. 'NDA to kick off India's most ambitious roads programme ever', *Livemint*, 19 April 2017.

82. 'Cabinet approves Rs7 trillion road construction plan, including Bharatmala', *Livemint*, 24 October 2017; 'Modi govt approves mega Rs 7-lakh crore project to develop 83,000 km highways in 5 years', *The Economic Times*, 25 October 2017.

83. This evaluation was made by senior journalist Karan Thapar during his interview to former Planning Commission deputy chairman Montek Singh Ahluwalia on 19 November 2017. Ahluwalia replied that Thapar's evaluation was «probably true». 'Raghuram Rajan's Note Advising Against Demonetisation Should Be Made Public: Montek Singh Ahluwalia'.

achievements» – did not prevent the same company owners who had bankrupted their firms from bidding for distressed assets, de facto buying back the firm that they had bankrupted for a song. This was enabled by the fact that, often, those who had bankrupted their firms belonged to politically well-connected and therefore powerful families. However, in mid-November, this opportunism was foreclosed by the Modi government issuing an ad hoc ordinance.[84]

84. Mihir Sharma, 'Narendra Modi government is getting one big reform right', *Livemint*, 29 November 2017. Of course, the ordinance needs to be ratified by parliament within six months.