

Peer Reviewed Journal

ISSN 2319-8648

Impact Factor (SJIF)

Impact Factor - 7.139

# **Current Global Reviewer**

International Peer Reviewed Refereed Research Journal Registered & Recognized  
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**Special Issue 21 Vol. I**  
**on**

## **Recent Economic Policies and Its Impact on Indian Economy**

**October 2019**

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Special Issue 21, Vol. I  
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SJIF

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## The Impact Of Government Policy on Economic Growth

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### 1. Introduction

Conditions of uncertainty have always been a part of the economic environment of free enterprise. Entrepreneurs and business strategists commonly seek opportunity in that arena. In the past two decades, however, policy uncertainty has risen to a level that makes forward economic planning and the search for opportunity more inscrutable for even the most adept in business challenges. In both United States and the European Union, the lack of new business formation, partly attributable to rising uncertainty, has contributed to stubbornly high levels of unemployment and underemployment.

The jobs that are being created in the U.S. are typically not of the quality of past economic recoveries, leaving many newly-employed workers in the unenviable position of remaining on various modes of government assistance, even after acquiring their new employment. As reported by Rampell (2012), "lower-wage occupations, with median hourly wages of \$7.69 to \$13.83, accounted for 21% of job losses during the retraction. Since employment started expanding, they have accounted for 58% of all job growth."

**Source: Northeastern University - Center for Labor Market Studies, 2013)**

In addition to the lower skills and wages in many of the post 2008 recession jobs, uncertainty has contributed to a significant increase in the number of temporary employees. In "Is the U.S. Turning into a Nation of Temps," Fastenberg (2013) notes that the "hiring rate of temp workers is five times that of hiring overall in the past year ... and the number of temp workers has been rising steadily since the recession-impacted year of 2009."

Supporting Fastenberg's research, Dhanya and Woh I (2013) reported that the largest retailer in the U.S. has embarked upon a strategy has in recent months been only hiring temporary workers at many of its U.S. stores, the first time the world's largest retailer has done so outside of the holiday shopping season. Internally, Wal-Mart calls these temporary employees flexible associates. According to Fastenberg (2013), the number of part-time workers at Wal-Mart has risen from just 1 % of its 1.3 million employee workforce to 10% in just one year. Given the employer's size, that has had a chilling impact on the already tepid market for full-time employment, and the trend has been adopted by many other large employers as well.

These difficult economic conditions have contributed to a decline in middle-class aspirations in America. While the question of policy uncertainty has received broad study, it is likely that the new and artful strategies of important policy making institutions, such as the U.S. Federal Reserve, have produced gaps in the literature.

### 2. The impact of quantitative easing

A review of the seminal work for Baker *et al.* (2013), *Measuring Policy Uncertainty*, demonstrated the exhaustive efforts of those authors in identifying indications of public policy uncertainty in the public domain. The authors distinguished between the level of policy uncertainty derived from fiscal issues and monetary issues. They concluded that, between 1985 and 2011, taxes, government spending, and fiscal policy accounting for about 40 percent of the policy uncertainty, with 33% precipitated by Fed policy. They determined that the uncertainty led to a postponement of business investment in hiring.

While this author found it unnecessary to further examine their rigorous work surrounding



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fiscal policy, it was apparent that the authors' work concluded prior to the imposition the largest tranche of the Fed's quantitative easing, known as "QE3." Further, it appeared that the authors' method of analysis might not fully capture the policy uncertainty implications of any of the Fed's quantitative easing programs, given that media articles reporting on the QE programs would focus on the enhancement in economic prospects to flow from the programs, rather than policy uncertainty. That is especially true with the Fed's latest, and, by far, the most robust program of QE3, which provides for a continuing flow of \$85 billion per month as long as the Fed determines that the economy is sufficiently weak. Thus, media articles following QE3 would, once again, focus on the certainty, or predictability, of Fed policy, which would have likely lowered the authors' 33% calculation. That reduction in the robustness of the monetary component would have given the Fed a higher level of policy credence than warranted, a theory supported by the data reported by Dunkelberg (2013).

The research by Dunkelberg of the NFIB, businesses surely look at a different policy scenario when contemplating the later, more voluminous states of quantitative easing, such as at QE3. First, the massive amounts of monetary intervention by the Fed were, in large part, precipitated by a stunning failure of fiscal policy, or lack thereof. The use of the Fed to intervene in the salvation of the economy, to the near exclusion of Congressional and Executive Branch action, is unique at current levels and indicative of the dysfunction in the political system. More importantly, small businesses realize that, despite the announced duration of the Fed's QE3, it is a poor substitute for enduring tax and investment policies and will someday come to an end. They appear to comprehend that the unwinding of perhaps more than \$4 trillion from the Fed's balance sheet could cause significant GOP shrinkage and calamitous conditions in the economy. From the NFIB research, those businesses clearly question whether the incipient recovery in the economy will be able to survive the removal of Fed stimulus, and thus, as shown in the data, are unwilling to borrow and expand under these conditions of uncertainty.

Due to its time frame, the Baker *et al.* (2013) work does not appear to identify this component of uncertainty. From the NFIB "Small business trends" report of April, 2013, it is clear that this QE uncertainty is extant for small business and impacting their expansion and job creation. Further research, with in depth quantitative and qualitative surveys of businesses, both large and small, will be necessary to better determine the impact on the economy from this component of Fed policy.

**3. Fiscal policy and entrepreneurship-** Entrepreneurs and small businesses have a lesser incentive to develop and grow in an environment shrouded in policy uncertainty, such as the current, highly-contentious climate that remains deeply impacted by the 2008 financial crisis (Patterson, 2011 and Barnes, 2012).

Governments around the world were faced with extraordinary challenges following the failure of Lehman Brothers and the near-collapse of the global financial system. In the United States, the federal government increased spending from 21.4% of gross domestic product (GDP) in 2007, to a high of 27.3% in 2009, including the historic budgetary legislation in the Troubled Asset Relief Program (TARP), an expenditure of \$860 billion. With TARP and additional measures, U.S. government "stimulus spending over the past five years totalled more than \$4 trillion" (Laffer, 2012), but has not achieved a significant growth in jobs and output. In fact, the recovery from the recession that ended in 2009 has been the weakest since World War II (Wiseman, 2012). The growth of nonfarm employment in the U.S. has been the most muted of any post-recessionary period since 1981, despite the record federal spending and stimulus programs.

This has been the first recession in the post-war period that combined U.S. federal, state, and local government employment has fallen. Most of that employment loss is at the state and local level, where budgets must be in balance and deficits are not allowed. As a result of the myriad headwinds in the current cycle, such as falling housing prices and weak tax revenues, states and local governments have been a significant drag on the U.S. economy.



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The rise in bankruptcies of U.S. cities, despite the public sector budget cuts and layoffs, has reduced small business investment and an increased economic uncertainty. With 706,000 jobs lost by state and local governments from May 2009 through June of 2012 (Dewan and Rich, 2012), those important sectors of the economy are creating another large obstacle to economic recovery and a deterrent to new business creation. According to Nayab (2011), such unstable political conditions and uncertain government policies suppress entrepreneurship. The historic financial problems of the public sector in the U.S. economy exemplify the instability and its impact on the economy. According to Haltiwanger *et al.* (2012), the start-up rate of firms has declined from "as high as 12 percent to 13 percent, as a percentage of all firms, in the 1980s to 7 percent or 8 percent in recent years."

#### 4. Uncertainty in trade policy

According to the U.S. House of Representatives Committee on Small Business, entrepreneurs and small businesses face a variety of barriers that significantly inhibit their ability to compete in the export market. Those barriers include higher tariffs, and anti-competitive technical standards. Adding to the global issues, some nations, including the U.S. create complex domestic rules regulating international trade. Entrepreneurs must navigate multiple federal agencies to obtain that license. With their limited resources, entrepreneurs and small businesses rely on free trade agreements to navigate the complexities of international trade (2012).

Despite the agreements in place, their complexity and uncertain, or disparate, enforcement have deterred entrepreneurial activity in international markets. Unfair trade practices, especially the theft of intellectual property (IP), deter small business engagement in that arena.

According to the U.S. House of Representatives, China is the preeminent offender, including dumping, intellectual property theft, and market access. In total, domestic firms lost an estimated \$48 billion from this theft. Notably, only one percent of the 27 million small businesses are engaged in export (2012).

#### 5. Conclusion

The role of governments can be helpful in fostering entrepreneurship and economic growth. Most efforts to stimulate business creation and expansion have been in the form of tax incentives. While preferential taxation, such targeted capital gains reductions and investment tax credits can be helpful, other, sometimes more subtle policy factors of predictability that are noted in this paper, can be more enticing. Chief among them is an environment in which a medium- to long-term assessment of government policy is possible. In the U.S., for example, the lack of policy visibility in a politically divided nation, and fear of new regulations, taxes, and rent seeking by lobbying groups, is having a chilling effect on new business creation. Some Western nations are recognizing the value of providing a more positive viewpoint from government, and one that can diminish policy fears harbored by entrepreneurs. The U.K.'s Department of Business, Innovation, and Skills recently announced the elimination or modification of 3,000 rules that impacted small companies. The U.K.'s Business Secretary noted that "in these tough times, businesses need to focus all their energies on creating jobs and growth not being tied up in unnecessary red tape" (Vina, 2012). Entrepreneurs and small businesses realize a nation that has incurred more debt in just four years than in its entire 200 year history, increased the rent seeking in its bastions of political power, and effectively printed nearly \$4 trillion, as is the case for the U.S., is on an unsustainable trajectory. As a result, the government's job creating and GDP enhancing efforts have produced modest, and arguably unsustainable, results. Some of these same issues are an impediment to business formation elsewhere, such as the European Union. Until a more stable environment, built upon policies that engender private sector growth and investment is visible to the job creating cadre, we can expect sub-par economic growth and missed opportunity. Further study is needed to quantify the impact of contemporaneous issues in policy uncertainty, such as quantitative easing. Research that would include a broad sampling of small business leaders would assist in closing the gaps



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in the literature and enhance the understanding of effective policy. The benefits of such an enhanced understanding would be beneficial on a global basis.

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