Facing the slowdown

The Indian government recently lowered its economic growth forecast for 2017-18 to 6.5 per cent, and there is reason to be concerned. That the economy would suffer a slowdown after demonetisation was inevitable, as all professional economists could see. But growth dropping to 5.7 per cent and 6.3 per cent in, respectively, the first two quarters of this financial year, when oil prices were roughly half of what they were in 2014, is a sharper decline than expected.

I believe that the long-run prospect for India is excellent and may be better than that of any other emerging economy. It is therefore incumbent upon us to try to dissect why the economy is doing poorly now, and to make policy corrections.

To begin with, some history. India had many achievements to be proud of during the first four decades after its independence — a vibrant democracy, secularism and freedom of speech, comparable to many advanced economies — but economic growth was not one of them. India's growth picked up only after 1990 and in three broad steps. It began with the reforms initiated by Manmohan Singh, with Narasimha Rao as prime minister, in the early 1990s, which got India growing annually at nearly 7 per cent, which at that time was quite an achievement. The second uptick happened around 2003, and a part of the credit for this goes to Atal Bihari Vajpayee as PM. India's savings and investment rates picked up and the annual growth rate moved to the 8 per cent range. The final step was in 2005 when India began growing at an unbelievable rate of 9.5 per cent per annum, and kept this up for three consecutive years, all the way till the global financial crisis of 2008.

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Some may be tempted to dismiss these as episodes. But if we compute the average growth of the last 30 years, it turns out to be 6.6 per cent. It follows that India is now performing below the average of not just the last five or 10 years, but the last 30 years. Given that during these three decades the trend of the growth rate has been steadily positive, this is indeed reason for concern.

One can see this slowdown in various dimensions, such as the international sector, where India is performing below capacity. With China ceding space because of rising labour costs and the abandonment of its low-exchange rate policy, India should have done much better in terms of exports.

An additional concern on the international front stems from the expected liquidity tightening by the US Fed. IMF research shows that this will cause a drop of $70 billion of portfolio capital flows to emerging economies over the next two years. This will be a result of the Fed's balance sheet reduction and likely interest rate hike. Even if interest rates are not raised significantly by the Fed, which is a possibility given the low interest rate policy followed by Japan, the Eurozone and other regions, there will be an expected decline in capital flows of $55 billion, as a consequence of purely the balance sheet action. This can cause turbulence in emerging economies, and India has to use professionally (not politically) drafted policies to minimise the negative shock.

However, the big worry for India lies elsewhere — it has to do with jobs and inequality. Because these numbers, unlike those pertaining to foreign exchange flows and stock market indices, do not fluctuate from day to day, they do not attract enough attention. But India's inequality — and especially wealth inequality — is rising, with the rich getting steadily richer and, at the other end, the slowdown in job creation is hurting not just the destitute but even the middle classes.

In fairness, job creation has been weak for a while, including during India's high-growth years, 2005-08. But this is beginning to hurt now. In 2004, agriculture and related activities provided jobs for 56.7 per cent of the working population. Ten years later, this number had dropped to 43.7 per

cent. The shrinking of the agricultural sector as a provider of jobs is not unnatural. What hurts are lopsided controls imposed on this sector in the name of protecting consumers and aiding the suppliers of fertiliser and other agricultural inputs. Farmers are getting squeezed between these two interventions. And further, even though global prices are high, Indian farmers are not allowed to access this route.

Workers leaving agriculture normally get picked up by other sectors, and often the export industry. But that does not seem to be happening. India's exports grew by 12.3 per cent during April to November 2017. However, a dissection of this number helps us understand what is happening. If we break up the exports into the labour-intensive segment and the rest, we find that the bulk of export growth occurred in the latter. The growth in exports of labour-intensive goods, such as electronic products, textiles and agricultural items, was a paltry 4.4 per cent. It is this failure in job creation which is India's big policy challenge.

What should be done? There are some green shoots. Recent data on the Purchasing Managers' Index and industrial production show some improvement. The challenge is to capitalise on these. Among other things, we need to step up savings and investment. By 2008 and 2009, India's investment rates were hovering close to 40 per cent and India was beginning to look like a fast-growing East Asian economy. This indicator has now slid sharply. It is the responsibility of the government to rectify this, in the absence of which there will be no sustained success in job-creation. My belief is if our monetary and fiscal policies are too tight-fisted on liquidity, it will hurt growth. We can and must spend to invest and create jobs.

India's economy is not doing well. Carefully-crafted policy reforms can turn it around. But for that we need to see the slowdown in the eye, and not get into a denial mode, which will be the surest way to turn the green shoots brown.

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