Understanding the slowdown

India's economy **is slowing down**: GDP growth has lost momentum in each quarter since the one ending March 2016. With every passing quarter, the slowdown is explained away either as a transitory phenomenon or as happening for reasons beyond the government's control: deficient rains, the sluggish world economy, or lately due to demonetisation and the goods and services tax (GST). The reasons offered change. The economic trend does not.

In the boom years during the United Progressive Alliance's (UPA) tenure, four engines powered the economy: exports, government investments, private consumption, and private investments. Of these, government investments and private consumption were still running at the time the National Democratic Alliance (NDA) took office. The other two were, and remain, out of steam. Official numbers have captured the weakness consistently — in exports for the past three years, and in private investments for more than five years. Yet, the debilitating impact of these on growth has received inadequate policy attention. The pain has begun to spread to the rest of the economy: growth in government investments and private consumption started slowing down in the quarter ending June 2017. The economy's four growth engines are stalling or slacking.

Government investments and private consumption depend on how well the economy is doing. As incomes improve, private spending and tax collections pick up. Let's look at exports and investments. The global economic downturn that followed the 2008 financial crisis dealt a body blow to exports, before which exports were growing smartly. Recovery in the global economy has lifted exports of most Asian countries, but Indian exports are stagnating, their competitiveness eroded by the overvalued rupee.

India's economic future can improve significantly with investments-led growth. The share of investments, the principal growth engine in the economy, in the GDP has declined steadily for the past five years. The decline in private investments is so sharp that it has offset the increases in government investments. The steps taken for improving the ease of doing business and the foreign investments regime have proved insufficient in restarting the private investments cycle. As a result, new jobs are not getting created. Without new jobs, consumption will only grow up to a point.

Time for course correction

Why are investments on hold? The returns-risk projections of projects are not favourable. Companies are not convinced that new factories will be sufficiently profitable. Among the variables that affect investment decisions are costs and availability of finance, land, labour, technology, logistics, and taxation. Market prices, or consumer prices inflation, is also a determinant of profitability. The government is politically sensitive. So, it has set a low target for consumer price inflation. For the same reason, it is unable to progress on land and labour reforms. The flow of credit in the economy has thinned to a trickle, as the government moved on bad bank loans belatedly and inefficaciously. Even if big companies can raise finance from alternative sources, the smaller ones cannot. Most of the other factors have escaped policy attention altogether. Additionally, in an environment of constant shocks and unanticipated policy changes, investment decisions tend to get postponed. If people feel unsettled, they are unlikely to invest.

Even though dark clouds loom over the economy, the situation is not irreversible. But the policy response so far has been feeble and misses urgency.

It's not as though there is policy paralysis. In fact, decision-making is speedy, perhaps too much so. The ill-informed idea of demonetisation and the GST rollout demonstrate the growing

disconnect between policy tools and objectives. The provisional official statistics show demonetisation proved to be a drag on an already slowing economy, even as we wait for its full impact to be estimated. The damage to the (more vulnerable) informal economy is being measured, and will be plugged to GDP estimates. On revision, past quarters' GDP growth may turn out to be even slower. The complicated design of the GST may have added to the vulnerabilities of the informal sector.

Demonetisation: now a proven failure?

The government insists these measures will prove beneficial over time. There is an inexplicable reluctance to take decisions that will deliver positive results quicker, such as reversing the investments slowdown and the exports stagnation. Politically difficult structural reforms have fallen off the agenda: liberalising land, labour, and agriculture.

Part of the problem seems to be the inadequate regard for sound economics and trained economists. The government is inert even to the advice of its own economists; the analyses documented in successive editions of its own publication, the Economic Survey, influenced policy minimally. Chief Economic Adviser Arvind Subramanian has diligently raised red flags over damages to the economy: from bad bank loans to the slowdown of investments, the distorted signals to farmers on what to grow and how much, and the GST's suboptimal design. The government must start paying heed.

Puja Mehra is a Delhi-based journalist

The new U.S. Fed Chairman is unlikely to opt for policies that might upset the President's plan

END