The faltering economy — On the weak numbers

A set of weak economic numbers has left the Central government scrambling to do something to set things in order. Finance Minister Arun Jaitley last week promised **appropriate action to revive the economy** without going too much into the details of what could be in store. There is, however, talk that increased fiscal spending to the tune of 50,000 crore or more may be approved by the government to make up for lack of private investment. This comes after the expansion in gross domestic product slowed to a multi-year low of 5.7% in the first quarter of 2017-18, and industrial output growth dropped to 1.2% in July, compared to 4.5% a year earlier. In addition, retail price inflation jumped to a five-month high of 3.36% in August from 2.36% in July, further dimming the prospects of a monetary stimulus from the Reserve Bank of India to help boost the economy. The demonetisation of high-value rupee notes in November, and the implementation of the Goods and Services Tax this year seem to be the most proximate causes behind the lacklustre growth numbers released so far. But, as many have pointed out over the last few months, the economy has been decelerating for the last five quarters. In such a case, demonetisation and GST have merely brought to the fore a more fundamental weakness in the economy.

Increased fiscal spending is unlikely to provide more than short-term relief to this problem, as it will not address any of the production bottlenecks in the economy. In addition, any loosening of the fiscal deficit target will affect India’s standing among global investors and project the image of a government resorting to fiscal stimulus to make up for the lack of more meaningful reforms. The real antidote to the current slowdown, on the other hand, is known all too well. The various rigidities in the market for land and labour have been holding back the economy for decades now, stopping investors from risking their capital on large-scale projects needed to boost growth. Further, the overall unease involved in doing business in the country and the even larger uncertainty looming around the rules that govern the conduct of business have seriously held back growth. It is no surprise then that, as reflected in the sluggish credit offtake numbers, private investment has failed to make sufficient use of the country’s relatively high private savings rate. But successive governments have found it easier to kick the can down the road rather than enact politically uneasy reforms needed to address the problem facing the economy. India’s major macroeconomic numbers, despite the recent worsening of the current account deficit, are still quite stable compared to a few years ago. The government must rise to the challenge and enact tough structural reforms, instead of finding an easy way out through the fiscal door.

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