Tackling the economic slowdown

Economic growth has slowed for five consecutive quarters, that is from late 2015-16 onwards. It should serve as a wakeup call for the government to take all necessary steps to revive the economy.

Why should it matter to us if the economy is growing more slowly?

Growth matters in India as a large number of persons have to make do with far too few goods and services as it is which is how poverty is defined. Note that these goods also include public goods or goods that are accessed by the entire populace of a country, such as parks, roads and bridges.Since these public goods are provided by government, the government needs tax revenues to supply them, and these depend upon national income.

Then there is employment. A demand for labour exists only when there is a demand for goods. So growth is necessary if employment is to be assured. In India we not only have a pool of unemployed persons to absorb but we also need to provide employment to youth continuously entering the labour force.

From this point of view, the slowing of the economy for last five quarters is a source of concern. Fiscal stimulus can help to recover the economy.

Why do Structural reforms must for growth of Indian Economy?

Structural reforms remain key to ensuring a steady 8 per cent growth in medium term for the Indian economy. After the passage of the bankruptcy law by Parliament, Structural reforms including GST and in areas like land and labour, will be key to boost India's economic growth potential going forward.

Since 2014, in particular, "the ease of doing business" has received great attention from this government. The economy today is far less regulated than it was in 1991. It would be correct to say that labour market reforms have not been taken up yet in Parliament and that exit is necessary for a dynamic economy.

Labour laws in India make exit difficult, and complying with requirements with respect to the hiring of labour is time consuming and therefore costly. It is possible that the share of manufacturing will rise if the labour market is liberalised. This could even benefit labour.

More reforms in land market are also needed

Apart from restrictions on conversion of agricultural land, no policy stands in the way of private parties transacting with one another. Surely, we can't treat the issue of the alienation of agricultural land so casually as to remove all discretion vesting with government.

If the argument is that the government must ensure as much land to private industry as they seek, though at a price, this is an intervention out of sync with a market economy. In this context, it may be said that an intervention that government in India should avoid is facilitating land acquired for industry to be alienated from manufacturing activity.

Cases in question range from land owned by public sector units in Bengaluru, private mills in Mumbai and private industry in rural Kerala.

Land and labour market reforms are a pre-requisite for accelerating growth today.

Stepping-up of public investment is essential for a slowing economy

Capital formation as a share of output has declined almost steadily for six years now. In 2014-15 it rose slightly but soon resumed it has been sliding at a faster rate. Actually, it contributed to the downward trend by reversing the rate of growth.

It is capital formation, or investment, that drives growth in the economy. Investment is an immediate source of demand as firms that invest buy goods and services to do so, but it also expands the economy's capacity to produce.

Of the two sources of investment, namely private and public, the first has been depressed for some years. In a slowing economy, private investment is unlikely to revive in the absence of some external force. This is so as investment involves committing funds for a long period under uncertainty.

It is for this reason that the stepping-up of public investment is essential when private firms are unwilling to invest more. Not only does increased public investment increase demand and quicken growth but it may be expected to encourage private investors, as the market for their goods expands.

Increase in inflation must be offset with the increase in growth

Increased public investment leads to a higher deficit, which is the gap between the government's expenditure and its receipts.

Among economists themselves there is resistance to governments running a deficit for fear that it may be inflationary. But in any such assessment, the increase in inflation must be offset with the increase in growth that would have been achieved due to greater public investment.

In India, the increase in inflation that could come with higher growth would be due to the shortage of agricultural goods. So any plan for increasing the rate of growth, not just at the present moment but in general, must reckon with agricultural shortages.

Moderation of fiscal deficit is important

Fiscal deficit is bridged by market borrowing and central bank printing fresh currency, if necessary. To a limited extent, FD is important as the Government's ability to help growth and welfare increases. However, FD becomes problematic and even destabilizing when it overshoots a rational threshold.

Moderation of fiscal deficit is important. Large and persistent fiscal deficits are a cause of concern, as they pose several risks.

Fiscal deficits may cause macroeconomic instability by inflating the economy as money supply rises.

Corporate sector is crowded out-they are left with inadequate funds in the markets as the government borrowing requirements increase.

Added to that, interest rates will be high as there is pressure on the available money in the market.

Inflation may mean fewer saving, less investment and eventually it hurts the sustainability of high growth.

Large deficits, even if they do not spill over into macroeconomic instability in the short run, will require higher taxes in the long term to cover the heavy burden of internal debt.

While it is right to be concerned with the consequences, the correct approach would be to aim to balance the budget over the growth cycle. That is, the deficit may be increased as the economy slows and contracted as the economy quickens.

Way forward

Since 2014 the government has focussed aggressively on the supply side by making it easier for private firms to produce. But we are now facing a demand shortage in the economy.

The immediate thing to do is to expand public investment in infrastructure.

Repair and reconstruction of India's poor infrastructure is the direction in which greater public investment must now flow.

It is the most direct and potent measure that can be undertaken to address the slowdown the economy is experiencing.