Why Indian Economy is Slowing Down?

(This editorial is based on the article 'No more half measures' which appeared in 'The Indian Express' on 17th April, 2019. The article talks about slow down in the economic growth and the reasons behind it.

India recently surpassed France to become the sixth largest nominal GDP globally and is looking strong to take over United Kingdom in near times.

India's post-independence journey which began as a modest agrarian nation has witnessed strong manufacturing and services sector growth in recent times. It has been a rather a long and painstaking journey. To get one of the largest economies in the world to maintain a seven to eight per cent growth pace requires effort, in the form of continuous reforms.

However, there has been recently, a steady decline in the economic momentum in India, and growth expectations for the current year have already fallen from 7.4% to 7%, thus making it important to find the reasons affecting our economic growth.

What is economic growth?

Economic growth means a rise in the real Gross Domestic Product; effectively this means a rise in the national income, national output and total expenditure. **Economic growth enables a rise in living standards and greater consumption of goods and services. As a result, economic growth is often seen as the '*holy grail*' of macroeconomics.**

Economic growth can help in achieving various macroeconomic objectives such as:

- **Reduction in poverty**
    - **Increased national output means households can enjoy more goods and services.** For countries with significant levels of poverty, economic growth can enable vastly improved living standards. Economic growth is therefore particularly important for developing economies.
- **Reduced Unemployment**
    - A stagnant economy leads to higher rates of unemployment and the consequent social misery that follows. **Economic growth leads to higher demand and firms/businesses are therefore more likely to increase hiring.**
- **Improved public services**
    - **Higher economic growth leads to higher tax revenues (even with tax rates staying the same).** With higher growth, incomes and profit, the government receives more income tax, corporation tax and expenditure taxes. The government can then spend more on public services.
- **Reduced debt to GDP ratios**
    - **Economic growth also helps in reducing debt to GDP ratios.** With government having more income in its hand to spend on public good and worrying less to pay the interests on its debts.

What is slowing the economy

One of the reasons of slowing down of growth can be attributed to shortage of money. While currency in circulation is not a problem, the money that much of the formal economy uses for transactions, and see as bank deposits i.e. M3 or broad money and is eight times the hard currency in circulation, is not finding its way to the market.

Our Financial system which converts base money to M3 is not functioning smoothly. When banks give new loans, they "create" money. When the financial system is not functioning effectively, this process of money creation slows down, and the ratio of M3 to M0 (also called the money multiplier) falls.

This can be seen in the failure of banking sectors to extend loans to credit seekers in the era of increasing NPAs.

Recent failure of Non-Banking Finance Companies (NBFCs) which had stepped in to support credit growth has resulted in restricted growth to ensure survival, as a result of which system-wide credit growth has slowed sharply.

Government has also failed in addressing these issues as there is a general apprehension of running into the risk of another build-up of bad loans.

There has been a reported drop in the households' financial savings to GDP ratio in 2017 to 9.4% highlighting the fact that there aren't enough savings available for both the government and the private sector to be funded adequately, which further impedes the growth.

There are several other challenges such as a weak and ailing real-estate market, problems in agriculture, worrying levels of external dependence in India's energy ecosystem, crumbling municipal infrastructure, and stagnating capital flows, among several others.

Curing the ailing growth

One way of addressing the economic woes is to speed up the privatization of Public Sector Banks as it has been established beyond doubt that there are structural problems with a state-owned banking system.

Reducing bank interest can also potentially boost the capacity of lenders to extend loans and, in turn, boost growth in the world's fastest-growing major economy.

Way Forward

India's growth has been impressive in recent years but this is a country whose development is hampered by endemic structural problems. India requires significant investment in infrastructure, manufacturing and agriculture for the rapid growth rates of the last fifteen to twenty years to be sustained. In order to fulfil this it needs to create a robust financial structure that can serve the needs and demands of growing nation.

Measures of Money Supply : M0, M1, M2, M3 and M4

- The total stock of money in circulation among the public at a particular point of time is called money supply.
- The measures of money supply in India are classified into four categories M1, M2, M3 and M4 along with M0.
- This classification was introduced in April 1977 by Reserve Bank of India.
- **Reserve Money (M0):** It is also known as High-Powered Money, monetary base, base money etc.
    - M0 = Currency in Circulation + Bankers' Deposits with RBI + Other deposits with RBI.
    - It is the monetary base of the economy.
- **Narrow Money (M1):**

M1 = Currency with public + Demand deposits with the Banking system (current account, saving account) + Other deposits with RBI

- **M2** = M1 + Savings deposits of post office savings banks
- **Broad Money (M3)**
  M3 = M1 + Time deposits with the banking system
- **M4** = M3 + All deposits with post office savings banks

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