



The architecture is not the force

Posted at: 05/12/2018

The architecture is not the force-How a business friendly government has failed to arrest the slide in private investment

- It may appear that the recent hullabaloo over GDP (gross domestic product) growth in the past decade has cast a shadow over assessment of the economy's progress since 2014, but it is not so.
- There exists enough information for this as GDP is not the sole indicator on which one needs to rely in such an exercise.
- Arguably, investment is another, mainly private investment, for governments can always raise their capital outlay ignoring the calculus of profitability.

The profit-economy link

- For a private investor, on the other hand, financial commitments are based closely on anticipated profit.
- The expectation of profit is itself tied to the expected state of the economy.
- For a government interested in invigorating the economy, then, it is essential to inspire confidence in the private investor.
- The investment meant here is the expenditure on productive capacity as opposed to buying shares or even durable goods in secondary markets.
- Private investment in relation to output has in most years since been lower than what it was in 2014.
- This may come as a surprise to some as the government of Narendra Modi had appeared a business friendly one.
- First, the private sector comprises two segments, the corporate and the unincorporated, termed household, in Indian national accounts.
- For an economy, by architecture, would mean the framework within which activity takes place while force is the ebb and flow of the demand for and supply of goods.

Elements to the architecture

- It is possible to see four elements of the architecture as visualised by the Modi government: the presence of foreign direct investment (FDI), a digital payments network, a streamlined indirect tax regime and less government.
- The government has had some success in moving the economy towards such an architecture.
- Finally, the counterpart of the election slogan, 'minimum government', has materialised in the form of a steadily declining share of public expenditure in the economy.
- So the government has been able to achieve the architecture that it aspired to.
- Extensions of it have reached the two arms of macroeconomic policy.
- First, there was the move to what is referred to as a 'modern monetary policy framework' with sole objective of monetary policy would be inflation control.
- A less recognised aspect of the modern monetary policy framework is that the real exchange rate has appreciated since its adoption.
- This could only have reduced the demand for India's exports, further lowering aggregate demand and holding back private investment.

Unimaginative maxim

- The economic policies of the Modi government have failed to enthuse the private sector.
- Actually, "minimum government" is an unimaginative maxim for governing the economy.
- The government must respond imaginatively to the emergent economic situation.
- In the context, to the extent that sliding private investment reflects declining profit expectations, economic policy must anchor profit expectations.
- Under India's new monetary policy framework, institutionalised by this government, the monetary authority aims to anchor inflationary expectations but this by itself can do little to convince firms of improved profits in the future.
- That this is how the economy works may be surmised from the fact that inflation has trended down steadily since even before 2014 but that has not revived private investment.