THE HINDU

GST countdown

There is still no clarity whether the loose ends can be tied up in time for the July 1 deadline

The Goods and Services Tax Council has finalised the rates at which tax will be levied for almost all products and services under the tax regime, just four weeks before the July 1 deadline for rollout. The decisions amount to a balancing act between competing demands. The Council has set the tax rate on gold, silver, diamonds and other jewellery at 3%, while uncut diamonds will attract a 'notional' duty of 0.25%; a credit can be claimed for exports of such diamonds after they are polished and cut in India's gem clusters. Footwear and readymade textiles will have differential tax slabs based on sale price (with a concessional 5% for footwear below ₹500 and clothes below ₹1,000). But oddly, no such distinction has been made for mass consumption items such as glucose biscuits. Textiles, leather, diamonds and food processing already are, or have the potential to be, India's biggest employment engines, and repercussions of tax structure anomalies can be felt hard and fast in a competitive global market. Though the low rates on gold and diamond can dampen smuggling opportunities, they introduce two more rates to an already complex GST structure of five rate slabs plus a variable cess on 'sin' goods. Taken together, with the exemptions for critical sectors such as real estate, electricity, petroleum and alcohol, GST in its current form is far from the 'One Nation, One Tax' it purports to be.

Not surprisingly, fresh demands for differential tax treatment have begun already, including for bidis. States and sections of industry want a review of rates finalised earlier for products ranging from biogas, fertilizers and tractors to agarbathis, human hair and cashew. Actor Kamal Haasan has threatened to quit cinema as it has been included in the 28% 'sin' category, and States have backed the demand that regional cinema be treated differently. The Council is slated to meet again on June 11 to discuss these demands while taking a call on a few pending items such as lotteries, and finalise rules pertaining to accounting and e-way bills (to be generated to transport goods). An assurance of input credit on existing stocks with dealers and simpler rules for filing returns should help industry gear up for the transition. But in the absence of final accounting rules or clarity on the anti-profiteering framework, there is concern whether all the loose ends can be tied up this month. The government is sticking to the July 1 deadline despite reservations about the readiness of the administration and the GST Network that would have to manage billions of invoices. The Council must take a realistic and honest stock of ground realities at its next meeting. A sub-optimal GST design can be corrected over time, but a hasty beginning could prove costly.

European variation

With global politics in a flux, India must make a careful choice of coalitions it forges

Prime Minister Narendra Modi's visit to Germany, Spain, Russia and France brings into sharp focus the shared dilemma India and Europe face with America's shifting policies, and the resultant flux on the world stage. Mr. Modi's first stop in Germany came a day after Chancellor Angela Merkel's strong comments aimed at President Donald Trump, that Europe could no longer 'depend' on traditional partners. Europe's disappointment with Mr. Trump at the G-7 and NATO summits was three-fold: his refusal to reaffirm NATO's Article 5 on 'collective defence'; his warning on the trade deficit with Europe; and his expected decision to pull America out of commitments in the Paris Agreement on climate change. For the past few months India has faced a similar disappointment as the U.S. has forged closer ties with China, indicating what Mr. Modi called a loosening of the world order, while the U.S. has targeted Indian professionals and businesses to protect American jobs. Another blow came from Mr. Trump's comments on the Paris Accord when he blamed India and China for what he called an unfair deal. Mr. Modi's meetings with Ms. Merkel and subsequently Spanish Prime Minister Mariano Rajoy and French President Emmanuel Macron saw those issues raised one way or another, as they tried to explore new ways to cooperate on multilateral issues, including terror, trade and climate change. In particular, Mr. Modi's assurance in Berlin that the suspended India-EU free trade talks for the Broadbased Trade and Investment Agreement would resume soon has raised the hope that progress will be made before the EU-India summit in Delhi this year.

However, while the EU and India have a clear convergence in many areas, a dependable alliance can only come from a concurrent worldview. It cannot be ignored, for example, that Chinese Premier Li Keqiang's visit to Berlin and Brussels, also last week, saw the EU repose much more faith in Beijing than New Delhi would be comfortable with, given the current Sino-Indian tensions. European leaders praised President Xi Jinping's leadership on connectivity and climate change. Europe perceives its single largest threat to be from Moscow, not Beijing. Mr. Modi's attendance at the St. Petersburg International Economic Forum to unveil a new India-Russia vision statement for the 21st century along with President Vladimir Putin could cause similar discomfort in European capitals. This divergent worldview may be further highlighted this week as Mr. Modi travels to Kazakhstan to formalise India's membership of the Shanghai Cooperation Organisation, seen as a counter-NATO coalition of Russia, China and Central Asian states. Standing at a crossroads few had expected at this stage, India will have to consider its options carefully as it decides which coalitions to forge as the U.S. overturns traditional ties in favour of transactionalism. The Centre must undertake a full review of India's priorities and interests before Mr. Modi heads to Washington for a meeting with Mr. Trump at the end of June.

The economy in the time of Narendra Modi

Three years since 2014, standard indicators show little sign of an economic transformation

PULAPRE BALAKRISHNAN

GETTY IMAGES/ISTOCKPHOTO

As the Bharatiya Janata Party reportedly prepares for "Modifests" to celebrate the completion of three years in power the citizen would be interested in knowing how their government has performed in respect of the economy. This because in his election campaign in 2014 Narendra Modi had chosen to highlight his ability to turn the economy for the better, notably to raise its growth rate. Once he became Prime Minister, he quickly presented his idea of how this could be done. Manufacturing was to be the key and "Make in India" the government's programme to actualise it. Pressing ahead to produce in India can hardly be faulted as an objective, for in a market economy income generation depends upon making something. As for the focus on manufacturing, its relevance cannot be exaggerated. Indian agriculture is overcrowded. With shrinking farm size, the returns to this activity is set to shrink and only manufacturing can absorb the labour that will have to be transferred out of agriculture. Also manufactures are often easier to export than the services that India specialises in. So, "Make in India" is eminently sensible of itself. But how successful has this initiative been?

A slow starter?

Turning to the evidence, we would find that far from taking Indian manufacturing to new heights, the performance since 2014 does not match what has been achieved in the last boom in India, which was obtained during 2003-08. During this period, for the first time in decades, manufacturing had led the growth acceleration in the economy. In most of these years, annual growth of manufacturing had exceeded 10%, which has not been matched since. Interestingly, the performance of this sector in the last three years is not superior even to that at the tail end of United Progressive Alliance (UPA) II. Clearly, "Make in India" is yet to fulfil its promise.

Now, could it be that the programme has actually had a favourable impact but the fruits are yet to appear? This is possible, and would be the case if the programme has led to a surge in investment. But there is no evidence of this either. If we take a wider measure of investment – that for the economy as a whole – we see that capital formation as a share of total output has declined even more sharply since 2014 than it had been since the decline began in 2011. Private investment, seen as the bellwether of an economy, has not been forthcoming despite this government's business-friendly orientation. As the decline in investment had commenced in 2011, the development itself cannot be laid at the present government's door but it is unambiguously the case that it has not been able to reverse it. Part of the reason has to do with the fact that the focus of "Make in India", such as the ease of doing business, has mostly been on the supply side. But there is demand to reckon with. Firms invest in anticipation of demand, and when they perceive slow growth of demand, they are likely to hold back.

Explaining slow growth

It is clear that some part of the slow growth of demand in India is beyond the grasp of government due to the weather cycle. Two of the past three years have been years of very poor agricultural GDP growth, with the figure actually negative in 2014-15. But agriculture's performance cuts both ways, serving also as windfall when it turns out to be buoyant. Thus, for 2016-17 the Central Statistics Office's advance estimates indicate a more than three-fold increase in agricultural growth while industry and services register a reduction in theirs. Had agricultural growth not risen so dramatically, growth in 2016-17 would have slowed even more than it actually did. The government just got lucky.

Whatever may have been the demand-constraining impact of slow agricultural growth in the first two years of this government's tenure, the independent role of its macroeconomic policy is evident. At a time of declining private investment the prudent thing for a government to do is to raise public investment. This has not happened on anything like the scale necessary. Indeed, with regard to fiscal policy, the government had been guided by fiscal consolidation defined in terms of deficit reduction. Admittedly, in this the National Democratic Alliance-II has only taken forward a programme initiated by UPA-I. But the slowing of capital formation was not a feature then, and economic policy is meant to respond to a changing environment. In 2016-17, gross fixed capital formation in the economy turned negative. This worrying development requires addressing. But having tied itself down to a dogmatic policy stance, the government can do little. The centrepieces of this policy package are fiscal consolidation and inflation targeting. This combination leaves no room to address concerns of growth. The government's response to suggestions that it respond to the situation is that it will not sidetrack fiscal consolidation. Actually, no one is asking it to! It is possible to adhere to fiscal deficit targets while expanding public capital. You do this by switching expenditure from consumption to investment.

Impact of demonetisation

All this is from a macroeconomic point of view. To be fair to the government, we must acknowledge its other programmes. Admittedly there are several but it is demonetisation that it thinks of as its showpiece. Claims made have been the ending of corruption and tax evasion. So far we can only be certain that there was an immediate slowing of growth in the formal sector of the economy after November as reflected in the Index of Industrial Production. It is too early to establish what the impact will be on tax revenues but it is difficult to imagine that demonetisation will achieve more for revenues than the Goods and Services Tax. Interestingly, in his book *The Curse of Cash*, the guru of the "less cash" movement, Kenneth Rogoff, presents data that show countries with a relatively high cash-to-GDP ratio, such as Japan and Switzerland, having smaller underground economies than some such as the Scandinavian ones recording "far far" less cash. It may be noted that in Japan the said ratio is 50% higher than in India. No one thinks of Japan as backward. So, with demonetisation, has the government caused output loss without clear gains elsewhere in the economy? And if the argument was that large denomination notes abet corruption, it is difficult to comprehend the replacement of the ₹1,000 currency note with a ₹2,000 note, with its inconvenience. It is clear from this that politicians and economists do not employ daily-wage earners.

Prime Minister Modi is not a man for the understatement. He had come promising a transformation of the economy. Three years later the standard indicators show no sign of his government bucking the trend. It may be seen in the latest "Economic Survey" that growth had begun to rise and inflation fall before 2014. Since then the growth acceleration has tapered off, with the year just ended actually recording a slowdown. Finally, in what must come as an embarrassment of sorts considering the slogan of "minimum government", among the most prominent drivers of growth in the past three years has been a record growth of government consumption expenditure. The stock market, however, exults! Apparently the punter holds something close to his chest.

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Need for corrective action

Revised estimates show that demonetisation hurt, but a deepening investment slowdown remains the challenge

PUJA MEHRA

India's economic growth estimates lately seemed out of sync with the dampened feel-good sentiment in the economy. The GDP was growing at a world-beating rate, the stock market was booming, but little on the ground suggested that people were feeling better off. Consumption and investment behaviours suggested probably not. So when in February this year, the state statistical apparatus estimated that the impact on the economy of demonetisation was muted, doubts were cast on its credibility.

Dissonance between the statistics and ground reports considerably reduced in the latest released batch of data into which the updated Index of Industrial Production was plugged in.

The GDP data for the fiscal year 2016-17 present a sharp picture of the state of the economy. GDP growth has slowed for the first time in five years, in 2016-17, to 7.1%. The economic recovery that was gathering pace year after year abruptly lost speed last year. Corrective action should help the economy regain the lost momentum. Quarterly estimates show that demonetisation certainly hurt the economy, but growth impulses had started weakening six months earlier. A thorough understanding of the slowdown's causes will be crucial to the choice of policy tools.

Demonetisation's disruption

Demonetisation's damage is discernible in the last two quarters of 2016-17. It is more pronounced in the later one, when from January to March this year, coinciding with the peak cash crunch, gross value added (GVA) grew at its slowest pace in at least eight quarters. The loss of momentum is considerable. Growth slumped to 5.6%. Just four quarters earlier it was a robust 8.7%.

Construction and manufacturing, crucial sources of jobs, have been most severely affected. The GVA growth received a boost from agriculture that benefited from last year's good rains and Government spending, largely immune to demonetisation. The growth in the rest of the economy, minus this contribution, was barely 3.8%. In the same quarter a year ago, this was 10.7%.

Given the extent of the disruption, a sharp, sustained reversal in GVA growth looks difficult. Projections of a quick bounce back seem optimistic. At the time demonetisation was announced, GVA growth had been on a downward slope. It had decelerated in the two quarters preceding demonetisation. The shock dragged it further in the next two quarters. From the peak of 8.7% in the January-March 2016 quarter, it lost momentum consistently, decelerating for four straight quarters.

GETTY IMAGES/ISTOCK

Risks to the recovery

In the boom years during the United Progressive Alliance government's tenure, four engines had powered the economy. Of those, just two were still running before demonetisation: government investments and private consumption. The other two, exports and private investments, were, and remain, out of steam. Demonetisation briefly killed the third, private consumption. As the cash crunch eases, consumption will probably revive. But the risk to the recovery is from the credit crunch that demonetisation worsened.

Credit growth plunged to a multi-decade low as banks were devoted to exchanging notes that ceased to be legal tender. This overburdened banks and took attention away from the pressing problem of bad loans, the impact of which is visible in the continuing slide in the gross fixed capital formation, a measure for investments. Decreasing for the fifth straight year, the share of gross fixed capital formation in GDP shrunk to 27.1% last year. It was 34.3% in 2011-12.

Investments, the principle engine of growth, remain unresponsive to macroeconomic stimulus. The government stepped up its public investments, even deferring fiscal deficit targets, but the increase is more than offset by the fall in private investment. Liberalising foreign investment policies and improving the ease of doing business has not pulled the economy out of the investment slowdown.

The message in the revised estimates relevant to policy decisions is that unresolved bad loans are restricting banks' lending capacities, which is choking investments.

Investment slowdown

The investment slowdown is neither a recent development nor has data captured it for the first time. The government has so far played a passive role, first by relying on banks, and now on the Reserve Bank of India, to tidy up the bad loans mess. Unless addressed on a war footing, the credit crunch could stall the economy's recovery. The quicker the banking sector recovers its health, the speedier will be the pullback. The stress, if unattended, will limit the effectiveness of the monetary support of lower interest rates.

Since the economy was on a smooth recovery path for the last four years, the slowdown should probably no longer be ascribed to the policy paralysis that characterised the dying years of Prime Minister Manmohan Singh's government. The fresh bout of pain in the economy is to a great extent a fallout of decisions – both that were taken and those that should have been taken but were not – of Prime Minister Narendra Modi's government.

Puja Mehra is a Delhi-based journalist

LETTERS TO THE EDITOR

Letters emailed to letters@thehindu.co.in must carry the full postal address and the full name or the name with initials.

The U.S. walks away

By pulling out of the Paris Accord, U.S. President Donald Trump has not only refused to honour the developed world's obligations on climate change but also put the developing world in a double jeopardy: of having to emit large volumes of greenhouse gases to achieve growth, while preparing to adapt to the destructive effects of adverse weather conditions, such as droughts and floods, linked to climate change (Editorial - "We need Paris," June 3). It is unfortunate that instead of exploring the potential for energising international policies and linkage between external finance and climate action, the Trump administration has taken a myopic position by stoking unfounded fears about the U.S. economy losing manufacturing jobs.

SHREYANS JAIN,
New Delhi

■ Mr. Trump's callous disregard for the assiduously crafted climate pact is appalling given that it is widely regarded as the most important UN achievement in the recent past. What is ironical is that when smaller and poorer nations are weaning themselves away from fossil fuels and even an authoritarian state such as North Korea, perceived as a 'rogue state', has ratified it and launched a nationwide tree-planting initiative, the world's oldest and richest democracy, with a historic responsibility towards mitigating global warming, is irresponsibly and regressively continuing to depend on carbon-emitting fossil fuels. It is a great relief that China and countries of the European Union have vowed to abide by the climate pact.

NALINI VIJAYARAGHAVAN,
Thiruvananthapuram

NIA raids

The search operations by the National Investigation Agency (NIA) are welcome, though a bit belated ("On terror funding trail, NIA conducts raids on separatists," June 4). The government should ensure that such operations reach their logical conclusion – putting the brakes on terror funding – so that militant outfits and their sponsors can be exposed at the international level. Such operations, coupled with India's repeated assertions of the need for a permanent solution to bilateral issues, augur well for a trouble-free situation in the Valley.

V. SUBRAMANIAN,
Chennai

Guha's resignation

Ramachandra Guha's missive of 2,445 words has come as a bombshell and only shows that all is still not well with Indian cricket. The letter only indicates the perpetual hold of cricket superstars who can make or mar any career. However, genuine fans are concerned about the future of young players who depend on domestic cricket for a living, a concern pointed out by Mr. Guha. His exposé of the violation of norms and procedures will find resonance as he has raised his voice for a just cause – ridding the game of filth and promoting probity. The Committee of Administrators has received the mandate of the Supreme Court and it must appear to be a change maker. Better opportunities for domestic players, less politics and more transparency are needed. Let Mr. Guha's missive be the turning point.

PARTHASARATHY SEN,
New Delhi

Tribal heritage

The diverse socio-cultural traditions of the many tribal groups in our country, their rituals, their synergy with the environment, and their unique dialects impart strength to the social fabric of India ("Tribal communities in Odisha are speaking up to save their dialects," June 4). Against the backdrop of the fading influence and falling usage of traditional tribal dialects, the efforts by tribal communities like Saura and Oraon to revive them are heartening. However, the efforts need to be supported and invigorated through state assistance in earnest to achieve greater progress.

ATIN SHARMA,
Jammu

Son rise

That the DMK's M.K. Stalin is blossoming into a national leader is evident from the manner in which he conducted the mega meet in Chennai to celebrate the 94th birthday of his father and DMK patriarch, M. Karunanidhi. Mr. Karunanidhi has often been one of the main architects of political alliances at the national level and it is worth noting that Mr. Stalin is trying to take a leaf out of his father's book, especially at a time when the Opposition is struggling to counter the autocratic moves of the NDA government. There also seems to be a remarkable change in the attitude of Rahul Gandhi towards the DMK.

THARCIUS S. FERNANDO,
Chennai

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CORRECTIONS & CLARIFICATIONS:

In a report headlined "BJP has become biggest NPA: Cong." (June 3, 2017), the full form of NPA was erroneously given as Non-Performing *Authority*. It should have been Non-Performing *Asset*.

Late correction: A Business page report headlined "Usha eyes double-digit growth in *fan* sales" (May 21, 2017) erroneously referred to the growth in the *fan* business (in the headline and twice in the text). It should have been *air cooler* business.

It is the policy of The Hindu to correct significant errors as soon as possible. Please specify the edition (place of publication), date and page. The Readers' Editor's office can be contacted by Telephone: +91-44-28418297/28576300 (11 a.m. to 5 p.m., Monday to Friday); Fax: +91-44-28552963; E-mail:readerseditor@thehindu.co.in; Mail: Readers' Editor, The Hindu, Kasturi Buildings, 859 & 860 Anna Salai, Chennai 600 002, India. All communication must carry the full postal address and telephone number. No personal visits. The Terms of Reference for the Readers' Editor are on www.thehindu.com