Challenges to India’s Economic Aspirations

What is the issue?

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- Some projects have touted India to grow at high rate of above 7% in the coming years due to some positive economic indicators.
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- But these seem to ignore the role of the present favourable external circumstances and other inherent risks within the domestic economy.
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What are favourable indicators?

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- While demonetisation precipitated in the Indian growth rate dipping below 6%, it has now recovered to about 7%.
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- Going ahead, India is projected to grow at 7% in the current year and become the world’s fastest growing economy (overtaking China).
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- Additionally, the Indian economy’s foundations have also been strengthened in the last few years on multiple fronts.
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- Inflation has moderated to around the 4-5% range and trade balances with the rest of the world have improved.
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- The current account deficit has come down to about 1.5% of GDP.
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- Forex Reserves with the RBI has swelled to a comfortable $420 billion.
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- Moreover, despite political compulsions, central government has curtailed budget deficits considerably, albeit a minor target slip.
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- While these figures paint a dynamic and optimistic picture of the economy, there are significant vulnerabilities that deserve attention.
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What are the concerns?

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- **Investment -** For sustaining high growth, the economy need to continuously add to its "production capacity" through new investment flows.
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- Productive investment is money that is spent for building roads, ports and other public infrastructure, factories, and workforce quality enhancement.
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- India is seeing a sharp decline in the rate of investments in recent years which has come down from 34% of GDP in 2014 to 30% currently.
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- More strikingly, the current investment rate is the lowest in about 15 years.
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- This makes it incompatible with the aspired high growth rate of 7-8%.
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- **Industrial Production –** The industrial sector is a highly critical engine for growth in the Indian context.
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- But this has shown weakness lately.
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- Manufacturing grew by 6% in 2016, but plummeted to an abysmal 2% following demonetisation.
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- The subsequent recovery has not been that encouraging.
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- **Banks -** Banking finance plays a significant role in the economy, particularly in the context of small and medium sized enterprises and agriculture.
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- Mounting NPAs has created enormous stress in the sector, which has affected the ability of bankers to lend out to businesses, which is hurting the economy.
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- Notably, the pace of lending has come down significantly from 2014-16, when it grew at 10% to the present growth rate of a mere 6%.
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- Also, the proportion of NPAs to the gross outstanding loans has doubled during the same period from 5% in 2015 to 10% currently.
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- **Fiscal Statistics -** While the majority focus has always tended to be on the Central budget, the many states have displayed little fiscal discipline.
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- The combined Fiscal Deficit of the centre and all states accounts for as large as 6.5% of GDP.
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- Moreover, India's overall sovereign debt is a whopping 70% of GDP, which has not come down considerably in recently years.
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- This is in contrast with a number of other emerging market economies that had reduced their sovereign debt considerably over the past 5 years.
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What are the potential risks?

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- **Inflation -** While policy measures have helped control inflation, the decline in inflation has largely been driven by extraneous factors.
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- Food and energy prices are important components of the 'Consumer Price Index' (CPI) and decline in their prices has brought inflation down.
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- If prices of these commodities increase in future, it would be difficult for the RBI (through its monetary policy actions) to keep inflation under control.
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- **Imports -** The prices of "Oil, gold and coal", which constitute almost 50% of total imports in India, has declined considerably in recent years.
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- Hence, the bettering of India's trade balance is more a reflection of extraneous factors (decline in prices of imports), rather than increase in exports.
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- Additionally, lower oil prices have also benefited the Central budget as it has helped in reducing fuel subsidies and has bolstered fiscal prudence.
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- But the prices of the critical import commodities could increase anytime and end up constraining the trade balance.
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Why have the growth projections failed to capture these?

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- While some claim that growth numbers are being tampered to project an

optimistic economic outlook, it would be a stretch to affirm these.
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- But one can argue that there is a genuine difficulty for statisticians to quantify the numerous variables and its potential impact on GDP.
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- Also, initial estimates are based on formal sector projections, which get revised subsequently as the information from the informal arenas comes in.
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- It is to be noted that both demonetisation and GST had largely affected the informal businesses in the short term, which needs to be accounted for.
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- Hence, while the projections may be academically correct, there is a need for considerable caution.
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Source: The Hindu

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