A Commentary on India’s Dream of Becoming “A Five Trillion Dollar Economy by 2025”

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Abstract

At the outset, it may appear to be an overambitious dream of making India a Five Trillion Dollar Economy by 2025. The dream has taken a hit due to the current slowdown. But the slowdown in the economy is an aftereffect of demonetization and broad reforms in the field of taxation, credit lending, insolvency and meeting compliances taken in the past few years. Considering the strong fundamentals of the Indian Economy and vibrant demography led by a stable and determined Government, the slowdown seems to be cyclical and the dream of making India a 5 Trillion Dollar Economy should not be beyond reach. However, realization of this dream is subject to a lot of assumptions like continuity in economic policy, government stability, controlled inflation, fiscal deficit and current account deficit, increase in domestic investment and export, credit availability and a conducive tax environment.

Key Words

Indian Economy, GDP, 5 Trillion Dollar, Economic Slowdown

Introduction

For a large part of over 50 years since Independence, India remained an exemplar of an underdeveloped economy. India could barely be an economy worth $400 billion by 1996-97 (MOSPI, 2019). But since then the pace of growth has accelerated thanks to the effects of liberalization and changing demographic set up in terms of a population that was both young and restless. It took the next ten years for India to reach a mark of $1 trillion for its GDP in 2007-08. Precisely it took 60 years for India's GDP to reach $1trillion. But it took just

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another seven years for the country to double its GDP in absolute terms. India crossed a $2 trillion GDP mark in 2014-15. Continuing the effect of acceleration India added another $800 billion to its nominal GDP by 2019-20 (MOSPI, 2019). With high growth rate in mining, manufacturing and services, the last addition in GDP has absorbed the effects of poor agriculture growth (Economic Survey, 2019). However, it was based on a strong public mandate for a stable and determined government along with growing acceptance of India's growth model around the World that gave courage to India's Prime Minister Narendra Modi to announce his dream of making India $5 trillion economy by 2025. Quoting from *Upanishad* at the World Economic Forum 2018 annual meet in Davos Mr. Modi assured the Global Business Leaders that India considers the World as a one big family with a common future. The theme of the meet 'Shared Future in a Fractured World' could not have been more suitable for India to announce its dream of $5 trillion economy and invite business leaders to invest in the world's fastest-growing economy and one of the largest consumption markets. Mr. Modi restated his vision in June 2019 at Niti Aayog-India's Think Tank's governing council meeting. But it was only July 2019 during the Annual Budget speech of India's Finance Minister Mrs. Nirmala Sitharaman that this dream was transformed into a target. Since then experts and policymakers have started taking sides with their optimistic and pessimistic opinions primarily influenced by their biases for and against the Modi government. In this entire discussion on achieving or failing to achieve $5 trillion GDP, it is important to consider the variables which will play an important role. Other than the dream or target that is set by the Modi government, what will decide its fulfillment is a set of variables like continuity in economic policy, government stability, controlled inflation, fiscal deficit and current account deficit, increase in domestic investment and export, credit availability for business and conducive tax environment.

Economic Factors

The International Monetary Fund (IMF) in July 2019 had cut India's real economic growth forecast from 7.5 to 7.2 percent for 2020-21, but it has restated that India's growth will remain very much above 7 percent, making it retain its record of fastest-growing economy in the world. From 2014-15 to 2019-20 India's GDP growth in nominal terms has been at an average growth rate of 8 percent. Assuming the same level of growth, along with the current level of inflation at around 3-4 percent and the foreign exchange rate around 70

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per Dollar Government is expecting the GDP growth rate in nominal terms from 2019-20 to 2024-25 to be around 11.5 percent (Union Budget, 2019). The *Economic Survey* 2018-19 states that the headline inflation based on consumer price index (CPI) has been declining constantly in the last five years, from 5.9 percent in 2014-15 to 3.4 percent in 2018-19. Controlled inflation has been an outcome of focused policy decision on the part of the government during the last five years. Managing supply, curbing hoarding and black marketing, targeted subsidy and regulated market economy are a few of the many measures taken by the Central and the State government to keep inflation in control. CPI at 4 percent was expected to significantly boost domestic demand. However, on the contrary, due to lower returns the Indian industry is underutilizing its capacity by nearly 25 percent. Low consumer inflation and high demand can only motivate the industry to increase capacity utilization in the future and contribute to a high economic growth rate. The Reserve Bank of India is responsive to the situation of low consumption demand and has been lowering the interest rates since 2018. The government too recently has ensured that the rate cuts are passed on to the customers by lowering housing and auto loans, to begin with. These measures before the start of the festival season should push consumer demand on the higher side.

Another vital economic variable that is in favor of both the ruling government and the economy at large is the controlled fiscal deficit (Business Standard, 2019). The relationship between fiscal deficit and economic growth is very interesting and complex. To a large extent for a developing economy, it is advisable to maintain a certain amount of fiscal deficit through government borrowing to infuse additional investment in the economy. The investment made through borrowing should be in infrastructure and other capital heads. This will complement the domestic investment and increase production and growth in the long run. However, a rising fiscal deficit beyond acceptable limits will negatively affect GDP, as payment of interest in the coming years will drain out the resources which could have been invested in a more productive use. Also, a higher fiscal deficit will result in a fall of gross domestic savings and investment in the country further pulling down economic growth rate. In India, the Fiscal Responsibility and Budget Management Act (FRBM) 2003 enforced the government to maintain fiscal deficit around 3 percent of GDP. In the last few years, the Modi government has been successful in bringing down fiscal deficit from over 4 percent in 2014-15 to around 3.4 percent in 2018-19. This is commendable as the expenditure on capital

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account has increased. Higher tax collections have helped the government to borrow less and invest more. For the current financial year, the 2019-20 government has kept a target of 3.3 percent. With a gradual reduction of 0.1 percent per year, it will be possible to achieve the FRBM target of 3 percent in the next few years. This will increase India's credibility in global markets and attract higher FDI's and other investments into the country. All this will considerably contribute towards higher economic growth of 11 percent per annum.

Similar to the fiscal deficit, the current account deficit is also an indicator that shows the economic stability of an economy. At 2.1 percent of GDP, India's Current Account Deficit (CAD) for 2018-19 is highest since 2013-14. In the last five years government was successful in keeping CAD in acceptable limits. CAD indicates the difference between the inflow and outflow of foreign exchange. An important reason for higher CAD is the widening of the trade deficit. In the last few years, India's exports have fallen due to lower industrial output and a shift in global demand from India and China towards other smaller economies in Asia. Also, higher crude oil prices have continued to keep import bill on the higher side. However, CAD is still considered to be in the limits indicating the government's ability to manage its balances in the current account of the balance of payments. At $400 billion-plus, India is 8th largest in terms of foreign exchange reserves which provides adequate protection to sustain a marginal increase in CAD. But if not controlled well, CAD is a big threat to economic growth. Higher CAD will put pressure on dollar-rupee rates. A depreciation of Rupee will pull down the country's prospects of a higher nominal economic growth rate. Already a 3 percent fall in Rupee in the last few quarters has forced the Indian economy to slip from 5th to 7th position in the World GDP ranking 2018. After the US, China, Japan, and Germany at the top four positions, UK and France have moved up the ladder at fifth and sixth positions respectively. While India's GDP in nominal terms slipped from $2.8 trillion to $2.72 trillion due to a weak Rupee against dollar. Depreciation of Rupee means increasing demand for foreign exchange within the country. This will put pressure on the import bill leading to a rise in CAD and also inflation. Both are negative factors for economic growth. For a $5 trillion GDP, it is least required to keep Dollar – Rupee rates at 69-70 till 2024-25. A breach upward i.e. above 70 per Dollar will dampen India's dream of becoming the 3rd largest economy in the World.

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On the domestic front, the government needs to do a lot for raising sentiments of investors to remain committed to Indian markets. This is one area where not much progress has been done in the last few years. Investment as a percentage of GDP accounted for only 29.8 percent in March 2019. From 2004 to 2011 this rate was over 36 percent of GDP (RBI, 2013). A lower investment rate has pulled India's economic growth downwards in the last few years. The government was hoping to fill the deficit created by domestic investment from higher Foreign Direct Investment (FDI) and to a large extent it was successful. FDI to India increased from $45 billion in 2014-15 to a record high of $64 billion in 2018-19, with an aggregated FDI inflow of worth $286 billion in the last five years. High FDI not only balances falling domestic investment but also create the necessary supply of foreign exchange in the country and help in stabilization of foreign exchange rate. However, given India’s increasing economic growth rate to over 11%, the inflow of FDI should not be considered just as a secondary source of investment. It is imperative to attract higher FDI over and above to high domestic investment.

Political Factors

Never in the history of India is the ruling government at the center so comfortable in its position to take bold steps. With a full majority in the lower house of the Parliament and with support from a few opposition parties in the upper house, the ruling government can take all measures required to make India's GDP jump up several points in the next five years. The government today also has support from international markets and political leadership. These factors can be used for increasing investment in India in a host of sectors like civil aviation, automobile, infrastructure, and agriculture. The central government led by India's largest political party is also ruling in over 20 states in the rest of the country. This makes it convenient for the central government to get its policies and intent executed well across the country through the state governments making a way for achieving a unified target of $5 trillion.

Challenges and Conclusion

The comfort on the economic and political front does not come without challenges. Major challenges in achieving a $5 trillion GDP dream are in the form of socio-economic and international factors. It is going to be a real challenge for the government to ensure that the

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sentiment and confidence of people remain high and positive for a long period. Another major challenge is to protect the Indian economy from a demographic disaster. The signs of which are already visible in terms of widening gaps between education and industry. Lack of skilled workforce and rising unemployment will derail the progress towards $5 trillion GDP. Simultaneously, India needs to strengthen its foreign policy, especially concerning trade and commerce with the US and other economies to ensure export demand remains intact and rising. Inward foreign investment alone cannot make India a high GDP economy. It is important to focus on meeting international standards for expanding exports. Another international challenge is to ensure that the supply of crude to India remains available from alternative sources and at a reasonable price. Any disturbance in these international factors will affect the Foreign exchange rate on the higher side and thereby pull down India's economic growth rate.

The current economic growth rate of 5 percent in the first quarter of 2019-20 creates a reasonable doubt on the economy's capacity to achieve an above 11 percent nominal growth rate for the current financial year. It is high time the Government will have to take necessary actions to boost demand and investment at the same time. But in the process Government should not come under the pressure from industry and compromise on the structural reforms in the area of taxation, meeting compliances, ease of doing business, attracting foreign investment and others taken during the last five years.

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