India's GDP Growth: Challenges and Opportunities

This editorial is based on **"An unfolding economic tragedy"** which was published in The Hindu on 30/10/2023. It argues that India is facing a severe economic downturn due to the Covid-19 pandemic, the mismanagement of the government, and the lack of structural reforms.

For Prelims: Gross Domestic Product (GDP), Global financial crisis of 2007-08, Appreciation of rupee, GST, Corporate tax cuts, Insolvency and bankruptcy code, Production-linked incentive scheme, National infrastructure pipeline , Labour code

For Mains: India's growth trajectory, Reasons behind Decline in Growth Rate in Past Years, Positive Factors that Can Help India Recover from the Slump, Way Forward to make India's Growth Rate more Robust

The National Statistics Office (NSO) announced in late August, 2023 that India's Gross Domestic Product (GDP) had surged in the April-June quarter, showing an impressive annual growth rate of 7.8%. This remarkable economic performance prompted widespread excitement and enthusiasm, as it reaffirmed India's status as the fastest-growing major economy in the world.

What has been the Growth Trajectory in the Past?

- **Mid-2000s:** Indian GDP **grew at an annual 9% rate in the mid-2000s** as historically high world trade growth lifted all economies.
  - A financial sector-real estate-construction bubble added froth to that growth which was unsustainable.
  - Growth **slowed** to 6% after the global financial crisis of 2007-08 as world trade decelerated quickly.
- **2012-15:** By 2012-13, GDP **growth had fallen to about 4.5%**, but growth for that year and the next three jumped courtesy of a data revision in January 2015 (The Government **started calculating GDP on market price** instead of factory price).
  - This change in methodology **increased the GDP growth rate in numbers but not in real.**
- **2016-2018**: The **slowdown resumed after the** demonetisation and GST rollout. And once the finance-real estate bubble collapsed following the IL&FS bankruptcy in 2018, **GDP growth came down** to 3.9% in the year before the pandemic.
- **Pre-Covid Years**: In fact, the pre-Covid growth was **more dire than the publicized estimate implies.**
  - Indian statistical authorities present income from production as their measure of GDP.
    - In principle, **expenditure on Indian products (by national residents and foreigners) should equal income** because producers earn incomes only when someone buys their wares.

            - But **expenditure grew at a mere 1.9%** in the pre-Covid year.
- **The Covid Years**: By that averaging method, **GDP grew by 2.9%** in the pandemic year.
    - The slowdown from the heady 9% GDP growth in the mid-2000s to 3%-4% before the pandemic reflected **severe weakness in demand.**
        - That **weakness manifested in the glaring drop in private corporate fixed investment** from a peak of 17% of GDP in 2007-8 to 11% in 2019-20.
        - Private corporations cut back investments, recognising that domestic consumers, fearful of job and earning prospects, had constrained purchasing power, and **foreigners had only a limited appetite for Indian goods.**
- **Post-Covid Years**: In the post-Covid-19 years, the **economy has bounced around. It fell sharply, recovered modestly, slowed severely**, and experienced a dead cat bounce from late-2022.
    - The only way to assess this bouncy post-Covid phase is by determining the average growth rate over the entire period.
    - Even that is not straightforward. If we consider the latest four quarters over the **four quarters before Covid, the annual growth rate (of the income and expenditure average) is 4.2%.**
    - If we **compare only the latest quarter over the quarter before Covid, the annual growth is just above 2%**.
    - The tell-tale sign of post-Covid demand weakness is the **further drop in private corporate investment to 10%** of GDP in 2021-22.
        - Analysts believe that it has remained anaemic in 2022-23.

What are the Primary Reasons behind Decline in Growth Rate in Past Years?

- **A Weak External Demand**: External demand is another important source of economic growth, as it reflects the competitiveness and integration of the economy with the world. However, India's exports to GDP ratio has been declining since 2013-14. The ratio was 25% in 2011-12 and declined to 18% by 2019-20.
    - This fall can be attributed to various reasons, such as a slowdown in global growth, appreciation of the rupee, loss of market share, and trade barriers.
- **Low Capital Investment:** India's **investment rate fell from 39.8% of GDP in 2010 to an estimated 29.3% in 2021**. This reflects a lack of confidence and demand in the economy, as well as structural bottlenecks such as land acquisition, environmental clearance, and credit availability.
- **Policy Uncertainty and Shocks:** The government has implemented several policy changes and reforms that have had mixed effects on the economy. Some of these include demonetization, GST, corporate tax cuts, insolvency and bankruptcy code.
    - While some of these may have long-term benefits, they also caused short-term disruptions and uncertainties for businesses and consumers.
- **Rising Inequality and Poverty**: India’s economic **growth has not been inclusive** or equitable. The income share of the top 10% of the population has increased from 31% in 1980 to 56% in 2016, while the share of the bottom 50% has fallen from 24% to 15%. The **poverty rate has also stagnated** at around 20% since 2011.
- **Poor Performance of the Manufacturing Sector**: Manufacturing is a vital sector for economic growth, as it contributes to value addition, exports, and employment. However, India’s manufacturing sector has been underperforming for the past decade, with its real gross value added (GVA) declining by about 3% in 2019-20.
    - This decline can be attributed to various reasons, such as demonetisation, GST implementation, global trade tensions, and lack of competitiveness.
- **A Decline in Consumption**: Consumption is another major component of GDP, as it reflects the purchasing power and living standards of the people. However, India’s consumption expenditure (as a share of GDP) has also fallen from 60.5% in 2019-20 to 57.5% in 2021-22.
    - This decline can be attributed to various reasons, such as low income growth, high inflation, rural distress, job losses, and reduced credit availability.
- **Reduced Savings:** To maintain consumption, households have slashed their savings rates to 5.1% of GDP, from 11.9% in 2019-20. Those eligible for credit cards are racking up worrying levels of debt.

What are the Positive Factors that Can Help India Recover from the Slump?

- **A Large and Young Population**: According to reports, India has a **population of over 1.4 billion people, with more than 40% below the age of 25.** This provides a huge demographic dividend for economic growth, as it implies a large and growing workforce and consumer base.
    - However, this also **requires adequate investment in human capital development**, such as education, health, and skills.
- **A Resilient and Diversified Economy**: India has a diversified economy that spans across various sectors and regions. This provides a cushion against sector-specific or region-specific shocks and helps maintain macroeconomic stability.
    - Moreover, India has **shown resilience in coping with various crises** in the past, such as the **global financial crisis of 2007-08** and the **Covid-19 pandemi**c of 2020-21.
- **A Reform-Oriented and Proactive Government**: The Indian government is committed to pursuing reforms and policies that can enhance economic growth and development.
    - Some of the recent initiatives taken by the government include the Atmanirbhar Bharat package, the production-linked incentive scheme, the national infrastructure pipeline and the labour code bills.
        - However, these initiatives also require effective implementation and coordination among various stakeholders.

What more needs to be done to make India's Growth Rate more Robust?

- **Boosting Investment and Consumption**: These are the two main drivers of domestic demand, which **accounts for about 70% of India's GDP.**
    - To increase investment, the government can continue to implement reforms that reduce policy uncertainty, regulatory hurdles, interest rates, and bad loans.
    - To increase consumption, the government can **support income growth, inflation control, rural development, job creation, and credit availability.**
- **Enhancing Manufacturing and Exports**: These are the key sources of value addition, employment, and external demand, which can help India diversify its economy and integrate with the global market.
    - To improve manufacturing and exports, the government can continue to implement initiatives such as the Atmanirbhar Bharat package, the production-linked incentive scheme, and the national infrastructure pipeline.
    - The government can also address issues such as currency appreciation, market share loss, and trade barriers.
- **Investing in human capital and social services**: These are the essential factors for improving the living standards and productivity of India's large and young population.
    - To invest in human capital and social services, the government can continue to implement programs that enhance education, health, skills, nutrition, water, sanitation, energy, housing, and healthcare.
    - The government can also ensure that these programs reach the people who actually need them and are delivered efficiently.
- **Maintaining Macroeconomic Stability and Resilience**: These are the necessary conditions for sustaining economic growth and coping with various shocks and uncertainties.
    - To maintain macroeconomic stability and resilience, the government can continue to pursue prudent fiscal and monetary policies that balance growth and inflation objectives.

Drishti Mains Question:

India's economic growth has witnessed significant fluctuations in recent years. Analyze the key factors responsible for the decline in GDP growth rates and the measures that the Indian government should undertake to rejuvenate the economy.

UPSC Civil Services Examination, Previous Year Questions (PYQs)

Prelims:

Q. Increase in absolute and per capita real GNP do not connote a higher level of economic development, if: (2018)

(a) Industrial output fails to keep pace with agricultural output.
(b) Agricultural output fails to keep pace with industrial output.
(c) Poverty and unemployment increase.
(d) Imports grow faster than exports.

Ans: (c)

Q. In a given year in India, official poverty lines are higher in some States than in others because: (2019)

(a) Poverty rates vary from State to State
(b) Price levels vary from State to State
(c) Gross State Product varies from State to State
(d) Quality of public distribution varies from State to State

Ans: (b)

Mains

Q1. Define potential GDP and explain its determinants. What are the factors that have been inhibiting India from realizing its potential GDP? **(2020)**

Q2. Explain the difference between computing methodology of India's Gross Domestic Product (GDP) before the year 2015 and after the year 2015. **(2021)**