A giants' advance

Nirupama Soundararajan asks if the $5 trillion economy target is meaningful, and argues that India's growth should be in alignment with the SDG goals

In July 2019, during the Budget Speech, the Finance Minister stated confidently that India would become a USD 5 trillion economy by 2025. In FY 2019 the size of the Indian economy, in nominal terms, was pegged at USD 2.7 trillion.

A basic back of the envelope calculation will reveal that, in nominal terms, a USD 5 trillion target would not have been insurmountable had India's gross domestic product (GDP) continued to grow at 6-7 per cent.

However, India's growth rate for the second quarter has slowed down to 4.5 per cent. This only means that the USD 5 trillion target would maybe take slightly longer to reach.

Before India addresses the how of reaching this target, it is important to take a step back and examine if this is a meaningful target to pursue. Nominal GDP measures output at current prices, while real GDP measures output at constant prices.

This is why economists are always more concerned with real GDP. For India to become a USD 5 trillion economy, in real terms, growth rates will have to be as high as 9-10 per cent. Even then, India will reach the five trillion mark only by 2030. If India must chase a target, then this should be it.

The significance of being a five trillion economy, even in nominal terms, is not quite clear. For one, it allows India to enter an elite club of countries. India's economy today is about the same size of the United Kingdom. The United States of America and China are the only two economies to have economies significantly larger than five trillion.

To become the third largest economy in the world is a commendable achievement, but is that a sufficient achievement; clearly, the answer is no.

There are three pertinent data points that merit attention. First, India's GDP per capita is USD 2,306[1], a rank of 142 amongst 189 countries.

Second, India has had the most success in reducing extreme poverty the fastest. By 2022, the percentage of extreme poor to total population in India is expected to be only 3 per cent[2].

Third, over the last decade, as per the United Nations Development Program (UNDP) Multidimensional Index for 2019, India was able to reduce the number of people in poverty by half. In 2005-06, there were 640 million people in multidimensional poverty, which came down to approximately 350 million in 2016-17[3]. India is well on her way to meet the United Nation's first Sustainable Development Goal (SDG) target of no poverty by 2030.

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Interestingly, India's USD 5 trillion (real economy) aspiration will also loosely coincide with the SDG targets laid down for 2030. Even the India government has laid out that Ease of Doing Business (EoDB) and ease of living (EoL) as twin goals. The Prime Minister of India had also mentioned at a meeting with Indian industry in November 2018 that the ultimate aim of easing business practices is to ensure ease of living for citizens[4].

If improvement in EoDB is not carried out in tandem with improvements in EoL, then meaningful growth may not be achieved. Not only will India have to find new ways of stimulating growth, but also find ways of doing so that have a positive impact on the ordinary citizen.

India's economy has been fueled by the services sector. The 'normal' economic growth journey in one in which economies move from being agricultural to industrial and eventually to largely services. India's journey was different, in that it has leapfrogged from being primarily agrarian to a services economy.

As a result, the manufacturing sector, even those that were once upon a time globally competitive, have lost their sheen are woefully underperforming. Even so, India has always hoped that a fillip to the manufacturing sector is what will truly provide India that additional two per cent growth that could have taken India's GDP growth rate from 7 per cent to 9 per cent, or even a double digit growth rate. To say the least, this has been a disappointing ambition.

India needs a shift in strategy to stimulate growth. The current slowdown has become somewhat of a temporary impediment to the USD 5 trillion target. To achieve this target, India must adopt a two-step approach. Step one would be bring India's growth rate from its current 4.5 per cent to at least a respectable 6.5 per cent. Step two would be to identify sectors that would help boost growth further to an 8.5-9 per cent, an addition of another 2 per cent growth.

As step one, for India to go back to previous levels of growth, India must focus on reforms in the financial sector. While some may argue that the cause of the slowdown in cyclical, the truth is that investments have slowed down, and this is because credit offtake has slowed down.

In 2018, the Infrastructure Leasing & Finance Services (IL&FS) Limited, one of India's premier long term infrastructure lending companies, defaulted on payments, which only compounded to the existing weakness in the financial system due to mounting non-performing assets (NPAs) in the banking sector. It was the non-banking financial companies (NBFCs) that managed to keep the credit flow alive, especially to the smaller companies, since bank credit had slowed down.

However, the default of IL&FS did created enough panic in the market that all refinancing lines to NBFCs, which were also provided by banks, also closed. The contagion of IL&FS spread and affected one of the largest NBFCs – DHFL, a housing finance company, so much so that they had to file for insolvency recently.

The crisis in the financial sector is not just about inadequate regulations, but that of trust. When deposit taking entities file for insolvency, it affects the retail sentiment. Almost too quickly in succession to DHFL came the failure of Punjab and Maharashtra Cooperative (PMC) Bank that led to a further deterioration in trust.

When retail investors and the industry lose trust in the financial sector, and the financial sector considers every lending proposition to be particularly risky (once bitten twice shy), the economy is bound to slow down.

India must work on setting the financial sector in order and on recreating an ecosystem of trust for recovery to begin in any meaningful manner. Step one in itself is a formidable task, but one that can be persevered through with targeted policy measures and regular communication.

Even as India inches upwards to reach earlier growth rates, policymakers will have to identify new sectors that can push growth. While employment in agriculture has gone down steadily over the past five years from 46.6 per cent in 2013 to 43.8 per cent in 2018[5], it still accounts for a large portion of India's total employment.

Even so, agriculture contributes the least to India's GDP and still remains heavily dependent on the vagaries of the monsoons. Even though successive governments have done their best to bring in reforms to step up agriculture's contribution to the economy, they have not been particularly successful.

However, because a large population is still dependent on agriculture, the government must focus on maintaining the current contribution. Hopefully, technology may reduce the number of people dependent on agriculture, while hopefully driving up farmer income and agricultural contribution.

The biggest change that is required for agriculture is a change in perception. Agriculture has always been viewed as a laggard sector. Agriculture must be treated as a business, like any other sector. This may yield better results.

India is no longer globally competitive in the manufacturing sector. It is probably time for us to accept that India may never gain ground on that front again. Even though it is the second highest contributor to India's growth, the rate of contribution has fallen.

India will have to step away from mainstream manufacturing sectors and focus on those that will unleash value, and construction is one such sector. It contributes nearly 8 per cent of India's GDP and employs nearly 50 million people. Construction can be divided into three segments - residential, commercial and infrastructure. The infrastructure segment is further divided into public and industrial construction.

Public infrastructure includes roads, railways, airports, irrigation, waterways, hospitals, schools and ports. Industrial construction mainly consists of oil and gas refineries, power sector, telecommunications and other industrial assets.

Given the slowdown in credit, constructing industrial infrastructure or even airports and roads may be challenge, due to long gestation periods and sometimes even regulatory uncertainty, but what presents an opportunity is for India to focus on constructing public infrastructure that are schools and hospitals.

These kind do not have as long a gestation period as infrastructure projects, returns would appear sooner, and they are in line with the SDG requirements as well. Construction also has strong interlinkages to core sectors such as steel and cement and will indirectly help the latter sectors grow, even if at only a reasonable rate.

Traditional sectors that have driven the services sector for India, like information technology, have plateaued. The champion sector for services will be tourism. India has been underestimating the contribution that the tourism sector can make to the country's economy, to employment, and to growth.

Along with the construction sector, it also employs close to 8 million people across the value chain. Like the World Bank's Ease of Doing Business indicators, there also exists a Travel and Tourism Competitive Index (TTCI), in which India is ranked 40 out of 136 countries. Ironically, for specific indicators such as tourism infrastructure, and for prioritizing tourism as an important sector, India ranks 110 and 104 respectively.

This indicates how India seems to have overlooked tourism as an economically viable sector. This must be set right immediately!

For what reasons may be, the USD 5 trillion seems to be an important milestone. It would be even more meaningful if it were in terms of real GDP rather than nominal. It would also be ideal if India's growth trajectory is in alignment with the SDG goals. Only when ease of doing business and ease of living come together will there be meaningful growth. India must shun what has been considered as 'normal' growth trajectory, and embrace the fact that India will be a service led economy.

Manufacturing sectors per se may not be globally competitive, but if the right service sectors are provided effective policy stimulus, the interlinkages, and domestic demand alone will ensure that core manufacturing sectors do well. For this, India must move away from what have been considered as traditional growth engines and focus on what will drive growth for the next decade. ■

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Endnotes

1. World Economic Outlook 2019, International Monetary Fund.

2. https://www.brookings.edu/blog/future-development/2018/12/13/rethinking-global-poverty-reduction-in-2019/

3. https://www.forbes.com/sites/niallmccarthy/2019/07/12/report-india-lifted-271-million-people-out-of-poverty-in-a-decade-infographic/#3daf667e2284

4. 'Ultimate aim of ease of doing business reforms is to improve lives: PM Modi', Subhayan Chakraborty, Business Standard, 20th November 2018. https://www.business-standard.com/article/economy-policy/ultimate-aim-of-ease-of-doing-business-reforms-is-to-improve-lives-pm-modi-118111901258_1.html

5. 'Employment in agriculture (% of total employment)', World Bank, 2018. https://data.worldbank.org/indicator/SL.AGR.EMPL.ZS?end=2018&locations=IN&start=2010