Calibrating a strategy for India’s future growth

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Context:

India’s growth in 2023-24 is currently projected by the Reserve Bank of India at 7% while the International Monetary Fund (IMF) and the World Bank have pegged it at 6.3%.

Introduction:

1. With a growth of 7.8% and 7.6% in the first two quarters of 2023-24, respectively, and a broad-based recovery in the second quarter, India is likely to realise the RBI’s currently projected growth of 7% in this fiscal year.
2. In the medium term, the IMF has projected an annual growth of 6.3% up to 2028-29. India’s future growth strategy needs to be calibrated in view of the changing global conditions.

Movement towards deglobalisation:

1. There is a movement towards deglobalisation. Many ongoing geopolitical conflicts such as the Russia-Ukraine war and the Israel-Hamas war have created a climate of sanctions, leading to breaks in supply chains as well as disruptions in international settlements due to non-access to systems such as SWIFT for the sanctioned countries.
2. World real GDP growth has also fallen, leading to reduced demand for global exports. Many countries including India want to reduce their dependence on imported petroleum due to supply uncertainties and price volatility.
3. In India’s case, exports experienced a sharp acceleration in the share of GDP during 2003-04 to 2008-09. This peaked at 25% in 2013-14. In 2022-23, it was 22.8%, having fallen to a trough of 18.7% in 2019-20 and 2020-21. The erstwhile export-led growth strategy may not be available to India anymore. It must evolve its own future growth strategy.

Investment rate in medium term: Importance of savings:

1. India will have to rely relatively more on domestic growth drivers. To achieve and sustain a 7% plus real growth in particular, domestic savings will be critical. We estimate the nominal saving rate in 2022-23 to be about 29%.
2. One area of concern relates to the recently noted fall in the household sector’s savings in financial assets which declined to 5.1% of GDP in 2022-23 from an average of 7.8% during the pre-COVID-19 period of 2015-16 to 2019-20 — a fall of 2.7% points.
3. This fall consisted of 2.2% points of increase in change in gross household financial liabilities and 0.5% points fall in change in gross household financial assets. These changes may be temporary post-COVID-19 responses.
4. However, if these trends persist, it will pose a significant risk to India’s growth potential since it is the surplus household sector financial savings that become available to the

government and the corporate sector to draw resources from to meet their investment demand in excess of their own savings.
5. Savings are converted into gross fixed capital formation (GFCF) by adding net capital inflows and deducting change in stocks, valuables, and discrepancies. The estimated nominal investment rate, that is GFCF relative to GDP was 29.2% in 2022-23.
6. However, the deflator of capital goods is lower than that of all goods. The movement of the relative deflator of capital goods is somewhat volatile. Using the five-year average of the relative magnitude of the two deflators, the nominal investment rate of nearly 29% would provide a real investment rate of about 33%.
7. This needs to be increased by 2% points to provide investible resources amounting to 35% of GDP, enabling a growth of 7% at an Incremental Capital-Output Ratio (ICOR) of 5, which was its value in 2022-23. If the ICOR is lower, achievable growth would be higher.

Strategizing enhanced employment:

1. India would find itself in a unique position in the next three decades with a large potentially employable population seeking jobs in the presence of progressively more labour-saving innovations and technologies.
2. According to United Nations population projections, the share of India's working age population is projected to peak at 68.9% in 2030 while its overall dependency ratio would be at its lowest at 31.2%. These patterns call for increased allocation of resources for training and skilling India's growing working age population.
3. Employment growth is critically dependent on GDP growth and the structure of output. The growth rate of the working age population is projected to progressively fall from 1.2% in 2023-24 to 0% in 2048-49.
4. In 2022-23, according to the Periodic Labour Force Survey (PLFS), the worker population ratio, showing the number of employed persons in the population above 15 years of age, increased to 51.8% from 44.1% in 2017-18, depicting an average increase of 1.5% points per year.
5. Going forward, non-agricultural growth will have to be high enough to absorb labour released from agriculture which is estimated at 45.8% in 2022-23 by the PLFS.
6. It should also be able to absorb the labour-substituting impact of new technology. Facilitating absorption of productivity-enhancing technologies including Artificial Intelligence (AI) and Generative AI would add to overall growth.

Environment angle:

1. India has committed to certain targets to reduce carbon emissions in view of global climate concerns. In the COP26 Summit, in 2021, India had committed to reducing total carbon emissions by one billion tonnes between 2021 to 2030 and achieving the target of net zero emissions by 2070.
2. India's own initiatives include the Green Grids Initiative (GGI) and One Sun One World One Grid (OSOWOG). It is also placing an emphasis on the use of electric vehicles and ethanol-based and hydrogen fuels.
3. Climate-promoting technological changes may reduce the potential growth rate. This adverse impact can be minimised by emphasising service sector growth which is relatively climate friendly.

Fiscal responsibility:

1. To sustain growth close to its potential, it is important to ensure that the combined fiscal deficit and debt to GDP ratios are brought down to 6% and 60%, respectively, so that the

burden of interest payments relative to revenue receipts is kept within acceptable limits.
2. This would enable achieving a balance or surplus on the revenue account of the central and State governments, which in turn would reduce government dissavings and augment the overall savings rate of the economy.

Way forward:

In the next two years, a growth rate of 6.5% seems feasible. This represents, partially, a recovery from the low growth rate in the COVID-19 period.
Over the medium term, India's growth performance will be adversely affected by many factors, both domestic and external.
Raising the savings and investment rates, improving the skill acquisition of the young entrants to the labour market and adopting a technology mix which is employment friendly are issues on which the country must focus to achieve a growth rate of 7% to 7.5%