INDIA'S DREAM RUN $10 TRILLION ECONOMY

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Abstract : This paper documents the recent slowdown in investment in India and explores its underlying causes. The analysis suggests that interest rates, uncertainty and deteriorating business confidence have played a key role in the recent investment slowdown. The paper also suggests reforms to achieve 7% GDP Growth and target lifting India's GDP to 10 trillion economy in the next decade.

Key words: India's Dream , recent slowdown , global economy.

I.INTRODUCTION

India's remarkable economic growth in recent years has made it one of the fastest growing economies in the world. From the world's 50th ranked economy in nominal US dollars to the 11th largest in 2011. Along with growing incomes India's increasingly outward orientation makes it an important players in the global economy, and the optimism about India's economy in recent years has led to a surge in international investors' interest. Further, growth acceleration since 2003 has shifted the debate from a concern about the ability to sustain an annual growth rate of 6% to the prospects for increasing this growth rate to 8% and higher. This optimism about high growth has not been dented by the on set of the global financial crises India recovered remarkably well with only a transitory down turn in the growth path in 2008-09. Of late, a spate of corruption scandals and inflation have caused concern, but no one yet is predicting a sharp downturn in growth. In 2014 India ranked at the 11th largest in the world in nominal US dollars. With respect to purchasing power parity, India has the fourth largest economy in the world after the United States, China and Japan.

II – WHAT CAUSED THE INVESTMENT SLOWDOWN?

The investment slowdown has sparked an intense debate in India about is contributing factors, particularly whether a rise in interest rates is the dominant factor. However, a study by the Reserve Bank of India (RBI) concluded that interest rates are only partly responsible for the current weak level of investments (RBI,2013). According to the study, a monetary tightening (375 basis points between early 2010 and late 2011) is only one of several factors that has dampened economic growth, and alone cannot explain the current investment slowdown. Furthermore, the RBI report suggests that the real lending interest rate was about 300 basis points lower than the average during the high investment growth period of 2003/04-2007-08.

Tokuoka (2012) finds that high and volatile inflation and heightened global uncertainty may have contributed significantly to the slowdown in corporate investment. While monetary easing since the GFC supported corporate investment monetary tightening since early 2010 may have hurt corporate investments only marginally. Looking at the determinants of the decline in corporate investments only marginally. Looking at the determinants of the decline in corporate investment since the GFC in India, Tokuoka (2012) finds that structural factors, such as those related to the business environment, have an important role explaining corporate investment activity in India. He concludes that standard macroeconomic factors alone (growth interest rates, global growth, and global financial market volatility) fail to fully explain the recent investment deceleration. He further concludes that while the importance of structural factors in explaining the recent weakening of aggregate investment is not entirely clear, at the micro level, panel data analysis suggests that improving the business environment by reducing costs of doing business, deepening the financial system, and developing infrastructure, could stimulate corporate investment.

The IMF's (2013a) recent staff report on India argues that several causes of weaker growth seem to be of a supply – side nature. The following key factors are listed as possible contributors to the recent investment slowdown.

•Rising policy uncertainty. In particular, high profile tax policy decisions announced in the 2012/13 Budget have reduces foreign investors interest in India, While the increasing difficulty of obtaining land use and environmental permits have raised regulatory uncertainty for infrastructure and other large – scale projects.
•Delayed project approvals and implementation. As a reaction to high – profile governance scandals, project approvals, clearances, and implementation have slowed sharply.
•Supply bottlenecks are particularly pronounced in mining and power, with attendant consequences for the broader economy, especially manufacturing.

Measuring Economic Policy Uncertainty India's key structural problems due to supply side bottlenecks appear particularly challenging, given the limited space and scope for traditional monetary and fiscal policy tools to address them. It is not surprising, therefore, that traditional macroeconomic variables have not done well in explaining the recent growth slowdown (see for example an analyzing by JP Morgan, 2013).It has been argued that macroeconomic uncertainty brought about by limited monetary and fiscal policy space binding supply constraints and weak business confidence have played a crucial role in dragging economic outlook down.

III – POLICY REFORMS

We believe the path to sustained prosperity entails two broad sets of reforms. In the initial phase, the focus of policy measures needs to be sustaining 6.5-7% growth with moderate and stable inflation. Indeed, policymakers have been judiciously fixing the root causes for the slippage in GDP growth to 5%. Effectively reversing the distortions in the productivity dynamic.

First, Centre plus states combined fiscal deficit, which has been painfully reduced from the peak of 9.9% in 2008-09 to an estimated 6.5% of GDP in 2015-15, will need to be further reduced to 5% of GDP. Second, the government need s to ensure that its policies do not intervene in the labour market to ensure that wage growth matches productivity growth. We believe high rural wage growth of about 18% during 2009-13 was a key factor behind the spike in inflation to 10% in that period.

Third, real interest rates need to be maintained in a positive territory to anchor inflation expectations and also to check the rise in property prices. Finally, ensuring a smooth functioning of the executive branch, faster implementation and increased transparency of government policies for investment approvals is needed to revive investment.

As the effects of the reforms that are currently being implemented begin to feed through to the economy in terms of improved productivity and macro stability, the economy will be on track to transition back to 6.5% GDP growth in the next 18 months. The goal of 8% sustainable growth needs a 15 – year vision of medium term reforms some of which are perceived to be politically – sensitive.

The list of these measures is long, but the government should priorities. Indeed, the recent decisions taken by policymakers suggest that they are determined to accelerate the pace of implementation in each of these areas.

Since the implementation of the new Land Acquisition Act early last year, the process of land acquisition has come to a virtual standstill. To address this, in December 2014. The government promulgated an ordinance that exempted five key categories of project which includes infrastructure and public – private partnership (PPP) projects where landownership is with the government from consent and social impact assessment requirements. Converting this ordinance to a law will be a critical starting point for kick-starting the investment cycle.

In the area of labour laws, the government has made a series of important changes at a faster-than-expected pace. The most important step has been to reduce the discretionary powers of local labour inspectors, which has been a key bugbear of manufacturing companies.

Moreover, select states have taken the lead to increase the flexibility of labour market regulations. Going forward, the government is considering a complete overhaul of the 44 labour laws into five uniform codes, which we think can be a pathbreaking reform it it can get Opposition support in Parliament.

The goods and services tax (GST) is the single – biggest indirect tax reform that will bring about uniformity in taxation system and improve the competitiveness of the manufacturing sector. To this end, the government has successfully built a consensus among states and has introduced the GST Constitutional Bill in Parliament.

Parliament will likely take up this Bill for approval in the upcoming Budget session, with full implementation expected by April 16. On the infrastructure front, the government has moved to increase the FDI limit in railways, streamlined the process of reallocation of coal mines and approved some projects under the engineering, procurement and construction (EPC) route in the road sector. While these are steps in the right direction, the enormous infrastructure needs suggest that the government still needs to do a lot more.

More aggressive policy reforms are needed to revive infrastructure spending to around 8-9% necessary to reach the 8% GDP growth goal from the current estimated level of about 6%.

IV – CONCLUSION

Taken together, these important changes in the macro environment, when fully implemented, should have a lasting impact on boosting economic development in India, and will go some way in achieving the ambition of creating a $10 trillion economy by 2030.

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