Over the past 25 years, India has risen up the pecking order to become the world's fastest growing major economy. The third part of the series looks at the areas it needs to focus on to realise its $5 trillion ambition and be counted among the top three economies

How India, the 'bright spot', can continue to shine

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In 2000, India's gross domestic product (GDP) stood at around $468 billion. It would cross the $1 trillion mark only seven years later (in 2007), and it would be another seven years before it hit $2 trillion.

Fast forward to 2024. India is now the world's fifth-largest economy, with a GDP of $3.6 trillion. And, it aspires to become the third-largest economy, with a GDP of $5 trillion by 2027-2028 (FY28).

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India's 25-year journey, marked by landmark reforms such as the Insolvency and Bankruptcy Code, and the goods and services tax, and its resilience amidst the global financial crisis and the Covid pandemic, has placed the country among the world's fastest growing economies. Over these years, it has become a leading example of financial inclusion, propelled by the digitalisation of its economy. The UPI, for instance, has been a game changer, leading to what the G20 sherpa, Amitabh Kant, described as a "pole vault" in digital public infrastructure.

Reaching this point was no easy feat, and the journey wasn't always smooth.

Over this 25-year period, India faced the global financial crisis in 2008, followed by an audacious terror attack on its financial capital later that year. And then in 2016, about 86 per cent of the country's currency was demonetised – declared null and void overnight.

Despite these hurdles, there have been significant gains. The world is now looking at India with growing interest. The International Monetary Fund called it a bright spot in an otherwise gloomy global economy. However, if India is to maintain this momentum and achieve its goal of becoming a developed nation, much more needs to be done. Economists say that sustained GDP growth of 7 per cent or more is essential.

ILLUSTRATION: BINAY SINHA

At a recent summit, Chief Economic Advisor V Anantha Nageswaran said India must leverage all domestic growth drivers, especially as the global environment is far from conducive.

From addressing short-term challenges, like encouraging private capital investment and boosting consumer demand, to focusing on long-term goals such as improving human capital through investments in health and education, and preparing for climate change, economists have a long list of unfinished agenda for India as it enters 2025.

"If we are aspiring to be a $35 trillion economy, then we need growth of 7-8 per cent at a sustained level. We need structural changes," said Rajani Sinha, chief economist at rating agency CareEdge. "Some of those changes have happened. Now we need to push on social infrastructure." She is of the view that the country needs to invest in its people, otherwise the whole advantage of the demographic dividend will be lost.

Over 45 per cent of India's population is employed in agriculture, according to the Periodic Labour Force Survey (PLFS). Experts believe that with the share of agriculture in India's GDP declining, this workforce will need to be absorbed into agri-allied and other sectors, necessitating both job creation and skilling.

"Meeting the skill gap in the workforce will be critical to serving global demand. We need to give incentives to employees and employers," said Rumki Majumdar, economist at Deloitte India.

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Investment flows may be hit on higher trade restrictions

Beyond agriculture, the government is closely monitoring anecdotal reports of artificial intelligence (AI) displacing workers. Experts stress that skilling must take into account the fact that automation is here to stay.

In education, while enrolment was the major challenge in previous decades, experts say the current focus is on improving learning outcomes and the quality of education.

Linked to the employment challenge is the issue of slower wage growth, which leads to weak consumption demand. Economists cite this as one reason for the tepid growth in private capital expenditure.

At the summit, the CEA said that this trend could harm the corporate sector. Highlighting that fiscal incentives can only go so far in encouraging job creation, Nageswaran said, "Corporate entities have used their profits to deleverage. Now, it is time for a good combination of capital formation and employment growth as well." Without this, he said, there will not be enough demand in the economy for corporate entities' own products to be purchased.

Experts say the government must create an environment conducive to private capital expenditure and for the corporate sector to have the confidence to expand with the conviction that consumer demand would be strong.

"Consumption needs to grow on a sustainable basis. To continue growing, you have to implement strong reforms," Sinha said.

India's economic growth moderated to a seven-quarter low of 5.4 per cent in the second quarter of FY25. One of the reasons for this was weak consumption, besides subdued government spending, and adverse weather conditions.

Protectionism & China challenge

With trade restrictions becoming more common, and likely to intensify under the new government in the United States, economists in the government believe that investment flows to India could be affected.

As India seeks to integrate into the global supply chain and capitalise on the China Plus One strategy, it will need to upgrade its manufacturing capabilities. But first, it must address the challenge of integrating China into its supply chain. The CEA pointed out that countries that had increased their exports to the US had also increased their imports from China.

"India's imports of intermediate goods have risen over the past few years," said Tanvee Gupta Jain, chief economist, UBS Securities India. "The government needs to balance integrating China into its supply chain, given India's widening goods trade deficit with China, while also promoting FDI from China to benefit from the China Plus One strategy."

Finance Minister Nirmala Sitharaman had also pointed out that countries need to blend economic priorities with political and strategic needs in the context of global supply chains.

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The impact of trade barriers on India's services sector, however, has been less severe.

"Our focus on the services sector has paid off," Sinha said. "We took a different path by moving from agriculture to services, skipping the industrial phase, and it has worked to our advantage."

Capex push

Sitharaman recently said that the multiplier effect of capital expenditure is far greater than the multiplier effect of simply putting money into people's pockets.

Experts echo the merits of this approach.

"We expect the government to stay on the fiscal consolidation path, but the focus on capital expenditure must continue," said Gupta Jain. "Infrastructure spending in India is currently around 7 per cent of GDP. It needs to increase by 100 to 200 basis points for the next leg of growth."

According to an EY report, for India to maintain a growth rate of 7 per cent or more, general government total expenditure needs to rise to 35 per cent of GDP, up from its current level of 29.1 per cent (FY24). General government primary expenditure, currently at 23.8 per cent of GDP, should reach 31.4 per cent to align with developed economy standards, the report said.

"Fiscal consolidation will play a crucial role, with the general government fiscal deficit needing to drop from 8.4 per cent in FY24 to 6 per cent by FY31," said DK Srivastava, chief policy advisor, EY India. "India's aspiration to become a developed economy hinges on maintaining robust growth while addressing fiscal challenges."

If it is to realise its goal, India – the "bright spot" in the global economy – will need a 360-degree approach.