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Assessing the Recent Indian Economic Growth (/journal/2022/34/commentary/assessing-recent-indian-economic-growth.html)

Although the headline growth in 2021–22 and the projections for 2022–23 following the disastrous COVID-19 pandemic are impressive, indeed the highest among major economies, this is not the hoped-for V-shaped recovery as the output loss is far from being recouped. India's output loss is among the highest in major G20 economies. It may be difficult for the Indian economy to sustain an average growth above 5% in a business-as-usual scenario because its potential growth has declined through hysteresis, and it faces several headwinds going forward.

Following the sharp decline of -6.6% in real growth in 2020–21, the Central Statistics Office (CSO) has provisionally estimated that the headline growth in 2021–22 would recover smartly to 8.9%.¹ Further, in its April 2022 World Economic Outlook (WEO), the International Monetary Fund (IMF) projects that India would grow at 8.2% in 2022–23 and by 6.9% in 2023–24.² (For comparison with other countries, the IMF's growth estimates for India during 2022 and 2023 are 8.9% and 5.2%, respectively.) The IMF expects India to be the fastest growing major economy during both these years. Is this the much-talked-about V-shaped recovery that has at long last put the faltering Indian economy back on track?

While there also appears to be a strong bounce back in headline growth, revenue, and exports over the near term, it is a challenge for economists to interpret the headline numbers and assess the recovery on account of three separate base effects. There was, first, a declining growth trend prior to the COVID-19 pandemic that saw the annual growth fall serially from 8.2% in 2016–17 to 7.1% in 2017–18, 6.3% in 2018–19, and to 3.7% in 2019–20. Second, this was followed by the precipitous fall of -6.6% in 2020–21 on account of the pandemic when the economy reeled under the twin shocks of a sudden and stringent lockdown during the first phase of COVID-19, followed by a disastrous second wave. Third, interpreting the growth rates in some economic indicators in Table 2 (p 19) for 2021–22 cannot be taken at face value as these are distorted by high levels of underlying price inflation.

Table 2: Average Annualised Growth, 2019–20, 2020–21 and 2021–22

Indicator	2018–19	2019–20	2020–21	2021–22	AG
Rice production	100	100.7	103.922	110.573	3.5
Production of coal	100	99.6	97.7	106.0	2.0
Production of crude oil	100	94.1	89.2	86.9	-4.4
Production of cement	100	99.1	88.4	106.8	2.3
Consumption of steel	100	98.5	93.3	103.6	1.2
Sales of commercial vehicles	100	71.2	56.4	71.1	-9.6
Purchase of private vehicles	100	82.2	72.6	67.3	-10.9
Cargo handled at major ports	100	100.9	96.3	103.2	1.1
Cargo handled at airports	100	91	69.2	89.1	-3.6
Passengers handled at airports	100	98.9	33.4	54.7	-15.1
Railways net tonne kms	100	95.5	96.6	116.8	5.6
Railways passenger kms	100	90	19.8	51.1	-16.3
Exports of goods and services	100	99.2	97.6	133.4	11.1
Index of Industrial Production mining	100	101.6	93.7	105.1	1.7
IIP manufacturing	100	98.6	89.1	104.3	1.4
IIP electricity	100	100.9	100.4	108.4	2.8
IIP metallic minerals	100	113.9	94.9	118.3	6.1
Combined tax collection	100	98.6	96.9	116.8	5.6
Real GDP	100	103.8	97	105.7	1.9

Source: CSO (various press notes), RBI (2022).

Measuring Output Loss

When the second base effect is factored in, the gross domestic product (GDP) numbers show that in real terms India's GDP is 5.7% higher in 2021–22 than what it was in 2018–19, yielding an average annualised growth of 1.9% over the three-year period. A V-shaped recovery is usually defined as one that fully recoups the output lost during a downturn in the economy. The IMF's latest projections for the Indian economy translate into an output loss of 6.7% of the GDP up to the financial year 2022–23 and 4.9% up to 2023–24 using the average growth rate of the two years preceding the COVID-19 pandemic (that is, 2018–19 and 2019–20) baseline as the trend or potential growth rate. The World Bank's (2022) estimates of 8% and 7.1%, respectively, point to a similar output loss. On the contrary, the Organisation for Economic Co-operation and Development's more recent estimates of 6.9% and 6.2% would translate into a significantly higher output loss.³

Calculations of output loss are sensitive to the potential or trend growth estimate used. This is an unobserved moving target and therefore difficult to determine. The baseline of 5.1% used above is a conservative one as it includes 2019–20 when growth (3.7%) was well below the potential. India's average growth during the five years preceding the COVID-19 pandemic (2015–19) was 6.6%. If this is taken to be India's potential/trend GDP growth rate, the output loss as measured above comes to 13% and 12.6%, respectively. It is however widely believed that India's GDP growth was overestimated under the revised GDP series as this is not corroborated by a host of alternative indicators that are strongly correlated with growth (Sheel 2020). If the five-year average is lowered from 6.6% to 6%, the estimated permanent output loss comes down to 10.4% and 9.5%, which is still very high. How does India's output loss compare with other major G20 economies? While output loss is more accurately measured by working with the levels of GDP (which have been used in the above calculations) rather than GDP growth rates, the latter method is used in Table 1 (p 19) for the limited purpose of benchmarking the extent of output loss in G20

economies over four calendar years 2020–24. The average growth over the two preceding years, that is, 2018 and 2019, is used as the proxy for the potential/trend GDP. This table puts India in the top quartile of countries with the highest output loss.

Table 1: Output Loss in G20 Countries

Output Loss 2021–23 (2018 and 2019 Average Growth as Base)							
Country	2018	2019	2020	2021	2022	2023	Output Loss
Argentina	-2.6	-2.0	-9.9	10.2	4.0	3.0	16.6
Australia	2.8	2.0	-2.2	4.7	4.2	2.5	-0.4
Brazil	1.8	1.2	-3.9	4.6	0.8	1.4	-3.1
Canada	2.8	1.9	-5.2	4.6	3.9	2.8	-3.3
China	6.8	6.0	2.2	8.1	4.4	5.1	-5.6
France	1.8	1.8	-8.0	7.0	2.9	1.4	-4.1
Germany	1.1	1.1	-4.6	2.8	2.1	2.7	-1.2
India	6.5	3.7	-6.6	8.9	8.9	5.2	-3.9
Indonesia	5.2	5.0	-2.1	3.7	5.4	6.0	-7.4
Italy	0.9	0.5	-9.0	6.6	2.3	1.7	-1.3
Japan	0.6	-0.2	-4.5	1.6	2.4	2.3	1.1
Korea	2.9	2.2	-0.9	4.0	2.5	2.9	-1.7
Mexico	2.2	-0.2	-8.2	4.8	2.0	2.5	-2.9
Russia	2.8	2.2	-2.7	4.7	-8.5	-2.3	-18.8
Saudi Arabia	2.5	0.3	-4.1	3.2	7.6	3.6	4.7
South Africa	1.5	0.1	-6.4	4.9	1.9	1.4	-1.4
Turkey	3.0	0.9	1.8	11.0	2.7	3.0	10.8
United Kingdom	1.7	1.7	-9.3	7.4	3.7	1.2	-3.5
United States	2.9	2.3	-3.4	5.7	3.7	2.3	-2.2

Source: IMF database, <https://www.imf.org/en/Publications/WEO/weo-database/2022/April>.

The outsized loss in output and growth potential in recent years is also reflected in the measurements of economic activity that are strongly correlated to growth. While unemployment rates fluctuate on a monthly basis, as people keep falling out or entering the labour market, a more robust and durable medium- to long-term measure of employment trends is the labour force participation rate (LFPR). The Centre for Monitoring Indian Economy data show that this fell secularly from 47.7% in January 2016 to 41.9% in March 2020, at which point it fell sharply by over 500 basis points on account of the stringent COVID-19-related lockdown.⁴ While the LFPR recovered during the next two months, the rate has languished over 200 basis points below the pre-COVID-19 level and stood at 40.19% in April 2022. The number of employed has not risen in absolute terms since January 2016 even as the population and consequently the labour force have increased. Even more worrisome is the rising trend in youth unemployment (15–24 years) that rose sharply and continuously from 18.6% in 2008 to 24.9% in 2020.⁵ At over 30%, India along with South Africa currently has the highest percentage of youth who are neither employed nor in education or training among the G20 countries.⁶ This is almost twice the G20 average of 17.1 and also much higher than the BRICS (Brazil, Russia, India, China and South Africa) average of 25.6 and the global average of 23.4. Various economic activity indicators monitored by the CSO also show that except for rice production, the external sector and metallic minerals, and railway freight, the average annualised growth over the last three years (2019–20 to 2021–22) was below 3% per annum. Several indices are still to recover to the pre-pandemic levels. While comparing these growth rates with the GDP numbers, it must be kept in mind that unlike GDP, some of these indices, such as exports, are not adjusted for inflation.

Engines of Growth

The national income is estimated by the CSO by both the income and expenditure methods. An analysis of both trends can give us a good idea of the sources and engines of growth. The income method indicates that the agricultural sector weathered the pandemic well, growing at an average annualised rate twice that of the GDP; other sectors did not. Trade, hotels, and transport communications had an average annualised negative growth of -1.9%, as

these suffered the most from the COVID-19-related restrictions. Financial and real estate services and also public administration and defence continued to grow at over twice the GDP growth rate, but only a thin layer of elite at the top benefit directly from this (Table 3).

Table 3: Sources of Growth—Income Method (%)

	2018–19	2019–20	2020–21	2021–22	AG
Agri, forestry, fishing	100	104.3	107.7	111.0	3.7
Mining quarrying	100	97.5	89.1	94.0	-0.2
Manufacturing	100	97.6	97.0	106.6	2.2
Electricity, gas water other utilities	100	102.1	98.4	105.8	1.9
Construction	100	101.0	93.6	104.4	1.5
Trade, hotels, transport, communication	100	106.4	84.9	94.3	-1.9
Finance real estate professional services	100	107.3	109.7	114.3	4.8
Public administration and defence	100	108.3	102.3	115.2	5.1

Source: CSO (various press notes).

The expenditure method can tell us a lot about the engines of growth of the Indian economy. Over the last three years, the government expenditure has been the chief engine of growth, with its average annualised growth being twice that of the GDP. Private consumption, investment, and exports grew at roughly the rate of the economy as a whole. However, both investment and exports staged a smart recovery in 2021–22, but this was after several years of stagnation and decline that precede the COVID-19 pandemic, and the effect of high inflation over the near term needs to be factored in (Table 4, p 20).

Table 4: Engines of Growth—Expenditure Method (%)

	2018–19	2019–20	2020–21	2021–22	AG
GDP	100.0	103.8	97.0	105.7	1.9
PFE	100.0	104.8	98.5	106.0	2.0
GFE	100.0	103.9	107.6	112.8	4.3
GFCF	100.0	102.8	92.1	105.5	1.8
XGS	100.0	96.2	87.4	105.8	1.9

Source: CSO (various press notes).

Based on the average long-term trends and the averages that factor in base effects, the current upturn in growth is not V-shaped. Several years of declining growth appear to have reduced India’s growth potential through hysteresis. It may therefore be difficult for the Indian economy to grow at an average significantly above 5%—the average rate at which it grew during the two years preceding the COVID-19 pandemic—in the foreseeable future unless the green shoots visible in investment and exports in 2021–22 can be sustained and private consumption bounces back. Over the last three years, the fiscal policy shouldered the burden of sustaining growth on account of the declining private demand. But this came at a great fiscal cost, as the central government expenditure grew at three times the rate of growth of tax revenue. The fiscal consequence of this was that the centre’s fiscal deficit grew by an annualised average of 46% and its public debt by 16% during the last three years. This is unsustainable going forward from the macroeconomic perspective. The burden for growth would need to shift back quickly from the government to the private demand and government finance should be put back on track (Table 5).

Table 5: Fiscal Impact

	2018–19	2019–20	2020–21	2021–22	AG (%)
Net tax revenue	100	98	98	120	7
Total expenditure	100	116	149	164	21
Gross fiscal deficit	100	145%	282%	238%	46
Public debt	100	113%	132%	148%	16

Source: Controller General of Accounts (cga.nic.in).

If the current levels of high headline growth are the lagged effect of two successive years of low growth, the base - effect can work in the reverse direction as well. It might be difficult to sustain high headline growth following two - successive years (2021–22 as actual and 2022–23 as forecast) of outsized growth. Going forward, growth also faces headwinds from high oil prices and monetary policy tightening by the United States (US) Federal Reserve, worsening public finances, and stagflationary trends that have no monetary policy solution.

In Conclusion

The question that needs to be asked is, why is the Indian output loss so high relative to other major economies? India's potential growth was falling sharply in the pre-COVID-19 period. It grew at an average of 7.7% over 14 years between 2003–04 and 2016–17 as all three engines of growth, namely exports, investment, and consumption were firing. Its growth started to decline as the export and investment engines started stuttering. As a result, its annual growth fell serially and sharply from 8.3% in 2016–17 to 6.8% in 2017–18, 6.5% in 2018–19, and to 3.7% in 2019–20. The third engine, private consumption, also started stuttering over the last three years with the COVID-19 pandemic.

The declining trend prior to that is attributed by observers to the tardiness in addressing the long pending issue of stranded banking assets and policy missteps such as the demonetisation of the economy and a hastily implemented transition to a complex goods and service tax that had an adverse fallout on India's buoyant informal economy that accounts for a major share of economic activity, including both exports and investment. The decline in consumption is more recent. Beyond this, there is now some confusion in the minds of private corporate investors on the economic policy road map laid out in the early 1990s, following which the Indian economic growth moved into a higher gear. The absence of predictability, including reversals in the road map, and the perceptions that there is no longer a level playing field, may have sapped the animal spirits of the private investors. India has kept out of regional free trade agreements, and there is a lack of clarity on whether the Atmanirbhar Bharat Abhiyaan is meant to incentivise domestic production or as a return to self-reliant growth as both customs tariffs have increased and the share of exports in the economy has shrunk. The extraordinary decline in economic activity in 2020–21 is ascribed to the suddenness and stringency of the COVID-19-related lockdown in an economy overly dependent on the informal and the micro, small and medium enterprises sectors.

What has happened to the India story and what are its prospects going forward? The Indian economy sustained an average real growth of almost 8% for close to a decade and a half. The WEO projections continue to show India as the fastest growing major economy. Over the medium to long term, India's relative growth potential remains high. It has several inherent strengths, not the least of which are its economic size, its large domestic market, high savings, young population, a fast-growing middle class, cheap and abundant labour, strong private entrepreneurship, capacity

to absorb large investments in infrastructure, and well-known strengths in the sunrise information age and pharma-linked economic activities. India's investment needs are high in a demand-constrained world with a savings glut. With good economic management, it can be a major growth driver for the global economy.

While India's medium-term growth potential/trend has declined through hysteresis, its long-term prospects for raising the current growth remain intact and are waiting to be unlocked. The overall ease of doing business, low labour productivity, continuing large infrastructural gaps, addressing perceptions regarding governance and social order, and assurances of a level playing field also need to be addressed to the satisfaction of private investors. The return of animal spirits, and with it its private investment, can be considered as the proverbial canary in the gold mine that would herald the return to a high growth trajectory. The reversal of the US Fed monetary policy and the rising inflation and oil prices, a negative environment for exports and a weak fiscal position are likely to be the major challenges for the Indian policymakers going forward, apart from reassuring private investors about a stable and even-handed policy environment.

Notes

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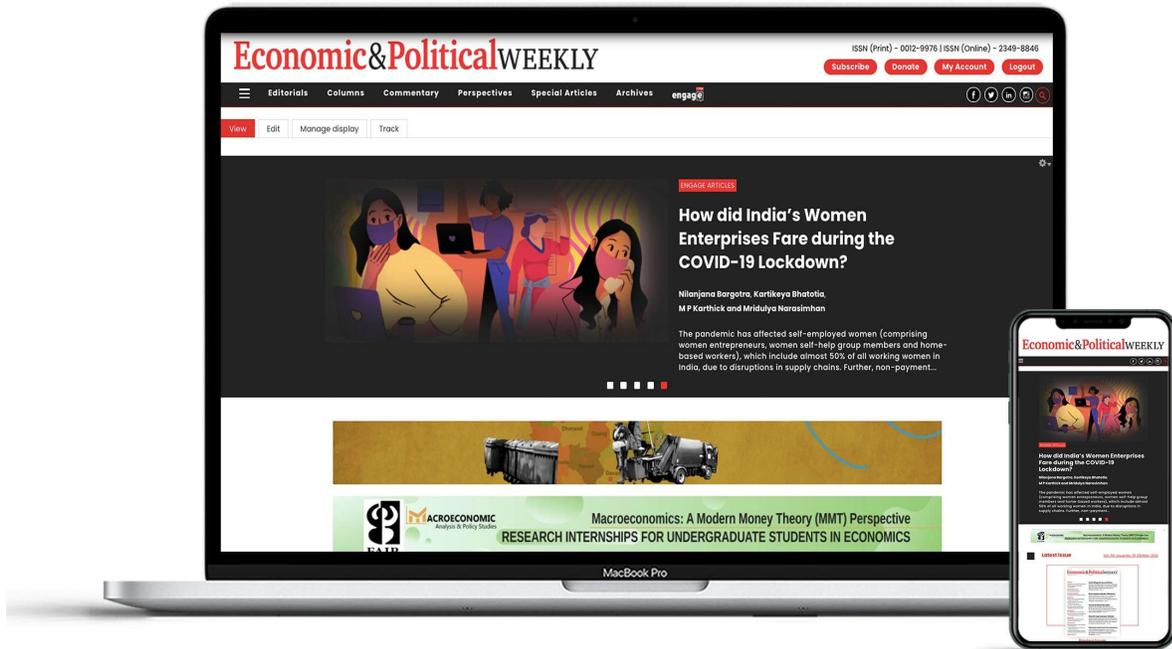
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