

CAN INDIA SUSTAIN ITS RISE?

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How quickly the narrative shifts. Only a year ago, India was in a celebratory mood. Growth was robust. Inflation was benign. The current account deficit was modest. Bank and corporate balance sheets were at their healthiest in over a decade. India had overtaken the United Kingdom to become the world's fifth-largest economy and seemed poised to surpass Japan. Armed with the tailwind from China+1, under which multinational companies diversify production beyond China, an Indian growth miracle appeared to be a tantalizing possibility.

Today, that buoyant confidence faces a stark reality check. A steep rise in oil prices triggered by conflict in the Middle East has exposed India's structural energy vulnerabilities. Growth momentum is cooling, inflationary pressures are reemerging, and the rupee faces persistent downward pressure. Capital outflows have weakened the external sector, private investment remains stubbornly stalled, and India has slipped to sixth place in the global GDP ranking.

Is this turbulence the result of a temporary external shock that will blow over once geopolitical tensions ease? Or is it a warning sign that India's celebrated Goldilocks moment was built on a shallower foundation than many assumed?

The answer carries global consequences. As multinational firms actively seek structural alternatives to China and advanced economies hunt for new growth engines, India remains uniquely positioned. It is the world's most populous nation, boasts an unmatched demographic profile, and represents the latest large emerging market capable of sustaining rapid growth for decades.

A promising growth story confronts structural constraints in jobs, productivity, and innovation

Goldilocks narrative

For sure, the Goldilocks narrative was not built on hype. During the postpandemic era, India achieved a rare trifecta: high growth, fiscal consolidation, and macroeconomic stability. Annual real GDP growth averaged roughly 7 percent, outpacing almost all major peers. Meanwhile, consumer price inflation was successfully anchored near the 5 percent mark—well within the Reserve Bank of India's target band—despite severe global supply shocks.

At the same time, the banking sector successfully resolved the twin balance sheet problem of the previous decade. Gross nonperforming assets plummeted from a peak of more than 11 percent to a multiyear low of less than 3 percent, and corporate leverage dropped significantly, restoring profitability. Concurrently, the government executed one of the most ambitious infrastructure drives in modern history. Capital expenditure as a share of GDP expanded rapidly across roads, railways, and logistics networks. Simultaneously, India's digital public infrastructure—anchored by Aadhaar, the Unified Payments Interface, and Direct Benefit Transfer—became a global model for scalable, low-cost digital finance.

For optimists, the conclusion seemed clear: India had discovered the holy grail of rapid growth without running into balance of payments or inflationary walls. Yet the current headwinds challenge that view. The question is not whether India has achieved monumental successes—it undeniably has. The real question is whether those successes are structurally sufficient to lift the economy onto a permanently higher, self-sustaining growth trajectory.

Three structural vulnerabilities stand out.

Missing private investment

The first is the missing private investment engine. Historically, every significant growth acceleration in modern India has been powered by a private investment boom. The high-growth era of the mid-2000s was driven largely by a massive surge in private corporate capital expenditure. Today, that vital ingredient is conspicuously absent. While India's overall investment rate has hovered around 33 percent of GDP—a level theoretically consistent with strong growth—the composition tells a different story. The bulk of recent growth is coming from public capital expenditure, while private corporate investment remains stuck at about 11 percent of GDP, far below its historical peak of nearly 17 percent in 2008.

This imbalance matters, because public spending can kick-start an economy, but it cannot sustain it indefinitely. Long-term noninflationary expansions depend on private businesses to

deploy capital to factories, proprietary technologies, and new supply chains.

The current gridlock represents a paradox: Corporate cash reserves are high, bank balance sheets are primed to lend, and physical infrastructure is vastly improved. Yet corporate boardrooms remain cautious.

The weakness is not uniform across the entire corporate sector. Investment has been concentrated in a handful of large business groups, renewable energy projects, telecommunications services, data centers, electronics assembly projects, and other sectors benefiting from government incentives. Much of the broader corporate sector, especially medium-sized manufacturing firms, remains hesitant.

Part of the problem is uncertainty about future demand and expected returns, and part of it is regulatory friction. Despite improvements in the ease of doing business, domestic firms still must navigate unpredictable policy shifts, compliance complexities, and an uneven playing field.

Capital investment is a long-term bet on the future; businesses will place those bets only when they have deep confidence in both long-term demand and the stability of the regulatory environment. Without a robust private investment cycle, sustaining growth rates above 7 percent over the next decade will be an uphill battle.

Jobs and productivity

The second concern is the jobs and productivity mismatch. The ultimate test of India's economic model is not the headline GDP growth rate, but whether

that growth generates productive employment for its massive workforce.

The structural disconnect between output and employment is widening. Agriculture contributes just about 15 percent of GDP, but it accounts for nearly half the total workforce. Meanwhile, manufacturing, responsible for about 13 percent of GDP, absorbs only about 11 percent of workers. At the other end of the spectrum, the high-value modern sector, including information technology, finance, and business services, generates roughly 15 percent of GDP while directly employing a minuscule 3 percent of the workforce.

This massive productivity gap between agriculture and the rest of the economy is one of the highest globally. Standard economic transitions—like those seen across East Asia—rely on migrating surplus low-productivity agricultural labor into labor-intensive manufacturing and modern services. This structural process elsewhere has created a broad-based middle class able to generate sustainable consumption-led domestic wealth.

India's trajectory has defied this norm. Although the country has produced globally dominant and highly productive service sectors, including IT and global capability centers, and has made strides in high-tech niches such as electronics assembly, mass manufacturing remains stagnant. Consequently, growth is heavily skewed toward high-productivity, capital-intensive sectors that require specialized skills but absorb relatively little raw labor. Output is expanding, but the creation of formal high-quality jobs is not keeping pace. For the millions of young people entering the labor market each year, the country's aggregate GDP growth rate matters far less than their access to a secure, upwardly mobile livelihood.

Where will jobs come from? India's answer increasingly points to manufacturing, backed by initiatives like "Make in India" and production-linked incentive programs. Skeptics argue that today's global environment—marked by protectionism, reshoring, and automation—makes it harder to replicate past export-led success stories such as those of East Asia, and notably China.

Nevertheless, manufacturing still holds unique potential. It is the only sector capable of absorbing labor at the scale India needs. With over \$100 billion in annual imports from China, even partial substitution through domestic production could generate millions of jobs. At the same time, global demand for labor-intensive goods remains strong, suggesting that even modest gains in export share could significantly expand output and employment, provided firms can scale up and integrate into global value chains.

A worker inspects photovoltaic cells used in solar panels at a factory in Gujarat's port city of Mundra.



Fragmented market

Which leads to the third concern. Because growth is concentrated in capital- and skill-intensive sectors, the aggregate wealth generated over the past decade is distributed unevenly. On one side of the ledger, India's formal urban economy is thriving. A world-class entrepreneurial ecosystem has produced more than a hundred "unicorns"—tech start-ups valued at more than a billion dollars each. Financial markets have hit historic highs, and luxury consumption—from premium real estate to high-end automobiles—is booming. On the other side, a large portion of the population faces a far more stagnant reality. Real rural wage growth has remained flat or negative when adjusted for persistent food inflation, and over 85 percent of the workforce is in informal employment, lacking social security benefits or predictable income.

This K-shaped cleavage between people who are prospering and those who are not has created a highly fragmented consumer market, where growth in demand for premium goods vastly outpaces that for entry-level mass-market consumer staples. This divergence is not just a moral or social issue; it is a structural economic bottleneck. Broadly shared prosperity is the primary fuel for mass domestic consumption, which in turn triggers private corporate investment. When a small segment of the population drives the bulk of discretionary spending, the domestic market size remains structurally capped, making long-term economic momentum harder to sustain.

Innovation deficit

Together, these three vulnerabilities point to a deeper structural challenge as India attempts to escape the middle-income trap. Countries routinely transition from low- to middle-income status via basic industrialization, urbanization, and the adoption of frontier technologies. However, moving from middle-income to advanced economy status requires an entirely different playbook. At this stage, growth can no longer rely on cheap labor, capital accumulation, or favorable demographics alone. It must be powered by domestic innovation, total factor productivity, and deep investment in human capital.

India has not yet hit this trap, but its long-term ambitions demand that it build defensive capabilities now. First, there is a research and development deficit. India possesses an elite pool of engineering talent and a vibrant software ecosystem, yet its total spending on R&D remains stuck at roughly 0.7 percent of GDP. Advanced innovation economies, however, routinely spend

3 percent of GDP or more. India is currently a prolific user of frontier technology, but it remains a marginal producer of core intellectual property in semiconductors, artificial intelligence, biotech, and advanced manufacturing.

This innovation deficit complicates India's most celebrated asset: its demographics. With a median age of roughly 28—compared with nearly 40 in China and over 44 in Europe—India has entered a historic demographic window. But a demographic dividend is not inevitable. It must be earned by educating and upskilling the workforce for jobs in high-productivity sectors. A youthful population without adequate economic opportunity could turn a demographic dividend into a demographic liability. India faces an urgent race between job creation and labor-force growth.

Unleashing potential

The Goldilocks narrative was not an illusion. India's macromanagement, infrastructure expansion, and digital transformations remain institutional breakthroughs. Few large economies are as strategically well positioned to capture the realignment of global manufacturing and supply chains.

The true metric of success for India over the next decade is not whether it can mechanically clock 6 or 7 percent GDP growth. The true metric is structural translation: Can India convert that macroeconomic growth into a self-sustaining private investment cycle, abundant formal jobs, domestic technological sovereignty, and a broad-based rise in household incomes?

That outcome rests on three priorities. First, the government must revive private investment through a more predictable regulatory environment, lower compliance burdens, and conditions that raise expectations for returns on long-term capital. Second, India must accelerate the shift of labor from low-productivity agriculture to labor-intensive manufacturing and modern services through investment in skills, logistics, and urban infrastructure. Third, limited fiscal resources should increasingly prioritize human capital—including education, health, and R&D—alongside physical infrastructure.

India has already shown that rapid growth can coexist with macroeconomic stability. That was a hard-fought victory. The next phase—ensuring that growth is structurally deep, inclusive, and innovation driven—is significantly more challenging. **F&D**

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