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# The Control Inflation Targeting to Reach the $ 5 Trillion Economy: A Strong Will

**Deepak Kumar Chauhan,**
**(M.A., M. Com,)**
**Senior Assistant**
**51 UP Bn NCC, Balrampur**
**Distt Balrampur**
**(UP) India**
**Address – Shubham Niwas, Moh. – Tedhi Bazar, Balrampur – 271201**
**Uttar Pradesh, INDIA**
**Email : chauhan1971deepak@gmail.com**
**Mobile - 9580138031**

**Abstract :**

The $ 5 trillion economy and India becoming the third largest economy in the world. Even if me take for granted that India will reach $ 5 trillion economy by 2024, one wonder what kind of society we will have the than will all the problems that India is facing resolve themselves similarly ? Will India have a more equitable and harmonious society ? Some of the problems sharing in the face are the problems of widening inequality agricultural stress, high unemployment, low human development record, rotting financial system, environment degradation, communal strife, low manufacturing growth and serious problems like war by neighboring countries, but all the above mentioned things were limited to the previous government of 2014, whose will power was not strong. This is a past-2014 India with strong will power, unwavering faith in its 130 crore population. To make the country an economy of $ 5 trillion, the growth rate will not only have to increase, but it will also have to maintain the increased growth rate. This growth rate should be 8% for the next 5 years.

"*In 2014, when the National Democratic Alliance (NDA) was voted to power by the world's largest democracy, India was a USD 1.7 trillion economy. In 2019, India has become a USD 2.7 trillion economy, having added one trillion US dollars in the last five years. Our vision to become a 5 trillion dollar economy by 2024-25 is challenging, but it is realisable.*" Nirmala Sitaraman said (Finance Minister of India)

***Key Words*** : Economy, GDP growth, Inflation, Population, Will power.

## Section 1. Introduction

Some analysis believe that India did not increase arrow in the economic sector after Independence, as a results, it look 55 years for the Indian economy to reach $ 1 trillion, while at the same time the Chinese economy continued to grow rapidly. Due to limited economic capacity of India, after necessary resources have not been available in different areas. In India there is after a shortage of funds for many sectors like railways, social sector, defense and infrastructure etc. The present government is considering to overcome the shortage of resources by increasing the size of the Indian economy. To achieve the $ 5 trillion target, India would need a growth rate of around 8% of GDP. Currently, many economists are talking about the slowing down of the Indian economy, with peers considering it a different goal to achieve high economic growth.

After all, national development depends on having educated citizens, rural development, the productivity of workers, women empowerment, health and nutrition, social justice, sustained economic growth could go on adding to this list of national tasks where education is the common denominator. All services provided through the various e-Governance initiatives are expected to assist the governments at the Central and State levels in reaching the yet 'unreached' and enable involvement and empowerment of marginalized groups through their participation in the government processes thereby contributing towards poverty reduction and bridging the sharp social and economic divide.

An increase in inflation means that prices have risen. With an increase inflation, there is a decline in the purchasing power of money, which reduces consumption and therefore negativity impacts GDP growth. India's inflation (Consumer Price Index) has been under check and has been continuously hovering below 4% level since August 2018, and recorded the inflation rate of 3.05 percent, last month. Similarly, the rupee-dollar exchange rate also needs to be in check to make India reach the desired target of $ 5 trillion. It rupee depreciates further, it will adversely affect India's GDP growth in dollar terms and if rupee starts appreciating against the dollar, it maps it easier to reach the target. Inflation rate in India is just above 3% and even global inflation is not very high. The outlook for inflation also took largely benign and even the global inflation rate has not shown signs of prices going up.

Inflation targeting is a monetary policy strategy used by Central Bnaks for maintaining inflation at a certain level or within a specific range. In general, central banks normally follow a policy of keeping inflation sufficiently low. However, in inflation targeting. There is a present, publicly disclosed target. Using methods such as interest rate changes the central bank and other monetary authorities are expected to guide inflation to a targeted level or range. Such a policy makes a central bank focus on a 9 single variable and imposes a penalty if the target is not adhered to. This policy was initially adopted by New Zealand in 1990, although other countries, most notably Germany, had evolved something close to inflation targeting considerably earlier. Thereafter, many countries have adopted inflation targeting as a part of monetary policy during the 1990s.

Some analysts believe that India did not increase arrow in the economic sector after independence, as a results it took 55 years for the Indian economy to reach $ 1 trillion, while at the same time the Chinese economy continued to grow rapidly. Due to limited economic capacity of India after necessary resources have not been available in different areas. In India, there is after a shortage of funds for many sectors like railways, social sector, defense and infrastructure etc. The present government is considering to overcome the shortage of resources increasing the size of the Indian economy.

To achieve this goal, it is necessary to emphasize on increasing investment. It has taken 55 years for the country to become economy of one million crores and in the last five years only 100000 crores were added to the economy. Therefore, the country to achieve the goal of the government is high. 5 years ago, the size of the Indian economy was 1.850 trillion dollar, which has now reached 2.7 trillion dollar. Inflation is the biggest hurdle in the way of targets. Rising inflation means that prices of commodities will rise. With the rise in inflation, the purchasing power of the rupee will decrease, which will reduce consumption and negatively impact GDP growth, which may cause the target to deviate from its path. To reach the target of 500000 crores dollar, rupee and dollar exchange rate will also have to be kept under control. If the value of the rupee decrease in the coming time, it will have a bad effect on the dollar or the economy of India. But if the rupee is strong against the dollar, then it will be easy to reach this goal.

## Section 2. Measures to Control Inflation

Controlling inflation is an important part of RBIs functioning core. There are certain measure that are employed by the Central Bank to restrict inflation and control cash flow. Here are a few of those methods. Rope rate is the percentage with which RBI (Reserve Bank of India) lends money to commercial banks. The rope rate is very important in terms of the monetary outflow from the government. The rope rate comes into play usually when commercial banks are short of money and needs to lend from the RBI. Another important instrument is the CRR (Cash Reserve Ratio) which is employed by the RBI as the amount commercial banks need to keep with them by default. Reserve Repo Rate is another consideration, as it is the rate at which commercial banks lend money to the RBI. Here are the practical uses of all three of these banking terms.

**Repo Rate -**

Whenever commercial banks face a shortage of funds, they can approach the RBI for a loan. The repo rate is the rate at which it would be possible for commercial banks to borrow money from the RBI. Repo rate is often used by the government as a tool for inflation. Whenever the government wants to restrict the flow of money in the economy, it can increase the repo rate as a deterrence for commercial banks to borrow money. Thus, repo rate makes for a very important financial instrument that is reflexively used to restrict the quantity of cash.

**CRR (Cash Reserve Ratio) -**

CRR is another measure that excels in controlling the amount of money the commercial banks are able to circulate into the economy. This is because CRR represents a certain amount of money that commercial are by law stipulated to keep with the RBI. Inflation can be directly controlled by the central government simply by means of increasing the CRR rate and thereby restricting the ability of commercial banks to lend money.

**Reserve Repo Rate -**

Reserve Repo Rate is the rate at which the RBI borrows from commercial banks. This is part of a liquidity adjustment facility employed by central banks to resolve short term cash shortages that an economy might end up facing. Reserve repo rate is usually set 1 percentile lower than the existing repo rate. This is also done in a bid to control inflation as reserve repo rate helps RBI extract money from the economy when it feels like there is excessive cash rolling about in the economy.

## It might be time to rethink our inflation-targeting framework

The first ever monetary policy committee (MPC) of the Reserve Bank of India (RBI) has held its last meeting. By and large, tributes have poured in for its believed role in reining in the rate of inflation in India. Simultaneously, given the recent spike in the rate of change in the consumer price index (CPI), analysts have reconciled themselves to RBI not cutting its policy rate till inflation falls. This shows the stranglehold of inflation targeting (IT) on our policy framework and mindsets. Both are unhealthy for India. Let us be clear. Price stability matters. More precisely, a stable trend in the rate of inflation matters. High inflation acts as a tax on the poor. However, in practice, to assess its impact on them, we need the basket of goods and services from which it is calculated to be aligned with the basket of what they consume. Further, there is considerable disagreement on what constitutes high inflation. There was no basis to the 2% rate that is supposedly targeted by central banks in developed countries.

As for developing countries, India in particular, there is enough empirical evidence to suggest that a 4% inflation rate is too low a target. After analysing 40 years of data up to 2000, Robert Pollin and Andong Zhu (Inflation and Economic Growth: A Cross-Country Non-Linear Analysis, 2005), concluded that there was no justification for inflation-targeting policies as they were being practised throughout the world's middle- and low-income countries—that is, to maintain inflation within a band of 3-5%. Madhu Sehrawat and A.K. Giri (2015) found the threshold level of inflation (above which there is an adverse impact on economic growth) to be 6.75% for India, while Wiston Adrian Risso and Edgar J. Sanchez Carrera (2009) estimated it at 9% for Mexico.

In theory, price stability is the best guarantor of medium- to long-term economic growth. But, as shown above, the threshold level at which inflation turns adverse for growth is not a settled issue, nor are the causes of inflation and the agency of the central bank in achieving price stability. If central banks were instrumental in bringing down the inflation rate in the developed world, then their abysmal failure in pushing it up, despite repeated and increasingly reckless attempts to do so, explodes the myth of their efficacy. The inflation generating process (IGP) is poorly understood everywhere. The Bank for International Settlements (BIS) wrote in its Annual Report 2015-16: "*Inflation is a highly imperfect gauge of sustainable economic expansions, as became evident pre-crisis. This would especially be expected in a highly globalized world in which competitive forces and technology have eroded the pricing power of both producers and labour and have made the wage-price spirals of the past much less likely*." In this explanation, the BIS almost lays out its theory of inflation. Wages matter a lot more than central bank mandates do. Indeed, that is why inflation targeting is a political economy project.

For developing countries like India, food prices are an important part of the IGP. In the 'Technical Issues' that accompany the annual Article IV economic assessment of a country, the International Monetary Fund, in March 2015 (India's Food inflation: Causes and Consequences), has documented and quantified the role played by rising food prices in generating inflation in India. During the term of the country's first MPC, food inflation was rather well behaved. In the calendar years 2016 to 2019, food price inflation averaged 5.3%, 1.3%, 1.3% and 3.75%, respectively. This is due, in no small measure, to the moderate increases in minimum support prices that the previous National Democratic Alliance government had announced over the first three to four years of its rule.

The inflation expectations of Indian households have closely tracked the trajectory of food price inflation, and attributing it to the formation and functioning of the MPC is a case of confusing correlation with causation, as Barry Eichengreen and his co-authors do in a recent paper. In 2015, I had written in favor of India's inflation targeting framework in the light of the experience of persistent double-digit inflation up till 2014. Now, we have evidence of its performance for four years. In those four years, the MPC had disregarded the impact of food inflation on the overall inflation performance, and relied on its own inflation forecasts, causing it to keep monetary policy too tight in 2017 and 2018. In the process, it ignored financial stability and the growth implications of the collapse of IL&FS, and thus contributed, in part, to lower growth outcomes in 2018 and in 2019. On balance, a case can be made that India has been a precocious inflation targeted. The country may have sacrificed financial stability and economic growth in the process. So India may need to re-examine the appropriateness of the IT framework for its development needs, and, failing that, at least revisit its target rate and range.

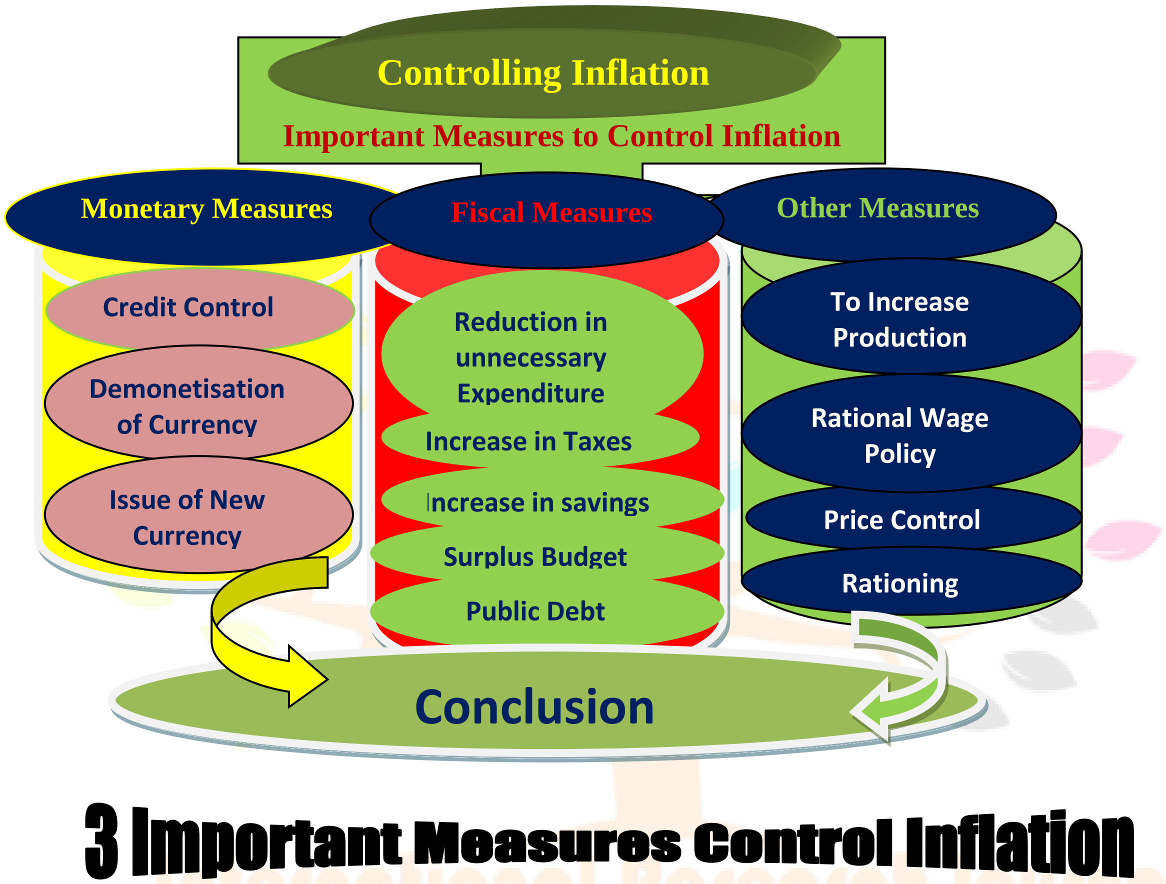


## I. The Need to Control Inflation

When the quantity of money rises above a certain threshold, the increased buying power of the consumer class can lead to shortage of goods and services. This is because capitalism, that thrives on the idea that infinite resources can be employed to satiate the needs of a growing demographic is slightly flawed. This is what generates the need for measure like the repo rate, CRR and the Reserve Repo Rate. They help restrict cash flow and keep inflation in check. These measures help bring a certain balance to the whole economic framework that the world laboriously functions under.

Central bank uses certain methods to inordinately function and maintain a level of balance to the Indian economy. The aspects mentioned in this article are a few of those methods that help keep the economy fresh and vibrant. This is because controlling inflation is a highly critical step in the direction of conceiving a system that is financially reaching an equilibrium. The 3 important measures to control inflation **Figure -1**.

***Figure 1- Controlling Inflation : 3 Important Measures to Control Inflation***




Some of the important measure to control inflation are as follows :

1. **Monetary** Measures
2. **Fiscal** Measures
3. **Other** Measures

Inflation is caused by the failure of aggregate supply to equal the increase in aggregate demand. Inflation can, therefore, be controlled by increasing the supplies of goods and services and reducing money incomes in order to control aggregate demand.

**1. Monetary Measures** –

Monetary measures aim at reducing money incomes.

(a) **Credit Control** : One of the important monetary measures is monetary policy. The central bank of the country adopts a number of methods to control the quantity and quality of credit. For this purpose, it raises the bank rates, sells securities in the open market, raises the reserve ratio, and adopts a number of selective credit control measures, such as raising margin requirements and regulating consumer credit.

Monetary policy may not be effective in controlling inflation, if inflation is due to cost-push factors. Monetary policy can only be helpful in controlling inflation due to demand-pull factors.

(**b**) **Demonetisation of Currency** : However, one of the monetary measures is to demontise currency of higher denomination. Such a measures is usually adopted when there is abundance of black money in the country.

(**c**) **Issue of New Currency** : The most extreme monetary measure is the issue of new currency in place of the old currency. Under this system, one new note is exchanged for a number of notes of the old currency. The value of bank deposits is also fixed accordingly. Such a measure is adopted when there is an excessive issue of note and there is hyperinflation in the country. It is a very effective measure. But is inequitable for its hurts the small depositors the most.

**2. Fiscal Measures** –

Monetary policy alone is incapable of controlling inflation. It should, therefore, be supplemented by fiscal measures. Fiscal measures are highly effective for controlling government expenditure, personal consumption expenditure, and private and public investment.

(**a**) **Reduction in Unnecessary Expenditure** : The government should reduce unnecessary expenditure on non-development activities in order to curb inflation. This will also put a check on private expenditure which is dependent upon government demand for goods and services. But it is not easy to cut government expenditure. Though this measure is always welcome but it becomes difficult to distinguish between essential and non-essential expenditure. Therefore, this measure should be supplemented by taxation.

(**b**) **Increase in Taxes** : To cut personal consumption expenditure, the rates of personal, corporate and commodity taxes should be raised and even new taxes should be levied, but the rates of taxes should not be so high as to discourage saving, investment and production. Rather, the tax system should provide larger incentives to those who save, invest and produce more.

Further, to bring more revenue into the tax-net, the government should penalise the tax evaders by imposing heavy fines. Such measures are bound to be effective in controlling inflation. To increase the supply of goods within the country, the government should reduce import duties and increase export duties.

(**c**) **Increase in Saving** : Another measure is to increase savings on the part of the people. This will tend to reduce disposable income with the people, and hence personal consumption expenditure. But due to the rising cost of living, people are not in a position to save much voluntarily.

Keynes, therefore, advocated compulsory saving or what he called ‘deffered payment’ where the saver gets his money back after some years. For this purpose, the government should float public loans carrying high rates of interest, start saving schemes with prize money, or lottery for long periods, etc. It should also introduce compulsory provident fund-cum-pension schemes, etc. All such measures increase savings and are likely to be effective in controlling inflation.

(**d**) **Surplus Budget** : An important measure is to adopt anti-inflationary budgetary policy. For this purpose, the government should give up deficit financing and instead have surplus budgets. It means collecting more in revenues and spending less.

(e) **Public Debt** : At the same time, it should stop repayment of public debt and postpone it to some further date till inflationary pressures are controlled within the economy instead, the government should borrow more to reduce money supply with the public.

Like monetary measures, fiscal measures alone cannot help in controlling inflation. They should be supplemented by monetary, non-monetary and non-fiscal measures.

**3. Other Measures** –

The other types of measures are those which aim at increasing aggregate supply and reducing aggregate demand directly.

(**a**) **To Increase Production** : The following measures should be adopted to increase production :

(**i**) One of the foremost measures to control inflation is to increase the production of essential consumer goods like food, clothing, kerosene oil, sugar, vegetable oils etc.

(**ii**) If there is need, raw materials for such products may be imported on preferential basis to increase the production of essential commodities.

(**iii**) Efforts should also be made to increase productivity. For this purpose, industrial peace should be maintained through agreements with trade unions, binding them not to resort to strikes for some time.

(**iv**) The policy of rationalisation of industries should adopted as a long-term measure. Rationalisation increase productivity and production of industries through the use of brain, brawn and bullion.

(**v**) All possible help in the form of latest technology, raw materials, financial help, subsidies, etc should be provided to different consumer goods sectors to increase production.

(**b**) **Rational Wage Policy** : Another important measure is to adopt a rational wage and income policy. Under hyperinflation, there is a wage-price spiral. To control this, the government should preeze wages, incomes, profits, dividends, bonus etc.

But such a drastic measure can only be adopted for a short period as it is likely to antagonise both workers and industrialists. Therefore, the best course is to link increase in wages to increase in productivity. This will have a dual effect. It will control wages and at the same time increase productivity, and hence raise production of goods in the economy.

(**c**) **Price Control** : Price control and rationing is another measure of direct control to check inflation. Price control means fixing an upper limit for the prices of essential consumer goods. They are the maximum price fixed by law and anybody charging more then these prices is punished by law. But it is difficult to administer price control.

**(d)** **Rationing** : Rationing aims at distributing consumption of scarce goods so as to make them available to a large number of consumers. It is applied to essential consumer goods such as wheat, rice, sugar, kerosene oil, etc. It is meant to stabiles the prices of necessaries and assure distributive justice. But it is very inconvenient for consumers because it leads to queues, artificial shortage, corruption and black marketing. ***Keynes*** did not favour rationing for it "*involves a great deal of waste, both of resources and of employment*."

**Conclusion** –

From the various monetary, fiscal and other measures discussed above, it becomes clear that to control inflation, the government should adopt all measures simultaneously, inflation is like a hydra-headed monster which should be fought by using all the weapons at the command of the government.

## II. Policies to Control Inflation

Inflation is a sustained increase in a country's general price level measured by the annual percentage rate of change of consumer prices. There are two main causes of accelerating inflation. Firstly, demand-pull inflation comes from a situation of excess aggregate demand relative to a country's productive capacity. When the output gap is positive, short-run aggregate supply becomes inelastic and therefore an outward shift of aggregate demand can lead to a sharp rise in price as producers look to increase there profits. Secondly, cost-push inflation happens when there is a rise in production costs leading to an inward shift of the SRAS curve. This could happen for example when unit wage costs have increased (i.e. wages are rising faster than productivity) or when imported goods and services become more expensive in the wake of a depreciation of a country's exchange rate.

Policies to reduce the rate of inflation are likely to be most effective when they address the main causes and these policies can focus either on short-term causes or longer-term factors.

### Monetary Policy –

In a situation of high inflation, monetary policy can have a key role play. The standard response of a central bank would be to raise official interest rates. This is an example of a contractionary of deflationary policy. Higher interest rates reduce aggregate demand, leading to a slower rate of economic growth and (eventually) lower demand-pull inflation. For example, higher interest rates might makes mortgages on property more expensive to service which has the effect of dampening down the rate of growth of house prices via a fall in housing demand.

A period of higher relative interest rates also causes an appreciation of the exchange rate which has the effect of reducing the price of imports and making exports more expensive.

Higher interest rates squeeze aggregate demand and can help reduce the size of a positive output gap. As part of monetary policy, the central bank might also introduce a lower inflation target. One argument in support of this is that if consumer and businesses  believer the inflation target is credible, then it will help to lower inflation expectations. And if inflation expectations are reduced, it becomes easier to control inflation because fewer people will be asking for hefty wage increases.

## Trade Policies –

In some countries, retail prices are kept artificially high because of the effects of import tariffs and import quotas. One policy option for a government might involve gradually lower import tariffs, perhaps as part of a wider trade agreement with other countries. A smaller tariff could have the effect of reducing import prices leading to an outward shift of short run aggregate supply. The costs of imported raw materials, component parts and finished consumer goods fall leading to a deflationary effect on the general price level. This might be shown in an analysis diagram by an outward shift or short run aggregate supply.

A potential downside of this approach is that domestic firms would then face tougher price competition from overseas suppliers and there might be a contraction in home-based production, employment and investment. The government would also be giving up some tax revenues from import tariffs which for a number of emerging/developing countries can be a significant source of tax income. Reducing trade frictions can be an effective policy to bring down the rate of inflation although domestic businesses would need to increase their efficiency to be able to complete with cheaper goods and service from overseas.

## Supply-Side Policies -

Supply-side policies are measures designed to increase the competitiveness and efficiency of the economy, putting downward pressure on long-term costs and therefore helping to control inflation. These policies might include government tax relief for business investment and also state funding to fast-forward major infrastructure projects in sectors such as transport, energy and power supply, telecoms and health care. Ultimately, if supply-side policies provide successful, then more new firms will enter markets (Increasing industry supply and driving down prices) and labour productivity will increase helping to control the unit costs of businesses so that fewer of them are under pressure to raise prices. Effective supply-side policies lead to an outward shift of the long-run aggregate supply curve and help provide the conditions for a period of non-inflationary growth. However, they are unlikely to have much effect on the rate of inflation in the short term. In this sense, monetary policy has a more important role to play in controlling price increases.

# III. Flexible Inflation Targeting : An Overview

Since the Central bank's own forecast contains all the information it possesses relevant to the outlook for inflation-including policymaker's preferences regarding the short-run trade-off between output and inflation, as well as the estimated effects of shocks working their way through the economy-it depicts an ideal intermediate target for monetary policy over the relevant policy horizon. Therefore, inflation-forecast targeting (IFT) is systemic, operational, flexible inflation targeting (**Box 1**). A successful policy regime provides an anchor to all nominal values, resulting in a significant reduction of uncertainly. The appropriate analytical framework work back from this anchor, and provides monetary policy with feasible medium-term paths consistent with it. In particular, it allows for the derivation of paths for the policy rate which guide the short-term interest rate in a way that the inflation objective is achieved. In this framework the policy interest rate has to be endogenous, determined ultimately by the goal-otherwise the system has no nominal anchor.

Actual inflation at any point of time may not be equal to the target within FIT as there are multiple shocks that affect inflation. There is a clear recognition that it would take time to bring inflation back to the target after a shock, given the lagged effects of monetary policy through the transmission mechanism. As a medium term framework, it is important to recognize that occasional deviations from the glide path should not be interpreted per se as monetary policy errors that require correction. The actual speed at which inflation adjusts to the long-run target would depend on the nature and magnitude of shocks hitting the economy and the response of monetary policy.

**Box 1 - Six Principles of Inflation Targeting**

**1**. The primary role of monetary policy is to provide a nominal anchor (i.e. low, stable long-run inflation expectations) for the economy; the weights given to any other objective must be consistent with this.

**2.** Effective inflation-targeting has beneficial first-order effects on welfare by reducing uncertainty, anchoring inflation expectations and reducing the incidence and severity of boom-bust cycles.

**3.** Fiscal and other government policies may make the task of monetary policy easier and more credible, or more difficult and less credible.

**4.** Because of

# Legs in the monetary transmission mechanism, and

# Concern for deviations of output from potential, as well as of inflation from the long-run target, following shocks it is not desirable to aim at keeping inflation exactly on target.

**5.** In view of possible short-run trade-offs between the inflation targets and other objectives, the conduct of monetary policy must have sufficient independence from the political process to achieve the announced objectives.

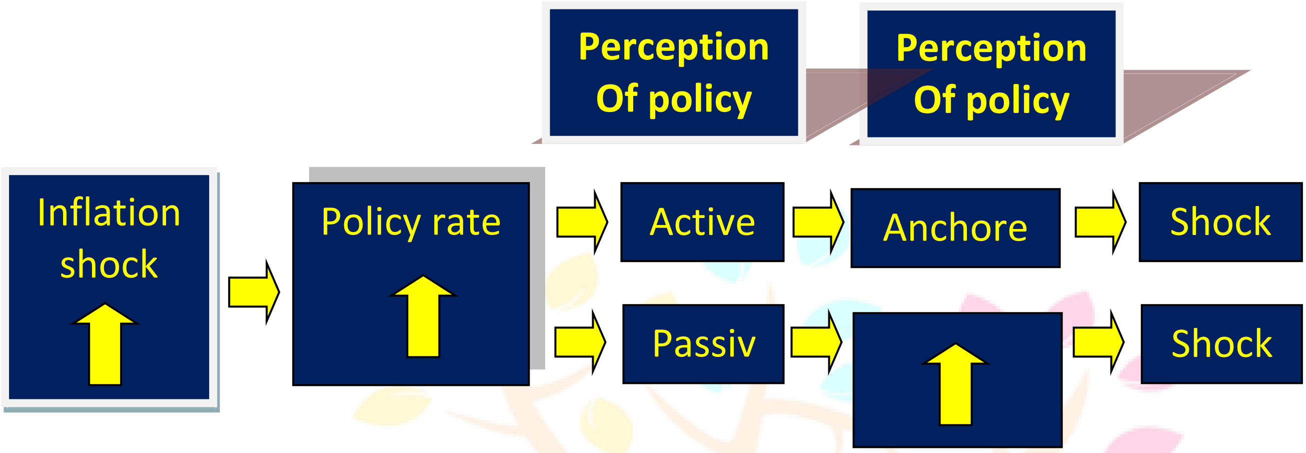
**6.** Effective monitoring and accountability mechanisms are required to ensure that central banks behave in a manner consistent with announced objectives and sound practice.

## IV. The Challenge of Building Credibility

Before the introduction of the FIT, the RBI did not have an explicit price stability mandate as its overarching objective. Therefore, the public has no historical record from which it can judge the commitment of the RBI to the announced long-run inflation target, or whether its actions to this end will prove effective. Despite the regime change, the history of high and unstable inflation doubtless weights heavily in the public mind. Credibility, therefore, can be established earned, over time, by achieving announced objectives, and by effective, transparent communications. On the other side, it can be lost through policy actions inconsistent with stated objectives.

Expectations may absorb or amplify an inflation shock, the mechanism of which is illustrated in **Figure 2**. In the event of an inflationary shock, even if the central bank raises the policy rate, the effect on the economy depends on how the public interprets this action.

**Figure 2 : Policy Credibility or Lack of Credibility**




**Credibility results in shock absorption** – If the rate hike is perceived as the assertive response by a credible central bank, long-term inflation expectations remain stable, and the policy action raises the real rate. In addition, uncovered interest parity implies a drop in the real price of foreign exchange.

$$\uparrow \sum_{j=0}^{k} r_{t+j} = [z_{t+k} - \downarrow z_t] + \sum_{j=0}^{k} \{r_{t+j}^{f} + \mu_{t+j}\}$$

Where : r is domestic real interest rates, z is real exchange rate µ is shock to interest rates.

With the tightened monetary conditions, demand is reduced, a negative output gap is opened, and inflation returns without unusual delay to the long-run target.

**Lack of credibility can lead to shock amplification**. If, however, the public perceives that the central bank to be passive, expectations of inflation ($E_t\pi_{t+1}$) could rise in a way such that the change in the real rate ($r_t$) following the policy rate (i) increases is difficult to ascertain.

$$\updownarrow r_t = i_t \uparrow - \uparrow E_t \pi_{t+1} \,.$$

In the worst situation, unanchored expectations amplify the initial impact of the shock, and propagate to yield a prolonged inflation spiral. An observer might think that policy rate increases are ineffectual in the fight against inflation, whereas the real confidence in the ability to deliver on the price stability objective.

During the initial years of adoption of FIT, the credibility evolves gradually, which helps in keeping the economy in between the two above discussed scenarios. It could also be possible that credibility-building happens at a rate faster or slower than expected, and such dynamics should be clearly accounted for while calibrating the models for policy simulation.

## Section 3. How to achieve $ 5 Trillion Economy Target

There has been a tremendous decline in the growth rate if India's GDP in the quarter in the early months of Lockdown. According to the Union Ministry of Statistics, the first quarter of the financial year 2020-21, i.e. between Apr to Jun, the growth rate has declined by 23.9%. It was estimated that India's GDP rate could fall by 18% from the first quarter due to the corona virus epidemic and nationwide lockdown. The total value of all goods and services produced in the country in a given year is called gross domestic product or GDP. GDP is a mirror of any country's economy. How is the performance of the economy of a country, it is only shown by the GDP ? At the same time, GDP still shows that it is accelerating in which sectors and in which it has come down ? If the GDP figures are lower than in the previous year, it implies that the production of goods has been less in that period and the service sector has been declining.

A nation's full potential is realised when its citizens have their most basic amenities taken care of PM Modi's government in its first tenure made every possible effort to make sure that people of India have access to fundamental necessities so that they can realise their full potential. For example, worries of the poor over housing are being taken care of Pradhan Mantri Awas Yojana which is being implemented in full force so that every Indian has a house over his head by 2022. Over 1.86 crore affordable houses were built since the scheme's launch in 2015. A house also need a running electricity connection. Under Saubhagya Yojana 99.9% households have been electrified. The work of electrifying every village had already been completed in 2018. With more than 8 crore women beneficiaries, Ujjwala Yojana has made the lives of rural women better and smoke free. Financial inclusion with Jan Dhan Yojana made banking accessible to a large Indian population. A bank account is an kind of financial activity or to ensure government benefits reach people directly. Talking about health, Ayushman Bharat is going to benefit 10 crore poor families giving them the insurance cover of Rs. 5 lakh per family per year. Crores of people who were earlier being pushed deeper into poverty due to lack of basic necessities and lack of access to healthcare are now able to assert their presence on the economic landscape of India due to the Modi government's empowerment measures.

Achieving such an aspirational growth target calls for pulling all the economic growth levers-
Investment, consumption, exports and across all the three sectors of agriculture, manufacturing and service. There is a fair amount of consensus that we have to address our inefficient factor markets as the topmost priority for India to achieve its full potential, especially the constraints imposed by our stressed financial and power markets. Without credit flow to support private investment and cheaper, abundant and good quality electricity to power growth, this GDP target will remain an aspiration. Formulating the strategies for 12% growth over the next five years becomes more complex because it comes at a time when we are seeing radical shifts that need to be accounted for as we go forward.

First is the shift in global trade. Growth in global trade, particularly merchandise trade, with its multiplier effect has been a crucial part of growth strategies of all developing countries. The trade intensity (ratio of global trade to global GDP) grew from less than 10% at the start of 20th century to over 50% by its end, reflecting the development of global supply chains. However , since the last financial crisis in 2008, trade intensity has stagnated, in particular for merchandise trade from which developing countries have benefited for the last half century. However service trade, especially digitally enabled trade (both service and merchandise) where developed countries are advantaged, is growing much faster, which represents a major structural shift in global trade. While there is a large short-term opportunity in attracting some of the capacity of labour intensive industries that is shifting out of China (if we can make our factor markets and incentive policies more attractive), our growth strategies need to be built in preparation for this paradigm shift taking place in global trading pattern.

The second shift is the emergence of a new 'factor market'-data-which no longer an 'output' of value added activity to be used to measure its effectiveness (e.g. through MIS), but has become an input into the very design of the activity through growth of IoT. An expert used to analogy that in the 20th century, data was like the 'exhaust' of the car, but in the 21st, it is like the 'fuel, a critical input to make the car drive better. Creating an effective market for data (through digital infrastructure, regulatory regimes, interoperability rules, robust privacy and security laws) is becoming as important for economic growth as creating more efficient traditional factor markets, and those countries that do it better and faster will reap the benefits and build global leadership in many industries.

A consequence of the growth of digital and data is the third major shift in the economic growth paradigm- the emergence of new value pools across industries. For instance, the traditional value pools in the automotive industry (new vehicle sales, components, finance, insurance, parts/service), which is nearly 100% today, can shrink to less than 60% in 15 years as the new pools driven by electrification, digitally-driven data service, ranging from preventive maintenance to restaurant location, and mobility service grow. Whether these new value polls will be captured by Indian or global companies will have an impact on India's longer term growth prospects, and this kind of radical shift is happening across industries, often faster than what regulatory bodies and /or government can react to. This has to change.

The fourth shift is equality radical. World over, formal manufacturing jobs are declining as the fourth industrial revaluation powered by digital technologies accelerates. However, digital technologies are also powering the emergence of new business models, start-ups and micro-enterprises, and growth of service by driving down costs. One of the major impacts of this shift is the emergence of the rapidly growing gig-economy jobs like the Uber car drivers and last mile delivery boys/girls of e-commerce companies. This poses several policy challenges. First, the nature and types of jobs, and the skills needed are changing. These jobs are not captured in our current laws which can facilities their regulation and growth. In their absence, these are not captured in formal jobs survey, and are often poorly paying with no social security.

In fact, given the growth of such non-formal jobs, many experts maintain that India does not have a jobs problems but a low income problem. The new economic paradigm is needed to facilities the formalisation and growth of income generation from start-ups, micro-enterprises and of the self-employed.

The fifth shift important for longer term economic planning is the increasing role of IP and talent as a source of value creation in the 21$^{st}$ century, as opposed to primary role, in the 20$^{th}$, of physical conversion of raw materials into final products. This is clearly visible by the complete change-over of top-20 market-cap companies in the world in the last two decades from the resources and manufacturing dominated global firms to digital technology based driven more by IP, data, and talent. We have to give at least equal focus to growing industries which develop and leverage IP and talent, as to those that physically convert raw materials.

Lastly, and, to me, one of the most interesting shifts is in the nature of what I call 'economic problem solving'. One of my senior BCG colleagues who had headed a global non-government institution recently remarked to me that economic development paradigms lag the development of on-ground cutting-edge solutions to economic and social problems. Today, technology, connectivity, financial flows allow more agility, flexibility and 'micro-solutioning' at local levels, which becomes critical in developing a world where government institutions are often weak.Our economic development models are still very much geared to large scale, top-down approach. We have to find innovative ways to identify, includes and scale these development efforts in our national planning in the 21$^{st}$ century.

## Five Achieving Targeting Resources

**Economy** – Indian economy was about $ 1.85 trillion when Modi government was elected at the centre. In 2019, it has reached around 2.7 trillion dollars. It took over 55 years for the Indian economy to reach 1 trillion dollars. But the Modi government added about 1 trillion dollars in just 5 years. Economic growth is boosted by a virtuous cycle of savings, investment and exports supported by a favourable demographic phase which India is already in. Job creation is driven by this virtuous cycle. When there is investment, there is more focus on building companies that leads to capacity creation, increase in supply of goods and service, more demand and jobs. This cycle further brings in massive employment opportunities for youth and ensures growth of savings, consumption and thus, economic growth.

Hence, encouraging investment is the key driver in boosting growth. In the first term of the Modi government many structural reforms such as bank mergers and recapitalization, insolvency Bankruptcy code, FDI reforms in various sectors and real estate reform (RERA) were implemented. With the landmark legislation of GST, which completely overhauled the indirect tax structure in the country, traders are benefiting from reduced taxes. In a major boost to Ease of Doing Business, FDI has been allowed in contract manufacturing through matic route and in coal sector. Additionally, FDI norms for single brand retail have also been eased. Modi Government's continuous efforts to improve eases of doing business have clearly reflected in the World bank rankings with India improving to rank of 63 in 2019 from 142 in 2014. The industry and analysis have hailed a huge cut in corporate tax as a historic move that gives India one of the most competitive tax rates in the region. It further impacts the job market as companies now have more money to invest bank in their businesses. The move to abolish Angel Tax was also widely hailed as it will not only unshackle angle investing for start-ups but also bring in domestic monies for them and help them to achieve global scale.

**Banking** – Creation of next-generation stronger global sized Indian public sector banks will be imperative for formation of 5 trillion-dollar economy. In this regard, the government has been taking several measures to strengthen the banking sector as well as reduce its NPA. The decision of the Modi Government to consolidate 10 public sector banks into 4 entitles will not only improve the efficiency of the bank and ensure economic of scale but also improves risk management and help banks to wider their coverage. Government also front loaded 70,000 crores for recapitalisation of public sector.

**Real -Estate Sector** – The move to set up an Alternative Investment Fund with initial corpus of 25,000 crores to revive 4.6 lakh housing units will further boost the real estate sector and bring relief to a large number of middle-class and lower middle-class homebuyers who are under financial stress.

**Infrastructure** – With a promise to invest Rs 100 lakh crores in infrastructure in the future, the Modi government realises the importance of infrastructure for driving India to a 5 trillion-dollar economy. Also, building infrastructure leads to massive job creation.

**Farmer -Welfare** – For the first time ever, the Modi government ensured a paradigm shift in policymaking in agriculture. Earlier, agricultural policies were about productivity. But the Modi government shifted it to profitability by setting a target of doubling farmers income and working towards it.

Going forward what steps can Government take to get closer to its target. Recently outlined these steps.

### 1. Increase Ease of Business and Ease of Living to Promote Private Investments -

Over the last four years, the government has scrapped over 1,300 antiquated law! It has done away with a lot of archaic procedures, rules and regulations.

Through a series of reforms, India has jumped up 65 positions in The World Bank Ease of Doing Business. No other large country has been able to do this. India has jumped up 65 positions, but our challenges is that in the next two years India must reach the top 50 and in the next five years reach the top 25.

### 2. Urbanization - a big driver of growth -

Cities account for less than 5% of the earth land mass, but they account for over 75% of the global GDP! So, Urbanization in cities is important as they are centers of economic growth.

While the process of urbanization has ended across America and Europe, and matured in China, it has just begun in India. In the next 5 decades, India should see more Urbanization than what we’ve done in the last 500 years. While there will be many challenges, India needs more Urbanization to grow rapidly.

### 3. Globalization for growth -

India exists in a globalized and interdependent world. Like in Japan, Korea and China. Globalization has helped large section of population to be lifted above the poverty line. India's share in global export is less then 2%. So, India must learn the art of size and scale, of manufacturing to size of scale and to penetrating.

### 4. Women Participation is key -

India cannot grow at high rates over a 3-decade period without gender parity. In India, only 26% of the women work; the worldwide average is 48%. If such a major chunk of the population is not working and we consciously don't put women into positions of power, it will be very difficult for India to grow.

### 5. Agriculture Reforms in vital -

It's not possible to grow over long periods of time without some very major structural reforms in the agriculture sector because that's where close to 60% of India lives. You can't keep growing on subsidies, you can't keep going on just giving assistance to farmers without ensuring betters markets, without putting technology, without contract farming and so on. Agriculture sector reforms are critical.

## Section 4. The Differential Relationship of Population, GDP and Poverty –

It is of immediate importance to consider the importance of population policy to understand the relationship between development and poverty. The route connecting population, gross domestic product (GDP) and poverty can go in two directions. The first direction with wide acceptance by the social scientists is that as the per capita GDP figure increases, the poverty rate decreases and it also reduces the population growth rate. Although more arguments have been made in favor of its reverse direction. GDP growth per capita should increase as soon as population growth rate is controlled, but does it also reduce poverty rate ? **Malthus** had hypothesized that poverty, famine and pandemics would arise from high population growth rates. The reality is that population growth, GDP growth and poverty are linked in both direction and both of them force each other. This problem has been very important for India for almost half a century. There has been no population policy of India since the forced population control policy failed in the 1970s. In the 1970s, bold advertisement of '**Nirodh**' and two are three children advocating slogans were in the news. These steps taken in the right direction also deviated from the path due to forced sterilization. As a result, political parties avoided touching the issue of population and turned this population into their vote bank. Its results can also be seen from the data across the country. We will explain the direction of the relationship between population growth and GDP per capita and its relation to poverty.

Nearly two decades later, during a recent visit to some countries of Southeast Asia. I saw a tremendous growth of economics and the standard of living and quality, and after seeing hundreds of Chinese guests flock to the population, national income and poverty. The nature of interconnection needs to be restored. An interesting assessment emerges from the comparison of Brazil, China and India. Let's start with the first table. This table shows the approximate picture of the total population from 1950 to 2100. It can be seen that in the 2020s, the total population of India will overtake China and similar situation will remain till the end of this century. The second table shows the reason behind this phenomenon. In the 1960s, China's population growth rate was higher than India, but he started trying to overcome this by applying embroidery. The effect of this is that China's population growth rate decreased from India since the early 1970s and the situation has remained the same since then. India s population growth during this period may have been steady, but China's population growth rate is once again catching pace, but it is still less than India. The third table outlining the relation of income growth with population growth shows the per capita GDP growth rate of countries from 1968-69 to 2016-17. China's per capita GDP growth has been ahead of India. But India has overtaken China in the last 2 years. This reflects the impact of some concessions made in China for half a century in population control policy. Overall, there is a close correction between population growth and GDP growth per capita.

### Section 5 : Conclusion and Recommendation –

## Is the "$ 5 Trillion" Target Realistic ?

The target is in terms of dollar, so there are two major variables which can impact India's growth towards achieving this target :

1. **Inflation rate** – India's retail price inflation claimed to 6.93% year-on-year in July 2020 from an upwardly revised 6.23% in the previous month and easily beating market expectations of 6.15%. The reading remained also above the Reserve Bank of India's medium-term target of 4%, as food prices continued to soar (9.62% vs 8.72% in June) due to disrupted supply chains. Additional upward pressure came from pen, tobacco and intoxicants (12.35%), housing (3.25%), clothing and footwear (2.91%), fuel and light (2.80%) and miscellaneous (6.95%) mainly boosted by personal care and effects (13.63%) and transport and communication (9.95%).
2. **Rupee-dollar exchange rate** – US dollar to Indian rupee exchange rate is at a current lrvrl of 73.71, down from 73.90 the previous market day and up from 70.93 one year ago. This a change of -0.26% from the previous market day and 3.92% from one year ago.

An increase in inflation means that prices have risen. With an increase in inflation, there is a decline in the purchasing power of money, which reduces consumption and therefore negatively impacts GDP growth. India's inflation (consumer price index) has been under check and has been continuously hovering below 4% level since August 2018 and recorded the inflation rate of 3.05%. Similarly, the rupee-dollar exchange rate also needs to be in check to make India reach the desired target of $ 5 trillion. If rupee depreciates further, it will adversely affect India's GDP growth in dollar terms and if rupee starts appreciating against the dollar, it makes it easier to reach the target.

"*Inflation rate in India is just above 3% and even global inflation is not very high. The outlook for inflation also look largely benign and even the global inflation rate has not shown signs of prices going* *up. This is going to aid India's GDP growth to achieve the $5 trillion target, which is not at all unrealistic until rupee doesn't start depreciating.*" Said Sujan Hajra, Executive Director and Chief Economist, Anand Rathi Securities.

The Indian economy is on the right track. India's nominal GDP in dollar terms was around $388 billion in 1996 , more than doubled in the next ten years to reach $920 billion in 2006. It again more than doubled to $ 2.3 trillion in 2016, another ten years, thus making India a $5 trillion economy is not an uphill task. To achieve this target India needs o grow at an annual average growth rate of 11.5% in dollar terms for the next five years. India witnessed a dip in its real GDP growth in rupee terms during 2018-19, as the economy grew by just 6.8% as compared to 7.2% in the previous fiscal. The International Monetary Fund (IMF) in April 2019 had cut its India's GDP growth forecast for 2019-20 by 20 basis points to 7.3% in 2019-20 and 7.5% in 2020-21. Downward revision by IMF was followed by a similar action taken by the Asian Development Bank (ADB) and the Reserve Bank of India (RBI) as well. ADB has forecast India's GDP growth to be 7.62%, a downward revision from 7.6% earlier. While India's Monetary Policy Committee of RBI has recently lowered its GDP forecast for 2019-20 to 7% from earlier 7.2%.

Even if India's real GDP grows as per the predicted growth rate of around 7.5% in rupee terms for the next five years, it can easily cross the $ 5 trillion mark by 2024.

"The target of $ 5 trillion is in nominal GDP terms, a 7-7.5% o real GDP growthand an average inflation rate of around 4-4.5% translated into a nominal growth of 11.5% a ballpark calculation," said Sujan Hajra.

We have modified **Modinomics** in our definition in a new for it has been divided into two part.

**Figure 3**

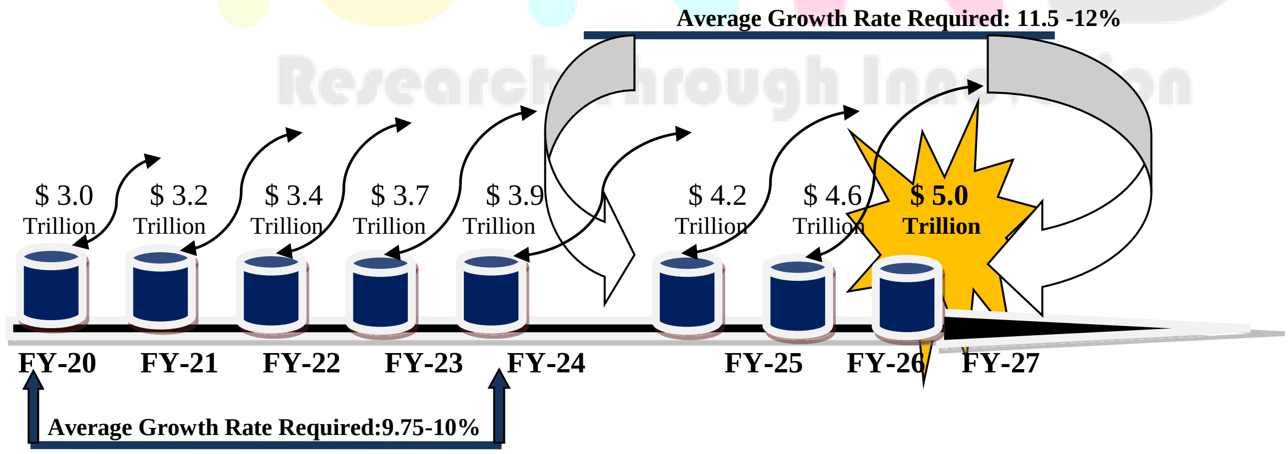
***Figure- 3***

**Modinomics Will India Hit The $ 5 Trillion Magic Figure By FY - 2027 ?**

*Part 1 - 2019-20 To 2023-24*

*Part 2 - 2024-25 To 2026-27*

*Analysis shows in order to become a **$ 5 Trillion economy**, **India** needs to grow at a rate of 11.5-12% for the next 08 years.*




Converted into dollars at an average USD/INR rate for the financial year, GDP, Current Price($

**Part – 1 (2024-25 To 2026-27)**

Estimated growth at 11.5-12% to reach $5tn by 2027

**Part – 1 (2019-20 To 2023-24)**

**Part-1** - 2019-20 To 2023-24

**Part-2** - 2023-24 To 2026-27

India will become a country with a target of 2024, **5 trillion dollar economy** under Prime Minster Narendra Modi. This hope is not only full faith, but due to the country's growing population, global epidemic Covid-19, communal riots, many disasters, economic recession, lack of cooperation of the opposition and the state of war by the neighboring countries. This goal seems a little distant but not impossible. To achieve this goal, it is necessary to work in the right direction and keep the ***GDP*** at ***9.75-10%***till ***FY: 2019-2024*** and ***11.5-12%*** for ***FY : 2024-2027*** , for which the trust and confidence of the present Modi government also, 130 crores Indian's have to show confidence in themselves. I have conducted an experiment that if the economic structure of the country continues in the right and well planned direction, then by FY- 2026-2027, we will definitely see something that we will leave behind Germany, the world's third largest economy, the target of $ 5 Trillion economy with in a strong will power.

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