Indian Economic Scenario:
Challenges and Prospects

"Seminar on Doing Business with India"

for Senior Executives of European Companies

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Management Development Institute

Gurgaon

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Prime Minister's Economic Advisory Council

New Delhi, India

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Comparative Country Table 2007

(World Bank)

	World	USA	Euro	Brazil	RussFed	India	China	France
Population (M)	6612	301.6	318.7	191.6	141.64	1123	1320	61.7
Area (MSqKm)	133.9	9.4	2.5	8.5	17.1	3.3	9.6	0.6
Cropland (MSqKm)	50.2	4.2	1.2	2.6	2.3	2.0	5.7	0.3
Agriculture/GDP	3	1	2	31.2	5	18	12	2
Services/GDP	69	76	72	64	57	53	40	77
GDP (PPP) ($ Trn)	54.3	13.8	12.2	1.3	1.3	1.2	3.3	2.6
GDP per capita $ PPP	8219	45789	38215	6858	9115	1043	2485	41540
Gini (UNHDR 2007-08)		40.8	<35	57	39.9	36.8	46.9	32.7
Merchandize Trade/GDP	51	23	61	22	45	31	66	45
Life Expectancy	68	78	80	72	66	64	72	81

Economic Decline and Resurgence

+ Compound Annual per capita GDP

Years	Growth Rate+
1-1000	0%
1000-1500	0.04%
1500-1700	0%
1700-1820	-0.03%
1820-1870	0%
1870-1910	0.69%
1910-1950	-0.30%
1951-1980	1.48%
1981-1990	3.50%
1991-2000	3.60%
2003-2008	7.18%

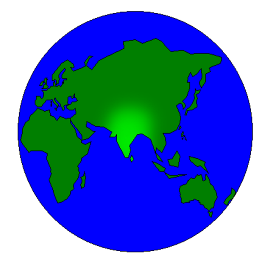
	Share of Global		
YEAR	*Population*	*GDP*	*GDP/Pop*
1	33%	32%	97%
1000	28%	28%	100%
1500	25%	24%	96%
1600	24%	22%	92%
1700	27%	24%	89%
1820	20%	16%	80%
1870	20%	12%	60%
1910	17%	7%	41%
1950	14%	4%	29%
1980	15%	3%	20%
1990	16%	4%	25%
2000	17%	5%	29%
2008	**17%**	**5%**	**29%**

India at Independence in 1947

- **Agriculturally backward**: Markets integrated, but food grain deficit and traditional technology.
- **Trade balance in India's favour**, but composition altered.
- Had been de-industrialised earlier, but the beginnings of modern, especially **textile industry**, laid.
- Beginnings of a **modern infrastructure**, physical and social.
- Low or **negative growth rates**, growing poverty and backwardness compounded by the first stage of the modern **demographic cycle** after 1921, resulting in (continuing) high population growth rates.
- Regional and linguistic **diversity** led to a federal political structure with strong central powers.
- British parliamentary **democracy** took firm root.
- Economically more advanced than most countries in **Asia.**

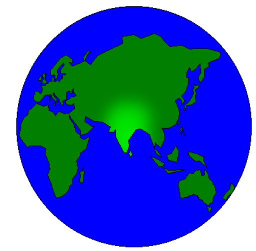
1950-1990 State-led Growth: Policy

- Thrust on **State-owned heavy** industries modelled on Soviet Five year Plans.
- Private industry permitted but under a stringent **licence permit** scheme so as to limit size and direct investment.
- Physical and social **infrastructure state owned**.
- **Agricultural** development left to private enterprise but with strong dose of state regulation and subsidies.
- Stringent **capital controls**. Financial sector state-owned to direct investment. Little reliance on external finance.
- **High tax** rates and Low Tax-GDP ratios : Victim of the Laffer Curve?
- Trade policy import-substituting, **inward-looking** and protectionist. Implicit anti-export bias.



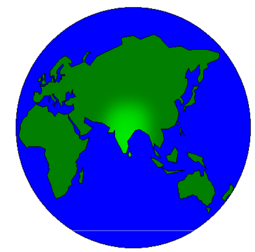
1950-1990 State-led Growth:Impact

- Development of a basic **industrial base**, but inefficient because of limited competition and underinvestment in infrastructure
- **Green Revolution**:India becomes agriculturally self-sufficient. Agricultural output ↑ 50 MT in 1950 to over 200 MT in 2000
- Financial repression and **capital flight**: Mounting NPAs
- Share in world trade shrinks from 3% in 1947 to 0.5% in 1990
- **Low rates of growth** (compared to NICs of E.Asia) and inflation.
- A ‘licence-quota-permit (‘**DUPS**’) raj’ spawns a flourishing parallel economy.
- Increase in agricultural productivity from second half of the seventies, and higher growth rates from second half of the eighties, results in **slow reduction in poverty.**
- Growing state expenditures financed by high tax rates and borrowings. **Fiscal and BOP crises** (vulnerable to oil price shocks): proximate cause of economic liberalization of the nineties.
- Reform process initiated in the **1980s**, but comprehensive policy overhaul after 1991



Changing Tack in Nineties

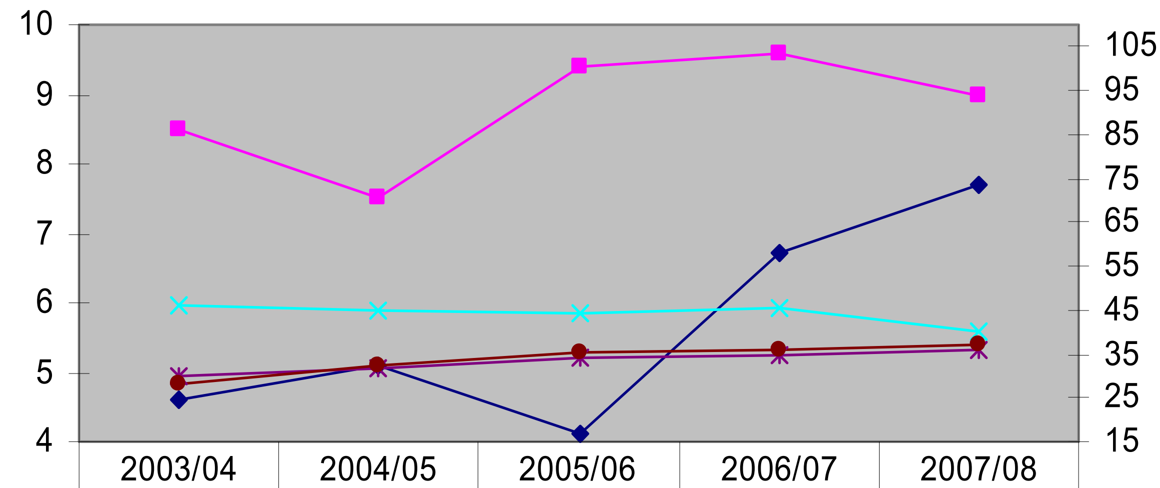
- Accumulation of unsustainable internal and external **deficits**
- Dissatisfaction with economic performance relative to **East Asia**
- **End of History**: An idea whose time had come?
- A minority government more willing to take **risk.**
- Trigger provided by BOP crisis induced by the **Gulf War**.



- **Major Reforms**:
  - Industrial delicensing;
  - Financial sector: Market interest rates- also applicable to sovereign borrowing; free capital markets; independent central bank but monetary policy constrained by fiscal weakness.
  - External Sector: Rupee floated on current account; openness to Foreign investment; trade barriers lowered;
  - Major domestic tax reforms
- First round of reforms **crisis driven** (hence swift); second generation **consensus driven** (hence slow): strong consensus on weak reforms?

India: Last Five Years

India: Macroeconomic Fundamentals 2003/04 - 2007/08



	2003/04	2004/05	2005/06	2006/07	2007/08
GDP	8.5	7.5	9.4	9.6	9
WPI_infl	4.6	5.1	4.1	6.7	7.7
Res_accretion	107.4	26.2	15.1	36.6	92.2
X_rate	45.95	44.932	44.273	45.28	40.24
savings/GDP	29.8	31.8	34.3	34.8	36.2
investment/GDP	28.2	32.2	35.5	35.9	37.4

REGIONAL DEVELOPMENT

Regional Development Indicators							
Regional Development Indicators	HDI	% BPL	% BPL	Infant	Total	Per Capita	Per Capita
	Ranking	(URP)	(MRP)	Mortality	Literacy	Consumption	Elect.Gwh
State / Years	2001	2004-05	2004-05	2006	2001	2005-06	2006-07
Andhra Pradesh	10	15.8	11.1	56	61.1	869	2285.6
Karnataka	7	25.0	17.4	48	67.0	780	1354.9
Tamil Nadu	3	22.5	17.8	37	73.5	926	2225.6
Kerala	1	15.0	11.4	15	90.9	1187	58.7
Gujrat	6	16.8	12.5	53	66.4	847	3044.9
Maharshtra	4	30.7	25.2	35	77.3	983	4595.8
Goa	0	13.8	12.0	15	82.3		9.2
Average Peninsular	**4.4**	**19.9**	**15.3**	**37.0**	**74.1**	**932.0**	**1939.2**
NCT Delhi	0	14.7	10.2	37	81.8		279.5
Punjab	2	8.4	5.2	44	70.0	1195	1481.3
Haryana	5	14.0	9.9	57	68.6	872	1119.5
Average High Income Northern	**3.5**	**12.4**	**8.4**	**46.0**	**73.4**	**1033.5**	**960.1**
West Bengal	8	24.7	20.6	38	69.2	766	2605.1
Orissa	11	46.4	39.9	73	63.6	530	357.8
Bihar	15	41.4	32.5	60	47.5	509	4.4
Madhya Pradesh	12	38.3	32.4	74	64.1	621	1306.3
Rajasthan	9	22.1	17.5	67	61.0	773	1808.3
Uttar Pradesh	13	32.8	25.5	71	57.4	643	2223.8
Average Low Income Northern	**11.3**	**34.3**	**28.1**	**63.8**	**60.5**	**640.3**	**1384.3**
National Average		27.5	21.8	57	65.2	783	43576.7

HDI: HDI 2001
Below poverty Line: Planning commission
Infant Mortality rate: Office of Registrar General of india
Per capita consumption: Household Consumer expenditure, NSSO 2005-06
Per capita electricity Growth: All India Electricity Statistics 2008

Outlook Magazine, October 6, 2008

How The States Rack Up

H= Healthcare; **E=** Education; **EMP=** Employment; **P.R=** Poverty Reduction; **W.E=** Women Empowerment; **W.S=** Water & Sanitation; **CS.J=** Citizen Security & Justice; **B.I=** Basic Infrastructure;**E=** Environment; **T.S=** Total Score

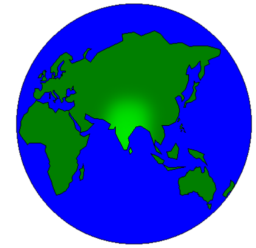
Rank	Name of the State	H	E	E	P.R	W.E	W.S	CS.J	B.I	E	T.S
	Weightage	**12.5%**	**12.5%**	**10%**	**12.5%**	**10%**	**12.5%**	**10%**	**10%**	**10%**	**100%**
1	Kerala	98.22	100.00	47.51	47.51	99.01	61.54	5.45	76.62	75.07	**68.33**
2	Himachal Pradesh	56.18	89.62	71.26	71.26	85.57	66.24	6.51	74.90	77.97	**64.84**
3	Punjab	63.91	83.05	55.02	55.02	78.27	85.2	4.40	63.67	30.98	**60.74**
4	Tamil Nadu	68.85	78.56	77.00	77.00	83.63	63.74	10.32	65.30	47.65	**58.66**
5	Gujarat	57.09	82.05	93.32	93.32	73.01	69.66	5.25	60.74	34.63	**57.13**
6	Karnataka	59.93	80.86	85.95	85.95	75.38	65.99	6.83	60.35	42.59	**56.62**
7	Maharashtra	65.17	88.35	74.37	74.37	80.24	67.34	4.59	58.86	34.39	**56.30**
8	Andhra Pradesh	58.78	78.56	80.03	80.03	74.75	58.77	6.27	56.67	40.43	**54.93**
9	Haryana	55.76	77.68	56.64	56.64	67.94	69.26	4.01	55.88	44.07	**53.85**
10	Assam	46.07	72.49	53.66	53.66	73.25	67.89	7.05	41.98	64.94	**50.68**
11	West Bengal	58.79	76.46	55.19	55.19	76.08	74.91	4.75	39.61	28.96	**50.10**
12	Madhya Pradesh	45.69	75.49	87.44	87.44	62.91	47.28	4.56	53.01	43.45	**48.83**
13	Rajasthan	49.91	69.13	76.27	76.27	59.05	50.32	5.72	53.19	36.59	**48.38**
14	Orissa	48.08	68.51	48.95	48.95	68.46	39.45	3.94	60.76	76.06	**48.08**
15	J&K	0.00	78.67	58.63	58.63	64.61	65.42	5.64	57.65	0.00	**47.18**
16	Uttar Pradesh	46.73	65.7	74.32	74.32	56.52	58.97	16.96	40.78	29.31	**46.26**
17	Uttaranchal	0.00	81.37	0.00	0.00	74.49	75.46	96.73	57.09	28.91	**45.33**
18	Bihar	49.63	57.31	49.29	49.29	52.02	53.5	5.24	28.87	28.57	**38.86**
19	Chhattisgarh	0.00	73.47	78.62	78.62	70.53	0.00	4.91	43.06	34.27	**32.32**
20	Jharkhand	0.00	62.77	53.73	53.73	58.68	34.25	5.38	22.38	21.23	**28.27**

SWOT Analysis

- ***STRENGTHS***
  - **Robust, services driven growth**
  - **External sector**
    - High reserves
    - Invisible flows
    - ↓Debt service ratios
  - **Big domestic Market limiting external contagion**
  - **High rates of domestic savings and investment**
  - **Low Gini index**
  - **Robust financial intermediation and independent central bank**
  - **Young labour force**
  - **Knowledge based eco. activity**
  - **English widely understood spoken**
  - **Limited long-term political risk: rule-based democracy**

- ***WEAKNESSES***
  - **Fiscal position**
    - power
    - Privatisation
    - Untargetted subsidies
    - public sector employment
    - State deficits
  - **Big POL deficit**
  - **Agriculture**
  - **High poverty and low median incomes with preponderance of low productivity informal sector**
  - **Relative high tariffs impacting allocative efficiency**
  - **labour market inflexible and labour intensive manufacturing weak**
  - **Infrastructure**
    - physical
    - social
  - **Emerging North-Peninsular divide**
  - **Corruption and governance**

Kaldor and Kuznets



GDP at factor Cost Constant Prices Base 1999-00			
	Ag_gr	GDP_gr	contrib of agric
1950/51 to 1979/80	1.90%	3.40%	24.50%
1980/81 to 1989/90	3.30%	5.40%	21.50%
1992/93 to 2001/02	3.20%	6.10%	14.50%
2002/03 to 2007/08	4.80%	8.80%	10.70%

Agriculture's share in total employment:

1950-51: 70% ***1980-81***: 68%

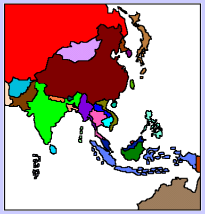
1990-91**:** 65% ***2004-05*****:** 58.4%

Agriculture's share in National Income:

1950-51: 57% ***1980-81***: 40%

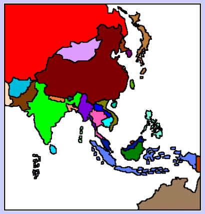
1992-93: 33% ***2006-07***: 20%

China-India: Similarities

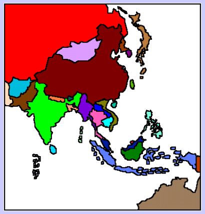


- Amongst the **biggest** countries in the world in terms of geographical extent, population, market-size and economy (PPP)
- **Ancient** prosperous civilisations, economically on par with, and arguably ahead of, Europe before the Industrial Revolution.
- **Colonised** by western powers, and attained independence in mid twentieth century.
- Amongst the **fastest growing** major economies today: China's growth industry led, India's services led.
- Followed a **socialist, ISI** model of development before opening up: China late 70's, India early 90's.
- The **State sector** continues to dominate economic activity even today, although role of private enterprise is expanding fast.
- In both China and India rapid economic growth has widened regional **economic disparities**: in China, the coastal areas versus the interior; In India, the south and west versus the north and east.

China-India: "Simi-rences"



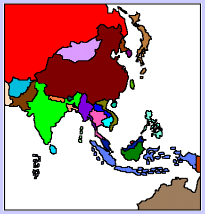
- Big **diaspora** a major factor in big foreign currency reserve build-up. Chinese diaspora more entrepreneurial (FDI), Indian more professional (Invisibles). External liquidity situation very comfortable.
- China very competitive in **visible exports** (manufactures), India in **invisible exports** (software services)
- Both face serious **fiscal problems** and ballooning domestic debt and would need to carry out a major public sector adjustment in the foreseeable future. India has a weaker fisc, China has weaker banks.
- Both countries face major future **developmental threats**: for India it is sustaining high growth, whereas for China the threat is more institutional, as they are not in synch with the needs of a market economy.
- **Corruption** endemic in both China and India. In China it is more centralized around the entrenched party which practically guarantees quick action. In India corruption is more dispersed, and outcomes less certain. Because corruption in India is subject to legislative, press and judicial oversight, it is less of a systemic risk than in China.



China-India:Differences I

- Pre-reform, China had made much greater investment in the social infrastructure such as health and education and agricultural infrastructure than India, thereby mostly eliminating absolute **poverty**. India has the largest mass of poor people in the world.
- China has shown greater urgency for **public sector restructuring**, and WTO accession is expected to intensify the process, with an unpredictable impact on political institutions.
- China is a **closed society** run by a tightly knit communist party (bereft of socialist ideology); India is an open, democratic society, with an independent judiciary and press.
- Local government in China have effective economic decision making powers, whereas India's **centralised control** is loosening only gradually.
- China has low **trade barriers** (custom tariff collections only about 3% of value of imports); India's customs tariffs still amongst the highest in the world.

China-India: Differences II



- China at the outset had an aggressive **FDI policy** for attracting investment in the labour intensive manufacturing sector in coastal SEZs insulated from the domestic policy environment. Indian growth largely service sector led.
- China invested huge amounts of public funds in developing its **infrastructure**; India relied relatively more on private funding, which has been slow to fructify, with a negative fall-out on growth.
- China has a very strong **political commitment** to reform at the top and in the regions. India has a weak, though growing, consensus.
- Political dissent not aired in the public domain which gives China **overt political stability** arguably difficult to sustain during a severe economic downswing/public sector restructuring. India has a long history of frequent transfer of political power through the ballot box at both the federal and State levels, an overt instability which nevertheless underscores the inherent stability its political institutions.

Global Shifts in Economic Gravity

Share of Global GDP					
	1000 AD	1820 AD	2007 AD	*2020 AD*	2050 AD
USA	0%	2%	21%	***18%***	11%
Euro	8%	21%	19%	***15%***	7%
China	25%	33%	11%	***20%***	24%
India	32%	16%	5%	***7%***	13%
	Angus Maddison		IMF_WEO	Projections	
GDP_per capita/world average					
	1000 AD	*1820 AD*	*2007 AD*	*2020 AD*	*2050 AD*
USA	88%	189%	465%	391%	252%
Euro	94%	186%	340%	290%	181%
China	103%	90%	54%	107%	154%
India	99%	80%	26%	40%	72%

Sub prime Financial Crisis and India I

- No direct impact because of marginal exposure to derivatives
- Initial impact was to inflate capital inflows and stock market based on ‘decoupling hypothesis’.
- Central Bank’s attempts to keep Rupee appreciation within limits injected liquidity that fed inflation.
- Central Bank adopted a tight monetary stance

Sub prime Financial Crisis and India II

- Over the longer term the crisis has spilt over into India
- Rupee under pressure as
    - CAD worsened because of spike in oil prices and weakening Rupee
    - Capital account deteriorated because of capital flight
- Commodity boom intensified inflationary tendencies because of dependence on Oil
- Fisc under pressure through absorption of most of the oil shock
- Combination of capital flight and ballooning quasi-fiscal deficit crowding out private borrowing with possible adverse fall-out on liquidity, investment and growth.
- Demand destruction in OECD also likely to drive growth below trend: chief transmission through 'invisible' trade.
- Sharp decline in stock market capitalization.
- Central Bank loosening monetary policy as inflation declining and liquidity is tight


Thank-you