

Economic Performance and Prospects

BY ALOK SHEEL

In the following selection, Indian economist Alok Sheel explains that India's economic performance since the restructuring of the early 1990s has been impressive, showing growth rates of around 6.5 percent and a reduction in the level of poverty from 36 to 26 percent of the population. Strengths of the Indian economy include the large population and potential market, a growing consumer-oriented middle class, and a stable political and legal system conducive to encouraging foreign investment. Underlying weaknesses that must be addressed if India is to realize her full potential relate to the country's poor state of physical infrastructure, particularly in the transport and energy sectors. In addition, the agricultural sector, which supports the majority of the poorer groups, has thus far not benefited from economic liberalization measures. Alok Sheel is the Economics Counselor at the Indian Embassy in Washington, D.C.

The Indian economy was relatively closed till 1991, following which sweeping reforms opened up trade, industry and financial sectors to domestic and foreign competition. The economic restructuring process has its protagonists and detractors. The latter consider the reform process too slow and partial, especially when compared to East Asia and China in particular, which have achieved much faster growth rates. Protagonists, on the other hand, point out that India has had one of the fastest growing economies during the nineties, averaging around 6.5 percent GDP growth per annum. Poverty levels have fallen from 36 percent to 26 percent over this period. Its international balance of payment is very comfortably placed. Growth rates recovered comparatively fast after the initial adjustment, and

Alok Sheel, "Political Economy of India, 1800-2001," *International Journal of Commerce and Management*, vol. 11, Summer 2001. Copyright © 2001 by *International Journal of Commerce and Management*. Reproduced by permission.

it escaped the more deleterious effects of the Latin American and East Asian debt and currency crises. Reform and growth, moreover, is being achieved in a much more challenging political environment, which reduces future political risk.

Following the collapse of the Soviet model of development, there is now a global consensus on the mix of policies for growth and development. The real debates now revolve around pace and sequencing. As India moves into the twenty-first century and integrates into a global economy where all barriers are fast breaking down, it is worthwhile to do a quick . . . analysis of India's political economy. Its greatest strengths derive from its numbers: its vast size, population and economy, and, in particular, its huge, ever expanding, middle class. This provides a powerful demand stimulus for boosting and sustaining growth rates, foreign investment and international trade. A stable political environment supplements this. Despite razor thin coalition-based majorities in parliament, the transition from one government to another has been smooth and through the ballot box. Close and heated parliamentary debates might slow down the policy reform process, but they also make the outcomes durable with little risk of reversal, thereby reducing political risk. India also has a robust legal system based on Anglo-Saxon jurisprudence, and English is widely spoken, thereby greatly facilitating its integration into the global economic mainstream.

The flip side of the state's disproportionate expenditure on higher education has been the creation of a big pool of skilled, white collar labor, whose global impact has been felt most tellingly in the Information Technology sector which is, not surprisingly, fast becoming the engine of growth of the Indian economy, as indeed it has been of the United States for some time now. The Indian Software industry growth rate exceeds 50 percent per annum, and India appears to be on track to becoming a global IT superpower with US\$50 billion exports by 2008, according to a recent influential survey done by McKinsey and NASSCOM [India's National Association of Software and Service Companies].

A Bright Outlook

India enters the twenty-first century on a relatively buoyant note. Despite global recessionary trends, especially in the leading IT sector, GDP growth in the financial year 2000–01 was around 6 percent, and export growth around 20 percent. Foreign currency

reserves have been sustained at a historic peak of US\$ 40 billion, despite the recent 75 percent rise in oil prices. Cumulative foreign investment stocks are touching US\$ 30 billion. IT technology export projections have been scaled down, largely on account of the IT downturn in the U.S., but these are, nevertheless, in excess of 40 percent. There is also good news on the fiscal front, with the fiscal deficit having been contained at the estimated level of 5.1 percent of the GDP for the first time in several years, as the expected tax buoyancy arising out of tax reform is beginning to be felt. The decline in interest rates is likely to improve the fiscal position still further, as interest payments on government debt is a major component of the government's budget deficit. The dip in inflation rates also makes it more likely that the drop in interest rates will be sustained in the market, making a virtuous cycle of lower deficits, with higher investment and growth a distinct possibility. The privatization efforts of the government have also picked up momentum with the first privatization of a profit making state owned enterprise, namely, the Bharat Aluminum Company. A number of major reform bills, such as the Fiscal Responsibility Bill, Information Technology, Communication and Entertainment Bill (or ICE which seeks to set up a unified regulatory framework to harness the synergy between these sectors in a bold attempt to convert India into an IT powerhouse), the Electricity Bill (which seeks to remove regulatory bottlenecks standing in the way of the financial closure of new power projects), and Competition Bill are being placed before parliament to be enacted into law.

India has the potential to become one of the fastest growing economies in the coming decade, and to emerge as a major economic power in the new millennium. However, certain fundamental weaknesses in the Indian economy will have to be addressed before this great potential is translated into concrete results. Huge investments in, and rapid development of, the infrastructural sectors, social and physical, are a necessary precondition for sustaining high rates of growth. Poverty indices have declined gradually over the years, but India still has a major share of the world's poor, which acts as a drag on the economy. Poverty reduction has a huge demand side upside, for it is well-known that the multiplier effect of putting more income into the hands of the poor is much higher than what it is in the hands of the more affluent.

The critical importance of a quantum jump in infrastructural investments cannot be over-emphasized. The IT sector, for instance, rides piggyback on the telecommunications network. But India's telephone density is below 2 percent, compared to over 7

A BLEAKER FORECAST

In contrast to the optimistic economic projections made by government economist Alok Sheel, in the following extract from India Changes Course: Golden Jubilee to Millennium in Historical Perspective, American author Paul R. Dettman paints a far bleaker picture of India's economic future given population trends and the continued divergence by the government of scarce resources from poverty-alleviation programs to its nuclear arsenal.

An indication of what lies in store over the next half century for the India that has joined the nuclear club was provided by a report issued by the Washington-based World Watch Institute following the May 1998 nuclear bomb tests. The report painted a picture of the state of India's natural resources, as it entered the third millennium, that raised serious questions regarding its ability to sustain a 1 billion plus population:

As the '90s unfold, the rise in grain productivity is slowing, as it is in many other countries. Against this backdrop, the continuing shrinkage of crop land per person now threatens India's food security. In 1960, each Indian had an average of 0.21 hectares of grain land. By 1999, the average had dropped to 0.10 hectares per person, or less than half as much. And by 2050, it is projected to shrink to a meager 0.07 hectares per person. . . .

Falling water tables are also threatening India's food production. . . . In a country where irrigated land accounts for 55 percent of the grain harvest and where the lion's share of irrigation water

percent in China and over 11 percent in Thailand. Rail, road, port and air links, and the energy sector, in particular are in need of huge investments for expansion, without which Indian industry cannot become internationally competitive in an increasingly

comes from underground, falling water tables are generating concern. The Water Management Institute estimates that aquifer depletion could reduce India's grain harvest one-fourth. Falling water tables will likely lead to rising grain prices on a scale that could destabilize not only grain markets, but possibly the government itself. With 53 percent of all children undernourished and underweight, any drop in food supply can quickly become life-threatening. India's population is projected to reach 1.5 billion by 2050, but there are doubts as to whether the natural resource base will support such growth. . . .

In some ways, India today is paying the price for its earlier indiscretions, when, despite its impoverished state, it invested in a costly effort to design and produce nuclear weapons and succeeded in becoming a member of the nuclear club. As a result, it has a nuclear arsenal capable of protecting the largest concentration of impoverished citizens on earth. Even today, India spends 2.5 percent of its GNP for military purposes but only 0.7 percent on health, which includes family planning. Unless India can quickly reorder priorities, it risks falling into a demographic dark hole, one where population will begin to slow because death rates are rising. It may be time for India to redefine security. The principal threat now may not be military aggression from without, but population growth from within.

Paul R. Dettman, *India Changes Course: Golden Jubilee to Millennium in Historical Perspective*. Westport, CT: Praeger, 2001, pp. 202-204.

globalized economy. Fiscal consolidation in the center and states, including deepening of tax reforms, privatization and rollback of the state, would be necessary to release resources for infrastructural development. Indian customs tariffs are excessive, and these translate into distorted resource flows and inhibit the growth of international trade. Inflexibilities in the labor market and bankruptcy laws also act as barriers to investment and growth. Finally, the agricultural sector has been barely affected by economic reform, so far.