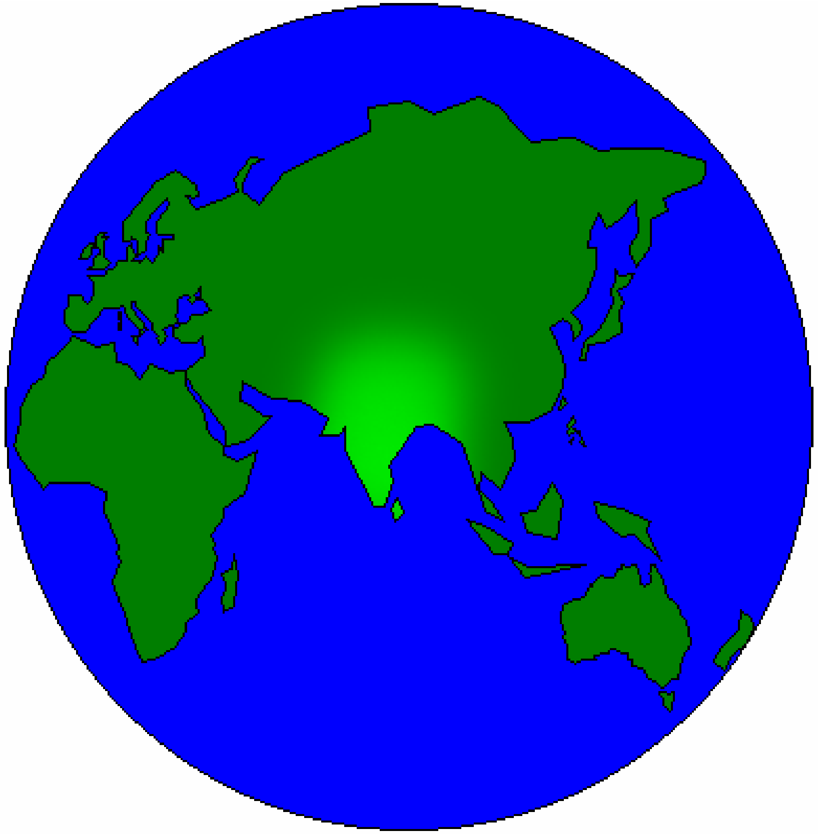
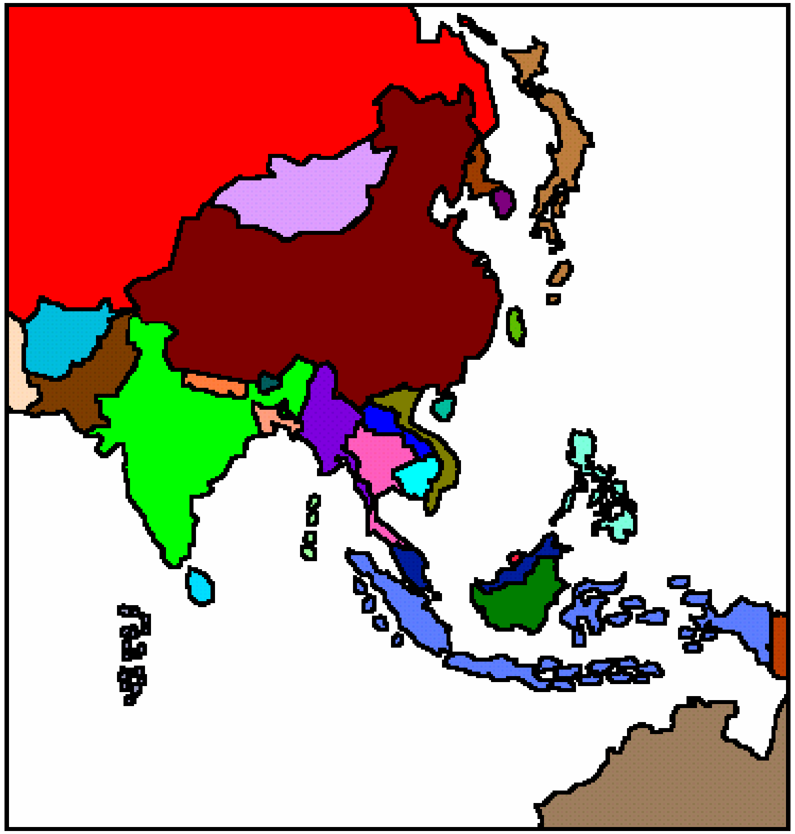
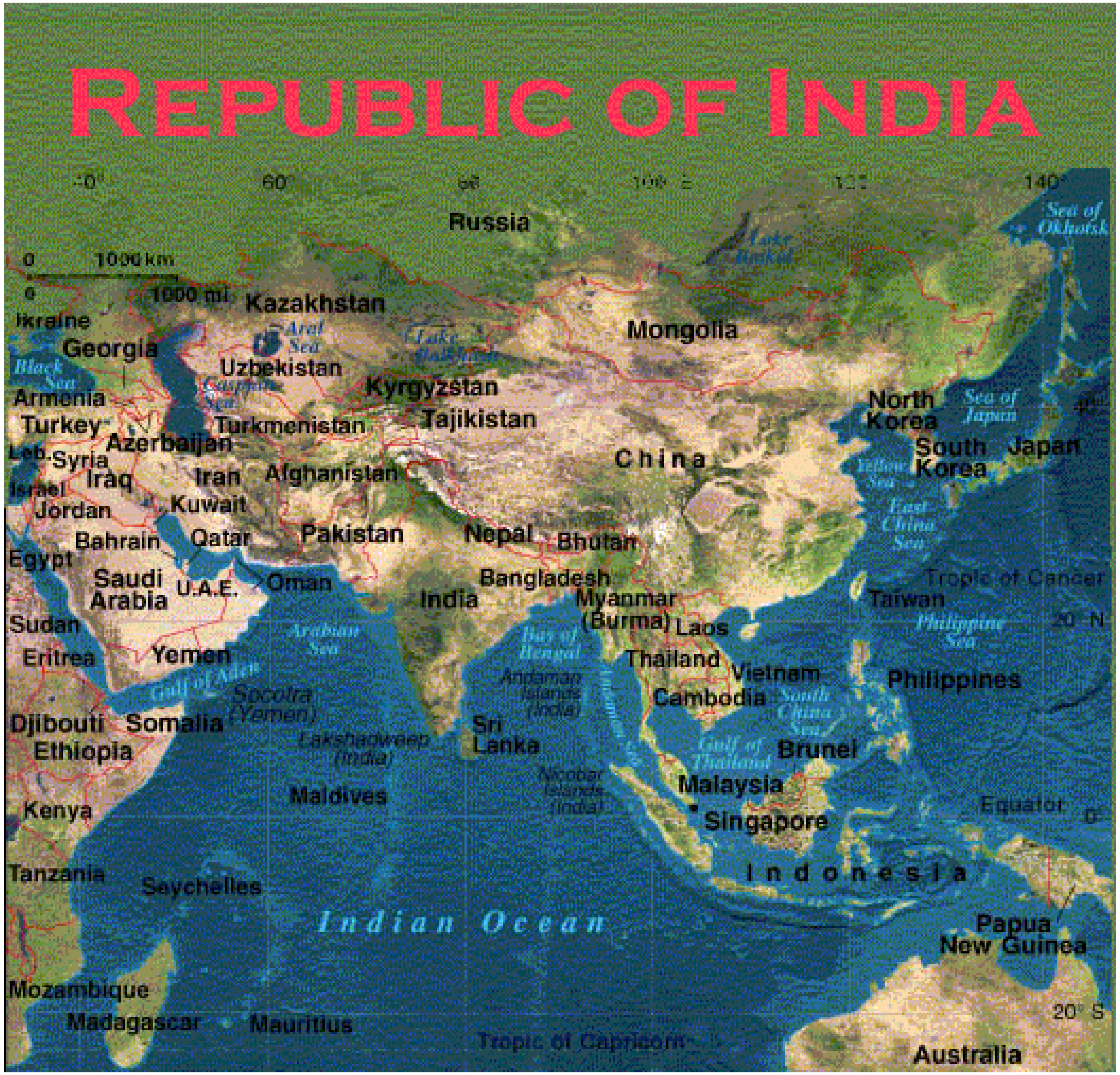
The Indian Economy 1947-2001





Alok Sheel


REPUBLIC OF INDIA
60°
140°
Russia
0 1000 km
0 1000 mi
Kazakhstan
Aral Sea
Mongolia
Georgia
Black Sea
Uzbekistan
Armenia
Kyrgyzstan
North Korea
Sea of Japan
Sea of Okhotsk
Lake Baikal
Turkey
Turkmenistan
Tajikistan
Azerbaijan
South Korea
Japan
Syria
China
Iraq
Iran
Afghanistan
Israel
Jordan
Kuwait
Yellow Sea
East China Sea
Bahrain
Qatar
Pakistan
Nepal
Bhutan
Egypt
Saudi Arabia
U.A.E.
Oman
Bangladesh
Tropic of Cancer
India
Myanmar (Burma)
Taiwan
Sudan
Laos
Philippine Sea
20° N
Arabian Sea
Bay of Bengal
Eritrea
Yemen
Thailand
Vietnam
Philippines
Gulf of Aden
Andaman Islands (India)
Cambodia
South China Sea
Socotra (Yemen)
Djibouti
Somalia
Sri Lanka
Lakshadweep (India)
Ethiopia
Gulf of Thailand
Brunei
Nicobar Islands (India)
Malaysia
Maldives
Equator
Kenya
Singapore
Indonesia
Tanzania
Seychelles
Indian Ocean
Papua New Guinea
Mozambique
20° S
Madagascar
Mauritius
Tropic of Capricorn
Australia

CONTENTS

Comparative Country Table: 2000

	USA	Brazil	Russia	China	India
Population	282 M	166 M	145 M	1260 M	1000 M
Area	9.4M Sq Km	8.5M Sq Km	17M Sq Km	9.6 M Sq Km	3.3M Sq Km
% area cropland	21% (1.9M)	6% (.5M)	8% (1.4M)	10% (1M)	57% (1.8M)
% area forest	32%	66%	45%	13%	16%
Agriculture/GDP	2%	8%	7%	21%	29%
GDP(PPP)	$ 9870 Bn	$ 1280 Bn	$ 722 Bn	$ 5900 Bn	$ 2038 Bn
GDP per capita	35000	7710.8	4979.3	4682.5	2038
Gini Index		0.58	0.5	0.41	0.34
Trade/GDP	20%	21%	60%	43%	27%
S&P Credit Rating	AAA	BB-	B	BBB	BB
Life Expectancy	77 years	67 Years	65 Years	69 Years	62 Years
Adult Literacy	100%	84%		81%	52%

India at Independence in 1947

- **Agriculturally backward**: Markets integrated, but foodgrain 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 based on the 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.**
- Massive state expenditures financed by high tax rates and borrowings. **Fiscal and BOP crises** (vulnerable to oil price shocks): proximate cause of economic liberalisation of the nineties.

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**.
- First round of reforms **crisis driven** (hence swift); second generation **consensus driven** (hence slow): strong consensus on weak reforms?

Eco. Policy Changes in the Nineties

- **Industrial**: delicensing and opening up the economy to private, including foreign, investment.
- **Trade**: Sharp reduction and rationalisation in custom tariffs and excise, including removal of all quantitative restrictions on trade.
- **Foreign exchange**: full float of the rupee on current account, and greater liberalisation of the capital account, especially on the non-debt component. External debt capped.
- **Public sector**: a major thrust on Tax-reform, privatisation and fiscal deficit reduction.
- **Financial sector**: opening up of the Insurance sector to private and foreign investment, de-regulation of interest rates, better regulation to ensure prudential lending norms (including reduction of non-performing assets) and investor safeguards, and moving away from monetisation of the government deficit.

Impact of First Phase of Reforms - I

- *Indicators averaged for 1980-81 to 1990-91 and 1992-93 to 2000-01 (Crisis year of 1991-92 excluded)*
- **External Sector Robust (1990/91 versus 2000-01)**
  - ED ratios improve
  - EDT/GDP ↓ from 31.5% to 24.2%
    - FE Reserves ↑ from \$ 2.2 B(1 month import cover) to \$ 39.5 B (8 months import cover)
    - EA/Capital flows ↓ 26.3% to 5.1%; FI/Capital Flows ↑ 60% from Nil.
  - Manageable CAD because of Invisibles
    - TB/GDP - 3.5%; CAD/GDP ↓ from 3.6% to 0.5%
  - Stable rupee: No sharp variations in real exchange rates
  - Economy more open: Trade/GDP ↑ from 17% to 25.1%
  - Float takes wind out of hawala market
  - Fiscal slippages not allowed to spill over externally.
- **Domestic Growth ↑ from 5.6% to 6.1%**
  - Agriculture declined from 3.8% to 2.8% (Unreformed, monsoon linked)
  - Industry: ↓ slightly from 7% to 6.6% (Distorted flows)
  - Spurt in growth of almost entirely services led ↑ from 6.1% to 7.2%
  - Some States forge ahead taking advantage of reform

Impact of First Phase of Reforms - II

- **Poverty continues to decline slowly**
  - ↓ from 40% in early eighties to 25% at present. Trickle-down of growth?
- **Inflation**
  - ↓ from 8.2% to 7%
  - Differential between US inflation and Indian ↑ from 2.7% to 4.4%.
- **Interest rates high in real terms**
  - Real interest rates ↓ by about 1% from 8.3% to 7.2%.
  - Real interest rate differential with US ↓ marginally from 2.2% to2%.
- **Savings and Investment growth private**
  - Savings/GDP ↑ from 19.8% to 23.2%
  - Public sector savings ↓ 1.8%, household savings ↑ 3.2% and Corporate savings ↑ 1.9%
  - Domestic capital formation ↑ 2.6% (from 21.8% to 24.4% of GDP)
  - Private capital formation ↑ 3%, while public sector ↓ 2.6%.
- **Fiscal Management still weak**
  - No significant change in consolidated GFD of Centre and States at around 8% of GDP
  - Centre's deficit ↓ about 2% while States' deficits ↑

Strengths of Indian Economy

- Robust, services driven **growth**
- Demographic profile: **youthful population.**
- **External sector**: High reserves, Invisible flows, ↓Debt service ratios
- Huge and growing middle class **market**
- **English** widely spoken and understood
- A **rule-based democracy** based on anglo-saxon rule of law
- Limited external **contagion**
- Cost effective **Knowledge** based eco.activity: Rapid IT and IT enabled services gowth, including outsourcing.
- **Agricultural** potential
- Limited long-term **political** risk

Weak Links

- **Infrastructure**, **physical and social**: perhaps the weakest link coming in the way of higher growth rates.
- **Fiscal reform** lagging: high deficits, slack privatisation and roll-back of the State, both in Centre and States.
- Indian **tariffs** still relatively high with resultant negative fallout on allocative efficiency and growth in trade.
- Big **POL** deficit
- **Poverty** and population growth rate.
- **Foreign investment** flows slack compared with China..
- **Labour** market inflexibility.
- Completing **financial sector and tax reforms.**
- **Governance**, including contract enforcement and creditor rights.
- **Agriculture** scarcely touched by reform

India 2001: The Road-map Ahead

- Investment in **Infrastructure, physical and social**
- **Lowering tariffs** to global levels
- Pushing up growth and **foreign investment**.
- **Labour** market reforms
- **Privatisation** and Roll-back of the State
- Deepening **financial sector** reforms, including Capital convertibility
- Completing **Tax** reforms
- Reforming the **agricultural** regime
- Dent on **poverty** and population growth
- **Fiscal consolidation** in the Centre and States.
- **Governance** issues.

China-India: Similarities

- Amongst the **five biggest** countries in the world in terms of geographical extent, population, market-size and economy (PPP)
- **Ancient** prosperous civilisations, economically 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, weaker banks.
- Both countries face major future **developmental threats**: for India it is economic stagnation, 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

- Domestic **savings** almost twice as high in China (40%)
- 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. Gradually moving up the technology chain. India initially encouraged FDI in high technology and infrastructure sectors, which were difficult to absorb, and is only now liberalising down the value chain.
- 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.

Thank-you for the patient hearing