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ON THE SUSTAINABILITY OF INDIA'S NON-INCLUSIVE HIGH GROWTH

Surajit Mazumdar [*]

[**Abstract**: *This paper examines the sustainability of the unprecedentedly high aggregate GDP growth witnessed in India from 2003–04 till the eruption of the global crisis. It argues that the post-liberalization highly non-inclusive and corporate-sector led growth trajectory in India suffers from a fundamental contradiction which renders it inherently unstable. This contradiction is between increasing dependence of growth on investment demand and the absence of a commensurate expansion of either output or employment in organized manufacturing, the main sector where rapid growth of capital formation tends to be relatively concentrated. This had already generated a collapse of investment and a manufacturing centered growth slowdown in the second half of the 1990s. The paper shows that high growth in India after 2003–04 did not eliminate this contradiction. Instead, the transmission effects generated by an exceptionally expansionary phase of the global economy enabled a sharp revival of investment which generated this growth, but in the process the contradiction started surfacing again. With the global crisis this phase came to an end, and in the post-crisis situation revival of that growth trajectory appears unlikely. In such circumstances even modest gains on the development front via the positive effects of high growth on public revenues cannot be guaranteed.*]

1. Introduction

Till the early years of the first decade of the current century the evidence was unequivocal that the extensive liberalization process initiated since 1991 had not brought about any shift of the Indian economy to a higher growth trajectory (Rodrik and Subramanian 2005). Since 2003–04 and till the global crisis erupted, however, the pace of aggregate growth of India's economy moved to levels unprecedented in her history. A sharp rise in investment levels, led by the private corporate sector, was a distinctive feature of this growth phase. That growth process remained highly non-inclusive in nature in a direct sense. However, that very non-inclusiveness produced a positive impact on tax revenues which has contributed to fostering the impression that if such growth is sustained it would be possible to indirectly impart to it a more inclusive character. Expansion of social sector expenditures, it is felt, would be possible even while

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maintaining low levels of taxes and of the fiscal deficit. Many objections could be raised in response to such an understanding of inclusiveness, and there would be good reasons to be dissatisfied with it even if it were to be achieved. This paper however does not go into a comprehensive discussion of these issues but instead makes a very specific point. This is that it is precisely the non-inclusive character of Indian growth under liberalization that makes it doubtful that the high growth seen in this century would be sustained over a long period of time. The instability which currently tends to be externalized and attributed to the global crisis in fact is inherent to India's corporate sector-led growth trajectory under liberalization.

If one closely examines the process making for it, rapid growth in India appears to have been the product of a very specific set of global and domestic factors whose continuation in the post-crisis situation is unlikely. At the same time, even without global conditions turning adverse, the process was characterized by contradictions which made its long-run sustainability seriously doubtful. In addition, with the crisis leading to a sharp widening of the fiscal deficit, 'fiscal consolidation' is back on to the Indian policymakers agenda with a vengeance. This threatens sustained expansion of either purely growth inducing or developmental public expenditures. In such circumstances, to pin one's hopes of significant advances in social development as an indirect effect of liberalization induced and private corporate investment-led rapid growth would be unwarranted. Instead it is important to continue stressing that employment generation and reducing of income-inequalities are not only laudable development objectives in themselves but are also necessary for imparting stability to the capital accumulation and growth processes of the economy.

The argument of this paper is developed over four parts. The first brings out the contrast between mainstream theoretical approaches to the role of capital in development and contemporary global as well as the specifically Indian experiences. In this are highlighted what has been called the global 'capital flows paradox' as well as the emergence in India of a peculiar relationship between capital formation, output growth and employment expansion. The second part then highlights the important role played by income-distribution related demand factors in generating these paradoxes, with particular reference to India's case. The third part then examines the conditions which made for the high growth since 2003–04, placing the Indian story within the larger global context. It shows how the Indian experience even if somewhat different from that of many other developing countries during this period was still linked to global economic trends. In the light of the previous discussions, the fourth part then considers the possibility of the sustenance of the high growth trajectory observed after 2003–04 and brings out the constraints faced by it. A brief summing up is provided in the conclusion.

2. Capital Formation and Economic Development: The Paradoxes of Contemporary Experience

In its early days, mainstream development economics laid great stress on the importance of capital formation for economic growth and development (Zuvekas 1979). The extreme scarcity of capital, underlying both the existence of large reservoirs of surplus labour as well as low labour productivity, was considered the defining feature of the underdeveloped economy. The situation of limited capital and corresponding low levels of income, it was argued, tended to be perpetuated as low income levels held down the savings ratio and weakened the inducement to invest, resulting in low levels of investment. If an underdeveloped economy had to break out of this low-level equilibrium trap, it would have to create conditions which would set off a process of rapid capital formation. The goal of development policy in this perception was to break this vicious circle between capital shortage and underdevelopment.

Early development thinking's emphasis on growth and capital formation was accompanied by a belief in the trickle-down effect and the validity of the inverted-U hypothesis. These facilitated the growth of the perception that there existed growth-equity as well as a growth-employment trade-offs in the initial stages of development. Egalitarian income-distribution patterns and high employment, it was felt, would lead to increase in consumption ratios and militate against finding resources for capital formation and thereby undermine the long-run increase in incomes and employment. That skewed income-distribution patterns could lead to problems of demand was not considered. Both the aggregate demand and the employment problems of these economies were seen as something related to capital scarcity rather than with a lack of effective demand in the Keynesian sense. It is through capital accumulation that these problems had to be therefore addressed, for which savings were a virtue. The use of relatively capital-intensive techniques which would maximize the surplus for accumulation was also therefore considered legitimate. For the same reasons, the holding down of mass consumption and unequal distributions of income were considered tolerable. While it was believed that there was no real alternative to increased mobilization of domestic resources, foreign financing was also accorded importance not only as a supplement to domestic savings but also for filling the foreign exchange gap.

Subsequently, however, the initial complacency about the issues of income-distribution and employment came to be increasingly questioned along with the value of GNP as an index of development (Todaro 1981). There were in some strands of traditional development theory indications that with the use of capital intensive techniques, a chronic existence of surplus labour could accompany capital accumulation. The influence

of the pattern of demand, a function of income-distribution, on the capital-intensity of techniques used was also pointed out. The possibility that lack of growth of employment and wages, and an unequal income distribution pattern, could inhibit investment and utilization of the potential surplus was also recognized. These were cautions against an exclusive preoccupation with capital accumulation and growth that traditional development theory could often foster. They pointed towards the possibility that the long run could become infinitely long and effective demand problems of a more Keynesian nature could arise even without the elimination of surplus labour. Thus both kinds of unemployment and demand problems, unutilized capacity and capital scarcity, could therefore co-exist and mutually reinforce each other in developing countries.

These advances in mainstream development thinking however proved to be short-lived as the neo-liberal counter-revolution upstaged Keynesianism in the West and then proceeded to obliterate for all practical purposes the distinctive character of the analysis of economic development in the Third World. Notwithstanding its initial neglect of issues like income-distribution and demand, development economics had been in a sense born heterodox. Its initial demarcation from the main body of economics lay precisely in its premise that standard western economic theory, included in which were both static neo-classical price-theory as well as short-period Keynesian macroeconomics, had limited relevance for the context of developing countries. There was also a clear understanding that the underdeveloped economy's spontaneous tendencies would not produce development and the state therefore had to play a key role in overcoming the obstacles to growth. The conception of the role of the state in development then became wider once it was further recognized that growth would not automatically take care of widespread poverty.

With the rise of neo-liberalism, however, the mainstream of development economics came to be captured by neo-classical orthodoxy. Growth once again took the centre stage, not necessarily as the actual outcome but as the central development objective and as the primary yardstick for judging development performance. Neo-liberalism however dispensed with the ideas in older development economics about the state's role. Instead it led to a virtually exclusive emphasis in development policy on creating an attractive 'investment climate', one that would encourage private investment, domestic and foreign. Elimination of barriers to capital inflows was particularly emphasized by neo-liberalism. The issue of distribution was pushed into the background as something to be determined by the market. No conception of any demand problem, in either a developed or developing country context, was of course part of the neo-liberal paradigm.

2.1. The Paradox of Global Capital Flows

Quite in contrast to what mainstream theory predicts and what was the expected outcome of globalization has been the peculiar feature of the world economy since the late 1990s that has been called the 'capital flows paradox' or the phenomenon of 'capital flowing uphill'. There are two parts to this paradox that have captured attention (See *Table-1*). The first relates to the *direction* of capital flows in the world economy, which has been has been *from* capital-scarce developing countries *to* the capital-abundant developed countries. This has mainly taken the form of accumulation of foreign exchange reserves by developing countries. The process of capital flowing uphill, of developing countries as a group running current account surpluses against deficits of developed countries, emerged after the East Asian crisis. Its scale however increased significantly from the early years of this century. This is of course an aggregate picture for the two groups of countries, and individual countries within each of them have exhibited in this period both current account surpluses as well as deficits. Broadly however the picture was one of improving current account balances amongst developing countries and the opposite in the case of developed ones. The second element in the paradox is that the capital flows have *not been following* growth, and instead the net capital exporting countries have been growing *faster* than the recipients of such flows. Developing countries as a whole experience a sharp upturn in their growth rates coinciding with the surge in capital flows and created a large gap with the rates of developed countries. Even within them, the capital exporters were generally those with relatively higher growth rates, typified by countries like China.

Table-1
GDP Growth Rates and Current Account Balances

Country Group	*Growth Rate of GDP at Constant Prices*			*Current account balance (U.S. Dollars Billions)*		
	1991–97	*1998–2002*	*2003–08*	*1991–1997*	*1998–2002*	*2002–2008*
Advanced economies	2.51	2.58	2.37	118.75	-783.14	-2137.01
Emerging and developing economies	3.44	4.13	7.22	-618.83	97.89	2803.60
All Countries	2.85	3.16	4.41	-500.08	-685.25	666.59

Source: World Economic Outlook Database

To explain the paradoxical combination of high growth and current account surpluses being exhibited by many developing countries, the UNCTAD's Trade and Development Report 2008 put forward an alternative to the mainstream analysis. In this view developing countries with diversified exports, like many East Asian countries, have been

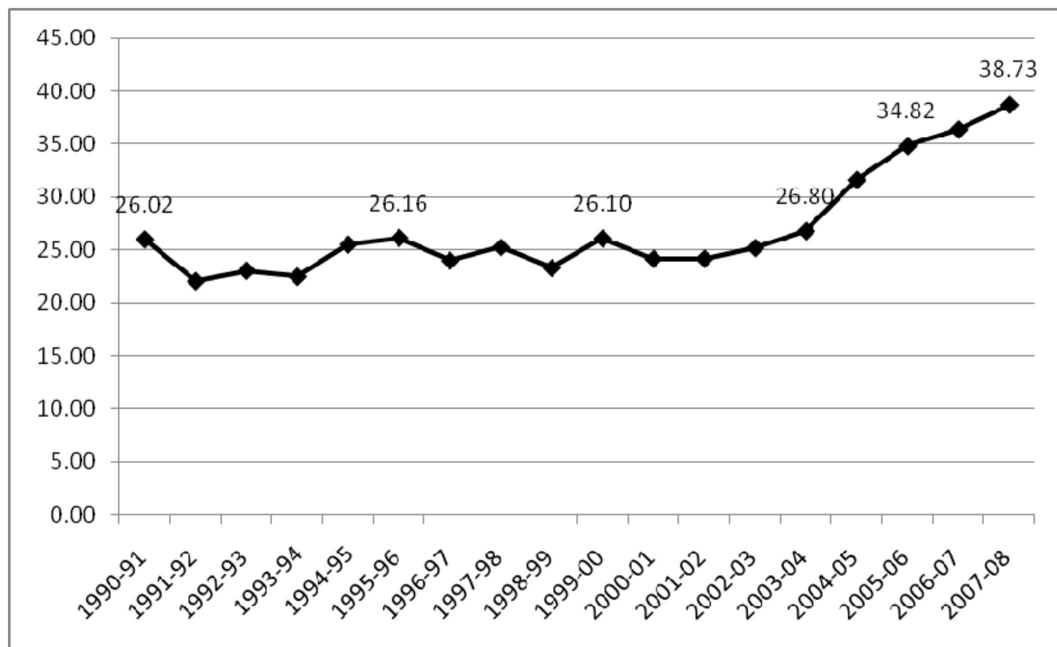
using competitive real exchange rates to generate export surpluses and accumulate foreign exchange reserves to reduce their vulnerability to volatile capital flows. This in turn permitted them to pursue monetary and fiscal policies encouraging investment financed by reinvested corporate profits and the banking system. Export surpluses and such domestic investment friendly policies worked towards stimulating demand and growth in these economies and expanding global demand for primary commodities. Primary commodity exporting developing countries and oil-exporting countries on the other hand benefited from these world demand conditions and rising prices after 2003.

2.2. 'Investment-led' High Growth in India

Clearly India's growth shifting into a higher gear from 2003–04 onwards was in line with the trend for developing countries as a whole. It ended the period of relative slowdown in growth into which the economy had slipped into in the second half of the 1990s, with growth averaging 8.8 per cent per annum till 2007–08 as compared to 5.4 per cent in the six-year period ending in 2002–03. This transition was accompanied by a quite dramatic rise in the investment rate. For more than a decade prior to this, the ratio of Gross Capital Formation to GDP in India had stayed at the 25–26 per cent level, but in the short space of five years beginning 2003–04 it increased to nearly 39 per cent (*Figure-1*).

In other words, a stimulation of investment was also part of the Indian story of acceleration in growth. Like many other developing countries, India too in this period accumulated large foreign exchange reserves. Where it was the most notable exception to the standard developing country story was that while it was amongst the developing countries with the highest growths, it was a net capital importer rather than exporter during this phase. Its foreign exchange reserves were therefore accumulated on the basis of capital inflows rather than current account surpluses. One aspect of this was that capital inflows had also led to a sharp appreciation of the rupee which hurt Indian exports. Not only this, India's current account balance, and its merchandise balance, actually worsened in the period of high growth and rising investment rate (*Table-2*). The merchandise balance in fact deteriorated to a much greater extent, attaining unprecedented levels (as a proportion of GDP). That not all of this was on account of oil imports is clear from the sharp deterioration that took place even in the non-oil balance. The non-oil balance and the current balance had both turned positive when growth was low, but this changed quite sharply once growth rates moved upward. India can thus be said to be an odd case amongst developing countries, one to which the UNCTAD kind of story does not exactly fit.

Figure-1
Gross capital Formation to GDP in India (Per Cent)



Source: CSO, National Accounts Statistics

Table-2
External Balances and Capital Formation to GDP Ratios: India (Percentages)

Item	*2001–02*	*2002–03*	*2003–04*	*2004–05*	*2005–06*	*2006–07*	*2007–08*
Merchandise Balance/GDP	-2.41	-2.11	-2.30	-4.82	-6.40	-6.78	-7.80
Non-Oil Balance/GDP	0.90	1.26	0.45	-0.73	-1.70	-2.29	-3.18
Invisibles Balance/GDP	3.13	3.36	4.62	4.43	5.18	5.71	6.34
Services Balance/GDP	0.70	0.72	1.68	2.19	2.86	3.22	3.20
Private Transfers/GDP	3.22	3.23	3.60	2.92	3.03	3.26	3.55
Current Account/GDP	0.72	1.25	2.32	-0.39	-1.22	-1.07	-1.46
GFCF/GDP	23.62	23.83	24.97	28.45	31.02	32.55	33.99
GCF/GDP	24.18	25.21	26.80	31.63	34.82	36.39	38.73

Source: RBI, Handbook of Statistics on the Indian Economy; CSO, National Accounts Statistics

The correlation between rising investment rate and worsening current account balance in India's case did not however mean that rising investment was mainly financed by capital imports. India's savings rate also increased concurrently, and to an order only marginally less than that of the investment rate (*Table-3*). The notable aspect of this rise as well as of investment was that both were to a great extent attributable to the private corporate

sector. The rather dramatic rise in the levels of private corporate investment since 2003–04 in turn is accounted for by the investment in manufacturing activities, the movement in the ratios of corporate and manufacturing investment to GDP being virtually identical. This rapid growth of corporate and manufacturing investment reflected a spectacular recovery from the collapse that had characterized these in the six years prior to 2003–04 after the boom of the early 1990s (*Table-4*).

Table-3
Savings and Capital Formation as Percentage of GDP: India

Item	*2002–03*	*2003–04*	*2004–05*	*2005–06*	*2006–07*	*2007–08*
Gross Domestic Savings						
household sector	22.95	24.11	22.76	24.11	24.09	24.35
private corporate sector	**4.04**	**4.61**	**6.73**	**7.71**	**8.29**	**8.83**
public sector	-0.65	1.07	2.19	2.42	3.34	4.50
Total	**26.34**	**29.79**	**31.68**	**34.24**	**35.72**	**37.68**
Gross Fixed Capital Formation (GFCF)						
household sector	12.03	12.26	12.51	12.11	12.11	12.25
private corporate sector	**5.52**	**6.26**	**9.52**	**11.92**	**12.83**	**13.41**
public sector	6.28	6.45	6.41	6.99	7.60	8.33
Total	**23.83**	**24.97**	**28.45**	**31.02**	**32.55**	**33.99**
Reg. Manufacturing	*4.01*	*4.77*	*6.81*	*8.37*	*9.15*	*9.59*
Total Manufacturing	*6.26*	*7.73*	*10.82*	*12.17*	*13.40*	*13.68*
Gross Capital Formation (GCF)						
household sector	6.09	6.34	6.89	7.58	7.98	9.08
private corporate sector	**5.93**	**6.83**	**10.76**	**13.72**	**14.80**	**15.88**
public sector	12.63	12.74	12.68	12.37	12.40	12.64
Total	**25.21**	**26.80**	**31.63**	**34.82**	**36.39**	**38.73**

Source: CSO, National Accounts Statistics

Table-4
Rates of Growth of Gross Fixed Capital Formation at Constant prices (per cent per annum)

At 1993–94 prices			*At 1999–00 prices*		
Period	*Registered Manufacturing*	*Private Corporate Sector*	*Period*	*Registered Manufacturing*	*Private Corporate Sector*
1990–91 to 1996–97	19.5	21.94	1999–00 to 2002–03	-4.91	-2.02
1997–98 to 2002–03	-6.06	-3.75	2003–04 to 2007–08	28.51	31.39

Source: CSO, National Accounts Statistics

The scorching pace of private corporate investment growth is clearly an important component of the story of high growth in India, and it indeed has been termed as an investment-led growth. But in what sense has it been an investment-led growth? This is

where an additional peculiarity of the Indian experience lies. The reasoning of both traditional development theory as well as neo-liberalism would suggest that growth of output at least, if not employment, should happen in the specific sectors where capital formation takes place. In the Indian case under high growth, rapid capital formation did not produce a commensurate expansion, of *both* employment and output, in organized manufacturing. While there was an upswing in its growth, a recovery from the slump it entered into in the second half of the 1990s, organized manufacturing's contribution to the increase in aggregate NDP at constant prices between 2002–03 and 2007–08 was just 7.67 per cent. In contrast, the sector accounted for nearly 29 per cent of the increase in aggregate net fixed capital stock (excluding real estate) over the same period. The complete stagnation of organized manufacturing employment while this was happening is of course well known.

The two-fold nature of the mismatch between capital formation, output growth and employment expansion tends to be hidden by the parallel rapid growth of output in sectors much less intensive in the use of capital, namely services and construction. The mismatch has however been characteristic of the entire liberalization period (Mazumdar 2008) (See *Table-5*). From the mid-1990s can be observed a clear and sharp reversal of the declining trend of the capital-output ratio in organized manufacturing observed in the 1980s. The stagnation of organized manufacturing (and its private component) employment has been a longer story (Kannan and Raveendran 2009), but became particularly adverse since 1997.

Table-5
Organized Manufacturing Sector Employment and Capital-Output Ratio

Sector	*1981*	*1991*	*1997*	*2003*	*2007*
Employment (in Lakhs)					
Public Sector	15.02	18.52	16.61	12.60	10.87
Private Sector	45.45	44.81	52.39	47.44	47.50
Total	**60.47**	**63.33**	**69.00**	**60.04**	**58.37**
Average Capital-Output Ratio (Years)					
	1980–81	**1990–91**	**1996–97**	**2002–03**	**2007–08**
Registered Manufacturing	6.12	4.87	4.94	6.73	7.45

Source: Government of India, Economic Survey

If the high growth since 2003–04 was at all investment-led, the effect was through the demand side. Instead of capital formation in manufacturing supporting aggregate growth because of the addition to capital stock it brought about, it is the expenditure investment involved which mattered. Indeed investment growth has clearly played a

more important role than consumption growth in expanding final demand. The pace of growth of non-food consumption at constant prices in fact moved up relatively marginally from 7.51 per cent per annum between 1997–98 and 2002–03 to 8.38 per cent per annum from 2003–04 to 2007–08. The corresponding increase in the rate of growth of capital formation was from 6.11 per cent per annum to nearly 16 per cent per annum. In the recent phase of high growth, investment more or less matched consumption in contributing to incremental final demand (*Table-6*).

Table-6
Contribution of Selected Components of Final Expenditure to Yearly Increments in Expenditure on GDP at Current Market Prices (Percentage Shares).

Item	*2002–03*	*2003–04*	*2004–05*	*2005–06*	*2006–07*	*2007–08*
Private Final Consumption Expenditure (PFCE)	47.93	49.36	35.60	49.72	46.16	48.51
Gross Fixed Capital Formation (GFCF)	26.67	34.29	52.71	49.53	42.63	44.02

Source: CSO, National Accounts Statistics

3. Income Distribution, Industrial Demand and the Problem of Sustaining Investment

In the global context, the heavy dependence of many developing countries on export markets and an excess of their savings over their investment can be said to reflect a limited absorption capacity of their domestic consumption. This in turn is a product of increasing inequalities and holding down of mass consumption. In India too income-distribution trends and the privileging of the private corporate sector in the economy's growth process have played a crucial role in giving rise to the combination of a demand expansion process heavily dependent on growth of investment, and the mismatch between the output growth and capital formation resulting from that investment.

Liberalization has not only privileged the private sector over the state as the agency for channeling investible resources to productive investments, within the private sector too it has similarly privileged the private corporate sector over other private units in the household sector. The private corporate sector however is not an equally effective agency for investments in different sectors and of different kinds. Manufacturing, however, represents one of the most natural outlets for private corporate investment. In addition, the services in which the corporate sector has found growth opportunities typically have a limited capacity to absorb investment given their relatively low capital requirement per unit of output. That is why private corporate and organized manufacturing investments

show such a strong correlation. The ascendancy of the private corporate sector in the Indian economy's investment process has therefore tended to bias that process towards the manufacturing sector.

With regard to income distribution, two elements of it are relevant in this context. One is that the corporate sector share in the economy is increasing even as the distribution of income within it has moved sharply in favour of profits. This has been particularly marked in the period of high growth one implication of which, a sharp rise in the corporate savings to GDP ratio, has been already mentioned. The second element relates to the liberalization related aggravation of personal income inequalities. This has reinforced the narrowness of the Indian domestic market and produced a double squeeze on industrial demand. At one end the holding down of incomes of a large majority of the population keeps them out of the market for manufactured goods. At the other, rising incomes of those already in the market is resulting in further diversification of their demand increasingly in favour of services. In non-food private final consumption expenditure in the domestic market (excluding that on gross rental and water charges), the share of manufactured commodities has been consistently declining since the early 1990s (Mazumdar 2008). Expenditures on services have increasingly displaced those on manufactured consumer goods. Demand for manufactures from the higher income groups, to the extent it is generated, also tends to be for more capital-intensive goods.

Inadequate expansion of domestic demand for manufactured consumption goods can of course be compensated by exports of manufactures, which in turn can spur investment. East Asian growth as mentioned earlier is supposed to have been based on precisely such a combination. But we have also seen that rather than export surpluses serving as the engine for investment and growth, the Indian experience has been of a widening deficit. This reflects the fact that the great manufacturing export success promised by trade liberalization has not materialized in India. India's major export success has been in a particular category of services rather than in manufactured products.

The declining share of manufactures in domestic consumption demand, a similar pattern in external demand, the squeeze on public investment, and rising corporate savings, in combination work towards making industrial demand increasingly dependent on private corporate investment. Such investment however is inherently unsustainable if it is heavily concentrated in manufacturing, because the capacity creation resulting from it would tend to outstrip the demand expansion heavily dependent on that same investment. The resultant instability has already revealed itself in the second half of the 1990s, when growth rates (particularly of manufacturing) slowed down along with the collapse of manufacturing and corporate investment, until their revival from 2003–04.

Manufacturing shows the greatest investment fluctuation because it is there that the mismatch occurs. In turn, because capital formation is manufacturing-intensive expenditure, manufacturing growth also shows the greatest degree of corresponding fluctuation (*Table-7*). This of course begs the question—how did investment growth revive after the collapse and make for India's transition to its high-growth phase? This question is particularly intriguing because the crucial elements in the typical developing county story put forward by the UNCTAD, export surpluses and improving current account balances, are missing in India's case.

Table-7
Rates of Growth of GDP at 1999-00 Prices (per cent per annum)

Sector	*1991–92 to 1996–97*	*1997–98 to 2002–03*	*2003–04 to 2007–08*
Industry	6.58	4.71	9.69
Manufacturing	*8.10*	*4.07*	*9.11*
Registered Manufacturing	***9.28***	***4.46***	***9.22***
Services	6.93	7.74	10.14
Aggregate GDP	5.84	5.41	8.88

Source: CSO, National Accounts Statistics

4. Explaining India's Investment-Led High Growth

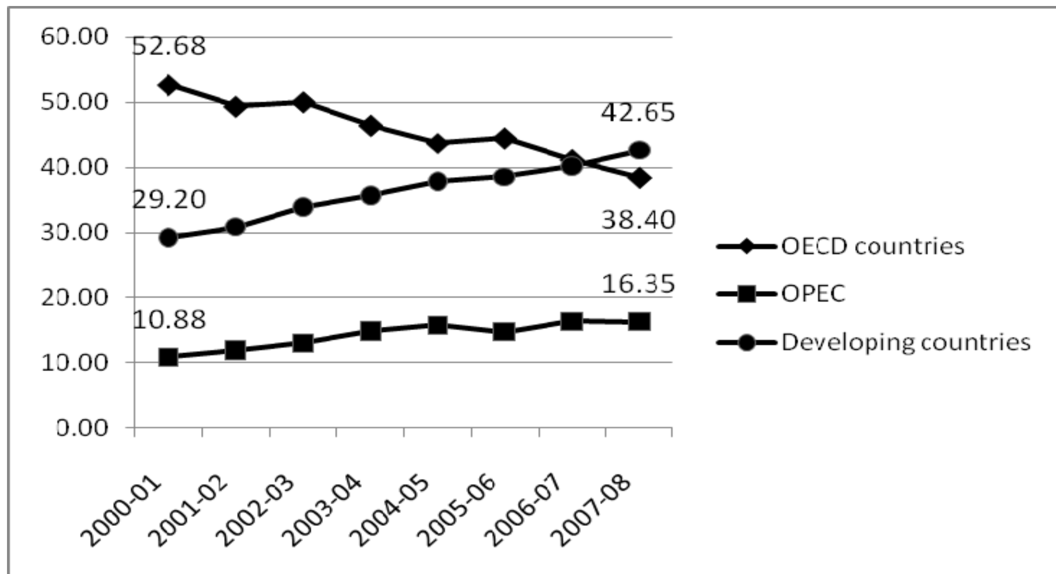
Though India's merchandise trade deficit worsened during the period of high growth, Indian exports of both goods and services did increase substantially faster during this phase than earlier (*Table-8*). Moreover, the surge in exports began before growth picked up. In the case of merchandise exports, the surge was accompanied by significant changes in both the direction of Indian exports as well as in its product composition (*Figures -2 and -3*). The share of developing countries and OPEC countries in Indian exports increased quite sharply indicating that the general growth story of these groups of countries was expanding demand for Indian exports. The products for which this demand was increasing most rapidly were not the items which traditionally dominated Indian exports, like textiles and gems and jewellery. Instead newer products—engineering goods (like iron and steel, metal manufactures, and transport equipment), chemical products, and petroleum products—assumed greater importance in Indian exports. These were different from India's traditional exports on one important count. Their requirement of capital per unit of output was much greater than the labour-intensive traditional exports. This and the export surge are likely to have worked in conjunction to trigger the revival of corporate and manufacturing investment growth.

Table-8
India's Exports of Goods and Services

Year	*Value (US $ million)*		*Increase Over Previous Year (%)*	
	Merchandise	*Services*	*Merchandise*	*Services*
1996–97	34133	7474		
1997–98	35680	9429	4.53	26.16
1998–99	34298	13186	-3.87	39.85
1999–00	37542	15709	9.46	19.13
2000–01	45452	16268	21.07	3.56
2001–02	44703	17140	-1.65	5.36
2002–03	53774	20763	20.29	21.14
2003–04	66285	26868	23.27	29.4
2004–05	85206	43249	28.54	60.97
2005–06	105152	57659	23.41	33.32
2006–07	128888	73780	22.57	27.96
2007–08	166163	90077	28.92	22.09
2008–09	175184	101224	5.43	12.37

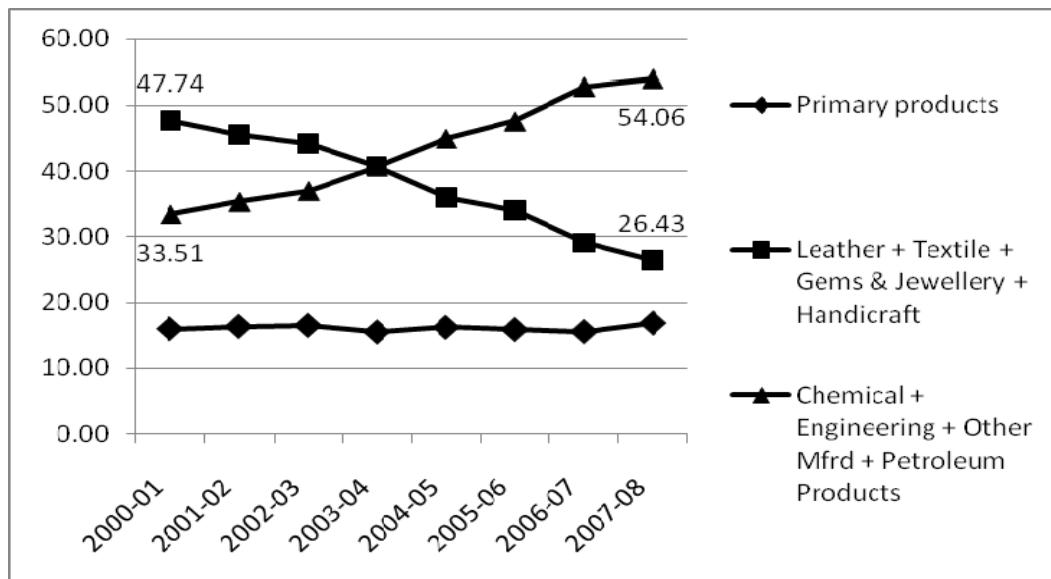
Source: RBI, Handbook of Statistics on the Indian Economy

Figure-2
Shares of Different Country Groups in India's Merchandise Exports (Percentages)



Source: RBI, Handbook of Statistics on the Indian Economy

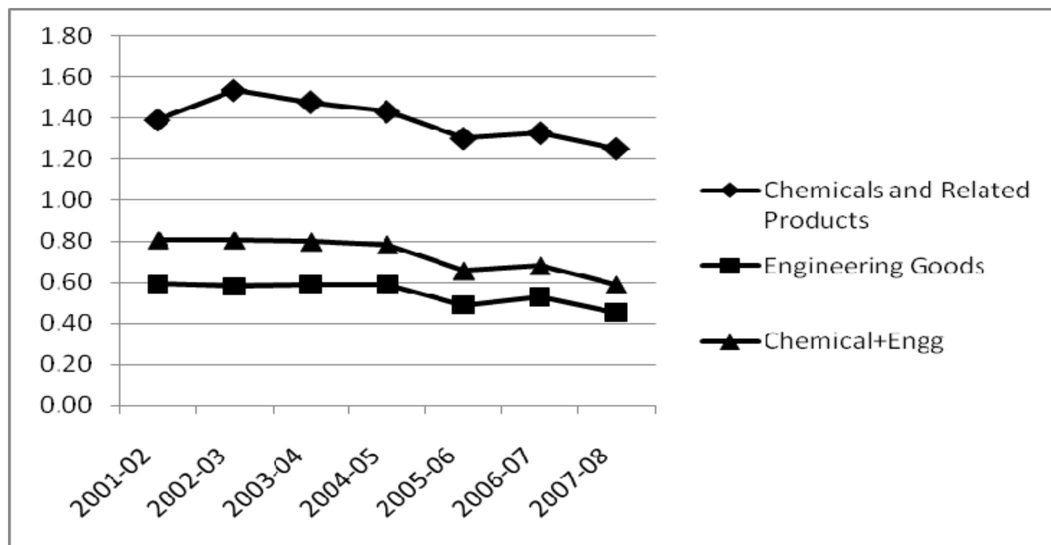
Figure-3
Shares of Different Product Groups in India's Merchandise Exports (Percentages)



Source: RBI, Handbook of Statistics on the Indian Economy

If the export surge did not contribute to an improving non-oil trade balance, it was because once investment and growth picked up imports eventually outpaced exports. This happened even in the very same categories of products whose share in Indian exports was rising (*Figure-4*). The export surge and the changes in the composition of Indian manufactured exports do not therefore contradict the earlier argument of absence of any significant export breakthrough. They were simply reflections of favourable global demand conditions. Indeed, if the trend in merchandise trade had been all that was there, India's high growth would have been hard to sustain even for the period that it did. This is where the parallel growth of India's services exports as well as the large inflow of remittances, both dependent on external economic conditions, played a crucial role. Even as the merchandise balance was increasing very sharply, these kept India's current account deficit in check and within reasonable limits. This in turn maintained conditions necessary for the large capital inflows into India that occurred during this period, which financed not only the deficit but enabled India to accumulate large foreign exchange reserves.

Figure-4
Ratio Exports to Imports of Different Product Groups: India



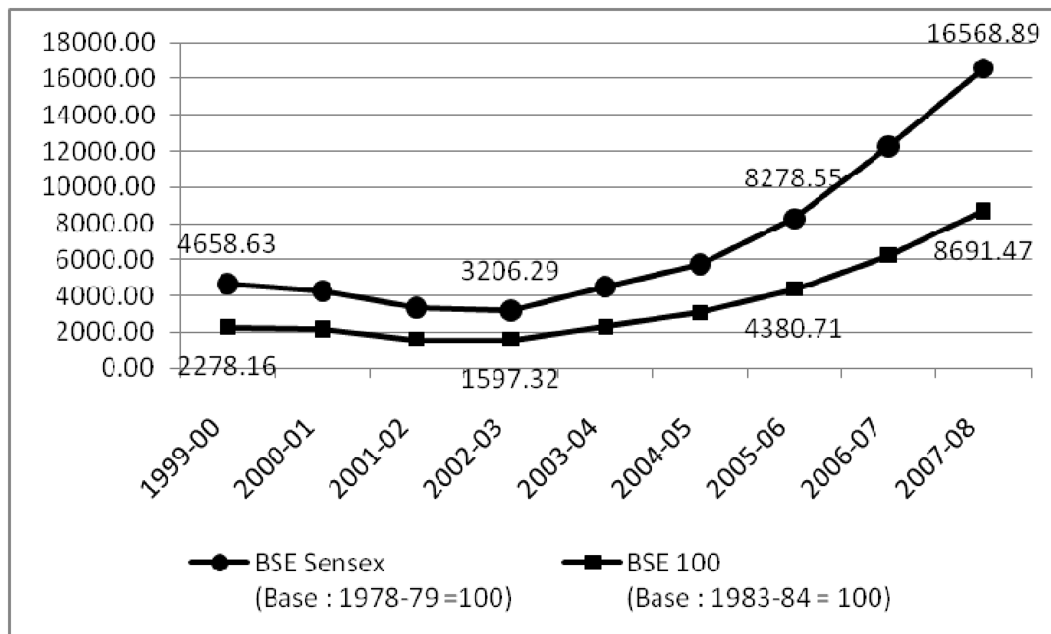
Source: RBI, Handbook of Statistics on the Indian Economy

The surge of portfolio capital inflows began from 2003–04 onwards, and it has been pointed out that even a large part of FDI flows which picked up subsequently were of a similar nature[1]. This resulted in a prolonged stock-market boom (*Figure-5*) which gave an impetus to spending in the economy. The rapid growth of corporate investment was also assisted by the boom in the capital issues and private placement markets this engendered, and also by external commercial borrowings. Additionally, speculative sentiments spilled over into the real estate sector and contributed to a construction boom. Construction actually was the fastest growing segment of the industrial sector in this period, increasing its output at nearly 14 per cent per annum at constant prices. In fact the entire increase in capital formation of the household sector during this period was accounted for by construction. Apart from its direct effect on investment, this also expanded the demand for a range of manufacturing industries. High growth also resulted in rising corporate profits which in turn led to rapid growth of corporate tax revenues. The corporate tax revenue to GDP ratio increased from 1.9 per cent in 2002–03 to 3.9 per cent in 2007–08 and contributed two thirds of the increase in the tax to GDP ratio. With this, public expenditure growth was able to keep pace with rapid GDP growth. Though its ratio to GDP did not increase, public expenditure grew faster than earlier and yet the fiscal deficit to GDP ratio (centre and states) fell from 9.5 per cent of

[1] K.S. Chalapati Rao, Presentation at the Symposium on *Concepts, Definition and Data Issues Relating to FDI in India*, ISID, New Delhi, 16 March 2010.

GDP to 4 per cent. This reinforced the process of demand growth without making financial markets too nervous.

Figure-5
Indices of Stock Prices



Source: RBI, Handbook of Statistics on the Indian Economy

If the analysis presented above is correct, then clearly India's high growth was not a purely Indian story. A 'favourable' international configuration did contribute to triggering and sustaining the investment boom which drove the growth process. More importantly, those favourable external conditions temporarily allowed the Indian economy to overcome certain structural weaknesses in whose presence even the maintenance of those conditions was unlikely to have been sufficient for sustaining the positive investment climate. The imbalance between investment in the manufacturing sector and manufacturing demand and output growth, as indicated earlier, was showing up again. Another collapse of manufacturing and corporate investment was therefore imminent even without the global situation turning adverse. Indeed, it has been pointed out that the slowdown of growth and investment in India began even before the global crisis erupted in full force (Rakshit 2009, Ghosh and Chandrasekhar 2009).

5. Future Prospects: Is a Return to the Pre-Crisis Trajectory Possible?

From the preceding analysis it would be clear that if the pre-crisis high growth process is to be recreated and sustained over an extended period of time, then two broad sets of conditions must hold on the external and domestic fronts respectively.

Firstly, Indian exports of goods and services must be able to expand rapidly enough to ensure the current account deficit does not become too large and capital inflows should be sufficient to cover the remaining gap. For this, the world economy including the developed countries to which India's services exports are primarily directed must also exhibit reasonably rapid expansion. If this does not happen at a level which is complementary to India's high growth, the rise in imports induced by the latter will tend to short circuit the growth. In other words global economic conditions existing prior to the crisis would have to reappear and reappear very quickly, a highly unlikely prospect.

The second condition required for recreating the pre-crisis trajectory would be sustenance of the growth of private corporate investment in manufacturing even in the face of inadequate expansion of demand. To put it differently, real investment should grow at over 15 per cent per annum to keep GDP growing at 9 per cent per annum or thereabouts. This would mean that in five to six years time the investment ratio should touch 50 per cent and cross 60 per cent in about a decade. Is this a realistic possibility?

In this context, attention may be drawn to some features of India's growth in the last two completed years, 2008–09 and 2009–10, which appear in sharp relief when compared with the high growth phase (*Table-9*). Most people noted that the slowdown in growth in these two years was not that dramatic and India relatively speaking performed extremely creditably. What was less highlighted is the fact that the slowdown in the pace of growth of the two most important components of demand, private consumption and investment, was far sharper and their combined growth rates were dragged down below that of GDP. In the last two years, some combination of fall in net indirect taxes, government consumption expenditure (pay commission effect), and decline in net imports, propped up growth even when the main components of demand lagged. Such propping up however can only be a temporary phenomenon, and in the long run the growth rate will have to adjust to the pace of growth of investment and consumption. These have picked up somewhat in the first half of 2010–11 but on the low base of last year and it is not clear how their sustained rapid rise would be possible.

Table-9
Annual Percentage Change in Selected Items of Expenditure on GDP (at 2004–05 prices)

Item	*2005–06*	*2006–07*	*2007–08*	*2008–09*	*2009–10*
private final consumption exp.	8.99	8.2	9.84	6.84	4.30
gross fixed capital formation	15.29	14.35	15.22	3.97	7.16
PFCE+GFCF	***11.05***	***10.29***	***11.74***	***5.8***	***5.32***
govt. final consumption expenditure	8.27	3.82	9.66	16.66	10.49
Net Imports	98.57	23.65	40.07	40.18	-9.75
GDP at market prices	**9.3**	**9.44**	**9.63**	**5.12**	**7.66**
Net Indirect Taxes	7.29	6.37	14.34	-12.43	10.55
GDP at factor cost	**9.49**	**9.71**	**9.22**	**6.72**	**7.44**

Source: CSO, National Accounts Statistics

Clearly therefore a quick return to the specific growth trajectory that India traversed in the half-decade preceding the global crisis, and its maintenance over an extended period of time, would appear to be very difficult. If India is to achieve similar levels of growth, the basis would need to be different given that neither global nor domestic economic conditions are the same as earlier.

6. Conclusion

This paper has argued that the relationship between capital accumulation, growth and employment expansion that has emerged in India under liberalization has a rather peculiar character. Any rapid process of growth of capital formation tends to have a concentration in manufacturing. This however supports aggregate growth not so much because of addition to capital stock it brings about but via the expenditure it involves and the demand it creates. On account of sharply rising inequalities, the dependence of the Indian economy on such demand generated by investment is increasing even as demand constraints simultaneously limit the possibility of sustained growth of investment. Standing testimony to this is the slowdown in industrial and aggregate growth and the collapse of corporate and manufacturing investment seen from the second half of the 1990s till 2002–03. The revival of investment from 2003–04 and the transition to a short phase of exceptionally high growth in India was enabled by the transmission effects generated by an exceptionally expansionary phase of the global economy. With the global crisis this phase came to an end even as the inherent contradictions of India's growth trajectory were simultaneously coming to a head. Under the conditions that have now come into being, neither an early return of India's economy to the pre-crisis growth trajectory nor a long life of such a trajectory can be considered reasonable prospects. Even the minimalist inclusiveness which is merely a side-effect of growth rather than being in-built into it is therefore unlikely to be forthcoming. This is an additional reason

apart from many others to continue to insist on a change in the character of Indian growth to one that would be more employment-intensive and egalitarian than the present process. Without that, the colossal waste of the Indian economy's capital accumulation potential will continue.

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