# Standing on the crossroads: The Indian economy in the 21st century

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# Indian Economy in the 21st Century: Strategic Choices

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## I Introduction: India Economy over the past twenty years

### a) Economic achievement

Indian economic development in the recent period has attracted both favourable and unfavourable attention abroad. The development community including academics and activists regards the record of the Indian economy during the last twenty years as being extremely good by international standards. On the other hand, workers and trade unions in advanced countries, particularly the US, have been alarmed by the outsourcing of service sector jobs to India by many large companies. There has certainly been an attitudinal change in assessments of the Indian economy over the last decade. This is partly because of the country's huge advances in Information Technology (IT); but it is also due to new thinking with respect to the theory of economic development.

The significant facts are that the Indian economy has expanded at a rate of 5.5% to 6% per annum over the last two decades. This may be regarded as a considerable achievement in itself in that the economic growth rate in the previous 30 years only averaged 3.6% per annum. Further, the world economy slowed down during the last 20 years compared with the period 1960 to 1980. Despite this slow-down, the trend rate of growth of Indian *per capita income* has almost tripled over the last two decades. This is mainly due to faster growth of GDP but also on account of some decline in the rate of population growth. There is also evidence that the Indian economy has been much less unstable in the last 20 years compared with the period before. At least in part due to good economic management, the country has been spared the debt crisis of the 1980s which brought the 'lost decade' to Latin America; it also escaped the Asian crisis of the 1990s.

Indian economic success is not limited to the IT industry. The country has managed to train a vast pool of educated manpower, and has established a scientific and technical infrastructure which is the envy of the developing world. Its corporations have been successful in a wide variety of industries, including in particular pharmaceuticals and auto components**.** The country also has broad-based technological capability as evidenced by the fact that India is one of the three countries in the world (Japan and US being the other two) that has built super computers on their own. It is among the six countries in the world that launch satellites.

b) The lack of achievement

India is a country of sharp contrasts. Some of the people live in the twenty first century, others in the eighteenth, nineteenth and twentieth centuries. The overwhelming majority of Indians work in the informal sector and live in habitations of under 200,000 people i.e. in small towns and villages. Although absolute poverty has decreased over time, it still remains very high, afflicting about a third of the population. The two Indias—the rich and the poor, the high-tech and low-tech—live side by side in a democratic polity.

## II Indian economy in the next twenty years

In a recent influential IMF working paper authored by Professor Rodrik of Harvard University and Dr. Subramaniam of the International Monetary Funds, the two authors are bold enough to project the growth of the Indian and the Chinese economies over the next twenty years. They estimate that during this period Indian economy will grow even faster than it has in the last two decades. It will achieve growth rates of 7 to 8% per annum, and most likely outperform China. The two authors' optimism about the future course of the Indian economy is shared by other leading economists and organizations, including Goldman-Sachs.

There are two major reasons for these very positive assessments of the prospects for the Indian economy. The first is that India is thought to have a high level of institutional development, much higher than that of China's. India's advantage lies in achieving functioning democracy and other associated institutions at various levels. This accords with the new theories of development economics which suggest that institutions are the most important `deep' determinants of economic development. The second reason for optimism about the Indian economy is that Indian labour force is expected to grow over the next several decades at a faster rate than that of China and other competitor countries. In making their projection, Rodrik and Subramaniam use standard economic methodology for examining the sources of growth. Within this framework, a faster growth of labour input should lead to a faster output growth.

## III The Indian economic model: continuity and change

After independence from British rule in 1947 India started its 'tryst with destiny' by embarking on a series of 5 years plans to bring about equitable economic development in a mixed economy and democratic polity. The economic thinking at the time was much influenced by social democratic ideas from Europe, and India followed these theories and accorded a large role to the public sector. The economic model called

'the Nehru-Mahalanobis model' (Nehru was India's first prime minister and the architect of many of the country's important institutions including those in science and technology, and Mahalanobis was a leading economist and statistician) was one which favored heavy industry, which sought for public sector to control the commanding heights of the economy, and which rigorously regulated investment activities of the private sector. The economy was run on this basis for the first 30 years of Indian independence when its growth rate, averaged over the whole period, was quite low—as mentioned earlier it was only about 3.6%. However, the low growth was not necessarily intrinsic to the Nehru- Mahalanobis model, but was, to an important degree, caused by very slow growth during 1965-1975, a sub-period in which the economy was subject to extraordinary shocks. This included two wars with Pakistan, suspension of foreign aid for various time spans following each of the wars in 1965 and 1971, oil price rise in 1973-74 and drought. It is a credit to the Indian system that these shocks were contained by prudent macro-economic policies even though it resulted in slower long-term growth for almost 10 years, 1965-1975. India ended the 1970s with low inflation and healthy balance of payments position. Indian economic management of these shocks compares favorably with the experience of Latin American countries during the 1980s.

If the 10-year period 1965-1975 of extreme economic shocks was excluded, there is much greater continuity in Indian growth experience over the second half of the twentieth century. In the 1980s, the Indian government changed course as the inefficiencies of the inward-looking Nehru-Mahalanobis model became apparent. Essentially during the decade of the 1980s, India greatly relaxed the internal regulations on business investment. After the liquidity crisis in 1991, the government also took big steps to liberalize the economy externally by reducing tariffs and encouraging foreign investment both portfolios and FDI. International financial institutions often mistakenly suggest that India's transition to a high growth path was due to external liberalization ushered by Dr. Manmohan Singh when he was the finance minister in 1991. However, evidence suggests that that transition took place in the 1980s, most likely as the result of the internal liberalization measures for which he was also partly responsible.

## IV Challenges facing the Indian economy

The first main task facing the Indian leadership today is how to ensure that a labour force of 400 million people which is growing at 2% a year can find productive and remunerative employment or work for all the people who need it. An important limitation of the Rodrik and Subramaniam exercise discussed above is that it assumes that all the labour force will be employed. Unfortunately for them the Indian economic managers cannot make that assumption. Their task is made more difficult by certain tendencies observed in the economy in the recent period.

(a) There is evidence of jobless growth in organized manufacturing as well as services—in other words, despite reasonably good growth in both manufacturing and services in the formal sector, there has been no increase in jobs in this sector. There is also quite slow pace of long term structural change in the economy so that more than 60% of the labour force is still employed in the agricultural sector;

(b) Economic history indicates that for developing countries at India's level of per capita income, economic growth has normally been led by the manufacturing sector. However, the leading sector in contemporary Indian economic growth has increasingly been services rather than manufacturing.

There is an important controversy about the implications of (b). Some regard it as a temporary phenomena and unsustainable in the long term, as it contradicts previous historical patterns of economic growth. There is, however, an alternative view which suggests that because of the new technological developments and other factors, services in the future may replace industry as the engine of growth, even in developing countries. In that sense, India may be regarded as pioneering a new development path which gives primacy to services rather than to manufacturing as the leading sector.

The second major challenge for the Indian planers is how should India further integrate with the world economy, in a way that the benefits of the integration are, and are seen to be equitably distributed. These are daunting challenges for a democratic society. If the visible results of globalization are simply more shopping malls and benefits only for the people in the cities and high-income groups, the process will be unsustainable. The last general election showed the determination of the rural masses not to be excluded, and the result was that the incumbent BJP government was unexpectedly defeated notwithstanding a very good economic record in conventional terms.

## V Strategic policy choices

In order to meet these challenges, there are two broad directions that the policy can take, although these are not mutually exclusive. Some argue in favour of export-led growth based on labour-intensive products such as textiles. This can have favourable consequences for employment and economic growth. However, the question is whether such a policy would be adequate and be superior to other alternatives. An alternative strategy would be based on internal demand-led growth. It can, for example, be based on the government's minimum employment guarantee programme. In principle, such a programme should cover the whole country; this would have positive consequences for employment generation and poverty reduction, provided the programme was properly administered and there was real, large-scale capital formation in the countryside, where poverty is concentrated. However, in a country like India, and given its enormous scale of employment problem, it should pursue both these policies. The textile industry should be helped by the government with the provision of infrastructure, appropriate human capital and other similar measures to enable the Indian textile industry to compete effectively in the new world environment following the end of the multi-fibre agreement. Unlike in the past when some have suggested a benign neglect of agriculture and concentration on industry, India must enhance its international competitiveness not only in textile and other manufactures but also in IT and other services (where it has acquired a competitive advantage), as well as in agriculture.

It is also necessary in this context to point out the difficulties which will be faced by the small-scale sector if it is opened up to external competition without adequate preparation by the public and the private sectors. Up to now, this sector, which employs several million people has been protected against India's large-scale business sector through a policy of reservation of specific industries for only the small-scale sector. However, if in the light of the WTO agreements, the protections currently available to the small-scale sectors were to be removed, it could lead to catastrophe for the small-scale producers. India should therefore be a pragmatic rather than an enthusiastic globaliser. This will not only be in the interest of Indian economy but also the world as a whole. An aggressive export-led growth policy for big countries like India and China could be very disruptive for the trading partners as the current controversy in the US about out-sourcing service sector job, mentioned earlier, illustrates. Economic expansion in these two large countries which is based mostly on the growth of internal demand, rather than on exports, will be much more helpful from a global perspective as well as being more inclusive domestically.