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The Indian Economy in the Second Decade of the 21st Century: Signs of a Crisis?

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Abstract: Despite apparently experiencing reasonably good GDP growth rates in that period, there are several indications that the growth process of the Indian economy entered into a phase of crisis in the second decade of the current century. Investment and trade stagnation and increasing dependence on consumption demand, coupled with poor industrial (including construction) and agricultural growth, mark out this decade and differentiate it sharply from the period of high growth that preceded the global crisis of 2008. Arguing that Indian growth has been primarily based on cheap labour throughout the liberalization period, this paper argues that the distributional imbalances implied in such a growth trajectory facilitated the earlier boom even as they made it unsustainable. The current crisis, however, is more than a cyclical downturn and may in fact reflect the limits of growth through cheap labour.

While there are many who may baulk at using such a strong term to describe the state of the Indian economy in the second decade of the 21st century, the word crisis does fit the situation very well even if this is not obvious at first sight. If an economy is stuck in a situation where its spontaneous economic processes have put a brake in its path of economic expansion and the prospects of any self-correcting tendency emerging are remote, then one could perhaps justifiably say that such an economy confronts a crisis. There are reasons to believe that the Indian economy may currently be in precisely such a phase of its history.

The most obvious challenge to any crisis thesis would be of course India's GDP growth record. It would be argued that India has been growing at a reasonably fast clip in the last few years - not as rapidly as in the first decade of the century but much faster than almost all other countries in the world. How can growth rates tending to be in the 6-7 per cent per annum range reflect a crisis? The first thing to note, however, is that these growth rates emerge from the controversial new GDP series with 2011-12 as the base year on which there has been much debate (Goldar 2015, Mazumdar 2015, Nagaraj 2015, Rajakumar 2016). There are many who hold the view that the new series overestimates the Indian growth rate. A case for India experiencing a crisis can however be made even if it is conceded that the overall GDP growth rate is what the new series shows it to be, or would still be at a reasonable level of 5 per cent per annum or thereabouts after adjustments are

made for any overestimation. GDP is after all only an aggregate and only one indicator of the pace of economic expansion. It is when one goes behind this aggregate that the picture of crisis becomes visible.

The Slowdown and its Features

To establish the fact that the second decade of the century saw a transition to a crisis, we undertake a simple exercise of comparing the movement of some selected variables in two time-periods of equal length which we define as Periods 1 and 2. Period 1 spans the years 2002-03 to 2007-08 and Period 2 from 2011-12 to 2016-17.

There is a case for such a comparison. Period 1, which ended with the onset of the global crisis, marked a transition to unprecedentedly high GDP growth rates. Till then, the major turning point in India's post-independence growth history had been way back in 1980 when the growth rate moved up from the 'Hindu rate of growth' (3.5 per cent per annum) to levels between 5-6 per cent (Virmani 2004). Indeed, the absence of any acceleration in the growth rate after 1991, when the more substantive economic "reforms' were undertaken, had led to a debate about how much of the shift to a higher growth trajectory could be attributed to economic liberalization (Rodrik and Subramaniam 2004, Panagariya 2004, Srinivasan 2005). 2011-12 on the other hand was the year in which at least the older GDP series indicated the onset of a slowdown after a brief period of growth revival following the drop in the immediate aftermath of the global crisis. Whether the high growth phase in the early part of the century marked a long-term shift of India's growth trajectory, or was it a temporary phase, can be at least partially assessed by examining whether the features that went with it were sustained beyond that phase. Period 1 was also significant as the one phase in the post-1991 period in which the tax-GDP ratio improved significantly and the share of direct taxes in total taxes increased. This allowed a stepping up of public expenditure growth alongside a process of reduction in the fiscal deficit to GDP ratio. However, the post-crisis stimulus package led to a slippage on the tax front while expenditure growth persisted for a few years, resulting in the fiscal deficit climbing sharply. 2011-12 then marked the reversion to fiscal consolidation in which the consistent emphasis was on curbing public expenditure while the recovery on the tax revenue side was slower and driven more by indirect taxes. Finally, the two periods also fall in different phases of the global economy – the first in the phase of the developing economy centred global boom and the second in which the global conditions are more subdued, and austerity has tended to rule everywhere.

To facilitate the comparison between Periods 1 and 2, we designate the first year of each of them as their respective Year 0, the next year as Year 1 and so on till Year 6. In other words, 2002-03 would

be Year 0 of Period 1 and 2011-12 would be the Year 0 for Period 2, and 2007-08 and 2016-17 would be their respective Year 6s. Further, each of the variables for both periods are converted into indices with their respective Year 0 as the base year.

The first comparison we undertake is of the movement of output of different broad sectors of the economy in the two periods from their respective base year levels. This is summed up in Table 1 (and graphically represented in Appendix Figure 1). For Period 1 we consider GDP at Factor Cost in each sector at constant 2004-05 prices while for Period 2 we take at GVA at Basic Prices at constant 2011-12 prices as the measure of output.

Table 1 clearly shows that every sector's growth performance in Period 2 has been below the level in Period 1. However, the degree to which this is the case varies across sectors. The services performance in the two periods are relatively similar while but the gap is particularly marked for the agricultural and construction sectors. In the case of agriculture, the comparison of the movement of the separately available index of agricultural production in the two periods corroborates the story emerging from the value-added data (Table 2). However, the situation is different for the industrial sector. The index of industrial production, even the new series introduced recently with 2011-12 as base year, indicates a much sharper slowing down of industrial and manufacturing growth in Period 2 (Table 3) than that indicated by the GDP/GVA trends. This difference in Period 2 between the GVA trend and the IIP trend in case of manufacturing clearly is on account of the changed method of measuring manufacturing value added adopted in the new GDP series – which is obscuring the stark picture of industrial stagnation that IIP data brings out.

Table 1: Indices of GDP at Factor Cost/GVA at Basic prices (at Constant Prices) for Periods 1 and 2 (Respective Year 0 = 100)

Sector	Period	Year 0	Year 1	Year 2	Year 3	Year 4	Year 5
Agriculture & allied activities	**Period 1**	100	109.0	109.2	114.9	119.6	126.6
	Period 2	100	101.5	107.1	106.9	107.7	112.9
Industry	**Period 1**	100	107.3	117.9	129.3	145.0	159.1
	Period 2	100	103.3	107.2	115.2	125.3	132.3
Manufacturing	*Period 1*	*100*	*106.3*	*114.2*	*125.7*	*143.7*	*158.5*
	Period 2	*100*	*105.5*	*110.7*	*119.8*	*132.8*	*143.3*
Construction	*Period 1*	*100*	*112.4*	*130.8*	*147.5*	*162.8*	*180.3*
	Period 2	*100*	*100.3*	*103.0*	*107.8*	*113.2*	*115.1*
Services	**Period 1**	100	108.1	116.8	129.6	142.6	157.3
	Period 2	100	108.3	116.6	127.9	140.4	151.2

Source: Reserve Bank of India, Handbook of Statistics on the Indian Economy [original source: Central Statistics Office (CSO)]

Table 2: Indices of Agricultural Production for Periods 1 and 2 (Respective Year 0 = 100)

Year	Foodgrains		Non-Foodgrains		All Crops	
	Period 1	Period 2	Period 1	Period 2	Period 1	Period 2
Year 0	100.0	100.0	100.0	100.0	100.0	100.0
Year 1	122.5	99.9	91.1	99.5	107.3	99.8
Year 2	113.9	103.2	92.5	105.5	105.6	104.4
Year 3	120.5	97.0	107.3	102.3	118.5	99.8
Year 4	125.4	96.7	128.2	94.4	135.4	95.6
Year 5	133.2	108.5	130.3	94.7	139.5	101.4

Source: Reserve Bank of India, Handbook of Statistics on the Indian Economy [original source: Ministry of Agriculture & Farmers Welfare Government of India]

Table 3: Indices of Industrial Production for Periods 1 and 2 (Respective Year 0 = 100)

	Manufacturing			General Index		
	Period 1	Period 2 (2004-05 series)	Period 2 (2011-12 series)	Period 1	Period 2 (2004-=5 series)	Period 2 (2011-12 series)
Year 0	100	100	100	100	100	100
Year 1	107.4	101.3	104.8	107.0	101.1	103.3
Year 2	121.5	100.5	108.6	119.5	101.0	106.7
Year 3	134.0	102.8	112.7	129.8	103.9	111.0
Year 4	154.1	104.9	115.9	146.6	106.4	114.7
Year 5	182.4	104.9	121.0	169.3	106.4*	120.0
*Based on April-February Average						

Source: Reserve Bank of India, Handbook of Statistics on the Indian Economy [original source: Central Statistics Office (CSO)]

The upshot of this is that not only has growth in period 2 been more subdued than in Period 1, it has also become even more concentrated in services activities, already the largest sector, with the rest of the economy showing signs of extreme sluggishness. Agriculture, the sector which still accounts for the largest share in employment, has been doing very poorly after the high achieved in 2011-12. From the employment perspective, the sharp and persistent slowdown of the construction sector that had grown quite rapidly since the mid-1990s is also extremely significant. The construction sector has been by far the largest absorber of labour shifting out of agricultural activities - it increased its share in total employment from less than 4 per cent in the early 1990s to 11% in 2011-12, even as agriculture went down from 61% to 49%. The industrial slowdown on the other hand reinforces the story of India experiencing premature de-industrialization (Rodrik 2015). Indeed, even the more favourable manufacturing output figures in the new GDP series have not been able to prevent the sector's share in GDP from persistently falling.

Are these all signs of a robust process of economic expansion? One should also keep in mind that 'output' of services is not constrained in the same way as that of agriculture and industry are by land and capital constraints. Further, in India unlike elsewhere in the world, the high share of services in

GVA is achieved with a relatively extremely low share in employment. In such circumstances, how valid is it to claim a relatively high GDP growth as a significant achievement?

The problems of India's current growth trajectory come out even more sharply if we track the movements in the components of the demand measure of GDP in the two periods. These are presented for most of the major components in Table 4 (graphical representation in Appendix Figure 2).

Table 4: Indices of Components of GDP at constant Market Prices for Periods 1 and 2 (Respective Year 0 = 100)

Item	Period	Year 0	Year 1	Year 2	Year 3	Year 4	Year 5
Private Final Consumption Expenditure	Period 1	100	105.9	111.4	121.0	131.3	143.6
	Period 2	100	105.5	113.2	120.2	127.5	138.6
Government Final Consumption Expenditure	Period 1	100	102.8	106.9	116.4	120.7	132.3
	Period 2	100	100.6	101.2	110.9	114.6	138.4
Gross Fixed Capital Formation	Period 1	100	110.6	137.1	159.3	181.3	210.7
	Period 2	100	104.9	106.6	110.2	117.4	120.2
Exports of Goods and Services	Period 1	100	109.6	139.4	175.7	211.5	224.0
	Period 2	100	106.8	115.1	117.2	110.9	116.0
Import of Goods and Services	Period 1	100	113.9	139.2	184.5	224.1	247.0
	Period 2	100	106.0	97.4	98.2	92.5	94.6

Source: Reserve Bank of India, Handbook of Statistics on the Indian Economy [original source: Central Statistics Office (CSO)]

The first noticeable fact there is that in Period 2, only consumption expenditure growth has come close to maintaining the pace of growth seen in Period 1. Moreover, it seems that the demand/expenditure growth in this period has been consumption-led. In sharp contrast to Period 1 in which both investment (GFCF) and India's trade grew rapidly and outpaced consumption growth by a wide-margin, in Period 2 they seem to have been virtually stagnant. If Period 1 saw an extremely sharp rise in India's investment ratio, Period 2 has been one of a consistent downward trend in this, and the same pattern is replicated in the case of the trade-GDP ratio (Appendix Figure 3). Investment stagnation is consistent with the poor growth of construction activities as well as manufacturing stagnation. These, along with the global economic situation, also perhaps underlie the sharply shrunk role of India's foreign trade in Period 2 while in Period 1 it was extremely important.

Thus, the growth process of the Indian economy in the second decade of this century can hardly be described as the continuation of the same process witnessed in the first at a slightly moderated pace. The high-growth phase of five years before the global crisis was in that sense temporary insofar as some of its distinctive mutually related features – rapid growth of investment, a construction boom, high levels of industrial growth and expanding trade – did not last beyond that

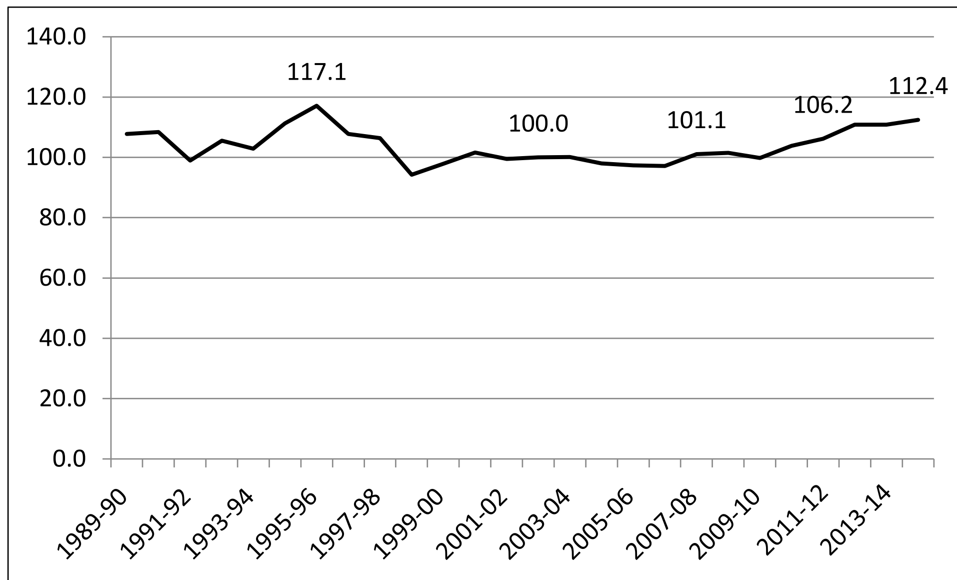
phase. In the second decade, income growth in the Indian economy increasingly come through expansion of services activities which together employ much less than a third of India's workforce. This growth has not been so heavily dependent on capacity creation through investment nor has it induced capital formation. Clearly also the linkage effects of this growth of services on the rest of the economy have been very weak and its demand has been generated by the growth of domestic consumption of services accompanying it. How did such a transition come about and so quickly? The answer perhaps lies in the fundamental imbalance that has not only been a feature of the Indian growth process for the last two and a half decades but also got aggravated over time – this is the imbalance in the distribution of income.

Explaining the Transition: The Limits to Cheap Labour Based Growth?

One of the harsh realities of the Indian economy is that whether they are counted below or above the official poverty line, the overwhelming majority of Indians continue to sustain themselves on extremely low levels of income. Growth in the last two and a half decades has not changed that situation substantially (Government of India 2007a) – one of the reasons being that it has been accompanied by sharply increasing inequality. In the absence of data on household income distribution, gauging of inequality trends in India have been mainly based on examination of estimates of consumption expenditure levels across different segments of the population. The broad consensus based on these is that the period of economic reforms has seen a significant rise in inequality (Kapoor 2012; Radhakrishna 2015; Subramanian and Jayaraj 2015). Recently, other sources have also been combined to arrive at a picture of trends in income distribution (Chancel and Piketty 2017) and these indicate extreme concentration of income growth at the top of the distribution, reversing the trend observed between independence and 1980.

Annual Survey of Industries (ASI) and National Accounts data also bring out two additional dimensions of the income distribution story since 1991. One of these is the almost complete stagnation in real wage levels in the organised factory sector (Mazumdar 2013, 2014; Muralidharan *et al*. 2014; Sen and Das, 2015; Sood *et al*. 2014). The second is the dramatic growth of the share of the private corporate sector surplus in total income that has accompanied the increasing weight of the sector in the Indian economy (Mazumdar 2013, 2014). What is significant is that while both reflect longer-term trends, they were particularly marked feature of the high-growth phase we have termed as Period 1.

Figure 1: Index of Real Wage Per Worker in the Factory Sector (2002-03 = 100)



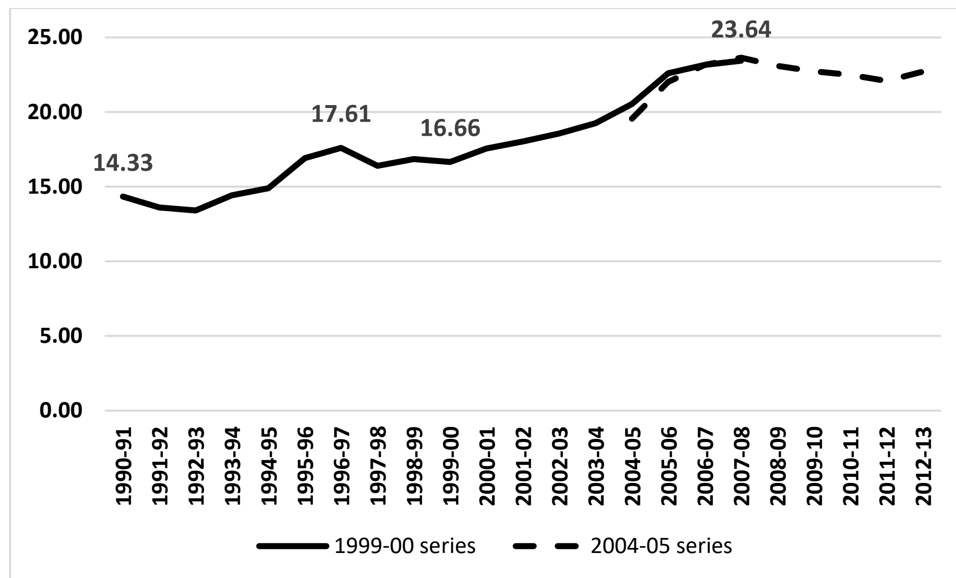
Source: CSO, Annual Survey of Industries and RBI, Handbook of Statistics on the Indian Economy

Real wage stagnation in the factory sector (Figure 1), accompanied by and also working through a process of increasing contractualisation and informalisation of labour (Government of India 2007a; Sood *et al*. 2014), reflected a larger picture of the general and persistent availability of cheap labour in the Indian economy – something that even a process of rapid growth did not change. The underlying basis for this was the agrarian crisis that set in since the mid-1990s (Patnaik 2003, 2007; Reddy and Mishra, 2008; Government of India 2007b; Bhattacharyya, *et al.* 2013; Ramakumar 2014). The increasing inability of agrarian households to sustain themselves through economic activity in that sector swelled the ranks of those seeking work in non-agricultural activities even as rural wages tended to stagnate. This enlarged the labour reserves which expansion outside agriculture could then draw on without that process exerting any upward pressure on wage levels. The context for a polarising growth was thus created whose principal beneficiary was the corporate sector.

The rapid and unprecedented expansion that the corporate sector in India experienced since 1991 received a further fillip in the high-growth Period 1 and it enlarged its weight in the Indian economy. This trend has ebbed after 2007-08 though it was not reversed. The level of the share of the private corporate sector appears to be considerably higher in the new GDP series than in the previous or older series. Till this new series, the value added in private corporations was not being explicitly measured. A proxy indicator, the estimated share of the private organized sector in national income, grew to a peak level that was a little under a quarter of NDP in 2007-08, up from under 15 per cent in 1990-91 (Figure 2). In the new GDP series on the other hand, the share in GVA and NDP of private corporations since 2011/12 has stayed around 35 per cent compared to 20 per cent and 45 per cent

of the public and household sectors respectively. Whatever the actual level, however, it is clear that the relative significance of the private corporate sector in India's economy has become considerably greater than it was before liberalization. A similar story of sharp rise up to 2007-08 and can be seen in the corporate sector's share in the economy's net fixed capital stock.

Figure 2: Share of Private Organized Sector in Net Domestic Product at Current Prices, 1990-91 to 2012-13 (Percentage)



Source: CSO, National Accounts Statistics

The extremely elastic labour situation of the Indian economy characterized by a strong wage-depressing tendency underlay the growth of the corporate sector and its rapid pace in Period 1 in several ways. To the extent that this depended directly or indirectly on significant expansion of employment in certain sectors like construction (and even organized manufacturing to an extent), the growth made use of the expanding labour reserve without facing any constraint. Real wage stagnation despite that in turn facilitated a decline of the wage share in value added after 1991. This is clearly visible in the ASI data but it must have also underlain the observed decline in the share of aggregate compensation of employees in the corporate sector as a whole between 1990-91 and 2007-08 (Table 5) – which happened despite the fact that this period also produced a class of high salary white-collar workforce in the private corporate sector. As a result, corporate savings, which were generally below two per cent of GDP for more than four decades after independence, climbed to reach a peak level of 9.4 per cent of GDP by 2007/08.

Table 5: Distribution of Factor Incomes in the Private Organized/Corporate Sector

1999-00 Base Year Series (Private Organized)			
	1990-91	**2002-03**	**2007-08**
Compensation of Employees	54.85	35.58	29.08
Operating Surplus	45.15	64.42	70.92
2004-05 Base Year Series (Private Organized)			
	2004-05	**2007-08**	**2012-13**
Compensation of Employees	32.46	27.69	32.12
Operating Surplus	67.54	72.31	67.88
2010-12 Base Year Series (Private Corporations)			
	2011-12	**2012-13**	**2015-16**
Compensation of Employees	33.96	35.13	37.00
Operating Surplus	66.04	64.87	63.00

Source: CSO, National Accounts Statistics

The impact of declining share of compensation of employees in value added on profits served as part incentive as well significant source of financing the investment boom in the first decade of the 2000s. The corporate sector drove this boom and a significant part of the capital formation was in organised manufacturing (Mazumdar 2014). If this investment was the source of increasing organised manufacturing sector employment (Nagaraj, 2011), it may have also facilitated the declining labour-intensity of the sector – taking place as it did in a background of cheapening of capital goods and an increase in the product wage-rates due to faster rises in prices of wage-goods (Sen and Das, 2015). The declining wage share trend thus in part reinforced itself. Apart from investment in manufacturing, the increasing demand for assets spurred by income growth at the top also played its part in the making of the real estate boom and rapid growth of the construction sector. Manufacturing investment and the real estate boom played an important part in generating the growth of demand for manufactured products.

Wage stagnation and low wages have also served to limit the potential adverse consequences of India's opening up to trade and capital flows (Mazumdar 2016). It kept unit labour costs in check and shored up the profitability of Indian production at internationally competitive prices – in manufacturing, even in the face of increasing capital and material costs per unit of output. Cheap labour in various supporting activities also partially compensated for the Indian economy's infrastructure deficits. Indeed, by holding down the prices of non-tradeables, it has helped maintain the Indian economy's 'national price level' (ratio of PPP conversion factor to market exchange rate) lower than that of many other Asian economies – allowing even high employee compensation sectors like the software industry to be internationally competitive by being located in a generally cheap labour economy.

India’s low wages did not, however, provide her manufacturing sector any decisive competitive advantage in export markets. Testimony to this was the fact that in Period 1, even as manufactured exports grew, and the composition changed to newer products from the traditional labour-intensive exports, this was accompanied by an even more rapid growth of manufactured imports (Mazumdar 2014). Indeed, the very dramatic widening of India’s trade deficit during that period was in fact led by her manufacturing trade (Chaudhuri 2013). Software service exports were, however, able to grow rapidly and combined with remittances from Indians abroad to moderate the consequences of the rising trade deficit on the current account. Capital flows from abroad were thus not deterred and in fact also fuelled the boom in Period 1 and pushed up the value of the rupee. In Period 1, therefore, on balance the interaction of India’s low-wage economy with the international economy helped spur growth rather than to constrain it. After 2007-08, however, as both manufactured and services export growth was hit, international oil prices went up and the demand for assets partially switched towards imported items like gold, the current account deficit widened. The rupee also gradually depreciated which partially helped maintain manufacturing competitiveness as manufacturing prices increased more slowly (Mazumdar 2016). It is only the subduing of growth and investment, and the sharp fall in international oil prices from 2014, that eventually restored some balance.

After 2007-08, not only were global demand conditions no longer the same, the growth process also started facing the adverse domestic demand consequences of the distributional processes and wage-stagnation on which it was based. Even as manufacturing capacity had grown by leaps and bounds, the demand for manufactured consumption goods could not keep pace as the market remained narrow and the consumption of higher income groups moved increasingly towards services (Mazumdar 2008). Without fast growing consumption demand or that from exports, its self-generated demand was not sufficient to sustain the investment boom in manufacturing. A real estate boom simply dependent on the asset demand of a narrow stratum of the population was also not sustainable beyond a point. The collapse of the investment and real estate booms was thus inevitable, and this in turn reinforced the demand constraint facing the manufacturing sector. At the same time, there were also limits to combining the holding down of wages with continued extraction of ‘productivity’ increases (Mazumdar 2016).

Thus, after 2007-08, the distributional imbalances that were in part the cause and in part the effect of the Indian economy’s growth process in Period 1, started expressing themselves more strongly as constraints on that growth. These constraints came to be firmly set by the early years of the current decade even as fiscal consolidation returned as a primary objective of state economic policy. The employment consequences of the slow-down have served to keep in check whatever little tendency was there after 2008 for wages to rise – they did rise for a period of time but not by very much (this

was true of both industrial as well as rural wages). On the other side, with neither demand growth from a widening of the market or its anti-thesis - the squeezing of the wage-share – being able to provide a basis for investment expansion, the growth of the corporate surplus and of corporate profits has also been checked.

Conclusion: The "Low-Income Trap"

The Indian economy seven decades after independence can scarcely be described as being caught in a low-level equilibrium trap in the classical sense of the term. Currently classified as a lower middle-income economy by the World Bank, it cannot even be said to have graduated to being in what is described as a middle-income trap. Yet, a large segment of the Indian population may be said to be caught in a low-income trap as the spontaneous growth process offers them little prospect of steady and remunerative employment. It didn't do so when the consequent cheap labour regime spurred rapid growth and expansion of investment. It is not going to do so when the very same cheap labour condition has brought that kind of expansion phase to an end. The crisis of India's macroeconomy in the second decade of the twentieth century – the narrowing of the elements of its expansion and the slackening of its pace – is only a generalization of the income and employment crisis that has characterized the economy for a long time. Dealing with that income and employment crisis has to be integral to addressing the macroeconomic crisis. The former cannot be left to be the spontaneous result of the latter.

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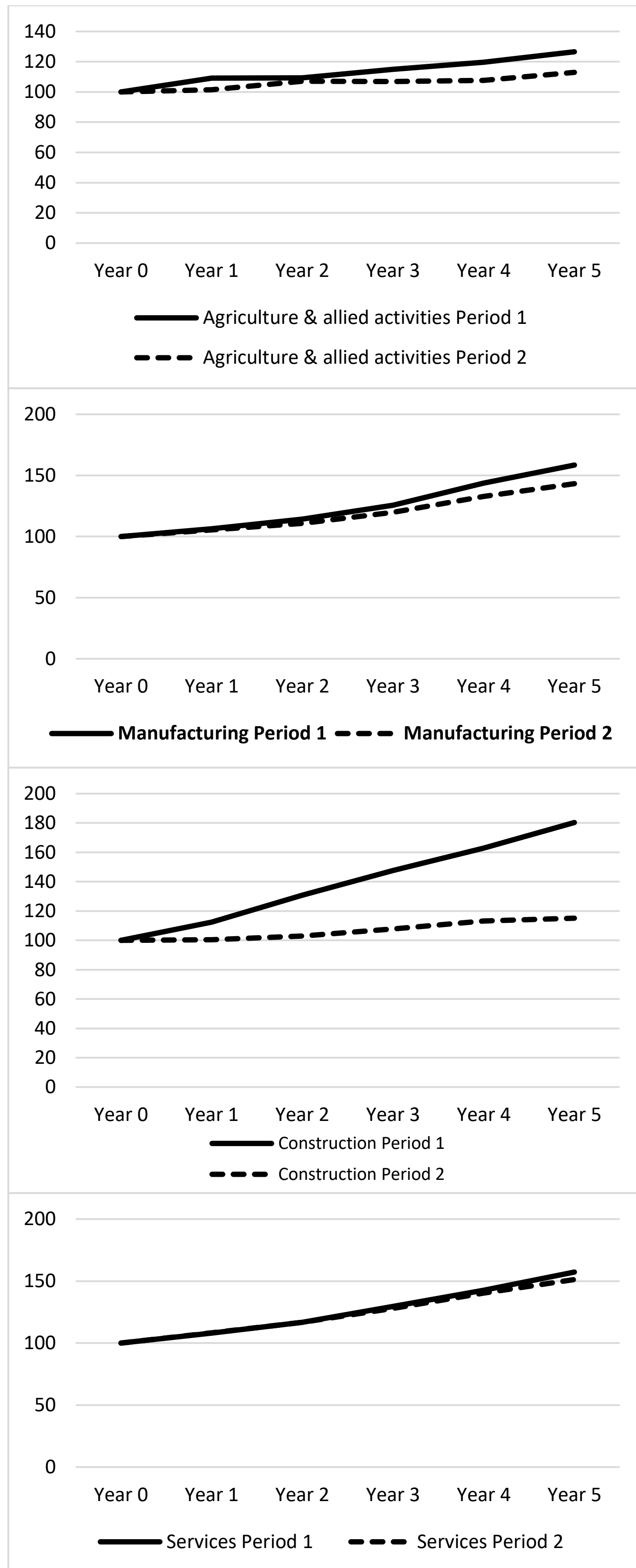
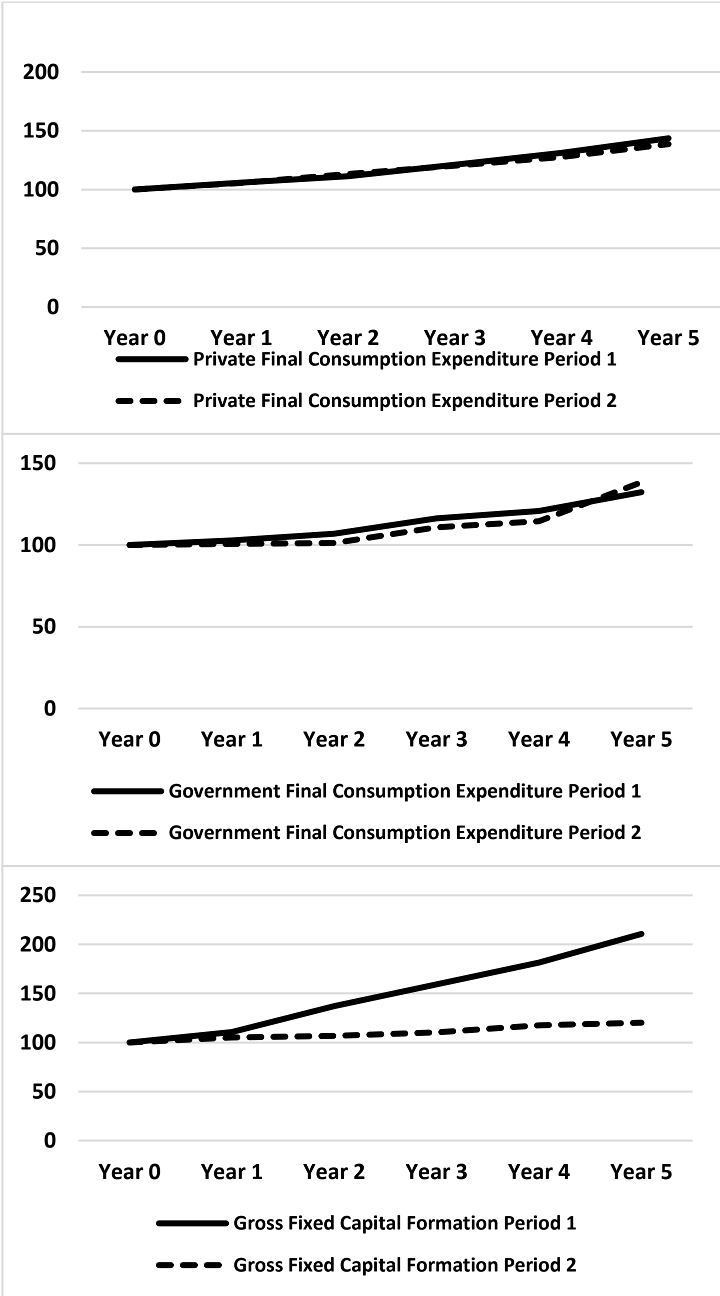
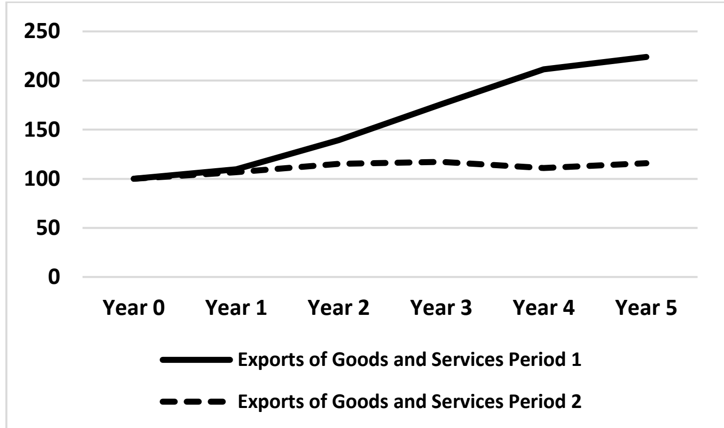
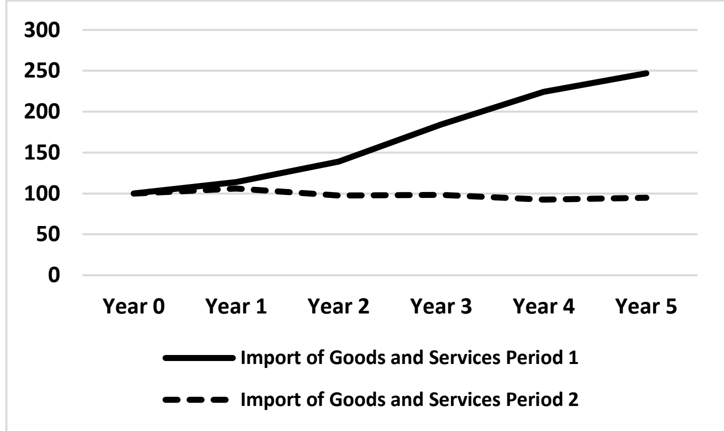
Appendix Figure 1 (Re: Table 1): Movement of Indices of GDP at Factor Cost/GVA at Basic prices (at Constant Prices) for Periods 1 and 2 (Respective Year 0 = 100)



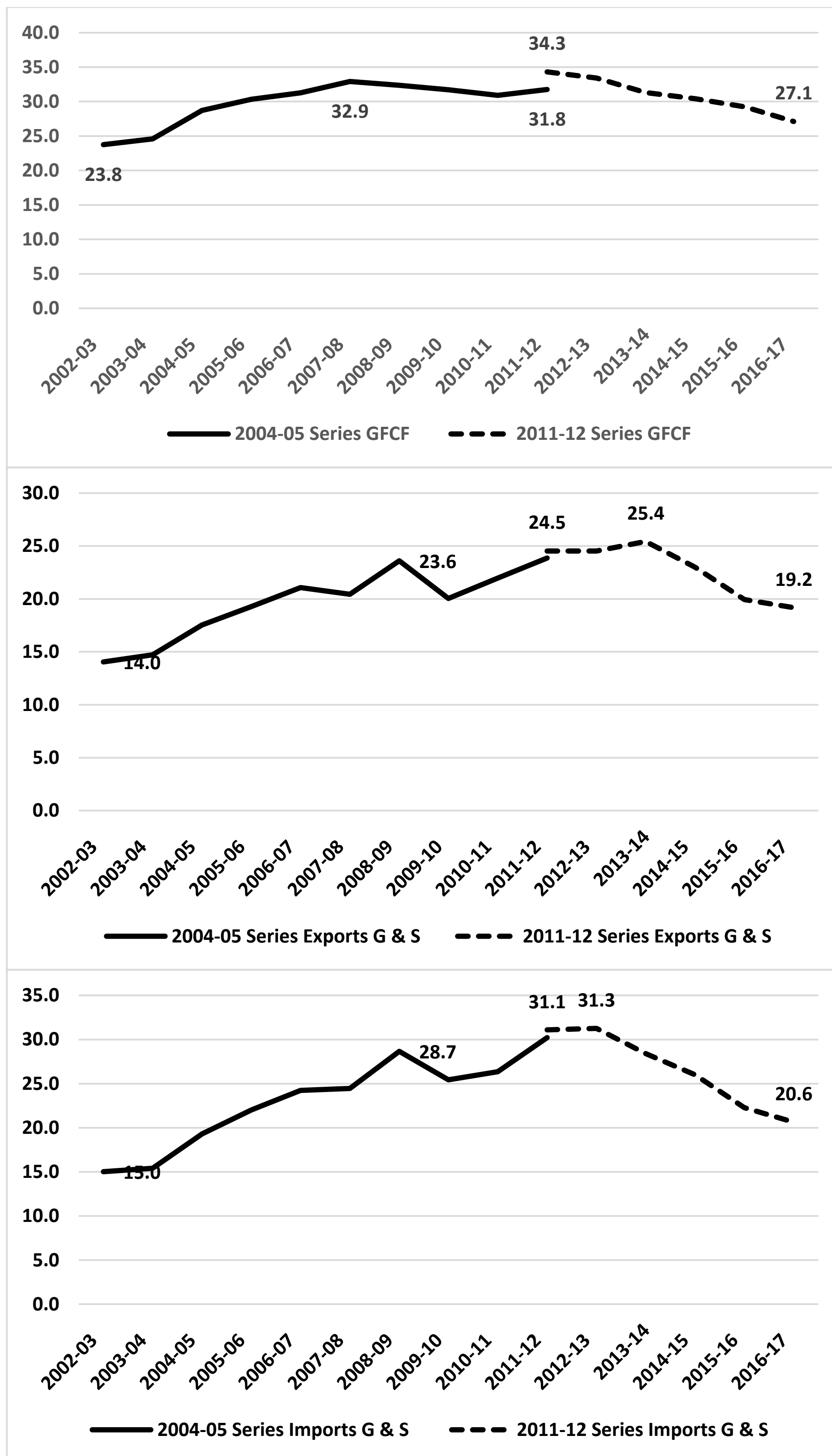
Appendix Figure 2 (Re: Table 4): Movement of Indices of Components of GDP at constant Market Prices for Periods 1 and 2 (Respective Year 0 = 100)




250
200
150
100
50
0
Year 0
Year 1
Year 2
Year 3
Year 4
Year 5
Exports of Goods and Services Period 1
Exports of Goods and Services Period 2


300
250
200
150
100
50
0
Year 0
Year 1
Year 2
Year 3
Year 4
Year 5
Import of Goods and Services Period 1
Import of Goods and Services Period 2

Appendix Figure 3: Investment and Trade in Goods and Services Ratios to GDP at Current Market Prices (Percentage)



Source: Reserve Bank of India, Handbook of Statistics on the Indian Economy [original source: Central Statistics Office (CSO)]