

Emerging Challenges in Indian Economy



M. Govinda Rao

*Director, National Institute of Public
Finance and Policy.*

*Conference on “South Asia: Environment
and Human Society” October 2-3, 2008*

Sustaining Accelerated Growth and Broadening the Developmental Base in India



- The Growth Story: Is acceleration in Indian Economic Growth structural or cyclical?
- Inclusive growth: Poverty and Income Distribution.
- Savings and Investment trends: Shift to a higher plateau.
- Productivity trends: The question of sustainability.
- Globalization and macroeconomic management.
- Fiscal policy and infrastructure deficit.
- Demographic dividend: How can we reap the benefits?
- Governance Issues: Fractured polity, oligopolistic power structure and rent seeking.
- Major Challenges.

Introduction

- Indian growth story is impressive.
- It raises important questions:
 - Have we reached the potential?
 - Is it sustainable?
 - How do we make it inclusive?
 - What are the constraints faced? Domestic and global.
 - What are the major reforms to be initiated?
 - Trade off between environmental sustainability and accelerating growth.
- Emerging challenges.

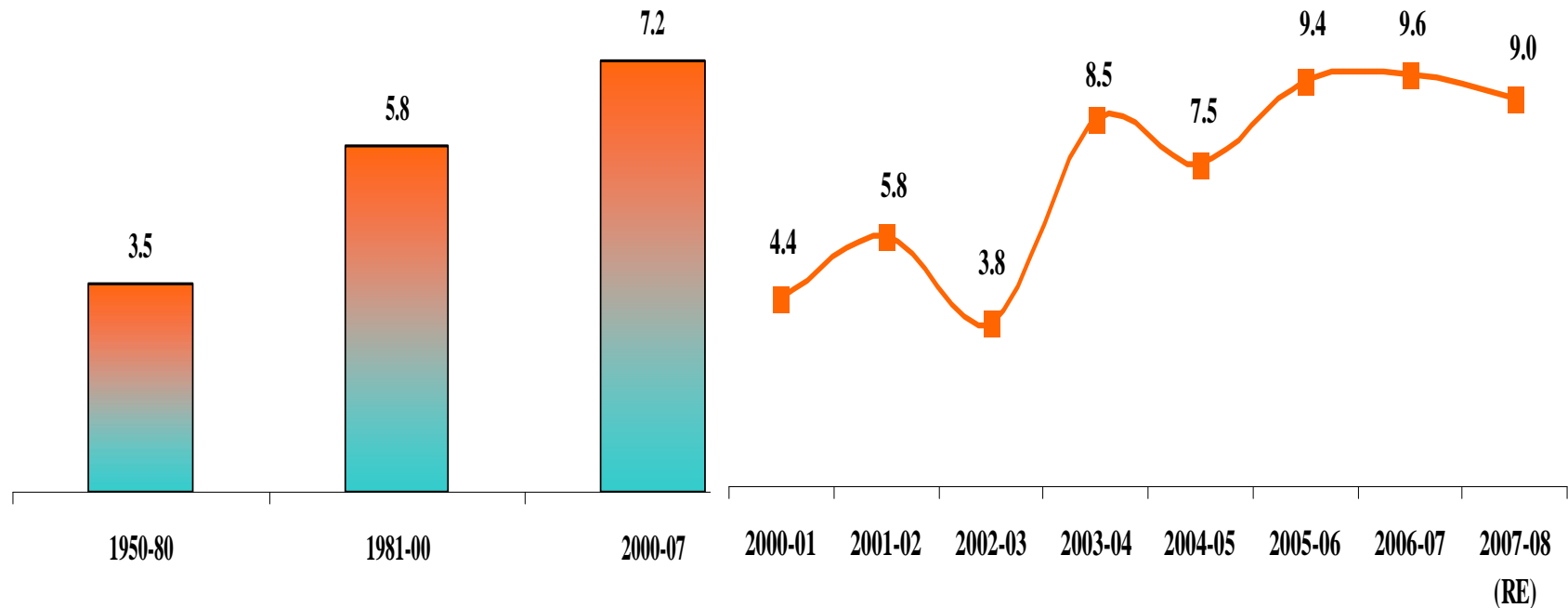
The Growth Story



- Recent growth story is impressive. Since 2000-01 – 7.8% - Last three years over 9 percent in each of the years - Last 5 years 8.9%. Slowing down of the economy in 2008-09 and the expected growth rate is about 7.7%.
- Steady acceleration in economic growth:
 - The first 30 years – Hindu rate of growth.3.5%
 - Next 20 years – 5.8%; Since 2000-01: 7.8%;
 - Last five years – 8.9%.
- Acceleration in growth is accompanied by lesser volatility. 2008-09 scenario –decelerating growth and increasing prices.
- Service sector led growth; agriculture is the laggard. 70% of growth contributed by services; manufacturing 25% and agriculture 5%.
- Agriculture continues to be the most volatile.

Indian Economy on an Upward Growth Path

GDP growth at constant prices
(% per annum)



Growth Rates of GDP: Major Sectors



A. Decadal Growth Rates							
	GDP	Agriculture	Industry	Manufacturing	Electricity	Construction	Services
1960-61 to 1970-71	3.8	2.5	5.4	5.3	11.2	5.6	4.8
1970-71 to 1980-81	3.2	1.8	4.4	4.1	6.9	3.3	4.4
1980-81 to 1990-91	5.4	3.5	6.7	6.2	8.6	4.7	6.6
1990-91 to 2000-01	5.6	2.8	5.7	5.9	6.8	5.1	7.3
2000-01 to 2007-08	7.6	3.1	7.3	7.9	5.4	11.2	9.2
B. Growth Rates and Coefficients of Variation*							
	GDP	Agriculture	Industry	Manufacturing	Electricity	Construction	Services
1960-61 to 1980-81	3.5	2.2	4.9	4.7	9.1	4.4	4.6
	(1.1)	(3.6)	(0.7)	(0.9)	(0.5)	(1.4)	(0.3)
1980-81 to 2000-01	5.5	3.2	6.2	6.1	7.7	4.9	7.0
	(0.4)	(1.5)	(0.5)	(0.7)	(0.3)	(0.8)	(0.2)
2000-01 to 2007-08	7.7	3.3	7.2	7.8	5.2	11.2	9.2
	(0.3)	(1.7)	(0.4)	(0.4)	(0.4)	(0.4)	(0.2)
C. Growth Rates: 2001-02 to 2007-08							
	GDP	Agriculture	Industry	Manufacturing	Electricity	Construction	Services
2001-02	5.8	6.3	2.4	2.5	1.7	4.0	7.2
2002-03	3.8	-7.2	6.8	6.8	4.7	7.9	7.4
2003-04	8.5	10.0	6.0	6.6	4.8	12.0	8.5
2004-05	7.5	0.0	8.4	8.7	7.9	16.1	9.1
2005-06	9.4	6.0	8.0	9.0	4.7	16.5	10.3
2006-07	9.6	3.8	10.6	12.0	6.0	12.0	11.1
2007-08 (RE)	9.0	4.5	8.1	8.8	6.3	9.8	10.8

* Figures in parentheses are coefficients of variation

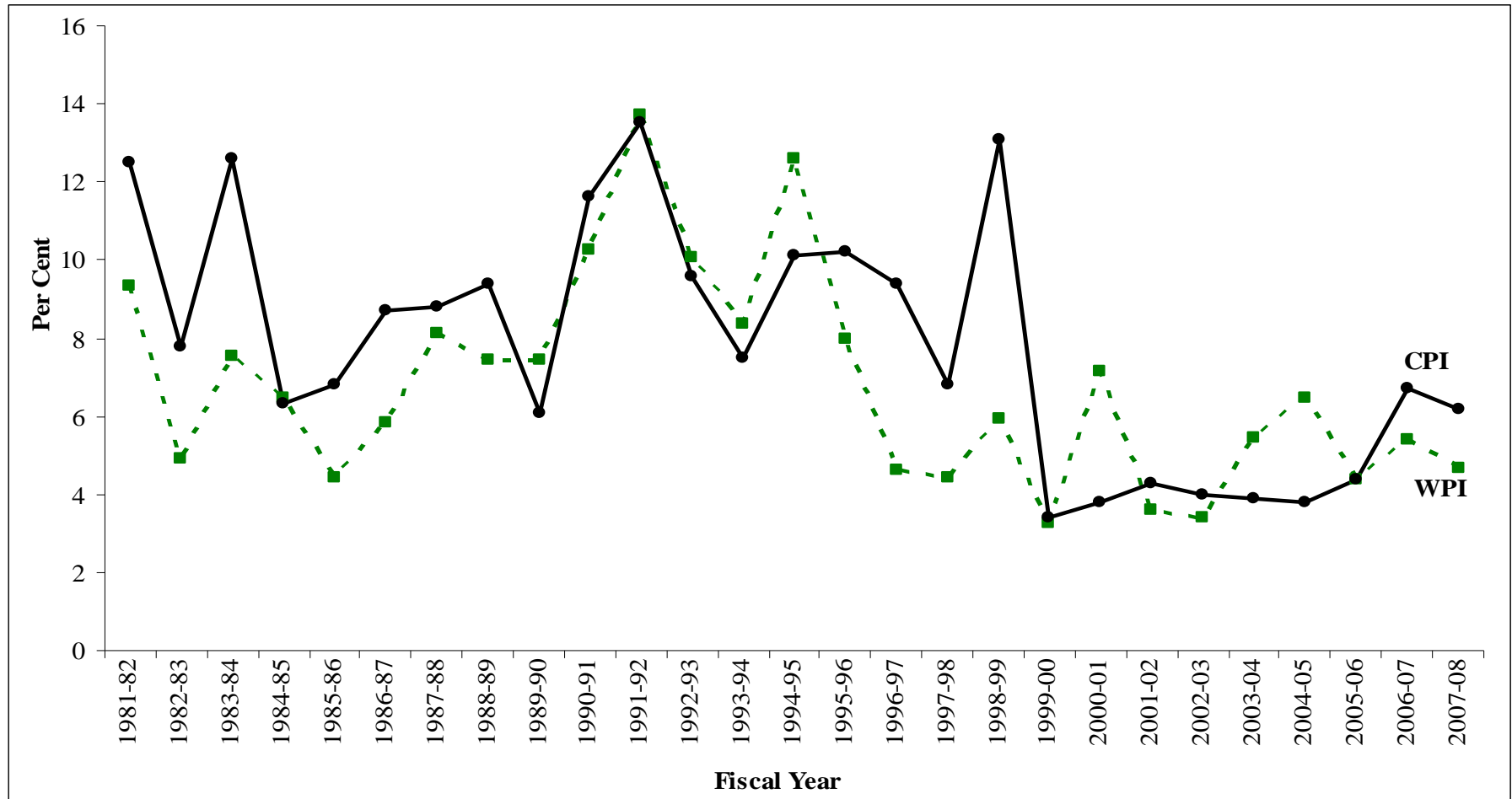
Source: National Accounts Statistics

Structural Change

GDP by Major Sectors: India and China

	India			China		
	1981	1991	2006	1981	1991	2006
Agriculture	38	32	18	32	25	12
Industry Manufacturing	25 (16)	26 (16)	28 (16*)	46 (39)	42 (33)	48 (34*)
Services	37	42	55	22	33	40

Inflation Rates: WPI & CPI*



* CPI is Consumer Price Index for industrial workers
WPI is Whole Price Index for all commodities

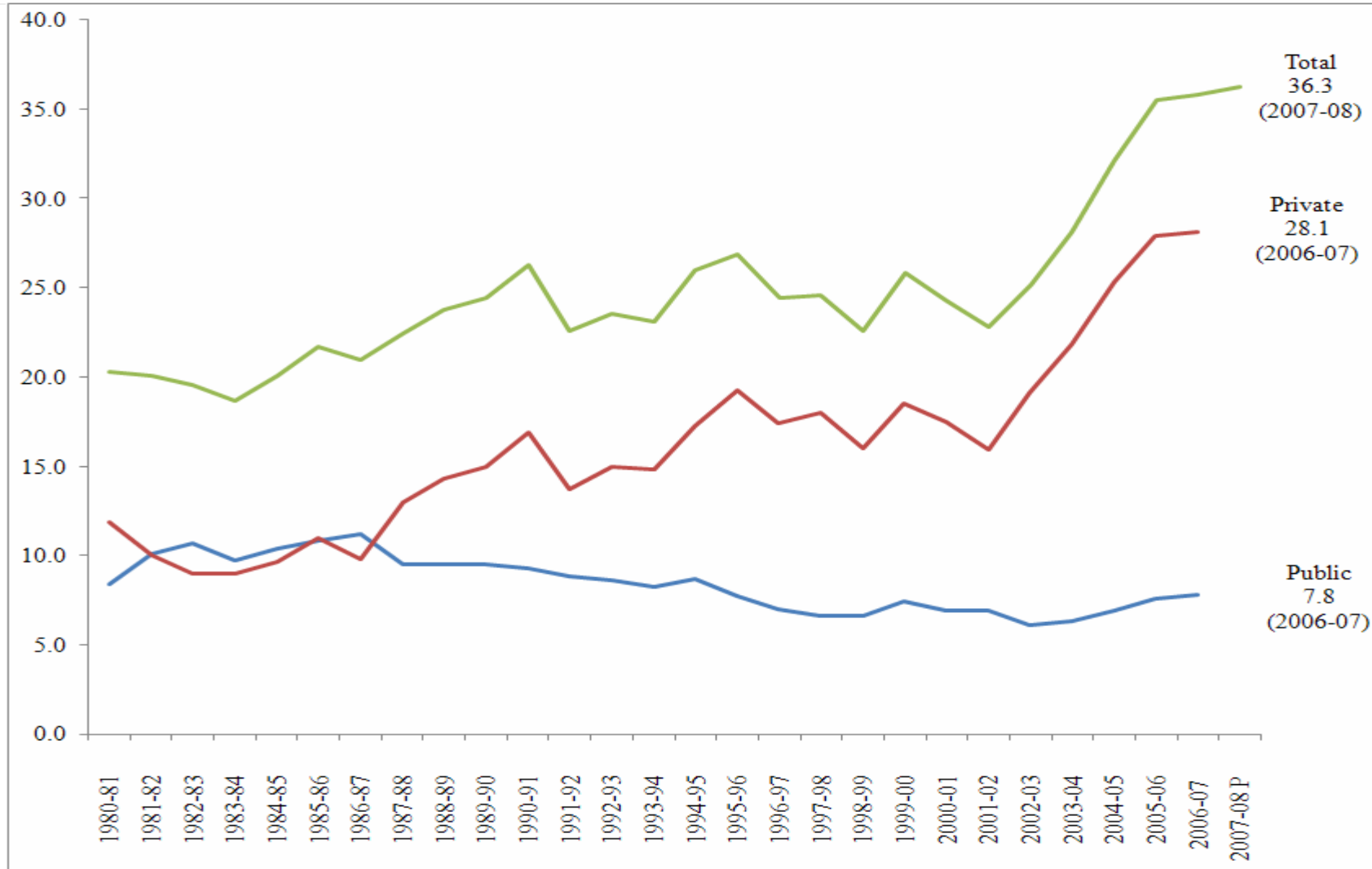
Source: Reserve Bank of India,

Question of Sustainability: Trends in Saving, Investment and Productivity

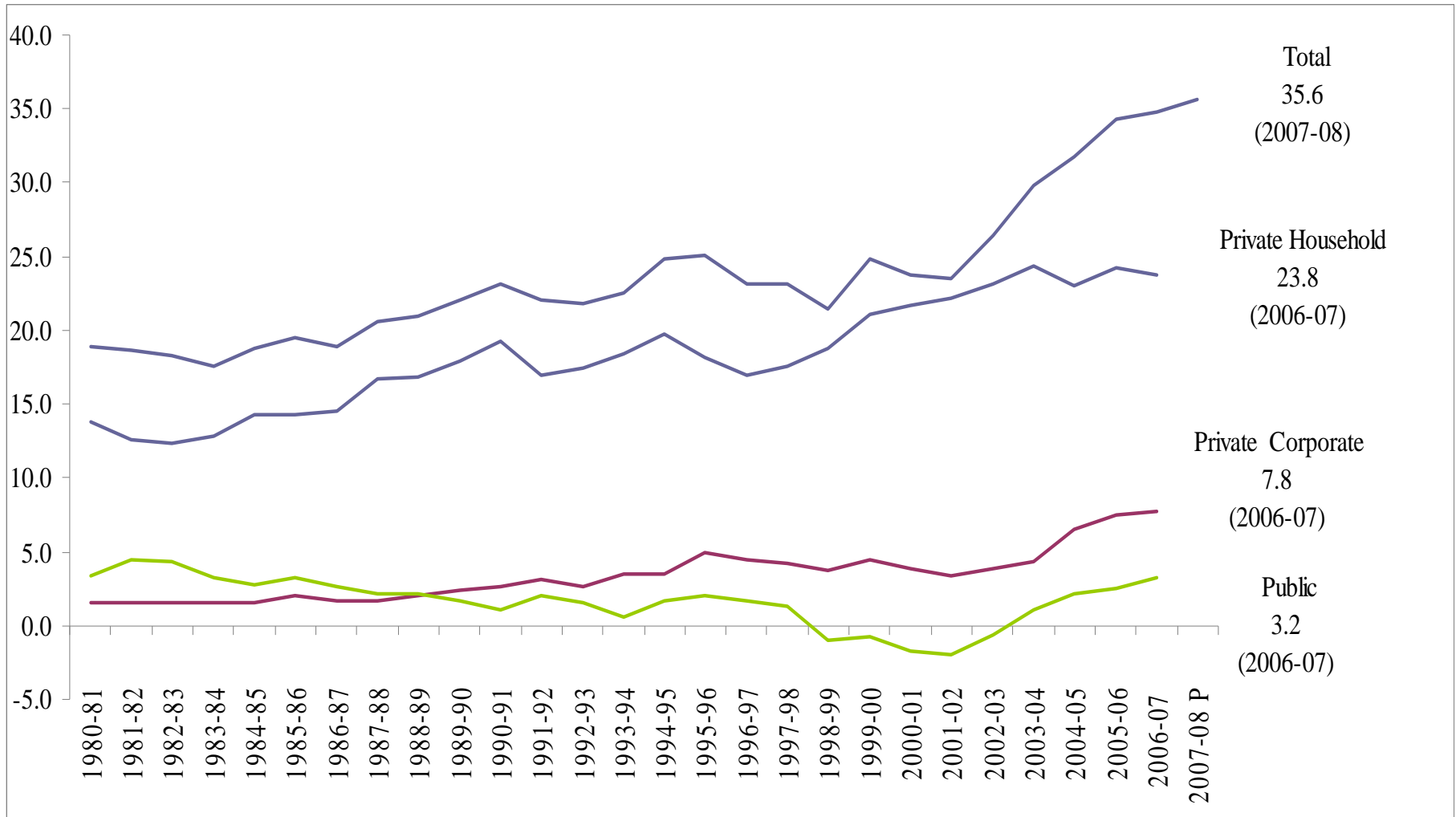


- Sharp increase in investment since 2001-02 mainly due to private investment.
- Increase in investment closely follows increase in the savings rate – mainly from public sector and private corporate sectors. Household savings has been stagnant.
- Sharp decline in fiscal deficits mainly due to increase in tax revenues.
- Problem from off-budget liabilities.

Gross Investment (% of GDP)



Gross Domestic Saving (% of GDP)

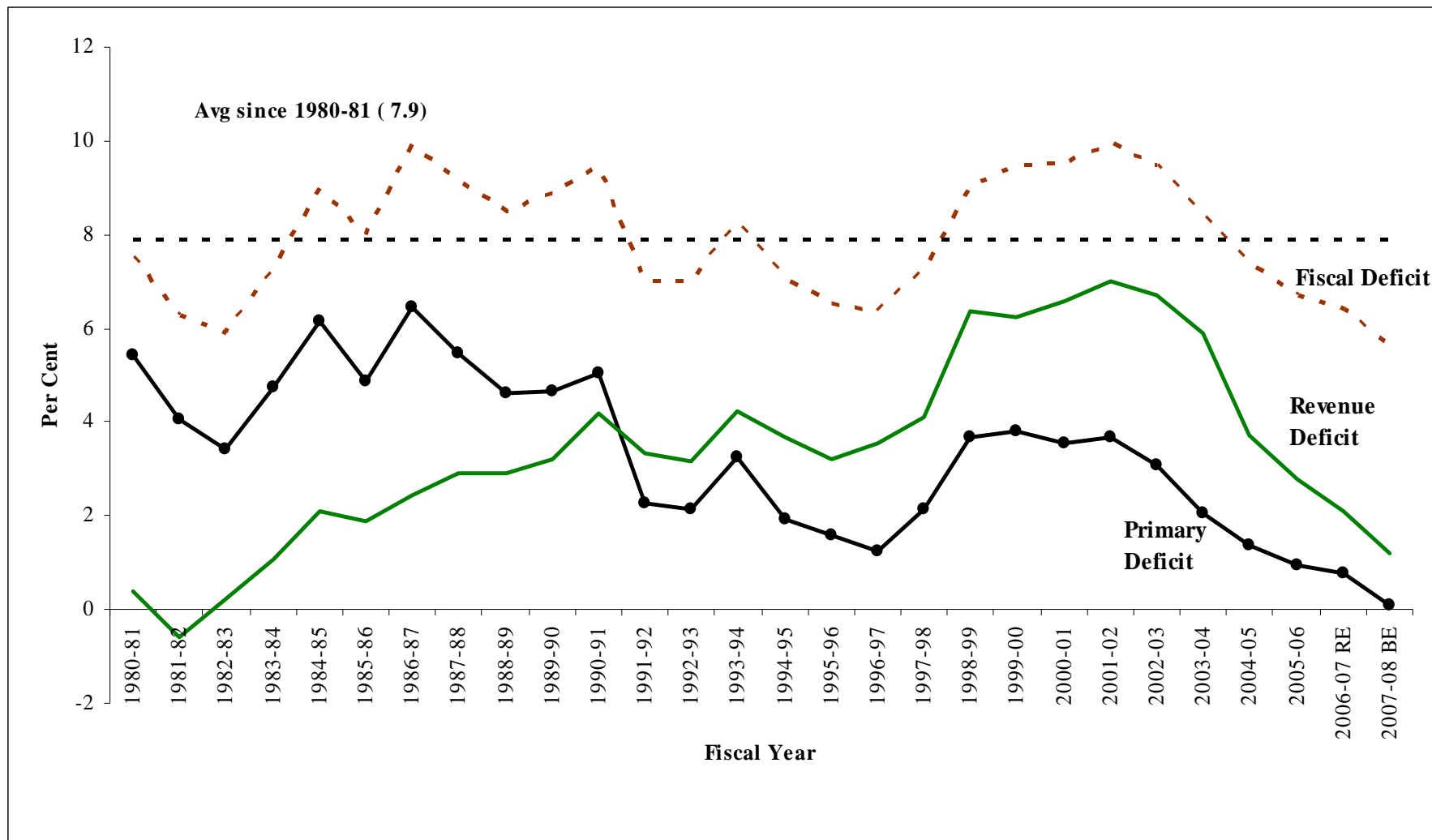


Source: Central Statistical Organization, GOI

Fiscal Management

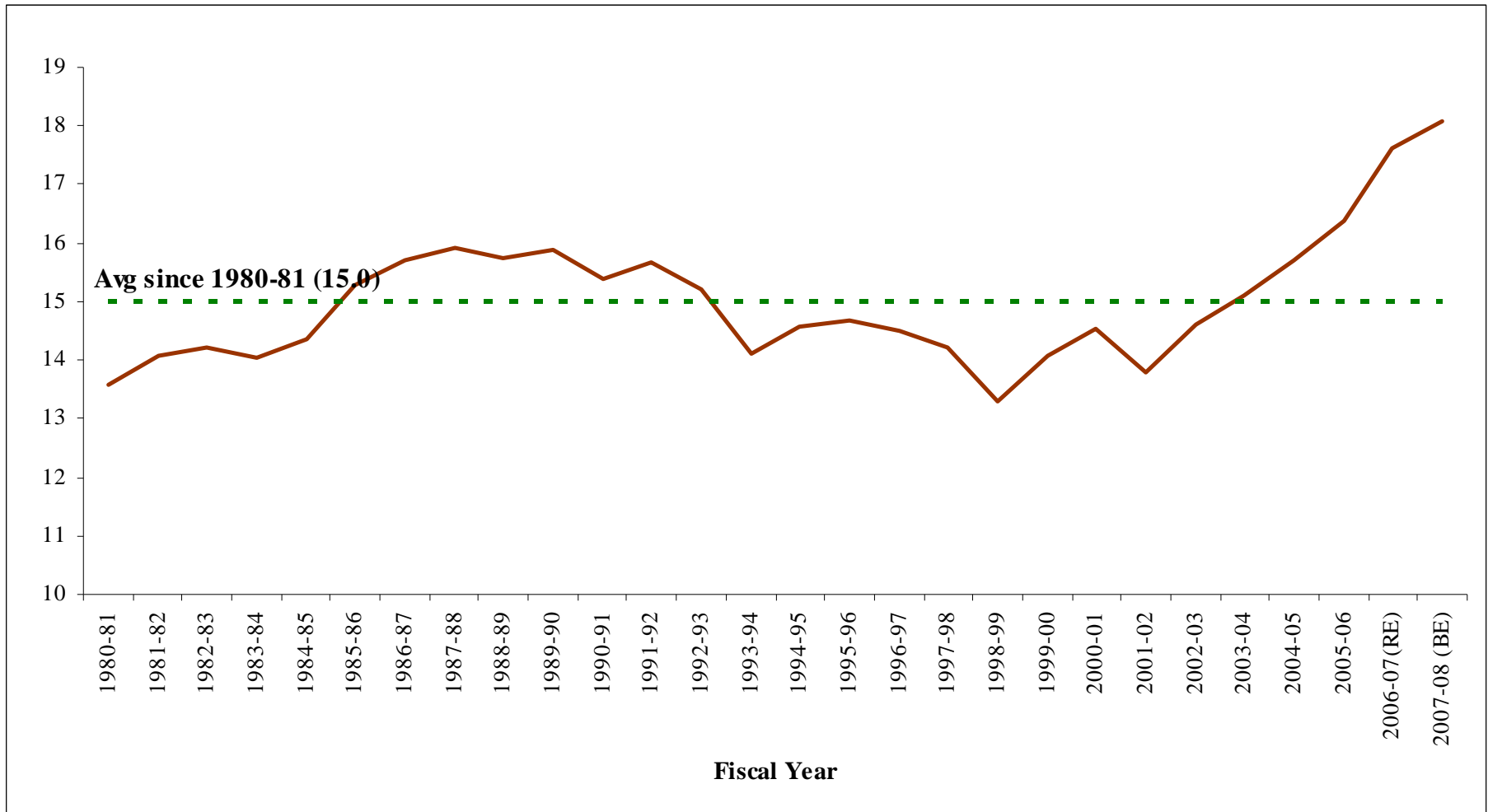
- The turnaround in fiscal situation in the country is remarkable.
 - Gross fiscal deficit relative to GDP declined from 9.9 percent in 2001-02 to 6.4 percent in 2006-07 and further to 5.6 percent in 2007-08 budget estimates - an improvement of 4.3 percentage points
 - Improvement in revenue deficit is even more impressive as it has declined by almost 5.8 percentage points relative to GDP during this period. The revenue deficit, which was 7 percent of GDP in 2001-02, declined to 2 percent in 2006-07 and is budgeted at 1.2 percent in 2007-08
 - Both the central and state governments have contributed to this fiscal turnaround by reducing fiscal and revenue deficits significantly.
- Off budget liabilities is a major problem.
- Capital expenditures continues to be a matter for concern. Capital expenditure is estimated at about 4.8 percent of GDP in 2008-09.

Fiscal Deficits: Consolidated Centre and States (% of GDP)



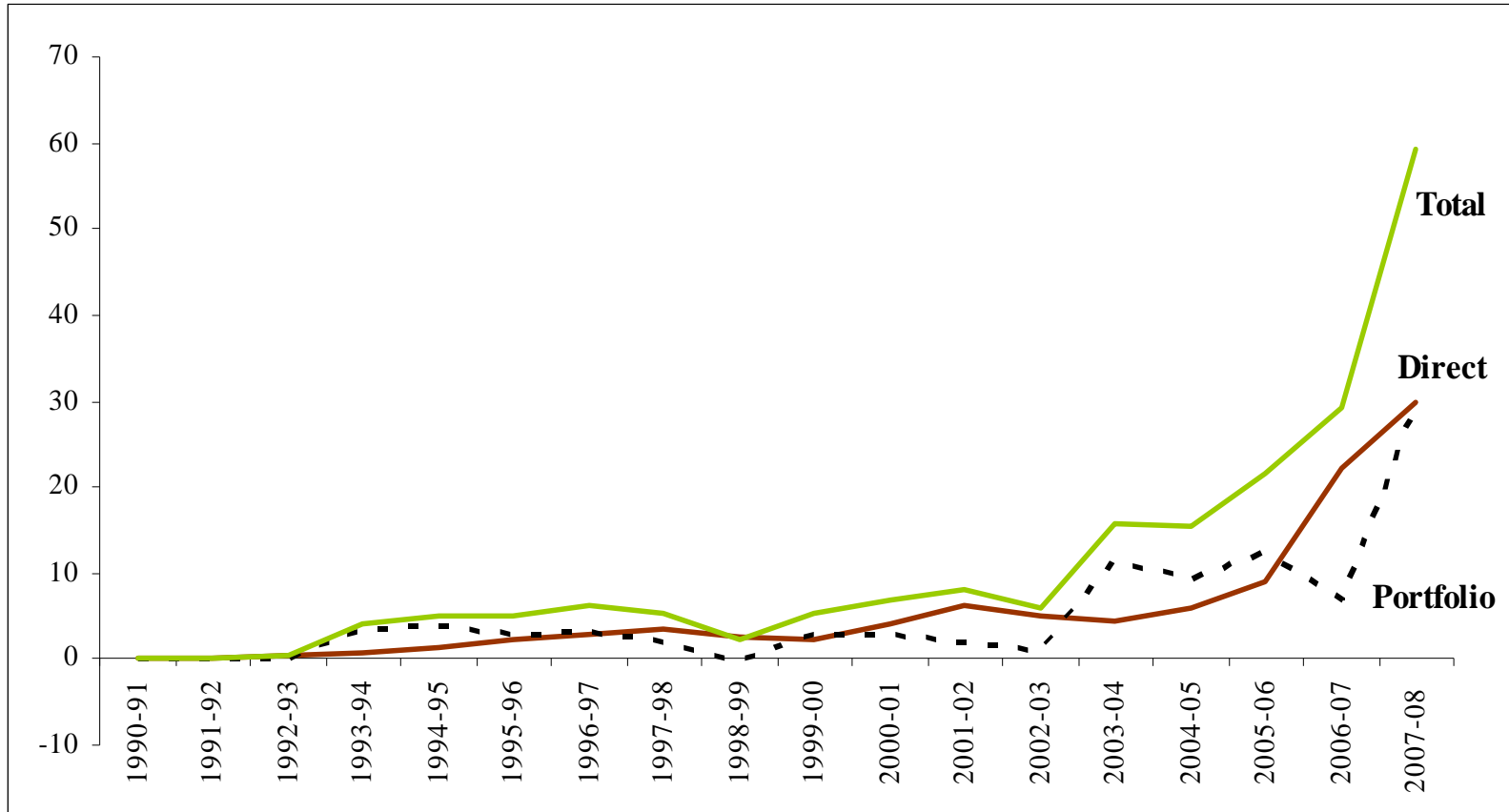
Source: Reserve Bank of India

Tax Revenue: Centre and States (% of GDP)



Source: Reserve Bank of India

Foreign Investment Flows (US \$ Billion)





Productivity Trends

- Decline in Import duties.
- Improved business confidence.
- Trends in imports and exports.
- Foreign investment trends and investment outflow.
- Corporate acquisitions.
- Increasing efficiency and profitability.



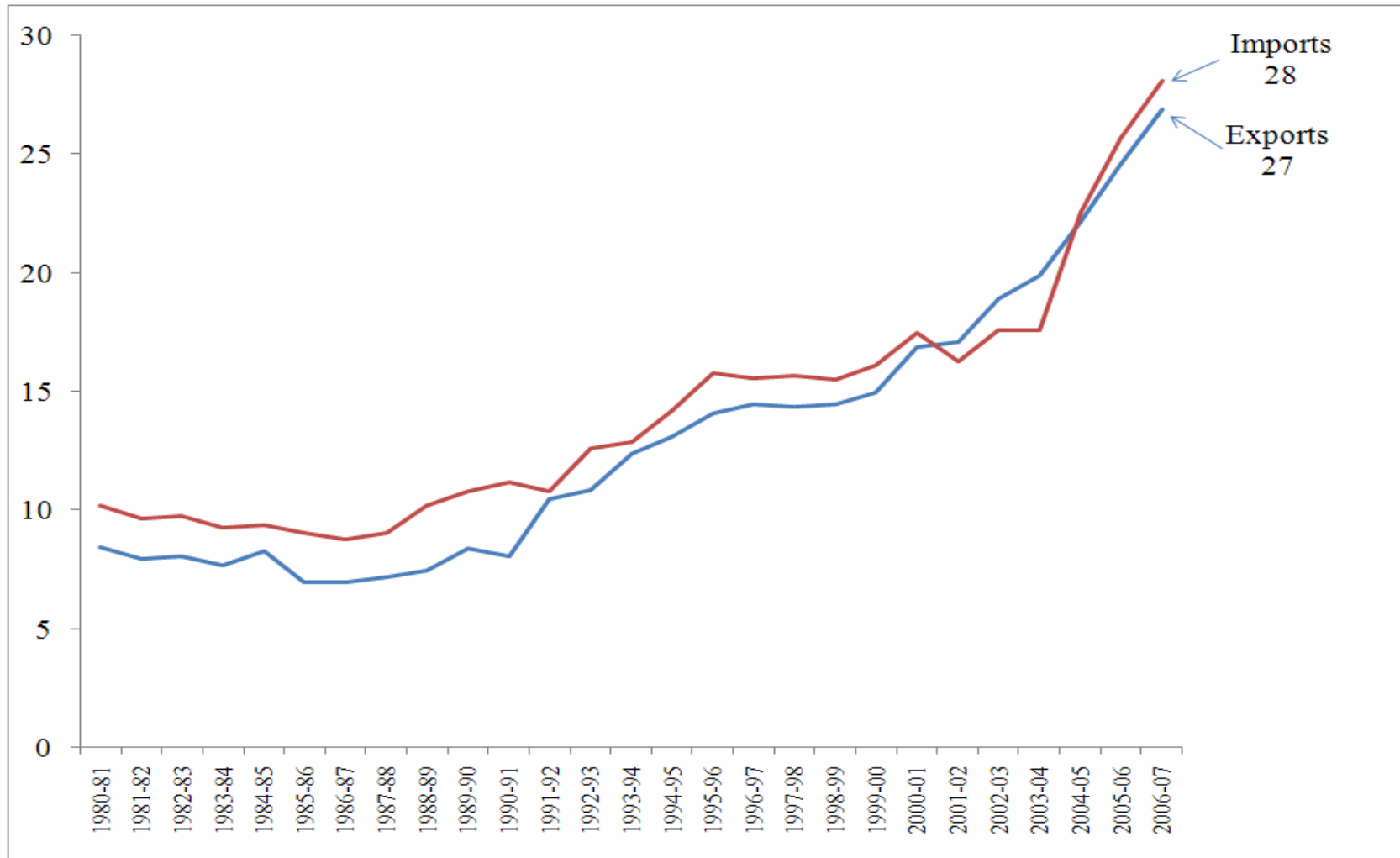
Import Weighted Average Import Duty Rates

	1991-92	2007-08*
Agriculture	68.3	63.0
Mining	95.5	5.4
Consumer Goods	114.1	23.3
Intermediate Goods	65.6	9.3
Capital Goods	94.8	6.4
All Commodities	77.2	9.0

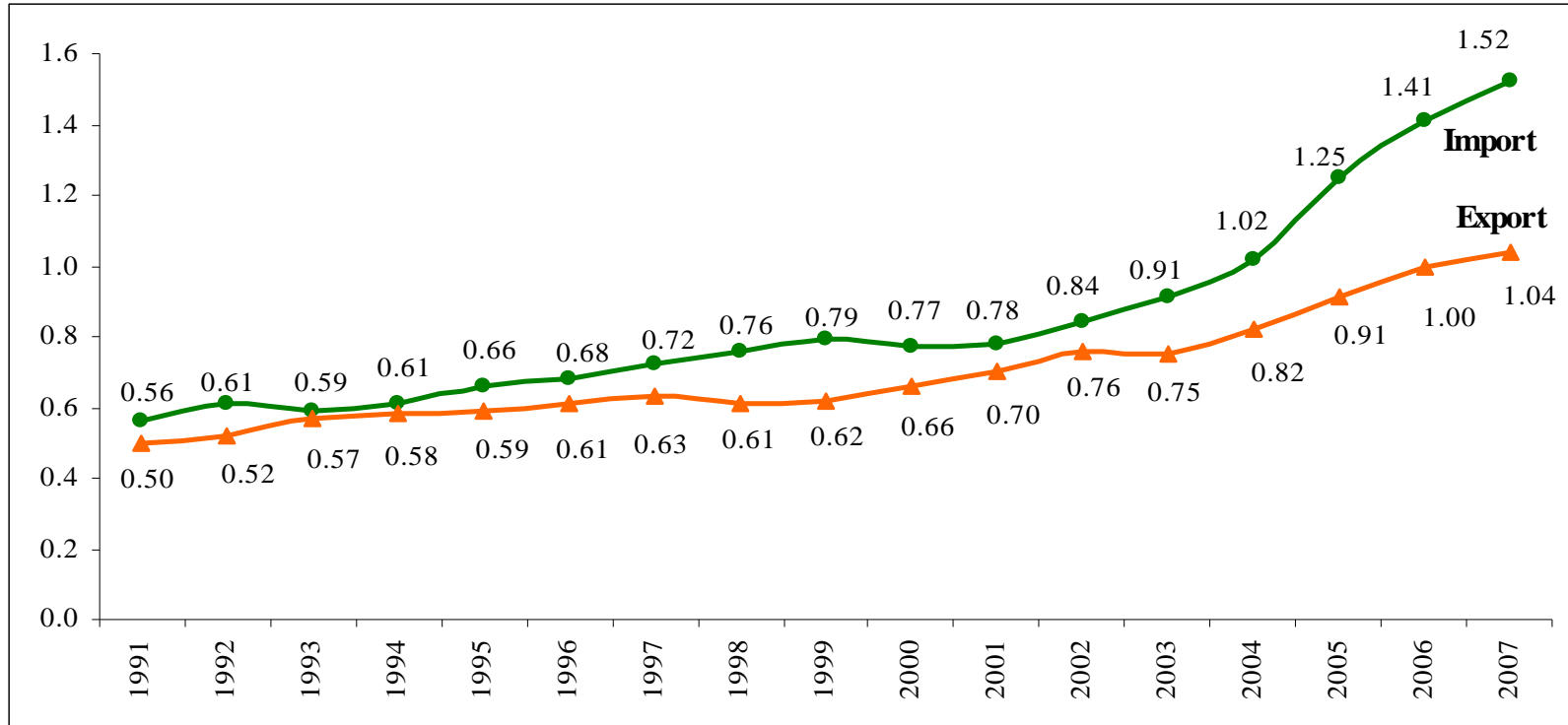
Source: Planning Commission

Note: * Imports of 2006-07 have been used as weights

Exports & Imports of Goods and Services (% of GDP)



Share of India's Merchandise Trade in World Trade



Trends in Foreign Investment

(US \$ Billion)



	Gross Outflow	Gross Inflow		
	FDI	FDI	Portfolio	Total
1990-91	-	0.1	0.0	0.1
1991-92	-	0.1	0.0	0.1
1992-93	-	0.3	0.2	0.6
1993-94	-	0.6	3.6	4.2
1994-95	-	1.3	3.6	4.9
1995-96	-	2.1	2.7	4.8
1996-97	-	2.8	3.3	6.2
1997-98	-	3.6	1.8	5.4
1998-99	-	2.5	-0.1	2.4
1999-00	-	2.2	3.0	5.2
2000-01	0.8	4.0	2.8	6.8
2001-02	1.4	6.1	2.0	8.1
2002-03	1.8	5.0	1.0	6.0
2003-04	1.9	4.3	11.4	15.7
2004-05	2.3	6.0	9.3	15.3
2005-06	2.9	7.7	12.5	20.2
2006-07	11.0	19.4	7.0	26.4
2007-08 Apr-Dec	9.5	17.9	32.9	50.8

Indian Corporate Acquisitions Abroad

Sector	Total Number of Acquisitions	
IT / Software / BPO	90	<i>Four companies (3i Infotech, Subex Systems, Teledata Informatics and Wipro) account for 29 acquisitions</i>
Healthcare and Pharma	62	<i>Five companies (Ranbaxy, DRL, Nicholas Piramal, Sun Pharma and Glenmark Pharma) account for 29 acquisitions</i>
Automotive	27	<i>Five companies (Bharat Forge, Amtek, M&M, Sundaram Fastners and Tata Motors) account for 19 acquisitions</i>
Chemicals and Fertilizers	19	<i>Two companies (United Phosphorus and Asian Paints) account for 12 acquisitions</i>

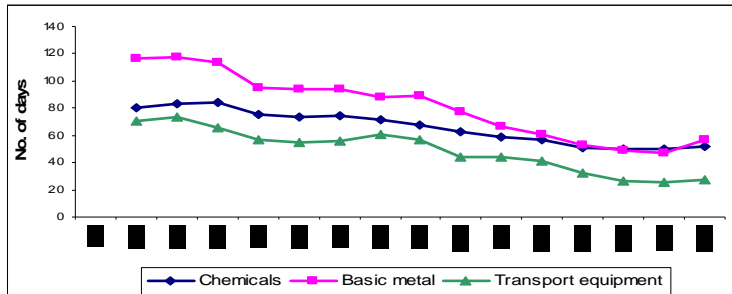
Source: FICCI, India Inc's Acquisitions Abroad

Indian Corporate Sector

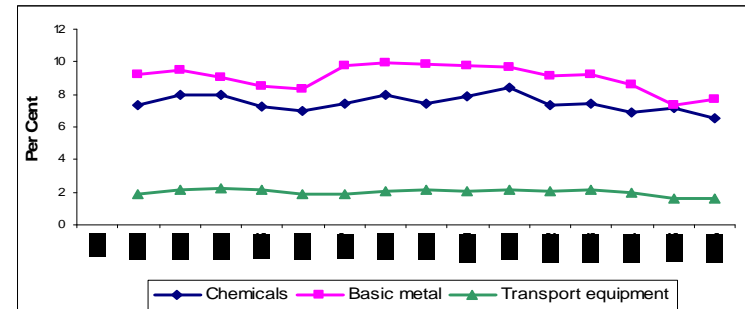


Increasing Efficiency and Profitability

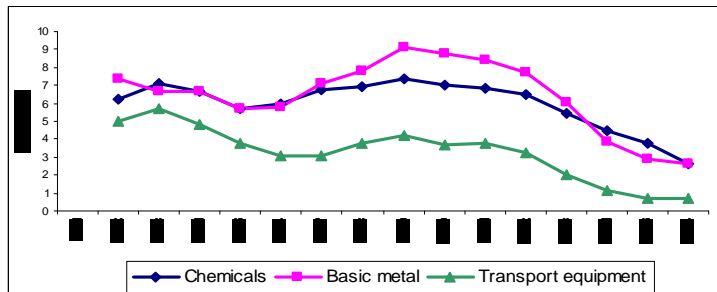
Raw material and Spares holding days



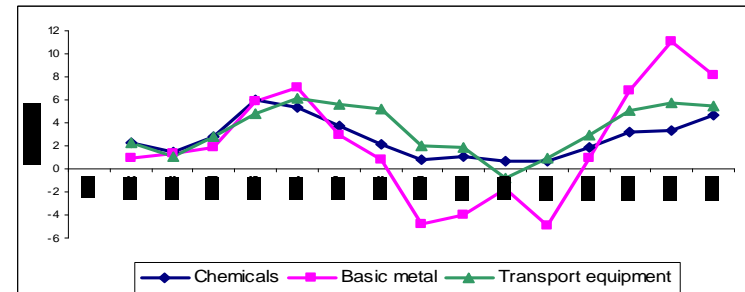
Energy Cost as % of Sales



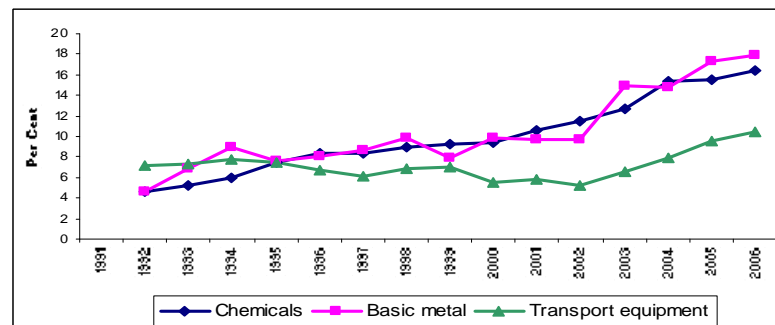
Interest Cost as % of Sales



PAT as a % of Gross Sales

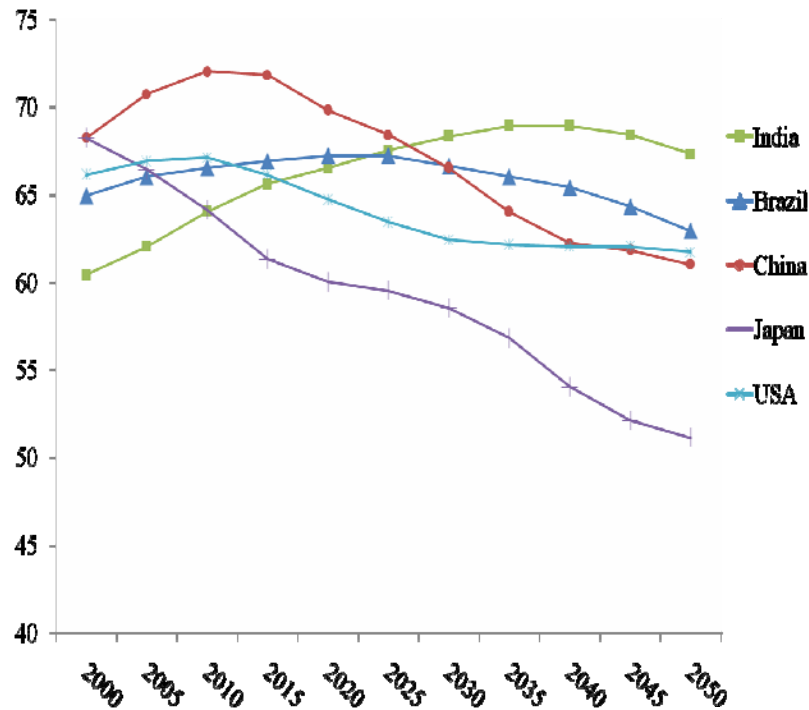


Exports as % of Sales



Demographic Dividend

% of Population aged 15-64



1. By 2035, 68.9% of population will be of working age between 15 and 65.

2. Hence the importance of generating employment and equipping the youth with good quality education.

3. Or, else, the demographic dividend could become a demographic liability.

4. Dependency ratio has declined from 0.8 in 1991 to 0.73 in 2001 & expected to decline further to 0.59 in 2011. This will have a positive impact on savings.

Is Growth Inclusive?

Lopsided growth: Agriculture with 52 percent employment share generates only 17 percent GDP

Decline in poverty: Impressive record – Mainly due to sustained growth and moderate inflation.

PC numbers – 26 % in 1999 to 21.8% in 2004

World Bank – measuring poverty at USD.1.25 a day at 2005 PPP prices estimates that poverty has increased from 421 million in 1981 to 146 million in 2005.

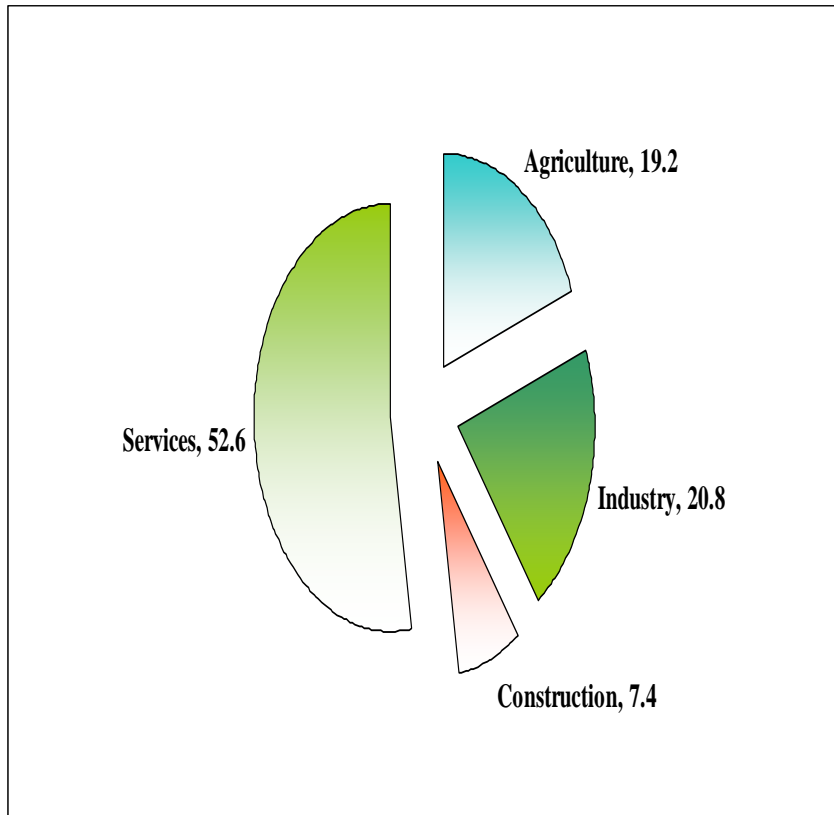
Changing Income distribution. Income distribution better than in China and Brazil.

Regional Income Distribution: A matter for concern.

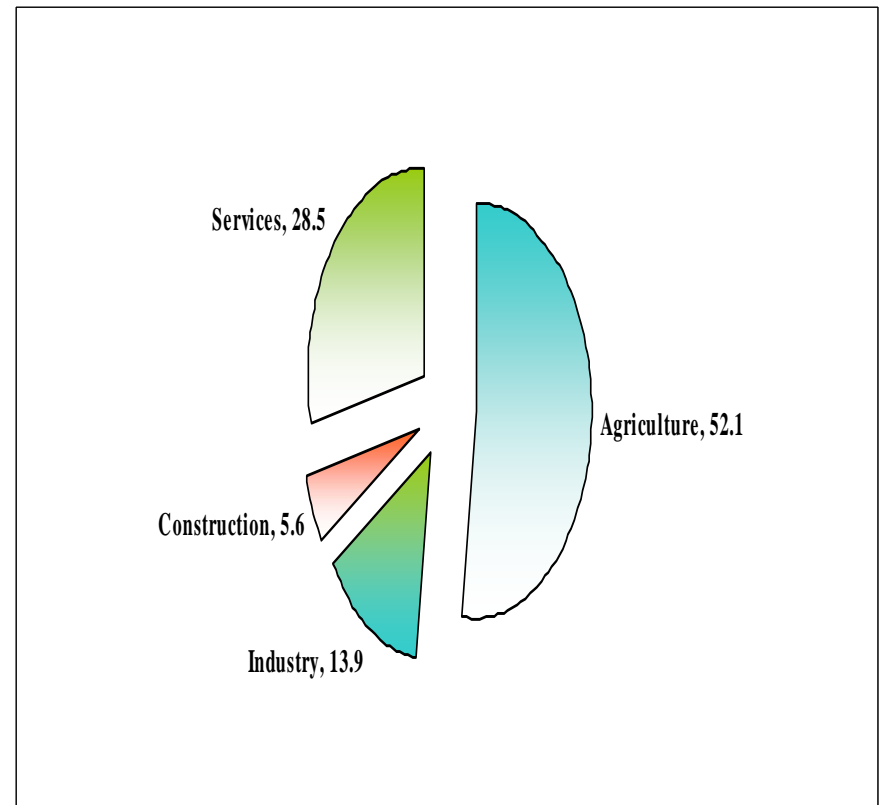
Employment growth: Declining organised sector employment.

Shares by Major Sectors: 2004-05

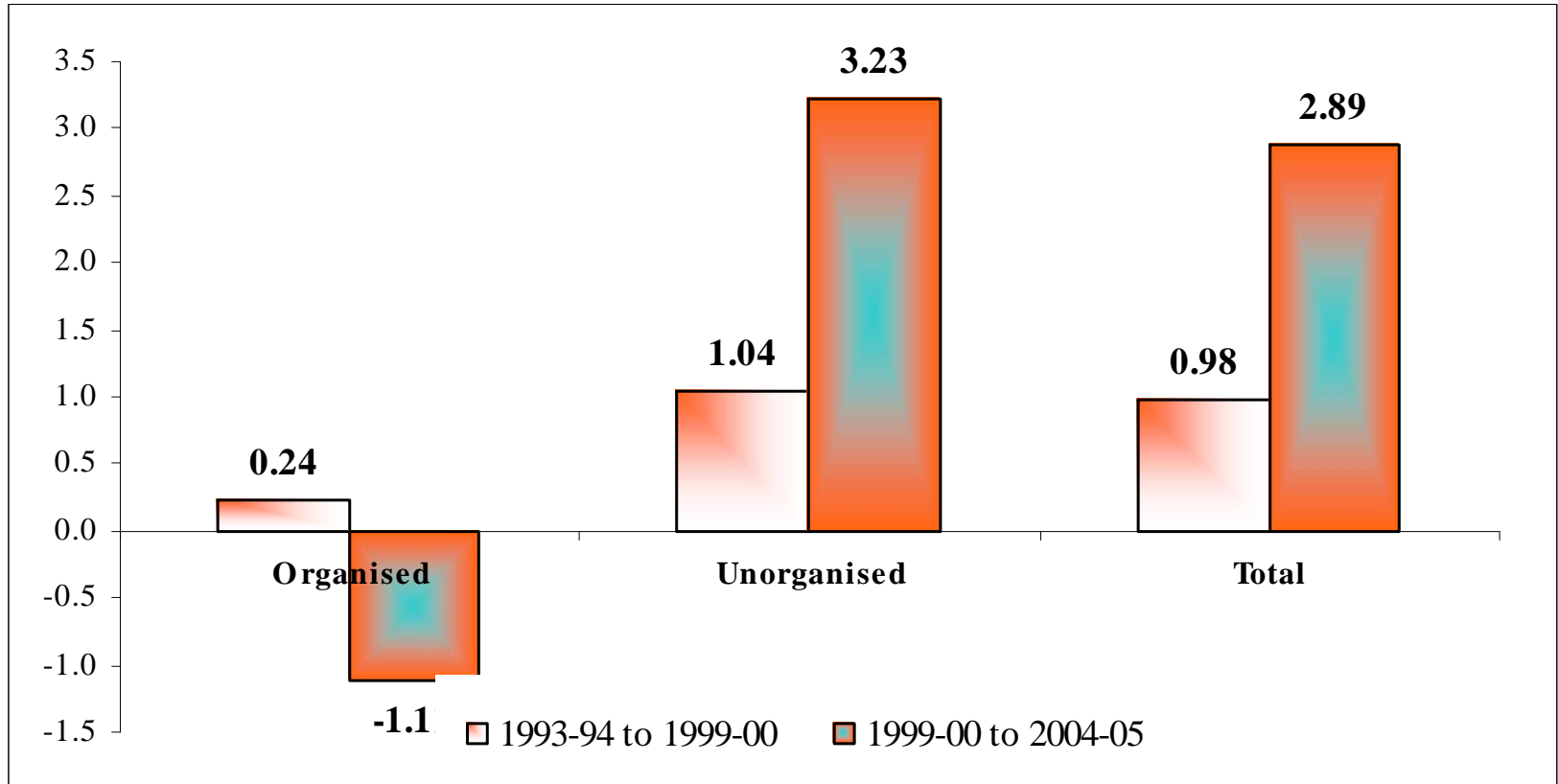
GDP



Employment



Faster Growth in Employment (%)

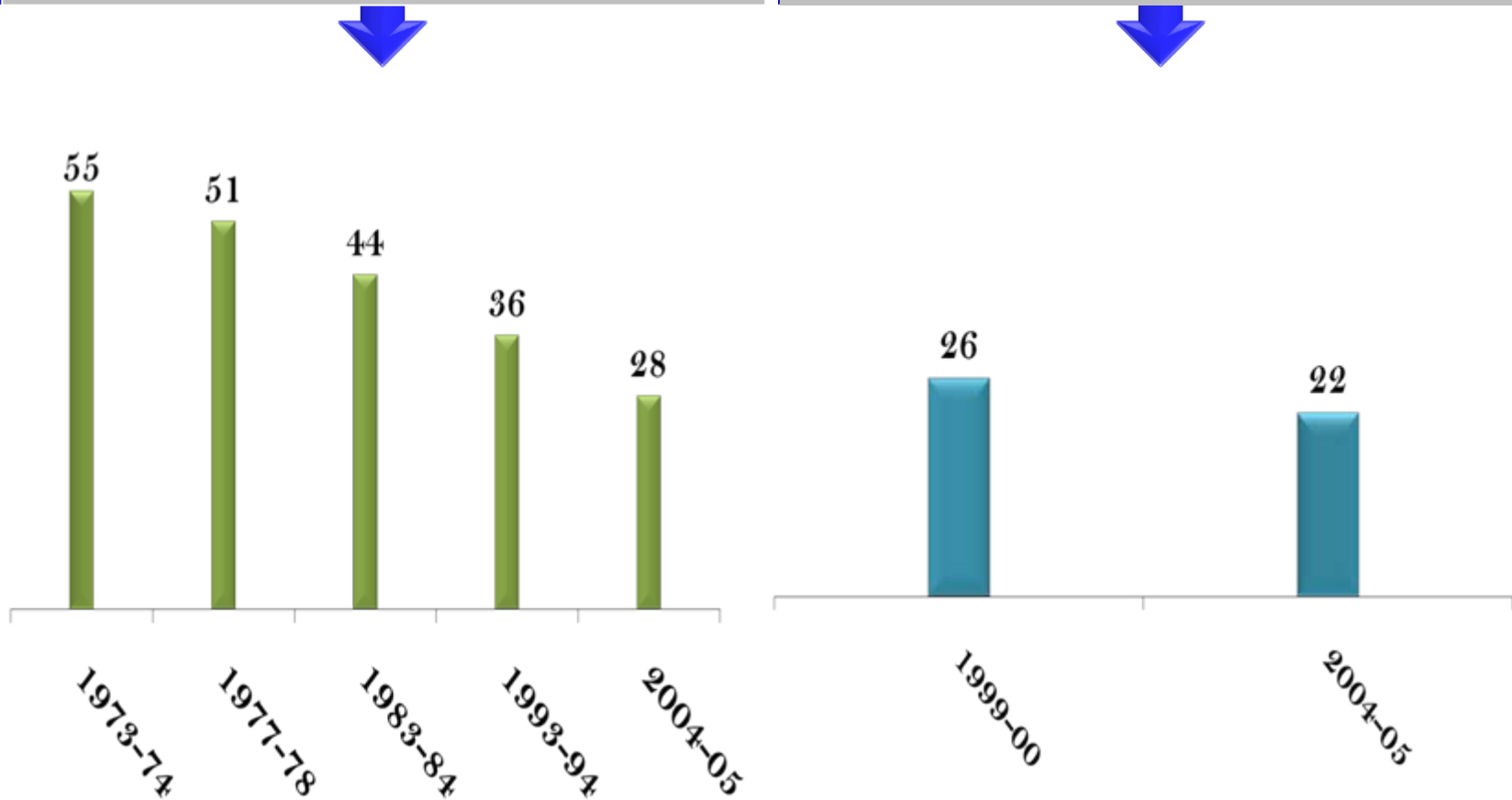


Declining Poverty



UNIFORM REFERENCE PERIOD

MIXED REFERENCE PERIOD



Source: National Sample Surveys (Full Sample), CSO, Govt of India

Climate Change

- Impact of Climate Change.
 - On agricultural productivity;
 - Rise in the sea level and displacement of people;
 - Natural disasters.
- Adaptation and mitigation strategies.
 - Trade off between growth acceleration and mitigation of CO₂ omission in the course of power generation.

Emerging Challenges

- Governance:
 - Fractured polity – Declining time horizon of political parties.
- Challenge of continuing reforms:
 - Creating a sustainable macroeconomic environment. Monetary and fiscal policy calibration in the context of surging capital flows and increasing oil prices.
 - Carrying forward market based reforms of policies and institutions.
 - Strengthening market based reforms
 - Fiscal consolidation.
 - Overcoming infrastructure .
 - Making the growth inclusive.
 - Accelerating growth with sustainable ecology.

Concluding Remarks

- Growth performance of Indian economy in recent years has been impressive. Along with growth acceleration the economy has gained greater resilience over the years.
- The current year is witnessing a slow down and increase in prices.
- The sources of growth are seen both in increased savings and investment in the economy as well as increases in productivity.
- There are a number of challenges in achieving the growth potential. These include:
 - Making the growth inclusive;
 - Sustaining the growth over the longer term and the reforms in policies and institutions and the reforms needed;
 - Overcoming the infrastructure deficit;
 - Sustaining high growth while meeting the challenges posed by climate change.
- Keynes stated “...Soon or late it is the ideas, not vested interests, which are dangerous for good or evil.” Given the influence of special interest groups in India, it is a major challenge to allow the ideas to work for the good.