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INDIAN ECONOMIC GROWTH AND SOCIAL PROGRESS

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Abstract

This paper analyzes the effects of the reforms initiated in India following the balance of payments (BOP) crisis of 1991 on the development strategy adopted by the government, its policies and the actual economic performance. The significance of the 1991 reforms as there is a debate on when reforms started, as a number of analysts claim that reforms started in the mid-eighties and that is why growth started accelerating in the 1980s. India's growth experience is often contrasted with that of East Asia and more particularly China. It is claimed that savings rates though increasing are considerably lower than in East Asia growth in India is based on the services sector rather than manufacturing which was the leading sector in East Asia and again unlike East Asia India has not attracted much foreign direct investment. While there were certain changes in policies in the 1980s as there had been in earlier years, these did not mean a basic change in the policy framework. The resilience of the economy as it recovered quickly from economic crises encouraged the government to persist with the import substituting industrialization strategy it had adopted. However, research conclusions of various committees set up by the government to study the effects of licensing and import controls and the experience of other countries especially China resulted in policy makers believing that a change in the growth model was needed and the 1991 crisis provided the opportunity to carry out such a change. There is an accelerating rate of growth of GDP after the mid 1970s and it is difficult to relate this gradual acceleration to specific policy changes. Furthermore, since corporate investment as a share of GDP did not increase in the 1980s it is difficult to identify the mechanism by which the more pro-business policies of the government were translated into higher growth as claimed.

***Keyword**: balance of payments, GDP, pro-business policies, industrialization, gross fixed capital formation, Indian Economy*

The 1991 Indian Policy Reform

The 1991 reforms which followed a balance of payment crisis resulted in a fundamental re-orientation of Indian policy unlike what had usually happened in previous crises. Policy adjustments had been made after previous crises but the broad strategy had remained the same.

The basic objectives of policy had remained constant since independence: rapid growth, poverty removal, a more equitable income distribution and self-sufficiency though the relative weights of the different objectives varied over time. These objectives were to be reached through the adoption of an import substituting industrialization strategy in which the state would play a prominent part through its almost total monopoly of production of capital goods and important intermediate goods. Policy changed as the relative importance of the different objectives varied and when the constraints facing the economy changed. One of the consequences of the crisis was usually a drop in the investment ratio which recovered only after a considerable lag. For instance, after gross fixed capital formation (GFCF) as a percentage of Gross Domestic Product (GDP) reached a peak of 15.9 per cent in 1957-58 it fell after the 1957-58 BOP crisis and did not recover to the earlier ratio till 1963-64 (RBI 2012). The fall in the GFCF ratio after the 1965-67 crisis was particularly severe from 20.4 per cent to 16.7 per cent and it did not recover till 1977-78.

Growth in the Indian Economy

The Indian economy has been on an accelerating growth path since the mid 1970s for over three decades. The financial crisis of 2008 has resulted in the growth rate becoming more variable. While the crisis lowered the growth rate from 9.7 percent in 2007-08 to 6.5 percent in 2008-09, the economy recovered quickly to grow at 7.9 percent in 2009-10 and 8.3 percent in 2010-11. But the high rate of growth has not been sustained and declined to 7 percent in 2011-12.

Growth Rate of GDP and Major Sectors in India

Plans	GDP	Agriculture	Manufacturing	services
6th (80-84)	5.4	5.7	5.1	5.4
7th (85-89)	5.6	2.8	6.0	6.1
8th (92-96)	6.6	4.7	9.4	6.8
9th (97-01)	5.7	2.4	3.3	7.8
10th (02-06)	7.6	2.4	9.3	10.1
11th (07-10)	7.9	3.2	7.9	10.0

Source Reserve Bank of India 2012

The acceleration in the rate of growth is partly because of the greater weight that faster growing sectors achieved over the years because of their faster growth. For instance if we apply the growth rates for the sectors during the 11th Plan to the sector shares during the 6th Plan the overall growth rate would be 6.7 percent. But if we apply the same growth rates to the sector shares in the 11th Plan the overall growth rate is 8.2 percent a full 1.5 percent greater. The share of the slow growing agricultural sector has been declining. But another important feature of the growth acceleration is the higher growth rate of the services sector. There has been a sharp acceleration in the rate of growth of value added in services from the eighties to the nineties and further in this century.

Annual Rates of Growth of Indian Value-Added (Per cent)

Year	Manufacturing	Services
1997	0.05	8.00
1998	3.13	8.36
1999	5.39	10.99
2000	7.30	5.37
2001	2.77	6.88
2002	6.87	6.97
2003	6.34	8.06
2004	7.38	8.12
2005	10.10	10.91
2006	14.32	10.06
2007	10.28	10.27
2008	4.33	9.98
2009	9.66	10.45
2010	7.56	9.35

Source World Bank Databank http://databank.worldbank.org/ddp/home.do

Despite this acceleration, the share of services in GDP in India, defined as a low middle income country by the World Bank, while higher than the average is not exceptional. The average for low income countries is 50 percent and for low middle income countries is 48 percent. Where India deviates significantly from other low middle income countries is in the share of manufacturing which averages 26 percent for low middle income countries as against India's 15 percent, and this share has come down in the past decade in India. Furthermore, the share of services in GDP increased between 1974-82 and 2001-10 by 85.3 percent in China whereas it increased by only 32 percent in India. In Korea it increased by over 33 percent in this period. In Malaysia and Indonesia in South East Asia it hardly increased and in Thailand it fell.1 Also, the share of manufacturing in GDP fell from 38.0 percent to 32.1 percent in China during this period and in India it fell from 16 percent to 15.2 percent.

Social Progress

A major objective of policy making in India has been to reduce poverty. Though poverty has been decreasing and there is an improvement in many other social indicators, included in the Millennium Development Goals (MDGs), progress has lagged in South Asia as compared to other regions and within South Asia India has lagged.

Regional Social Improvement (% decline 1990-2005)

	Poverty rate	Malnourishment	Infant Mortality	Child Mortality	Maternal Mortality
EAP	69.3	4.4	45.6	49.9	50.0
LAC	27.4	7.3	53.0	55.2	35.2
MNA	16.3	5.2	50.0	54.6	53.2
SA	22.1	4.7	37.0	41.9	47.6
SSA	11.6	11.6	24.7	26.6	18.4
Bangladesh	31.6	22.9	50.4	55.1	51.7
India	21.5	14.2	31.8	35.3	50.9
Nepal			51.3	56.1	49.4
Pakistan	67.4	16.3	24.1	26.7	40.8
Sri Lanka	55.8	24.2	36.2	39.8	50.6

- The decline in malnourishment is for the period 2000-08. Also for South Asia the individual country numbers seem to be at variance with the figure for the region.
- EAP is East Asia and Pacific, LAC is Latin America and Caribbean, MNA is Middle East and North Africa, SA is South Asia and SSA is Sub-Saharan Africa. The regions are as defined by the World Bank.

The elasticity of reduction with respect to growth of per capita GDP has been low in Asia, except for the elasticity of reduction of poverty with respect to growth of per capita GDP in East Asia. Again within South Asia this elasticity has been low in India.

Elasticity of Reduction with respect to growth of per capita GDP

	PR 1990-05	Malnourishment 2000-08	IMR 1990-2005	CMR 1990-2005	MMR 1990-2005
EAP	1.1	0.07	0.4	0.5	0.6
LAC	1.4	0.39	2.6	2.8	1.9
MNA	0.6	0.24	2.0	2.2	2.7
SA	0.4	0.12	0.6	0.7	1.0
SSA	1.9	0.55	0.8	0.9	0.8
Bangladesh	0.8	1.0	1.5	1.7	1.6
India	0.3	0.4	0.6	0.7	1.1
Nepal			2.4	2.7	2.2
Pakistan	3.8	1.8	0.9	1.1	1.8
Sri Lanka	1.3	0.8	0.8	0.8	1.2

Conclusion

We find that the Indian economy has been increasingly integrated with the world economy since the reforms started in 1991. The importance of exports of goods, non-factor services and labour services has increased. There are increasing capital inflows as well as outward FDI. Closer integration of financial markets has important implications for the conduct of economic policy in India. The behaviour of 12 economic indicators shows that the economy has done better after the reforms, in terms of the level of these indicators and also their reduced variability so that the economy seems to have become stable. While the growth rate of the services sector has increased after the reforms the growth rates of the manufacturing and service sectors are very similar except for the period of the 9th Plan (1997-2001). The behaviour of exports, growth of manufacturing and services sectors, FDI, all point to greater similarity in economic performance between China and India than difference, if the performance is judged with respect to the year of the reform, 1979 for China and 1991 for India. South Asia has lagged behind other regions in the extent of social improvement. Furthermore, India has lagged within South Asia. The elasticity of improvement in social indicators with respect to growth of per capita GDP has been low in India.

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