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India’s Economy: The Next Five Years

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The future belongs to those who earn it, and as Eric Hoffer has said, the only way to predict the future is to have the power to shape the future. India's economic future for the next five years has been described in various ways. People question whether it will be a giant or a pygmy, a hare or a tortoise, a tiger or an elephant. These descriptions from the animal kingdom often mask the real issues and complex policy dynamics of shaping a broad consensus, which are even more complicated when we consider how to secure implementation.

The history of post-independence India through its ten Five-Year plans has been a story of mixed results. In the first thirty years, the average GDP growth hovered around 3%. With the population growth rate at over 2%, this made annual per capita income rise only marginally. No doubt rapid strides were made in building up centers of educational excellence, creating a strong industrial base and achieving self-sufficiency in food grains, but these were no substitute for enhancing the economic well-being of the average Indian. The process of economic liberalization in the 1980s increased the growth rate to over 5%, but it was only in the 1990s that a growth rate around 6.5% was achieved for a decade. With success in improved demographic management, this implied a per capita growth rate around 3.8%.

The 1990s also saw a major policy of deregulation and reforms implemented. During this period, the trade sector was fully liberalized, with removal of quantitative restrictions and major reductions in peak tariff rates, the industrial sector was deregulated, the banking and financial sectors were reformed, with increasing compliance to Basel norms, and healthy debate on the future of the privatization program flourished.

The process was continued in the late 1990s and early 2000s, with deregulation in infrastructure emphasizing greater public-private partnerships, deregulation in the telecommunications sector, addressing endemic problems of the power sector with passage of the recent electricity legislation to deregulate generation, transmission, and distribution, increasing privatization of individual port operations, and deregulation of the hydro-carbon sector coupled with the dismantling of the Administered Price regime. Notwithstanding the continuation of economic reforms, GDP growth over the last few years has been somewhat sluggish at around 5%. This in no small measure has been due to poor monsoons. Agricultural production contracted last year, and since agriculture still constitutes 23% of GDP and employs nearly 65% of the labor force, this has pulled down the overall performance.

Against this background, what lies ahead in the next five years, or rather, during this decade? The National Development Council represents the highest policy-making body in the country, comprising of the Chief Ministers of all federal states and the central ministries. It adopted an Economic Roadmap in December 2002, committing the country to an 8% growth rate over the next five years. The achievement of this daunting target is predicated on a number of assumptions.

1. Domestic savings rate increases from 23.31% to 26.84%
2. Current account deficit increases from 0.91% to 1.57%
3. Investment rate increases from 24.23% to 28.41%
4. Incremental capital output ratio (ICOR) decreases from 4.53% to 3.58%
5. Tax to GDP ratio increases from 8.8% to 10.4%

It is contingent on the implementation of a strong policy reforms package, covering wide segments of the economy. It also recognizes that strong macro-fundamentals must be coupled with deep structural reforms to realize these objectives. Apart from growth in overall terms, the strategy involves a steep reduction in poverty to around 10% by the end of the decade, high growth in employment, increases in literacy, reduction in gender gaps, and a reduction in the ten-year population growth rate to 16% during this period. The medium-term strategy prescribes a set of monitorable social development targets which can be seen in Annex 1.

If the monsoons do not behave as erratically as they have over the past few years, achieving a GDP growth of over 6% will not be onerous considering that the services sector, which constitutes 48% of GDP, continues to grow at around 8% even with the global slowdown. It would therefore be useful to consider the behavior of the key macroeconomic parameters in two scenarios. Scenario A assumes a growth rate of 6.5% until the end of the decade, and may be considered a base line model. The alternative, scenario B, projects based on an 8% growth rate model. The picture that emerges can be seen from the table below.

Estimates of Key Macroeconomic Parameters

(Billions of US$)

	2001-2002	2010-2011	2010-2011
Assumed growth rate	NA	6.5%	8.0%
GDP	498	865	932
Industry	131	245	309
Share of Industry	26%	28%	33%
Exports	45	94	124
Foreign Investment	5.9	13	24
Market Size	319	519	540
Household Savings	105	173	185

If India grows at 8% over the next decade, what does it mean in terms of its competitive strength? By the end of the decade, per capita income would double (due to multiplier effects), the share in global exports would be reasonable, and a market size of US$540 billion would make us a formidable global player. India has a number of inherent advantages in achieving and sustaining high rates of growth.

First, India has stable macro-fundamentals, with modest inflation, high foreign exchange reserves, a rising growth rate in industry, sustained growth in the services sector, and self-sufficiency in food grains. These all make India less susceptible to exogenous vulnerabilities.

Second, there is a large reservoir of skilled manpower, with 700 million Indians in the younger age group. Their energies can be harnessed if human resource development programs are properly managed, and they can contribute by undertaking activities in this country, which the rest of the world, due to aging populations and social pressures, may not find possible.

Third, the Government's new emphasis on the knowledge economy will harness the country's skills for the ICE economy in areas such as information technology, IT-enabled services, e-medicine, bio-technology, and allowing India to quickly move to an innovation-driven society based on science and technology. Fourth, India has an external sector which is robust, and will continue to impart confidence to foreign investors as the country calibrates its movement towards full convertibility based on fiscal consolidation and improved financial intermediation.

Fifth, India possesses infrastructure which is being rapidly modernized to meet global challenges. Telecommunication rates are internationally competitive, road connectivity is improving dramatically, turn-around time in ports is no more a strain on international trade, and the power sector is bracing itself for a major reform. Sixth, India can harness the advantages of becoming a large common agricultural market. This is based on dismantling regulations which hinder free movement of food grains and other agricultural products, permitting farmers flexibility in their operations by eliminating cumbersome regulations, strengthening the agro-processing sector by a modern food law, and increased diversification in production patterns in consonance with changing consumer preferences.

Seventh, India is implementing reforms of the health and education sectors. Beneficiaries will have a greater role in the management of primary schools and health centers, and the reform should foster competition between public and private institutions to broaden consumer choice. The 73^{rd} and 74^{th} amendments of the Constitution, which delegates administrative and financial powers to local bodies, should make this increasingly possible. Eighth, deregulation of the urban and construction sectors, through computerization of land records, modern tenancy regulations, rationalization of stamp duty, and easier access to housing finance should free up the latent energy of the construction sector. According to some studies, like the McKinsey one, this can contribute an incremental 1.5% to GDP growth.

Finally, the completion of the on-going reforms, itself a daunting task, will make a decisive and qualitative impact on overall growth. The on-going reforms cover areas like the full implementation of the Narasimhan Committee's recommendations on banks and financial institutions, the power sector reforms, sorting out transitional problems to take full advantage of the telecommunications deregulation process, and the initiatives on privatization. It is hoped that these be completed within the stipulated time.

Can these inherent strengths be fully realized? Will there be perseverance and endurance to see the changes through? As Samuel Johnson said, "great works are performed not by strength but by perseverance, and while the will to succeed is important, what is even more important is the will to prepare for the success." Therefore, what are the key challenges which will need to be overcome? I will quickly mention five issues.

First is clearly the fiscal challenge. The combined fiscal deficit of the Central and State governments remains unacceptably high. Fiscal consolidation implies a more credible program for downsizing government, rationalizing and better targeting subsidies, particularly food and fertilizer, application of user charges, and adhering to the timeframe for phasing out kerosene and liquid petroleum gas subsidies. State governments, whose finances have just crawled out of the debilitating effects of the Fifth Pay Commission award, must seek fiscal rectitude. They must curtail wasteful expenditure, put a ceiling on fresh government employment, quickly implement power sector reforms, and privatize the loss-making public sector undertakings, even while adhering to the discipline of meeting their expenditures, but not through fresh borrowing or contingent liability through creation of para-statal entities. While the Central government's tax rates have been rationalized, the early introduction of CENVAT, in spite of pressures from vested interests created through years of tax evasion, and improving the quality of tax administration, will improve the tax-buoyancy ratio. Governments cannot afford to dither on privatization policies, even though it can exercise some latitude in choosing the most appropriate sequencing and timing to complete the privatization process.

The second challenge is one of attitude. When will the governments realize that the people in general are not anti-reforms but pro-growth? It is true that the fruits of growth do not automatically percolate to the poorer segments of the society and the rural areas. While growth with equity and justice may be a rhetorical slogan, it is necessary that policies of economic deregulation are coupled with credible social safety nets, reform of healthcare systems, and improved infrastructure so that the benefits of reform are felt by the average Indian. India is an old country with a young population: 700 million people are in the younger age group. Their expectation pattern is to seek an improved quality of life and gainful employment. Better roads to traverse in both urban and rural areas (the Prime Minister's rural roads program is a major initiative), improved telephone connectivity, and assured power at affordable cost, will certainly alter perceptions about reforms being consumer-friendly.

For too long without being electorally tested, it has been wrongly assumed that reforms are unpopular and impending elections mean that it is logical to postpone difficult measures. On the contrary, populist policies are not popular. State governments like Punjab, which guaranteed free water and power, fared badly in elections. The incumbent government in Andhra Pradesh was returned to power, even with the wide-ranging reforms pursued by the state government. The postponement approach is often prompted by strong vested and organized groups, but postponement of change is to the detriment of the people in general. It must represent failure of the communication strategy of successive governments for not bringing benefits to people in general, and not to benefit the corporate sector, the rich, the elite, or the pressure group which may drive these changes. The refashioning of a credible communication strategy is critical in shaping perspectives and bringing about a mindset change in the way in which reforms are perceived. Conversely speaking, electoral penalties for weak economic management and growth are not yet in the minds of the average electorate.

Third, the growing regional divide and high pockets of poverty, both among and within states, is a matter of serious anxiety. For example, the undivided Bihar, with a population of 115 million, grew at just over 2% in the last decade. It will have to grow at 6.2% over the next five years if regional disparities are not to widen. Uttar Pradesh, which grew at 2.8%, will have to grow at 7.6%, Orissa will have to raise its level of growth from 3.9% to 6.2%, and Madhya Pradesh will have to increase growth from 4.4% to 7% during the same period, if they do not wish to fall behind. What is more worrisome is that even if the change is made by some of these states, Bihar will still have 43.6% of its population below the poverty line, Uttar Pradesh will have 24.6%, and Orissa 41%. These are far above the present national average of 27% of the population living below the poverty line, which is projected to decline to around 19% by 2007.

Some of these states represent large demographic configurations. The experience of resource transfers to address pockets of endemic poverty has met with limited success, and issues of governance loom large in any discussion relating to balanced regional development. The medium-term strategy for the next five years for addressing this issue requires not only monitoring but constant adaptation. This could well become the Achilles heel to disrupt the integrity of the overall growth strategy. A chart contained in Annex II shows the extent of the wide regional divide and the daunting challenge which lies ahead.

Fourth, while the six successive governments since the commencement of the reform in 1991 have not reversed any major economic decisions, and have continued the policy of economic reforms, the continuation of bipartisan support is critical to the passage of important legislation pending in Parliament. These bills relate to areas like banking, coal, ports, and company law. The banking reform is crucial because the proposal to reduce government equity to 33% has yet to secure the support of the main opposition party. This has the result that an average borrower may be paying 150 basis points higher due to inefficient banking intermediation, making economic activity by small and medium entrepreneurs more difficult and uncompetitive. The legislation to convert Indian ports into port trusts will impart a new momentum to India becoming an efficient trading nation, while the legislation on the coal sector permitting private sector participation will impart competitiveness to the energy sector. Political parties must cease to be nostalgic in terms of what they did in the past or persist with ideological barriers, and permit the passage of these critical economic legislations during the tenure of this Parliament.

Finally, there is the issue of the government living up to its promises. The promise of bringing about changes in labor laws, further rationalization of the reservation policy with respect to the small scale sector, a rapid reduction in import duties to bring them on par with other Asian countries, restructuring of railways projects and finances, and a forward-looking civil aviation policy which makes India an easier destination, need decisive action. These are not new on the reform agenda. They are policies announced at various levels by the NDA government and their implementation brooks no delay.

If India can overcome these challenges, the next five years will catapult India into a position as a major economic power. This is the vision for the next five years, since a vision is merely a "compelling image of an achievable future." This future is an achievable one and political parties must realize what Shakespeare has said, that "we know what we are but know not what we may be." The India to be must be our over-riding national goal.

Annex I

Monitorable Social Development Targets for the Tenth Plan and Beyond

1. Reduction of the poverty ratio by 5 percentage points to 21% by 2007, and by 10 further points to 11% by 2012.
2. Providing gainful and high-quality employment to at least the addition to the labor force over the Tenth Plan period.
3. All children to be in school by 2003, all children to complete five years of schooling by 2007.
4. Increase in literacy rates from 65% to 75% within the plan period.
5. Reduction in gender gaps in literacy and wages by at least 50% by 2007.
6. Reduction in the decadal rate of population growth from 21.3% between 1991 and 2001, to 16.2% between 2001 and 2011.
7. Reduction in the infant mortality rate from 70 to 45 per 1000 live births by 2007 and to 28 by 2012.
8. Reduction in the maternal mortality rate to 2 per 1000 live births in 2007 and 1 by 2012.
9. Increase in forest and tree cover to 25% by 2007 and 33% by 2012.
10. All villages to have sustained access to potable water within the plan period.
11. Cleaning of all major polluted rivers by 2007 and other notified stretches by 2012.

Annex II

	Per Capita Net SDP 2001	SDP Growth Rate, 1991-2001	Projected SDP Growth Rate, Tenth Plan	% Poor in 1973-1974	% Poor in 1999-2000	Projected % Poor in 2006-2007, end of Tenth Plan
Andhra Pradesh	9982	5.4	6.8	48.86	15.77	8.49
Arunachal Pradesh	9013	5.3	8.0	51.93	33.47	29.33
Assam	5867	2.5	6.2	51.21	36.09	33.33
Bihar	3345	2.0#	6.2	61.91	42.60	43.18
Goa	26106	7.2	9.2	44.26	4.40	2.00
Gujarat	12975	6.3	10.2	48.15	14.07	2.00
Haryana	14331	4.8	7.9	35.36	8.74	2.00
Himachal Pradesh	10942	6.1	8.9	26.39	7.63	2.00
Jammu & Kashmir	7383	4.5	6.3	40.83	3.48	NA
Karnataka	11910	7.7	10.1	54.47	20.04	7.85
Kerala	10627	5.7	6.5	59.79	12.72	3.61
Madhya Pradesh	7003	4.4$	7.0	61.78	37.43	29.52
Maharashtra	15172	6.5	7.4	53.24	25.02	16.18
Manipur	7955	6.2	6.5	49.96	28.54	30.52
Meghalaya	8460	5.3	6.3	50.20	33.87	31.14
Mizoram	NA	NA	5.3	50.32	19.47	20.76
Nagaland	NA	NA	5.6	50.81	32.67	31.86
Orissa	5187	3.9	6.2	66.18	47.15	41.04
Punjab	15390	4.9	6.4	28.15	6.16	2.00
Rajasthan	7937	4.4	8.3	46.14	15.28	12.11
Sikkim	10250*	NA	7.9	50.86	36.55	33.78
Tamil Nadu	12779	6.2	8.0	54.94	21.12	6.61
Tripura	8372	6.8	7.3	51.00	34.44	31.88
Uttar Pradesh	5770	2.8	7.6	57.07	31.15	24.67
West Bengal	9778	6.7	8.8	63.43	27.02	18.30
A & N Island	NA	NA	6.6	55.56	20.99	5.82
Chandigarh	29208	NA	10.6	27.96	5.75	2.00
Dadra & Nagar Haveli	NA	NA	NA	46.55	17.14	2.00
Daman & Diu	NA	NA	NA	NA	4.44	2.00
Delhi	24450	6.8	10.6	49.61	8.23	2.00

Lakshadweep	NA	NA	NA	59.68	15.16	4.59
Pondicherry	18500	7.3	10.7	53.82	21.67	7.72
All India	10306**	5.6	8.0	54.88	26.10	19.34

*: For year 2000

**: Per Capita NNP

$ For the period 1991-2000 and includes Chattisgarh

#: For the period 1991 to 2000 and includes Jharkhand

NA: Not available

SDP: State domestic product