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INDIA'S ECONOMY AFTER THE ELECTIONS

During the five years under Rajiv Gandhi as prime minister, India's economic growth exceeded 5% per year, industry grew by an average 8.5% annually and agricultural output expanded despite setbacks. Economic liberalisation has benefited the middle classes but mass poverty remains.

India's economic policies are not likely to change markedly as a result of the November elections. An annual growth rate of 6% is the official target of India's Eighth Five Year Plan (1990-95). It reflects both confidence gained by the much faster growth of the 1980s and a need for rapid progress to improve welfare. Growth is to be achieved primarily by continuing the 1980s policies. There are several major goals for the year 2000: self-sufficiency in virtually all agricultural requirements, eliminating absolute poverty, population growth reduced to replace ment rate, providing potable water to every village, immunising every child. In this Briefing Paper we examine the prospects for achieving these goals in the light of recent experience.

Forty years of economic planning

Mileposts

Economic planning and the government's role in allocative decisions have had a major influence on Indian development. The Planning Commission was established in 1950, soon after Independence, under the chairmanship of the Prime Minister to co-ordinate all economic planning and oversee its implementation. While the First Five Year Plan (1951-56) was little more than a compilation of the various investment projects already in hand, subsequent plans were increasingly sophisticated exercises. The beginning of the Second Plan also coincided with a considerably enlarged government role in economic decisions.

Under the strong Fabian and Soviet planning influences of the Nehru period, the Congress Party adopted a socialist economic programme, and enacted an industrial policy in the 1950s which assigned the 'commanding heights' of the economy to public ownership. All but the smallest private factories were subject to stringent licensing. Scarce foreign exchange and foreign trade were strictly controlled. Comprehensive land reforms were also legislated by various state governments, controlling the size of individual holdings and tenancy practices. Rapid industrialisation was promoted through large-scale, government-owned facilities for production of basic commodities such as steel, machine tools, heavy equipment and infrastructure. In agriculture, large irrigation works were established although the system of agricultural management — chiefly, extension-led supply of inputs — was left to individual state resources.

By the mid-1960s, the effects of wars with China (1962) and Pakistan (1965) and droughts of 1965-67 had created such strains on the economy that drastic measures — devaluation of the rupee in 1966 and suspension of plans between 1966 and 1969 — became necessary. The Fourth and the Fifth Plans (1970-75 and 1975-80) aimed to provide greater resources to agriculture in view of the food crisis faced in the mid-1960s, but by the mid 1970s, the Planning Commission had lost much of its credibility. External factors, such as the oil crisis and the global inflation of 1973-75, made some aspects of the plans irrelevant. However, government control of the economy was extended through nationalisation of large banks, oil refineries and coal mines and agricultural output was also increased, largely due to a system of subsidies and price supports to allow farmers to take advantage of new technical opportunities. Throughout, concerns with poverty were expressed in plan documents; but they became more explicit in the 1970s, especially with regard to the rural poor. The main objectives of the Fifth and the Sixth Plan were rural development and the removal of poverty.

In 1980, the economy was faced with balance of payments difficulties which forced borrowing from the International Monetary Fund up to SDR 5bn. In return, there was some relaxation of controls on foreign trade and domestic investment, the rupee was floated against a basket of currencies (currently, $1 = Rs 16; in 1980, the rate was $1 = Rs 8). The major droughts of 1986-88, which initially invoked fears of mass starvation, slowed the economy but did not halt growth. Budget deficits continued to rise, but rupee resources for development continued to be provided at the planned rates. Exports have grown substantially over the past 40 years, but have not been adequate to finance increased imports following the relaxation of restrictions in the 1980s. Larger foreign commercial borrowings and 'invisibles' — largely remittances of Indians abroad — have provided additional resources, but a rising foreign debt has become worrisome.

Agriculture: a Success Story?

Indian foodgrain production was only 50m t at independence; the 1988-89 harvest is estimated at a record level of just over 170m t. This increase of 240% in food production is greater than the 140% increase in population growth and the per capita food availability has improved to 500g per day.

The recovery of Indian agriculture from the droughts of 1986-88, which affected all the main agricultural states, shows its resilience. Grain production in 1987-88 was lower than 1984-85 by nearly 15m t, but after adequate and well-distributed rains, increased by over 35m t in 1988-89. The shortfall in food production in the three years of drought was comparable to that of the Sahelian droughts of the 1980s, yet

Box 1: Liberalisation of the Economy

The liberalisation of the economy is popularly credited to the Rajiv Gandhi government; yet it began in 1980, although much of it occurred only after 1985. A new industrial policy formed part of the Sixth Plan (1980-85). Its aim was to 'improve productivity and efficiency' and to 'make optimum use of existing capacity' by removing procedural obstacles. Increased output was to be achieved through technological improvements, broad-banding (flexible product mix), 'appropriate capacities to achieve economies of scale' and added capacity for export.

The new measures relaxed restrictions on 'monopoly' units, import of technology or equipment, foreign collaboration, locations, etc. for new and old enterprises. Some of the protection afforded to public sector production was gradually removed. On the whole industrialists welcomed the new policy as an opportunity to grow by producing manufactured goods demanded by the domestic market. The initial international response was also enthusiastic, dubbing India an emerging major market, along with China.

The pace of liberalisation has been slower than expected for two main reasons: entrenched bureaucracy and increasing foreign currency shortages, leading to continuing but milder restrictions on imports and foreign investment. While the stated policy remained unchanged, these factors created an impression of 'stop-go' liberalisation. External responses became more cautious making a substantial rise in foreign investment unlikely. While liberalisation had appeared to flag in 1988-89, it was the intention to sell minority shares in the state-owned companies after the elections to reinvigorate the programme. The private sector was given a leading role in the new Eighth Plan. An incoming government will, however, be more cautious and may want to give the public sector more protection.

Box 2: Population Trends

The size of its population and its rate of growth is a major constraint of India's development. India's mid-1987 population was 798m (World Bank). The consensus of various projections is a population of near 1bn by the year 2000. World Bank projections suggest that India's population may exceed China's between 2020 and 2050, eventually stabilising at a similar level.

The target population growth rate of 1.9% p.a. for the Seventh Plan period (1985-90) will have been overshot: available evidence puts it at more like 2.0-2.2%. Similarly, the target of achieving a net reproduction rate of unity (an average of 2.3 children per couple) by the turn of the century appears elusive. Earlier official projections have all erred on the optimistic side. While fertility has slowly declined, mortality rates have fallen faster. Family planning has been accepted, but hesitantly. The changing profile of the population pyramid and recent experience with attempts to impose population policies make the task difficult. Although the proportion of literate females in the reproductive age group has increased, the absolute numbers of married and illiterate females in that age group have also increased because of earlier population growth. The immediate prospects are of a slower than expected decline in population growth.

neither mass starvation nor major migration was seen in India. The shortages were tided over with net imports of little over 1m t and a 17m t reduction in government buffer stocks.

Indian agricultural development can be directly attributed to two factors: the massive irrigation schemes of the first phase of planning, and the late 1960s strategy of promoting an intensive 'green revolution' package; wider use of improved varieties of seeds, fertilisers and more productive techniques, in agriculturally advanced areas, for selected crops. Farmers in these areas responded positively, largely because risks were covered through support prices. However, the achievements of the green revolution obscure certain other features of Indian agricultural development. First, until recently, it was chiefly confined to selected crops and to irrigated lands in the northwest, growing paddy rice in summer and wheat in winter, and in the southeast, growing two or three crops of rice. Even so, average Indian yields are often lower than the best achieved under similar conditions elsewhere: the average yield of Indian paddy is around 2 t/ha (compared with 5-6 t/ha in Egypt) and wheat around 2.5 t/ha (compared with 4 t/ha in China).

Second, growth in productivity and output has been uneven: the wheat yield has increased at 6% per year, but other crops have shown a yield growth of only 1-2% per year. In crops such as pulses and (until last year) oilseeds, there has been little or no growth; and, even among commercial crops such as sugar cane, cotton and jute, there is only fitful and sporadic growth. Agriculture also continues to make sizable demands on resources. Large sums are needed to provide relief from droughts: between 1986 and 1988, public works programmes are estimated to have cost over Rs 75bn. Sustaining production requires increasing amounts for subsidy and price support. Food and fertiliser subsidies are currently budgeted at Rs 51bn, or 8.5% of the revenue expenditure and 70% of the budget deficit. Most states provide further subsidies, adding to their own deficits. While only a third of the GNP is now contributed by agriculture as against 60% at independence, India's economic prospects are still largely dependent on it. The proportion of its population dependent on agriculture has declined only marginally from 68% in 1950 to 65% in 1989.

Growth in agricultural production, therefore, has not meant better living for all in rural India. The need to cover large groups of farmers, areas and crops left out so far — small and marginal holders, central and eastern India, crops other than rice and wheat — has been accepted, but as yet, not much has been done.

Industry: A Consumer Boom?

There has been a ten-fold growth in industrial output since 1950 (from a very low base) and manufacturing and associated infrastructure provision contribute around Rs 1,000bn to GNP at current prices. But industrial development is spread unevenly. States such as Maharashtra, Gujarat, West Bengal, Tamil Nadu, Karnataka and Andhra Pradesh show higher degrees of industrialisation than the north-east, Uttar Pradesh, Orissa and most parts of Bihar. Most industry is confined to the vicinity of large cities, such as Bombay and Calcutta or in special tax areas, such as Gujarat.

India today has the capability to manufacture virtually any product — though not cost-effectively — from domestic resources. Often, the small domestic market, with exports limited by uncompetitive prices and quality, restricts the size of manufacturing units to well below economic scale. An example is the emergence of many major petro-chemical complexes producing fertilisers, man-made fibres and plastics. India could be self-sufficient in these products (some amount of petroleum will continue to be imported), but at a higher than international cost in plants considered too small by international standards.

Indian industry has made little R & D effort on its own, preferring either foreign collaboration or outright purchase of technology. Since industry operates in a virtually captive domestic market, it is unable to meet the quality and consistency requirements of international markets, and exports suffer. The high technology firms in new growth centres such as Bangalore have not materially altered this picture. Most such plants are assembly units, using

Table 1: Indian Economic Indicators, 1950-89

		1950-51	*1960-61*	*1970-71*	*1980-81*	*1988-89*
Gdp, current prices	Rs bn	92	140	367	1,222	3,400
constant (1980-81) prices	Rs bn	423	616	886	1,222	1,875
Compounded growth rate	% pa	←	3.6	→	← 5.5	→
Population	m	361	442	551	690	810
Per capita gdp, constant prices	Rs	1,125	1,350	1,529	1,771	2,315
Compounded growth rate	% pa	←	1.5	→	← 3.4	→
Primary sector output: gdp	%	59.4	54.9	48.5	41.5	33.0*
Secondary sector output: gdp	%	14.4	17.3	20.7	21.6	28.0*
Tertiary sector output: gdp	%	26.2	27.8	30.8	36.9	39.0*
Gross domestic savings: gdp	%	10.2	13.7	16.8	21.2	20.2*
Gross domestic capital formation: gdp	%	10.0	16.9	17.8	22.7	22.1*
Foodgrain production	m t	50	82	108	130	172
Steel production	m t	1	2	5	7	11*
Coal production	m t	33	56	76	119	191*
Crude oil production	m t	0.3	0.5	7.0	10.5	30.4*
Power generation	bn kwh	5	17	61	131	217*

*1987-88 figures.

Sources: *Economic Survey*, various issues; 1988-89 figures from Eighth Plan Approach Paper.

components produced abroad. Their ability to add value and effect technology transfer is limited.

A relatively higher rate of growth (8% p.a.) of industrial and manufacturing activities in the 1980s has been highlighted by the *Economic Survey 1988-89* which attributes the strong performance this year to 'buoyant demand', 'good supporting performance of the key infrastructural sectors' and a 'continuing process of industrial policy reforms'. Many heavy industry sectors have responded poorly, however. A disaggregated review by the Reserve Bank of India showed that the Sixth Plan (1980-85) performance of fertilisers, metallurgical and chemical industries was poorer than in the Fifth. Steel output grew at 3.3% in 1980-85 as against 9% in the preceding plan, while fertiliser output rose by 12% as against 17%.

Durables, such as consumer electronics, motor vehicles, refrigerators, and communication equipment have all shown rapid growth in the 1980s. Their production in 1985 was up to 80% in excess of the target. The new policy seems to be responsible for most of this growth. The immediate impact of liberalisation has been a far greater availability of goods such as motor cycles, scooters, cars, and consumer electronics. Most are either assembled or manufactured by Indian firms with foreign collaboration and/or equity holding. However the rupee cost of imported components and payments for royalty has increased due to the rapid fall in the value of the rupee in the late 1980s (from about Rs 11/$ in 1985). Since this is passed on to the consumer, the demand has lately shrunk, leaving some units with excess capacity. Many of these new products happen to be areas vacated by developed countries; hence Indian manufacturers, often with their technology suppliers as equity partners, have started viewing even large-scale exports as a survival need.

The new policy thus seems to have been most effective in areas of strong domestic demand, particularly consumer durables, or the more obvious export possibilities. Most of the recent collaborative deals and industrial approvals are in these fields. The 'freeing' of the economy has in effect shifted the thrust of industrialisation away from basic to consumer goods. The performance of virtually all public sector-run industry, on the other hand, has caused concern from its inception. For example, the 221 central government enterprises showed a return of 5% in 1988, to be compared to average Indian interest rates of 14-15% per year. This is its best record so far: up to the early 1980s, the public sector as a whole lost money, adding to budget deficits.

India at the end of the 1980s

The trend rates of growth in national and per capita incomes up to 1980 remained around 3.6% and 1.5% per year respectively, despite shifts in strategy. The 1980s saw a marked increase, to around 5.5% and 3.4% respectively. This improvement is primarily due to a faster industrial growth and a continued growth of services at about 5% per annum, countering the slower growth in agriculture. In 1979, when agricultural production declined by about 15%, national income also dropped by 5%; between 1986 and 1988 agricultural production declined by about 8%, but national income grew by 7%. However overall Indian economic progress since independence — and even in the recent period — is slower than some other developing countries, especially those in East Asia.

Among the factors generally considered responsible for this relatively slow progress are poor choice of investments which placed too much emphasis on heavy industry; creation of an inefficient public sector; rigid control and excessive protection of industry; and worsening productivity of capital, as reflected in steadily increasing investment needs. Yet the larger role of the government was an economic necessity after independence. India has needed to develop basic industries such as iron and steel, heavy chemicals, fertilisers, to build up power generation capacity, to provide irrigation to the mostly arid agriculture and create adequate infrastructure. Private enterprise in the post-independence period could not have provided the required resources; and allowing large scale foreign investment in these activities was not acceptable to a government which drew its support from a long period of nationalist agitation.

Critics, who accept the historic necessity of the original strategy of economic planning, question whether it needed to be continued through the 1970s and 1980s when global and domestic conditions had changed substantially. They argue that allowing private investment and a gradual opening of the economy could have prevented some of the technical obsolescence presently faced by most Indian industry. The thrust of such views is that measures now considered necessary should have been taken 15 or 20 years ago. It is held, for example, that Indian steel plants (among the most efficient and economic in the world in mid-1960s) are now among the least efficient, since there has been insufficient investment to keep up with modern technologies.

Box 3: Poverty in India

The Indian per capita income of $300 is less than that of Pakistan ($350) or Sri Lanka ($400) and places it among the 20 poorest nations. Unlike Bangladesh ($160), it is not classified as a Least Developed Country (UN definition). Yet the average figure does not reflect India's skewed income distribution. Studies in the early 1970s showed that 54% of India's rural population lived below subsistence level, unable to afford 2,200 calories per person per day. Official claims of a fall of the proportion of rural population below the poverty line to 40% by 1983 and further to 30% by 1989 have been disputed by scholars, but there is general consensus that the relative incidence of poverty has declined, even as the absolute numbers of Indians living in poverty have increased.

Urban poverty is considered a spill-over of rural poverty; the rural poor migrate to cities in search of jobs, causing severe strains on urban facilities. The general consensus is that urban poverty is increasing, and slow growth in industrial employment has not mitigated the increase. The new five year plan aims broadly to *contain* poverty, at best, and the new government will be hard pressed to mobilise the resources to do more than this in the short-to medium-term.

India into the 1990s

The new government will be concerned with familiar tasks of economic management in India: managing deficits, arresting inflationary trends, and holding foreign borrowings to present levels. Devising major new plans is unlikely to be a preoccupation. Fulfilment of election promises could cause some additional drain of resources, and substantial increases in public debt to finance the deficit are likely. A further recourse to the IMF was thought to be imminent in 1989, but was probably deferred because of elections, so a fresh approach may be considered necessary to address the balance of payments problem. Some structural readjustments, including a depreciation of the rupee and further relaxations of economic controls would have to be offered in return. Control of government expenditure, especially subsidies, might also be a condition of such arrangements.

Increasing budget deficits have led to mounting concerns about a balance between government revenues and expenditure. Between 1980-85, the total deficit was Rs 108bn; between 1985-90, it rose to Rs 343bn. Both the *Economic Survey* and the *Reserve Bank of India Report* for the current year have made pointed references to government borrowings. The principal contributors to the deficit are losses in public sector, defence spending, interest payments and subsidies for agriculture and exports, the last three accounting for 70% of the current revenues. The election of 1989 did not help. Higher deficits have also meant rising inflation levels of nearly 10%, up from the earlier 7%.

The medium-term official scenario is stated in the Approach Paper to the Eighth Plan. An investment of Rs 3,500bn is envisaged to yield a 6% annual rate of growth. The objective is to improve the productivity of capital, to 'build on the strengths and resilience already found in the Indian economy and to take it to a faster growth rate', but concrete ways of achieving this are not spelt out. Resources would be mobilised through an increase in the domestic savings rate from 21 to 23% and exports are expected to grow at 12% per annum.

The achievement of the Eighth Plan targets thus hinges on two crucial factors: the ability to raise the needed resources and increasing productivity of investment. Further increase in private savings is possible only at the margin. Most

Box 4: Balance of Payments and External Trade

India now has a current account deficit of $5.5bn, 2% of GDP. External debt in April 1989 was officially $42bn, (20% of GNP), and rising, but the long-term debt service ratio of about 24% is more manageable than that of many African and Latin American countries. India drew SDR4.5bn from its 1981 IMF credit facility, half of which is yet to be repaid but it is not in arrears.

Remittances from Indians abroad have fallen in the last five years, reducing 'invisibles' by $1bn annually. This reflects a decline in the relative prosperity of Middle East host countries. Foreign currency reserves have consequently declined, from early 1980s levels sufficient to finance imports for 4 to 5 months, to $2.8bn in August 1989, enough only for 1½ months.

The share of agricultural products in India's exports declined marginally from 30% to 27% in the 1980s, while that of manufactures other than gems and jewellery remained stagnant at 46%, and Indian industrial products have not found greater acceptance globally. However, exports as a whole have risen by $4bn since 1985, to $14bn. Exports in dollar values have shown a sustained annual rate of growth of 10% in 1985-90. Imports have grown at the same rate. Some advocate import restrictions to restore the balance of payments but over 80% of current imports (of over $16bn) are either raw materials or capital goods; curbing them would adversely affect industrial production and exports.

The USA accounts for about 20% of India's external trade. In June 1989, the US government proposed trade retaliation measures under 'Super 301' against India, Brazil and Japan, citing 'unfair' Indian practices in insurance rate fixation and restrictions on foreign equity participation. Other global competitors tend to express concern about India's export subsidies and import regulations. Indian exports to the USA of around $2-3bn are too small to pose a major competitive threat; Japan's exports to the USA are £87bn, by way of contrast. The move to invoke Super 301 was intended to jog India into relaxing further restrictions, such as allowing up to 51% foreign equity without export obligations. This is already under consideration. The EC is by far India's largest export market, nearly $4bn in 1988, and it takes about a quarter of India's total exports. Only 5% of the total, however, comprises manufactures and engineering goods: much of the remainder is agricultural products and textiles (restricted under the MFA). Although without the benefits of a Lomé Convention, India's exports to the EC have expanded fast, especially since 1986, and the modest benefits offered under the GSP have been seized. At 0.33% of EC imports, India's exports cannot be construed as a 'threat'. Unlike Japan and many of the NICs, however, India may have to develop a capacity in 'smokestack' industry exports to maintain its growing penetration of the EC market unless its consumer goods manufacturing and international services become much more competitive.

additional savings and investment will have to come from either the government or external sources — particularly aid. On present reckoning, both these are difficult. Government efforts are constrained by relatively low returns to additional taxation and the demonstrated inability of the public sector to generate larger surpluses. Reductions in public expenditure, such as establishment expenses, subsidies and defence, have been weak.

While India has been receiving about $2bn annually as official development assistance, this amounts to under $3 per capita, among the lowest of all developing countries. As an aid recipient, India is perversely penalised for its size and the extent of its poverty; since the beginning of the 1980s global aid flows have been diverted towards Sub Saharan Africa and debt relief measures have addressed Latin American problems. India's prospects of rapid advancement in the 1990s must therefore depend on finding internal strengths to enhance investment productivity.

The most important Indian factor is a strong consumer demand backed by purchasing power. The developments of the 1980s resulted from higher income group consumer demand, but there is also growing demand among middle-income groups. For example, the television market is presently estimated to be Rs 15bn, and growing at five times the rate of income growth. While consumer durables will continue to enjoy buoyant demand as some prosperity percolates down, greater scope exists to meet demand for more essential commodities. These include medium-priced textiles, convenience foods and affordable housing. The rising demand for edible oils, for example, is lately seen as a source of profitable investment by both private millers and oilseeds farmers. Synthetic substitutes used in basic goods — clothing, shoes, appliances — have similarly provided a stimulus to highly dispersed plastic industry. These goods, unlike the previous scarce goods in high demand presently, depend on raw materials and intermediate inputs produced domestically. Their production is therefore likely to provide greater multiplier and spread effects within the economy.

Textiles provide a case in point. The oldest Indian industry is today unable to supply clothing to Indians at affordable prices; clandestine imports are significant. A programme of thorough modernisation of textile mills, allowing the smaller, older, inefficient units to close, to be replaced by large, modern and cost-effective units could provide the necessary incentive to increase production and employment. Similarly, pre-fabricated mass housing at affordable prices would not only reduce the acute shortages in the cities, but also stimulate demand for labour. In the agricultural sector, crops other than cereals provide some basis for optimism. These include oilseeds, horticulture and tree crops. They all need further processing located close to the source of raw material, enhancing the geographical dispersion of new industry.

The lessons of modest success

The critical lesson most economists draw from the 1980s is that the India of the 1970s suffered because it remained locked in the policies of the earlier decades. If the possibilities of the 1990s are to be converted into real opportunities of growth, policies looking to the future, rather than belated correctives to the past, appear to be necessary. If the spread of the 1980s reforms is to be continued in the 1990s, creating pockets of modern enterprises will not be enough; this approach will have to be extended more widely. Small scale industry and the problem of the landless and the impoverished urban dwellers will also have to be addressed.

Indian achievements, real or potential, will remain dwarfed in comparison to its population. Even the rudimentary welfare of such large numbers requires substantial financial and human resources. Whether any progress is made will depend on how soon population trends start conforming to targets. In the final analysis, maintaining merely acceptable levels of growth — neither spectacular nor rapid — requires a convergence of public and private sector initiatives. Important though national elections are, much will be determined at the level of the states. In the absence of healthy economic partnerships and firm economic policies, worsening shortages and chaotic conditions could yet emerge. In this sense, the India of the 1990s is still perched on a knife's edge.

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