India's Dream Run and Decline: 2003-08 and 2009-15

India's Dream Run 2003-08

- 2003-08 Indian economy began experiencing an acceleration in growth from 5.6 to 6.5 % and to 9.1 % growth rate by 2008. It became second fastest growing economy after China.
- From 2009-10 onwards the growth rate fell back to 8 to 7 to 6.5 to 5.4 percent in 2015. After revising estimation methodology, it is 6.5% for 2014-15.
- What enabled this acceleration? Why did it decline? Do we have any again on a sustainable basis?

- The dream run was a (private) corporate debt-led growth that until the 2008 crisis tapped into an exceptional rise in the world trade.
- Unlike the conventional consumption-led boom and-bust cycles, this one was led by investment financed by domestic savings, boosted by an unprecedented influx of foreign private capital.
- The investment-saving gap rose to 2.3% of GDP by 2008.
- Total private capital inflows rose to a phenomenal level of nearly 10% of GDP by 2007-08, raised corporate debt sharply, and also perhaps contributed to a steep rise in stock and real estate (asset) prices.
- After the 2008 Financial Crisis, export growth has collapsed, and corporate investment demand has contracted under adverse macroeconomic stress. Hence, output growth has decelerated.

Initial Conditions 2003

- After 1999 getting over Y2k fear and a dot com bubble busted, US companies began outsourcing business process activity, India took advantage of prior investment in IT sector.
- South Korean and Japanese capital after the 1996 Asian crisis began looking for opportunities to migrate. Thus automobile-consumer goods-IT opportunities began bringing massive foreign capital flows into in India.
- High interest rates in India began attracting Foreign Commercial Credit Bonds (FCCBs).
- Further, Chidambaram the FM, in 2004 abolished the capital gains tax for equities and extended it foreign institutional investment holding more than 365 days. This further brought FII inflows forming 30 % of FDI. About 30 % of FDI has come to takeover Indian capital, for example Vodaphone. FDI formed 10% of GDP in 2008.
- RBI reduced the interest rates and expanded credit against the accumulated foreign exchange reserves. Consequently, money supply expanded at an unprecedented rate of 23 %.
- 43% of the bank credit has gone into infrastructure, namely national highways, airports and telecommunications.
- Thus the exceptional credit boom financed the investment.

- Yet, in all in all, it was a dramatic turn around.
- The period 2003-08 was a blessing for India. World Trade dramatically increased by 16.5 %. Indian exports also grew by 22%.
- has begun outsourcing services to India, IT sector began growing at 35% per annum.
- Global capital started flowing into India attracted by High interest rates , pertinently after the busting of East Asian boom, zero % interest in Japan and low interest rates in US.
- In 2004 Budget, Chidambaram changed the definition of FDI, even those less than 10% fixed capital is recognized. This made virtually no difference between FDI and FII which is the short term capital inflow into equity markets.
- Further in 2005 Chidambaram allowed Participatory Notes, which do not need to disclose their location of origin, encouraging lot of hot money. This led to huge rise in `round-tripping' of capital through Mauritius.
- Further in 2005, Capital Gains tax is abolished on earnings from equity, which made the FII un-taxable, which further lifted the flood gates. India accumulated foreign exchange reserves crossing $330 billions by 2007-08, much of these have come as a part of capital flows rather than current account surpluses.

Investment-led?

- India recorded a high growth since 2003-04 until 2007-08 averaged at 8.8 percent, a clear acceleration compared to 5.4 % during 1998-03.
- This transition is accompanied by a dramatic rise in investment – GDP ratio, which has increased from 25-26 % during 1990s to a whopping 38.73 % during 2007-08.
- Studies conducted on TFPG suggest that there was no palpable rise in total factor productivity during 1991-04. But during 2004-08, studies have shown an improvement.
- However, even though productivity has marginally supported the growth, it is largely investment-driven.
- Besides this, it is not matched by employment and commensurate growth in consumption.

TFPG estimates

	1950-66	1967-80	1981-90	1991-00	2000-08
1.Acharya (2003)					
GDP	3.8	3.4	5.3	6.5	7.5
TFPG	1.4	0.7	2.0	2.6	3.5
%of GDP due to TFPG	38	21	38	40	
2.B.Veeramani					
NDP/Worker	1.3		2.4		
%NDP due to TFPG	54		69		
3. V.Goldar (2005) TFPG			2.14	1.88	
4. Kaur and Kiran (2005)			1.53	0.44	
5. Boseworth Collin					
TFPG	0.7	-0.5	2.5	1.6	
Rodriks and Subramaniam	1.2	05	2.9	2.4	

Table 5: Organized Manufacturing Sector Employment and Capital-Output Ratio

Sector	1981	1991	1997	2003	2007
Employment (in Lakhs)					
Public Sector	15.02	18.52	16.61	12.60	10.87
Private Sector	45.45	44.81	52.39	47.44	47.50
Total	**60.47**	**63.33**	**69.00**	**60.04**	**58.37**
Average Capital-Output Ratio (Years)					
	1980-81	**1990-91**	**1996-97**	**2002-03**	**2007-08**
Registered Manufacturing	6.12	4.87	4.94	6.73	7.45

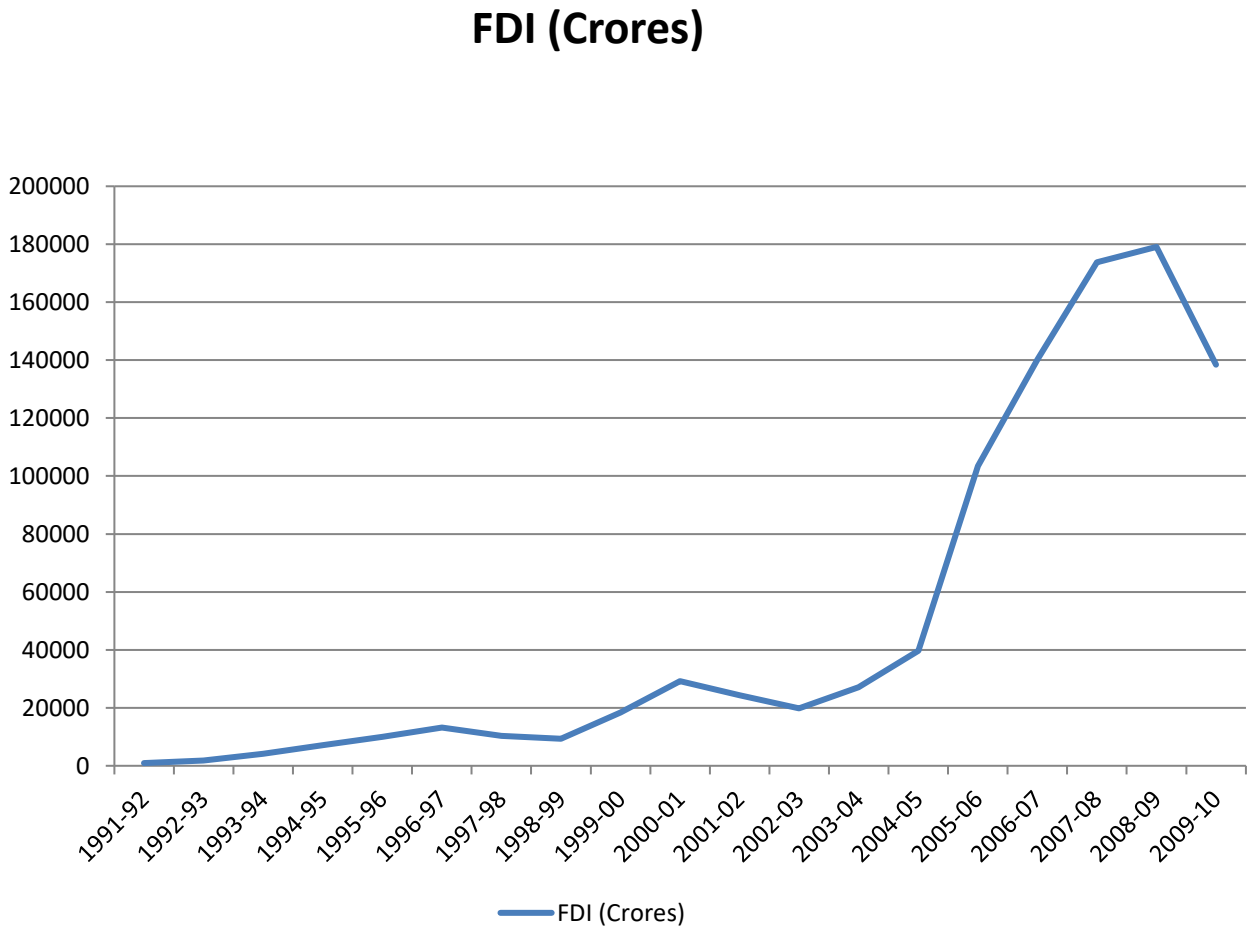
Source: Government of India, Economic Survey

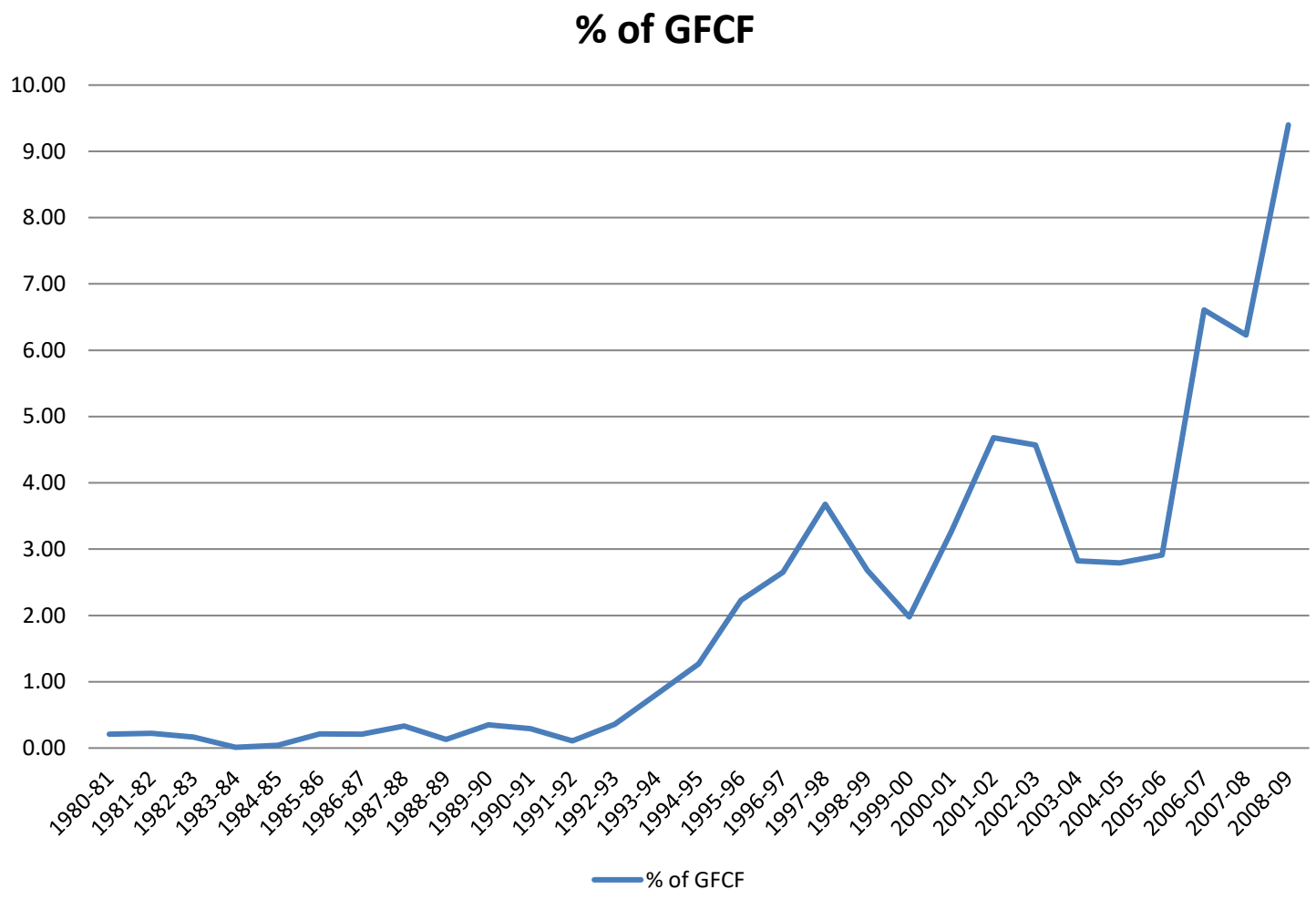
Table 6: Contribution of Selected Components of Final Expenditure to Yearly Increments in Expenditure on GDP at Current Market Prices (Percentage Shares).

Item	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08
Private Final Consumption Expenditure (PFCE)	47.93	49.36	35.60	49.72	46.16	48.51
Gross Fixed Capital Formation (GFCF)	26.67	34.29	52.71	49.53	42.63	44.02

Source: CSO, National Accounts Statistics

FDI Inflows in India in Post Reform Era




% of GFCF
10.00
9.00
8.00
7.00
6.00
5.00
4.00
3.00
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1.00
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1980-81
1981-82
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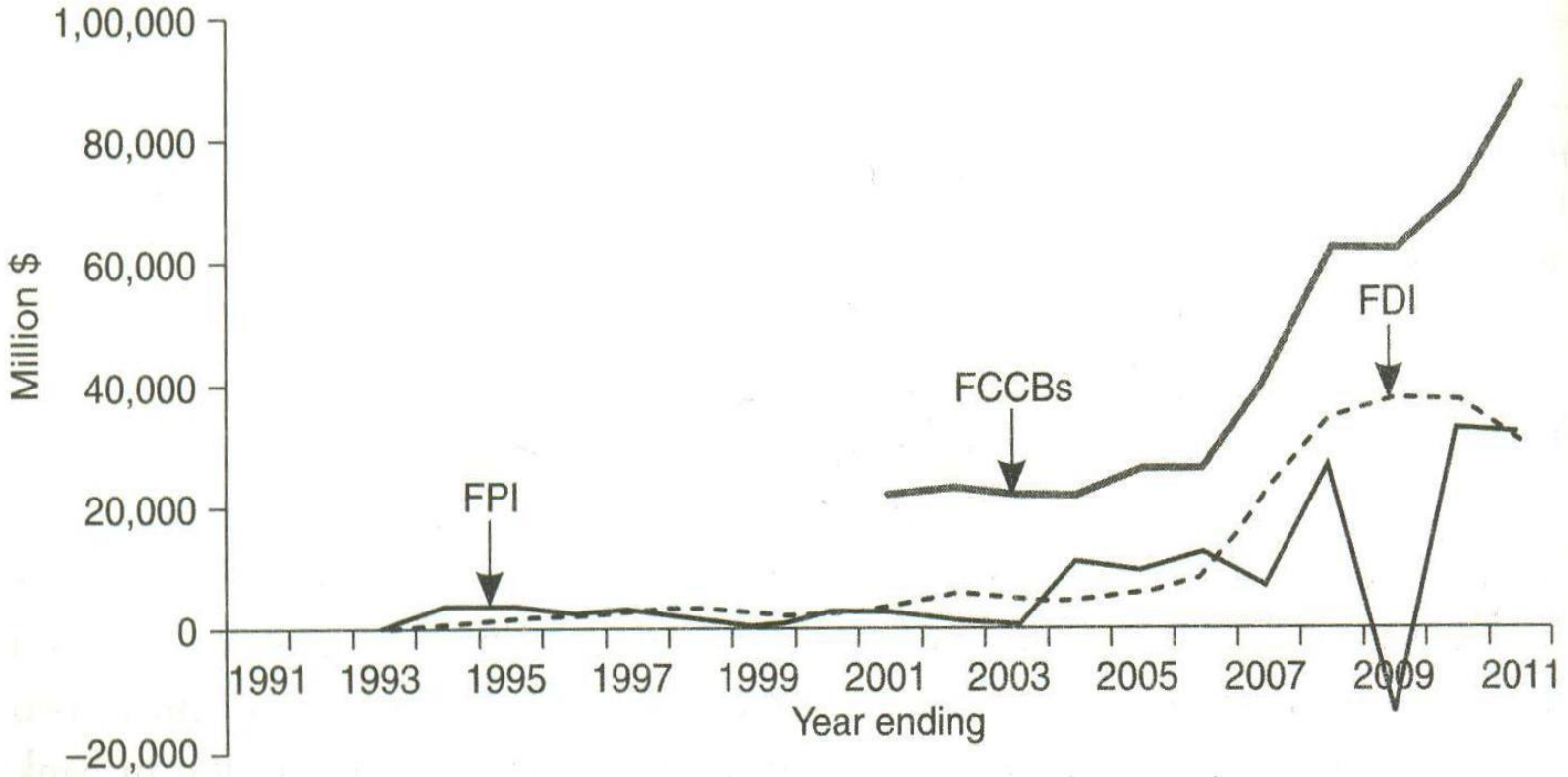
2005-06
2006-07
2007-08
2008-09
% of GFCF

Table 1: Growth Rates of GDP and Principal Sectors, 1991-92 to 2007-08, at 1999-2000 Prices

	Economic Activity	Percentage Shares in GDP		Average Annual Growth Rates			
		1990-2000	2007-08	2003-04/ 2007-08	2008-09/ 2010-11	1991-02/ 2002-03	1991-02/ 2007-08
1	2	3	4	5	6	7	8
1	Agriculture and allied	25.0	17.9	5.0	2.7	2.3	3.1
2	Mining and quarrying	2.3	1.9	4.7	4.5	4.2	4.3
3	Manufacturing	14.8	16.0	10.0	7.2	5.7	7.0
	3.1 Registered manufacturing	9.7	11.2	10.8	8.5	6.4	7.7
	3.2 Unregd manufacturing	5.1	4.9	8.4	4.6	4.5	5.7
4	Elec, gas and water	2.5	2.2	7.5	4.6	6.2	6.6
5	Construction	5.7	7.0	12.4	6.8	5.2	7.3
	Industry	25.3	27.0	9.9	6.7	5.5	6.7
6	Trade, hotel and restaurants	14.2	16.3	10.2	7.5	7.6	8.4
7	Transport and communications	7.5	11.1	13.6	13.4	8.6	10.1
	7.1 Railways	1.2	1.1	8.3	8.0	3.9	5.2
	7.2 Other transport	4.6	5.3	10.2	7.0	7.4	8.2
	7.3 Communications	1.6	5.3	24.2	28.0	18.1	20.0
8	Finance, insurance and real estate and business services	13.1	14.8	10.6	10.6	7.8	8.6
	8.1 Banking and insurance	5.9	7.3	12.8	13.3	9.6	10.5
	8.2 Real estate, business services	7.2	7.7	9.1	8.4	6.7	7.4
9	Community, social and personal services	14.9	12.8	5.8	9.7	6.1	6.0
	9.1 Pub ad and defence	6.9	5.2	4.6	13.1	5.5	5.3
	9.2 Other services	8.1	7.6	6.7	7.3	6.6	6.6
	Services (6+7+8+9)	49.7	54.9	9.8	10.1	7.3	8.0
	GDP	100	100	8.9	7.8	6.0	6.5

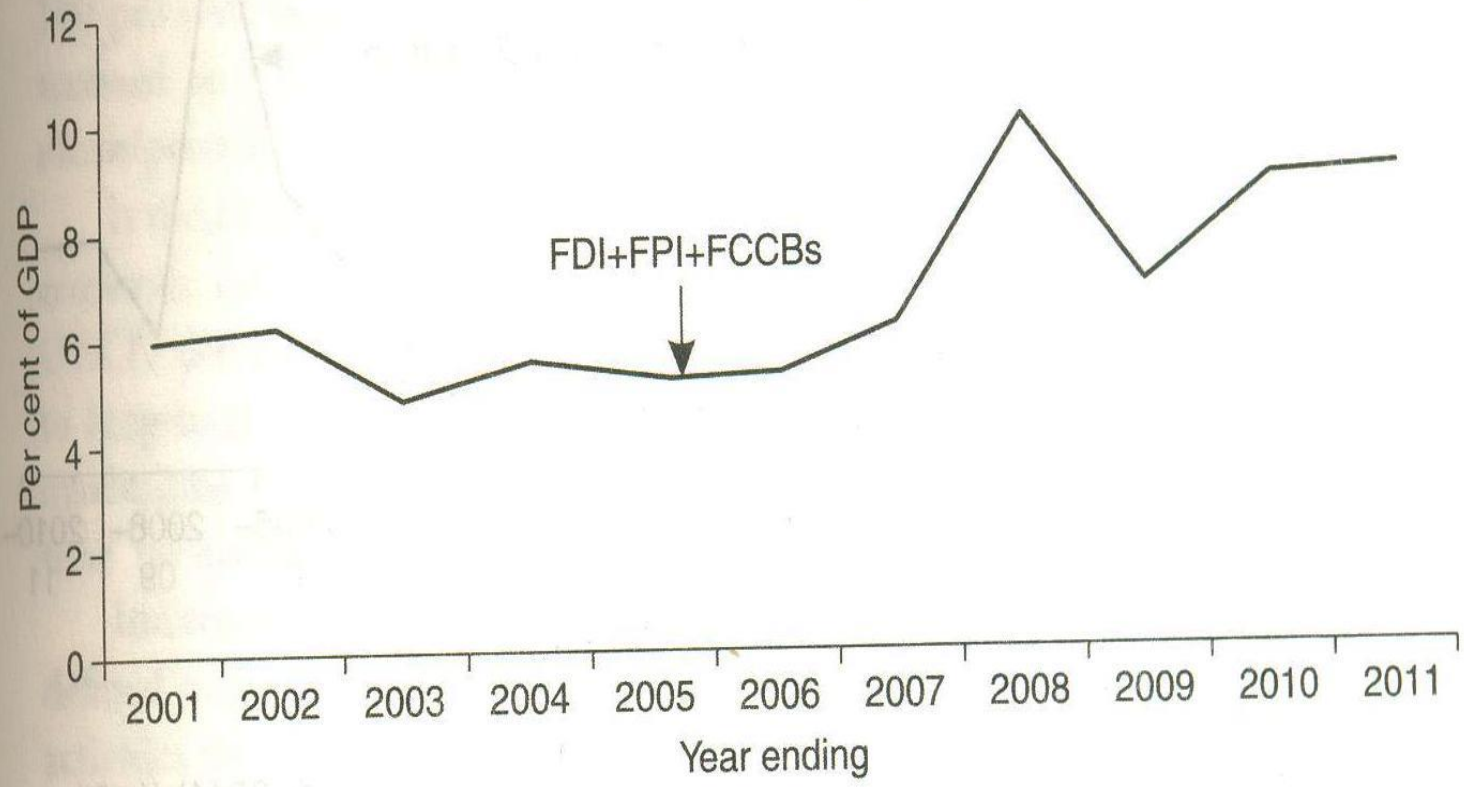
Source: *National Accounts Statistics*, various issues.

FIGURE 6.10: Foreign capital inflows (1991–2011)



Source: *Handbook of Statistics on Indian Economy, 2011–12* (RBI).

FIGURE 6.11: Foreign capital inflows as a proportion of GDP (2001–11)



Source: *Handbook of Statistics on Indian Economy, 2011–12* (RBI).

- **As a result, FDI started rolling into India, fro. $200 billion in 2003 they increased to $ 600 billion in 2007.**
- **This has begun pushing the investment-saving gap by 2.3%. FDI contributed 8% of total GCFC in 2008.**
- **Overall investment rate is pushed from 27% in 2003 to 36% in 2008, pushing the growth rate to 9%.**
- **The domestic corporate investment has complimented the FDI and increased to 22%.**
- **Both service sector and the manufacturing sector rose at 10 % per annum during the period.**
- **on a closer look the bulk of the incremental output came from a few narrowly defined industries and services, like the automotive industry, and telecoms and business services in the tertiary sector**

- The boom has two dimensions, real and financial.
- In the real sector, the boom was not a wide in its base. Registered manufacturing sector increased its share, reducing the informal sector.
- Within, manufacturing, growth concentrated in automobiles, consumer durables. Capital goods sector declined.
- The highest growth is recorded in infrastructural sector. Power sector improved in capacity, yet did not reverse it's the over decline. High ways has increased, rural connectivity did not improve.
- Telecommunications grew fastest among the infrastructure, besides the airports.
- Finally, construction sector became the third source of growth with real sector recording high growth.

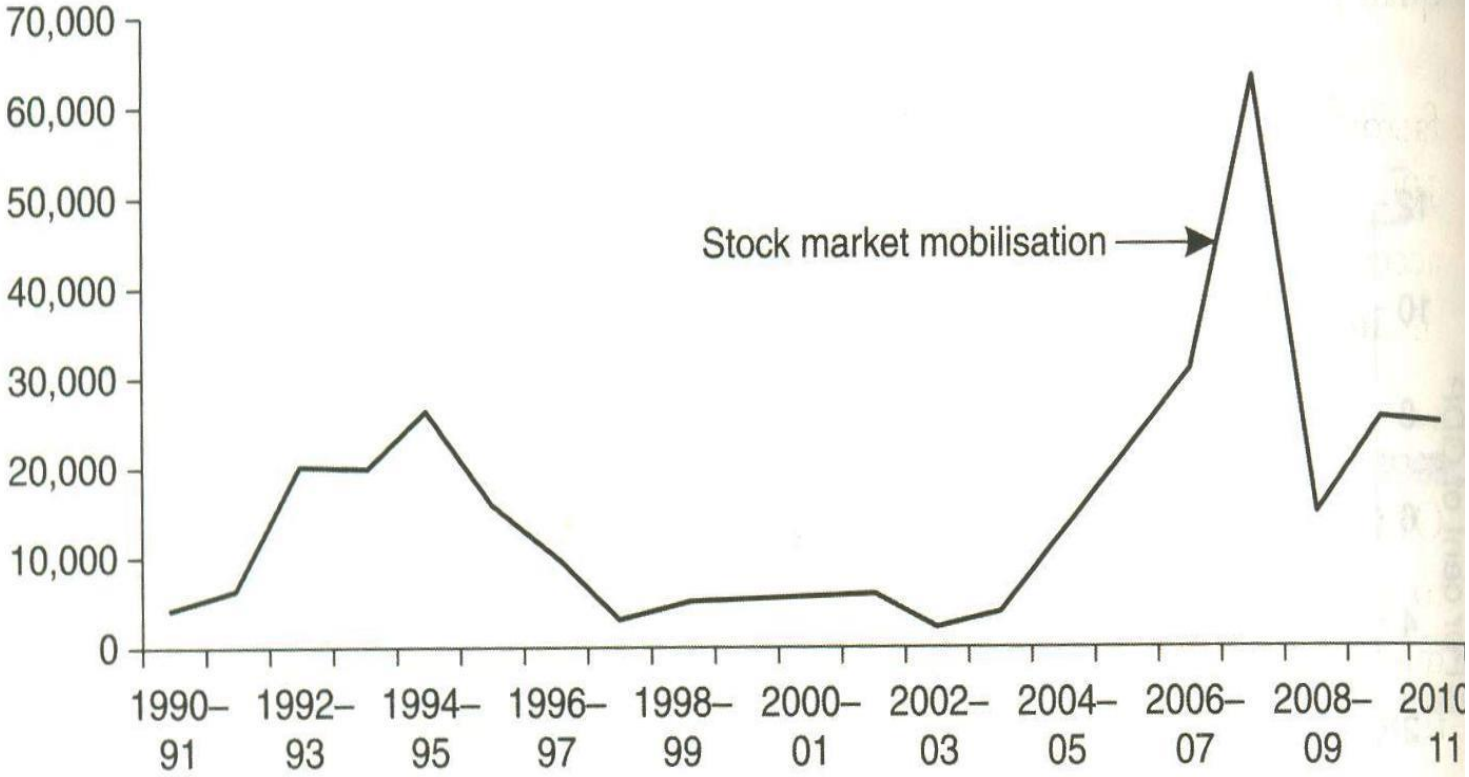
Table 3: GFCF by Industry, 1980-81 to 2007-08 (at constant prices, % of GFCF)

Sectors	Year				
	1980-81	1990-91	2000-01	2007-08	2010-11
1 2	3	4	5	6	7
1 Agriculture and allied activities	20.2	14.4	9.5	7.1	8.0
2 Mining and quarrying	3.2	5.4	1.6	4.5	3.9
3 Manufacturing	22.3	27.4	30.6	34.6	29.9
3.1 Registered manufacturing	12.7	18.8	20.4	28.6	24.1
3.2 Unregistered manufacturing	9.7	8.6	10.2	6.0	5.8
4 Electricity, gas and water	11.0	12.0	8.5	5.8	6.0
5 Construction	1.1	1.3	1.7	6.0	4.8
6 Trade, hotel and restaurant	3.9	3.3	2.8	6.6	8.8
7 Transport and communications	10.9	10.5	15.9	6.5	8.1
7.1 Railways	2.6	2.0	1.2	1.3	1.3
7.2 Other transport	6.9	6.0	9.4	3.1	3.3
7.3 Communications	1.3	2.5	5.3	2.6	3.4
8 Finance, insurance, real estate and banking	10.1	12.4	17.5	12.7	13.7
8.1 Banking and insurance	0.5	1.3	1.4	0.8	0.7
8.2 Real estate, business services	9.6	11.0	16.1	11.9	13.0
9 Community, soc, and personal services	17.4	13.4	11.9	16.3	16.7
9.1 Public administration and defence	14.9	10.4	7.8	8.9	10.1
9.2 Other services	2.5	3.0	4.1	7.3	6.7
Total GFCF/GDP ratio	21.5	23.9	24.6	36.7	34.8

Source: *National Accounts Statistics*, various issues.

- Yet, organized sector employment declined during this phase by 3.7 million. Thus job-less growth became the feature of this growth model.
- Consumption is largely aided by bank credit, through house loans, car loans etc.
- Capital markets surged forward, 30% of FDI in the form of FII have boosted the sector.
- Only 40 % of FDI remained direct, while the rest of 30% came in for mergers and takeovers and external commercial borrowings.
- About 10 business houses like Adani, Ambani, GMR, GVK, Vedanta, JAYPEE, Essar and Lanco emerged as major beneficiaries of corporate debt, who borrowed about Rs.8 lakh crores.

FIGURE 6.13: Stock market mobilisation (1991–2011) (*in crore Rs*)



Source: *Handbook of Statistics on Indian Economy, 2011–12* (RBI).

- This was financed majorly by the pushing the credit by the banking sector and rest in the capital markets. RBI has pushed the money supply at an annual rate of 24-26% against the FDI back up.
- The credit was also directed to infrastructural areas, namely, real estate (24%), automobiles (9%), telecom (42%), national highways (11%), power sector 8 %, ports (3%).
- Housing loans, car loans, consumer loans and credit card loans marked the bank credit profile.
- The real estate boom led the high growth story from domestic side.

- A notable feature of the investment is that 31.9 % is contributed by private corporate sector on a 4-year av, 40% in 2007-08. This growth of private corporate investment is significantly high compared to the low levels during 1999-03.
- This rapid growth of corporate investment is clearly an important component of the story of high growth to term this as an investment-led growth.
- But this rapid investment in corporate sector did not produce commensurate output or employment. The share of organised manufacturing remained 7.67 % of GDP during 2002-08, which has 29% of capital stock. The capital-output ratios also increased to 7.75 during 2004-08.
- The total employment is in organised manufacturing has declined from 63.33 lakhs to 58.37 lakhs during 1991-2007.
- In the organised sector, The public sector employment is reduced from 18.52 to 10.87 lakhs and private sector employment has gone up only from 44.81 to 47.5 lakhs.
- The private final consumption expenditure (PFCF) declined from 49.72 % to 48.52% during 2005-08. Where as Gross Fixed Capital Formation has increased from 34.29 % to 42-44% during 2003-08. So this is clearly shows that it is the investment that caused the growth not so much the consumption. Lets see the table

- As said earlier, the growth in India in this phase is solely driven by investment. Problem is when it is concentrated in few sectors, not spread, not contributed to employment, then the growth would hit the demand constraint.
- If the investment is accompanied by productivity growth, then it can reduce cost of production and productivity thus sustain the profitability.
- The various studies on industry have shown that not much progress is made on the productivity front.
- By 2008, world trade collapsed to 3.5 % and Indian exports fell to 14 %, leading to rising current account deficit and depreciation of Indian rupee and inflation. This has stopped the FDI inflows since 2009.
- Corporate savings fell to 17% and overall saving rate fell to 27%.

Chart 1: Current account balances

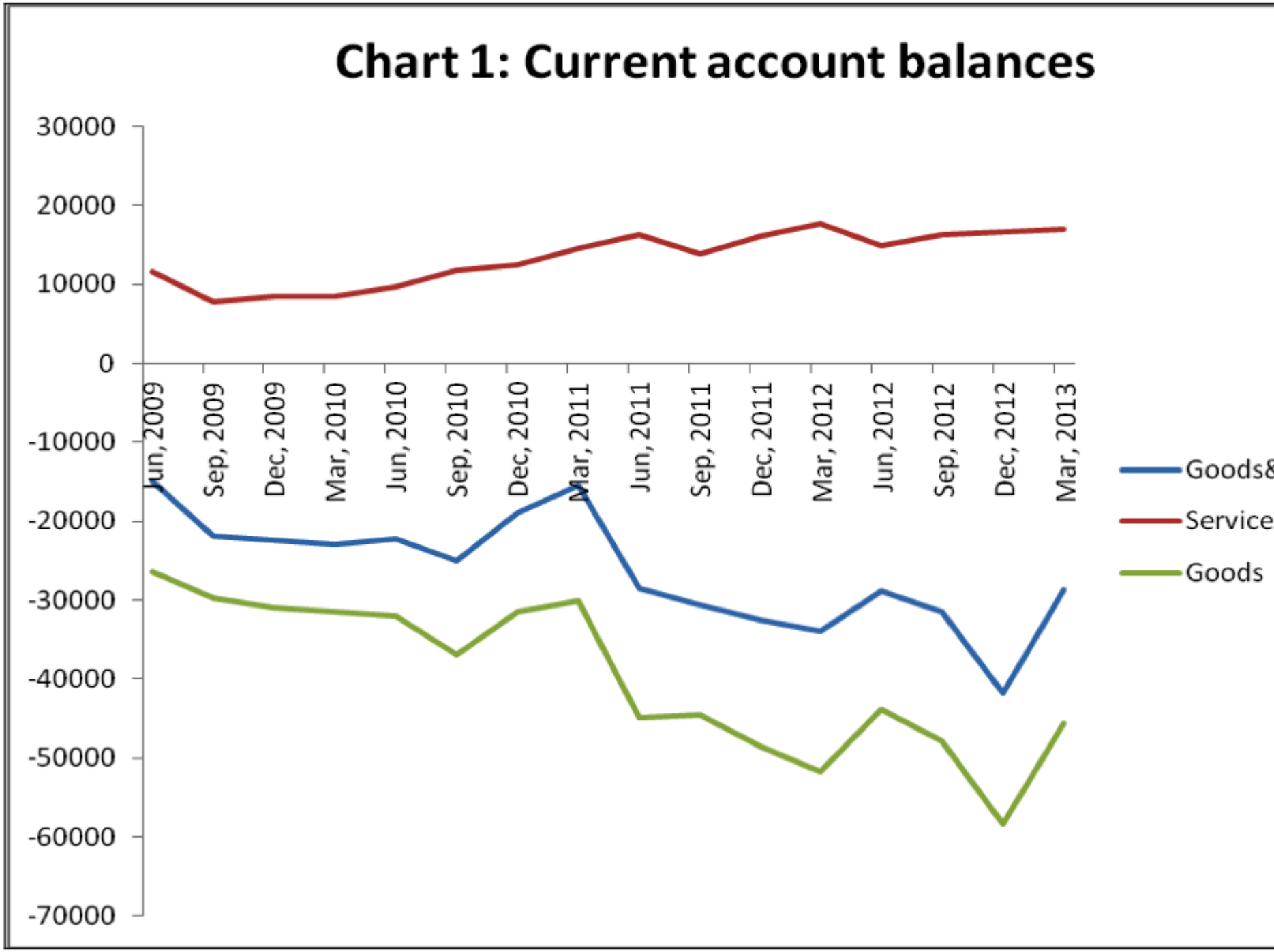


Chart 2: Current account deficit to GDP (%)

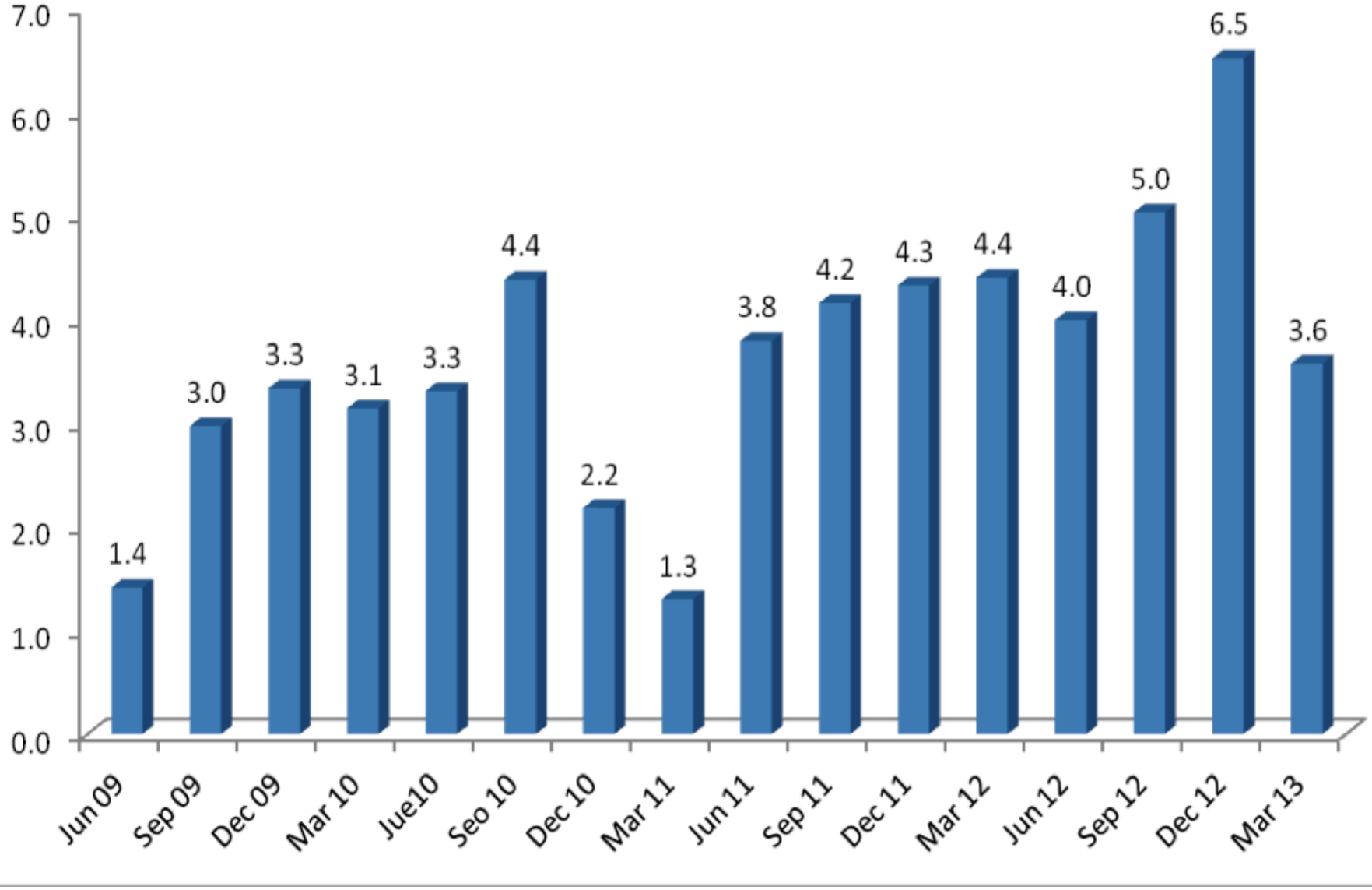


Chart 5: Merchandise trade ($ mn)

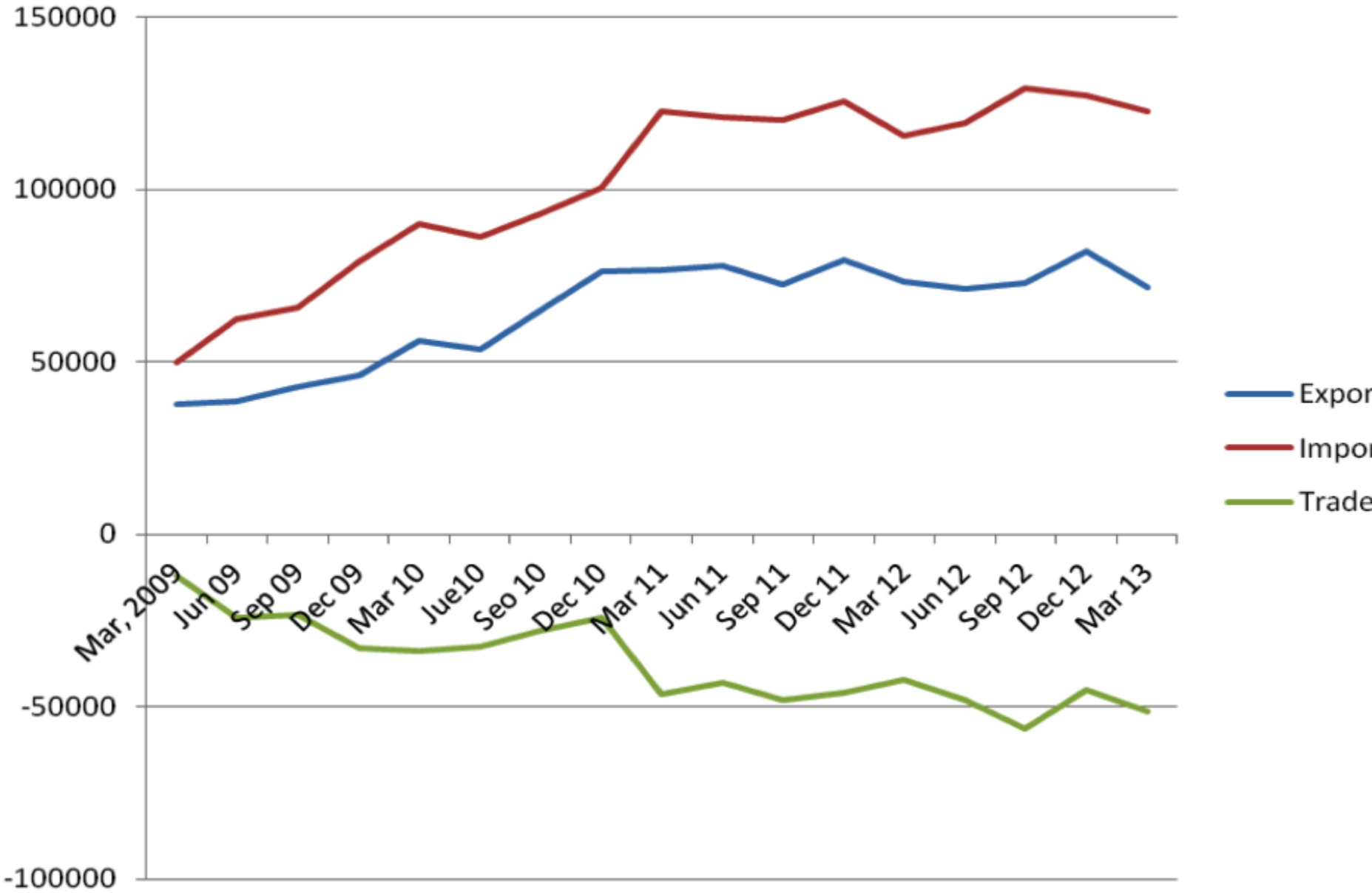
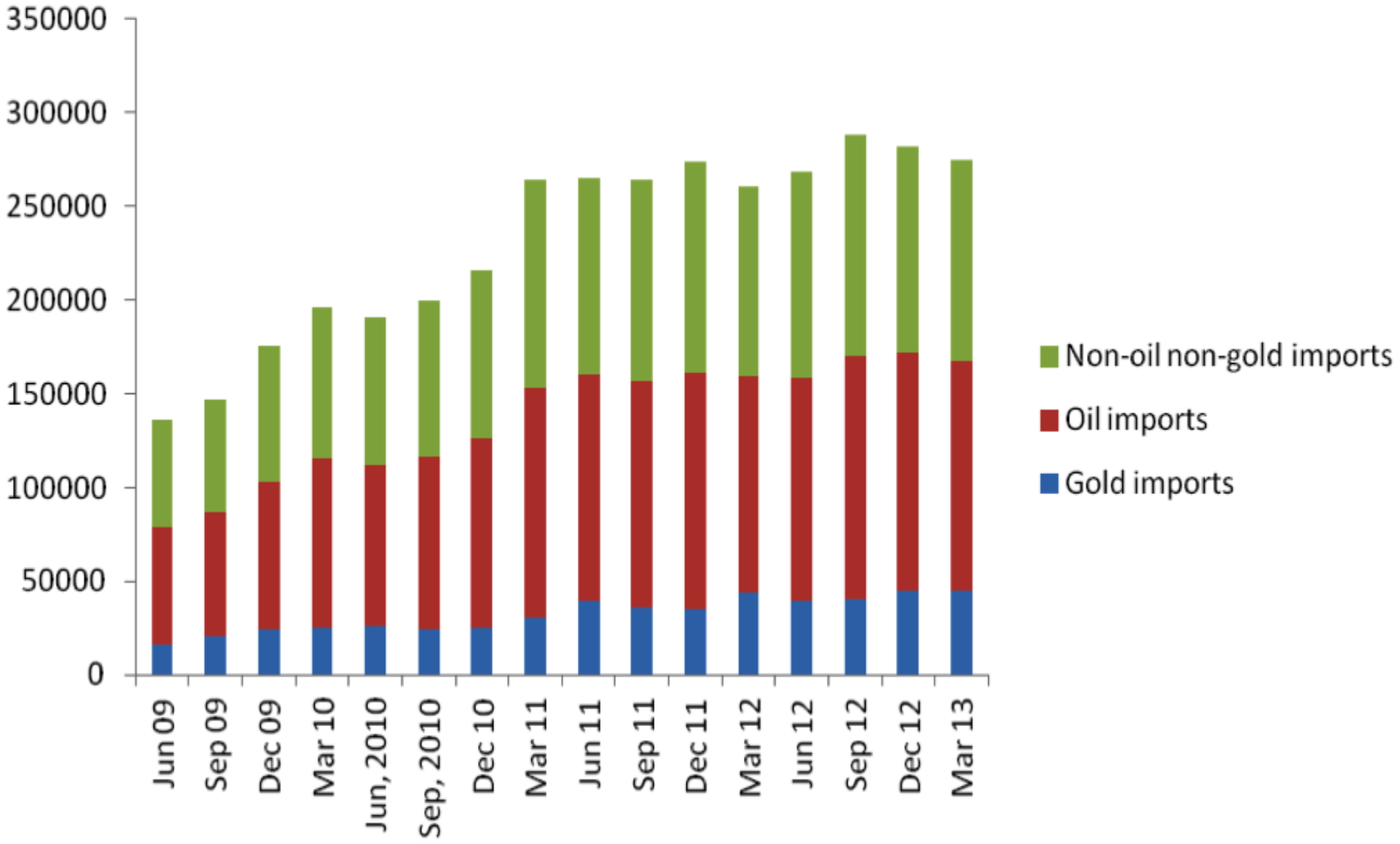
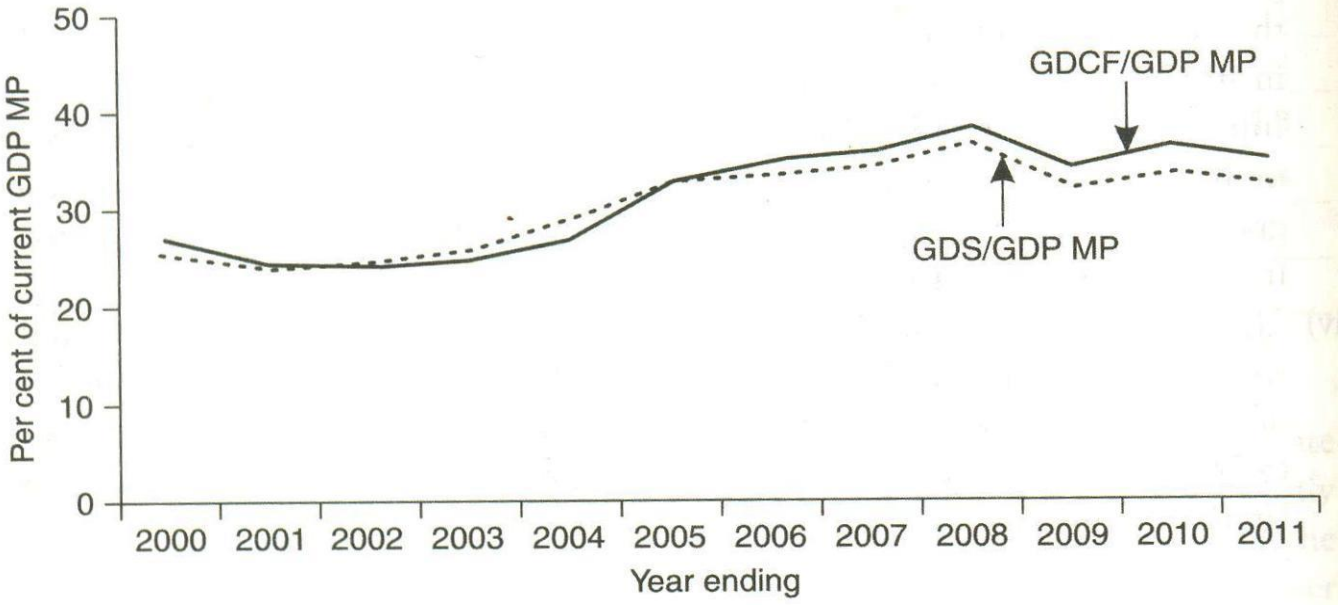


Chart 6: Import categories ($ mn)



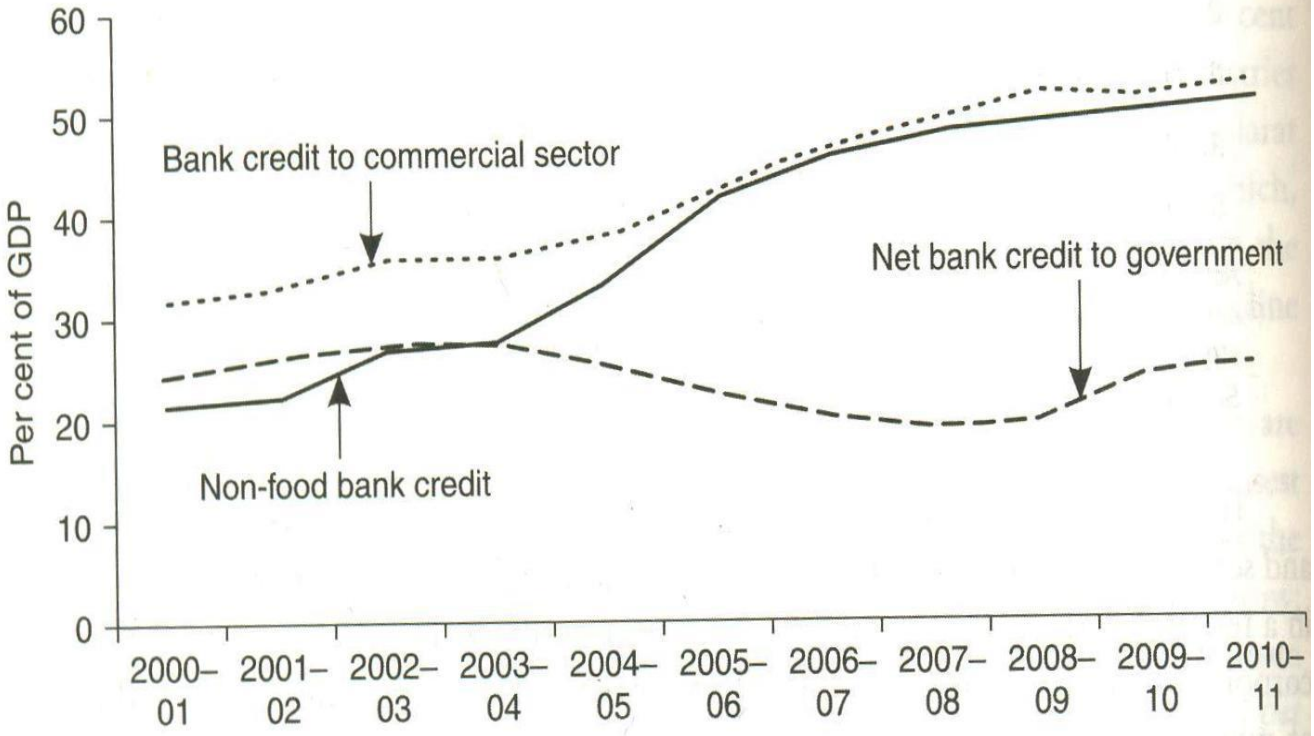
- Additionally, speculative sentiments spilled into the real estate sector, given the housing loan drive, created a construction boom. Construction was in fact the fastest growing segment, at 14% of the industrial sector in this period.
- In fact entire increase in the capital formation in the household sector is accounted by the construction.
- Apart from its direct effect on investment, demand for several industries also grew.
- As a result of high growth, government revenues too rose; corporate profit share has increased from 1.9 to 3.9 % of GDP. Fiscal deficit too grew due to faster growth in expenditure. This reinforced the demand without making the financial markets too nervous.

FIGURE 6.3: Investment and savings ratios (2000–11)



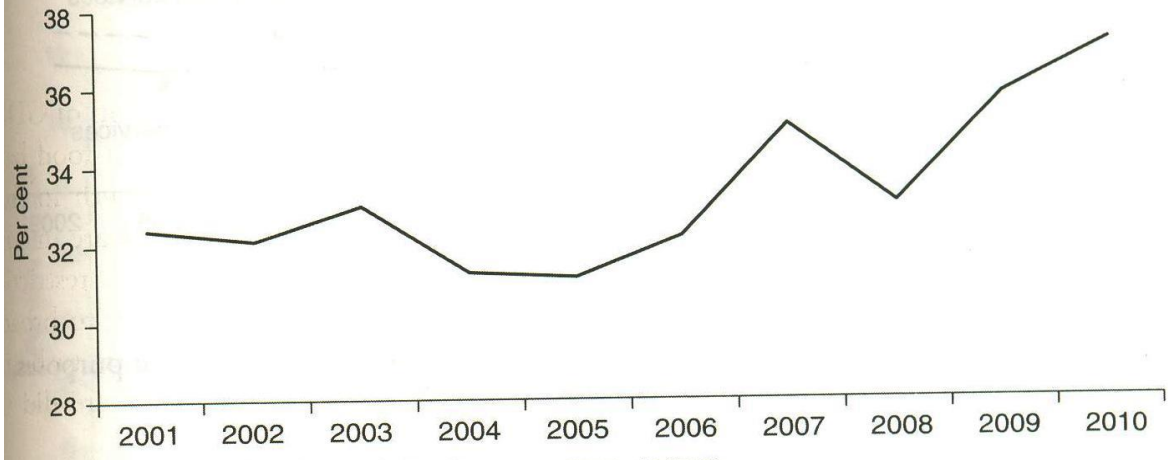
Source: CSO (2011); CSO (2012); *Handbook of Statistics on Indian Economy, 2011–12* (RBI).

FIGURE 6.6: Composition of total bank credit (2001–11)



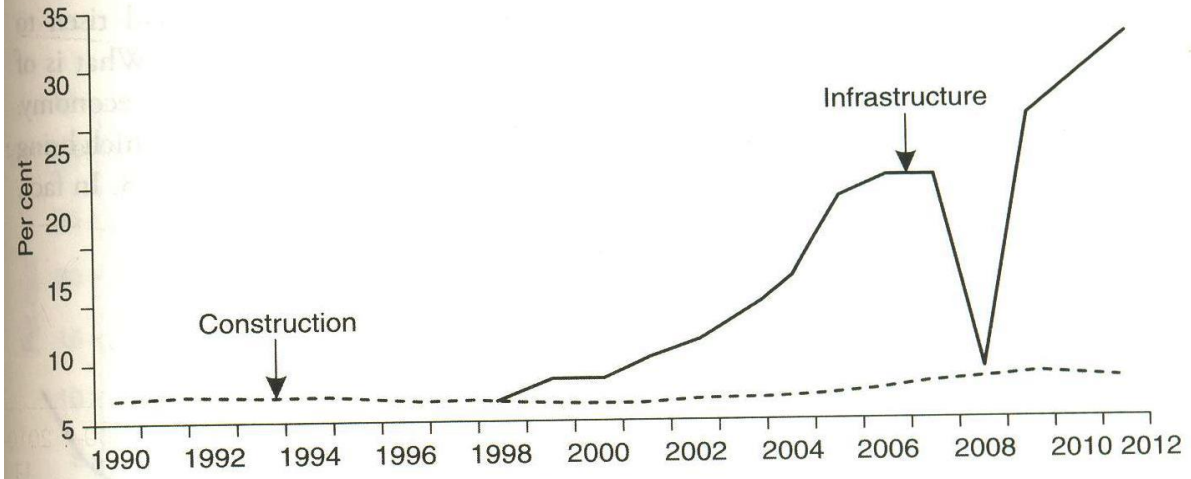
Source: *Handbook of Statistics on Indian Economy, 2011–12* (RBI).

FIGURE 6.7: The private corporate sector's share on total bank credit (2001–10)



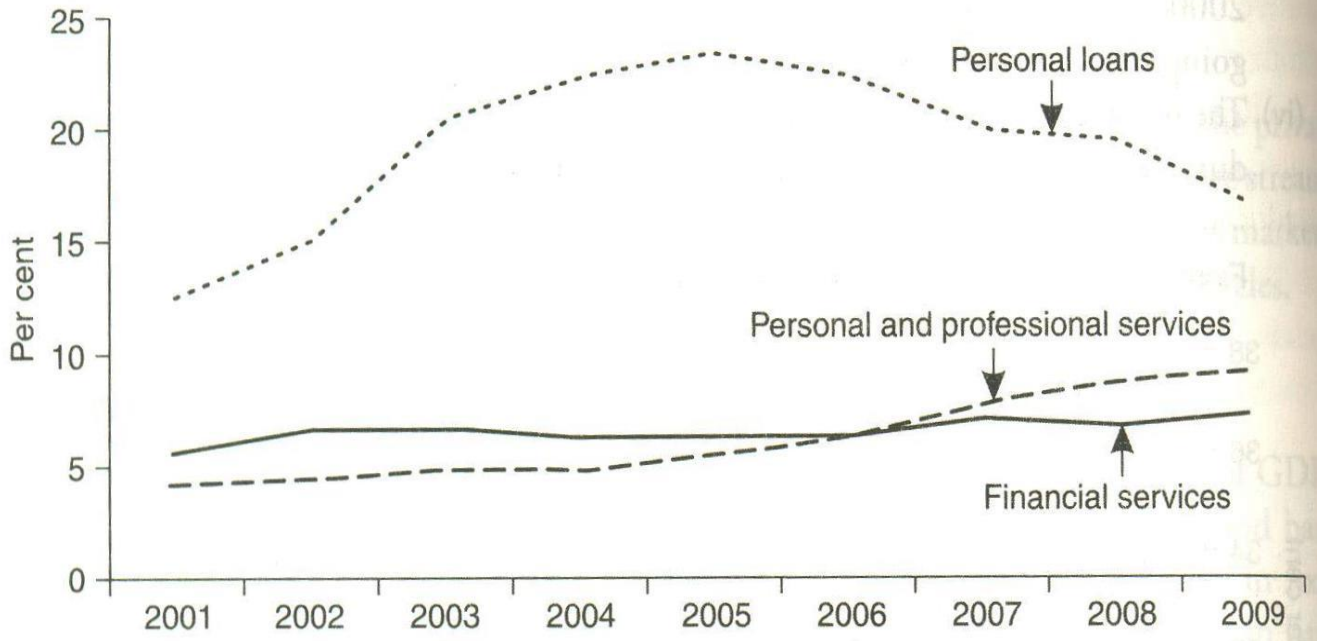
Source: *Handbook of Statistics on Indian Economy, 2011–12* (RBI).

FIGURE 6.8: Construction and infrastructure's share in bank credit (2001–11)



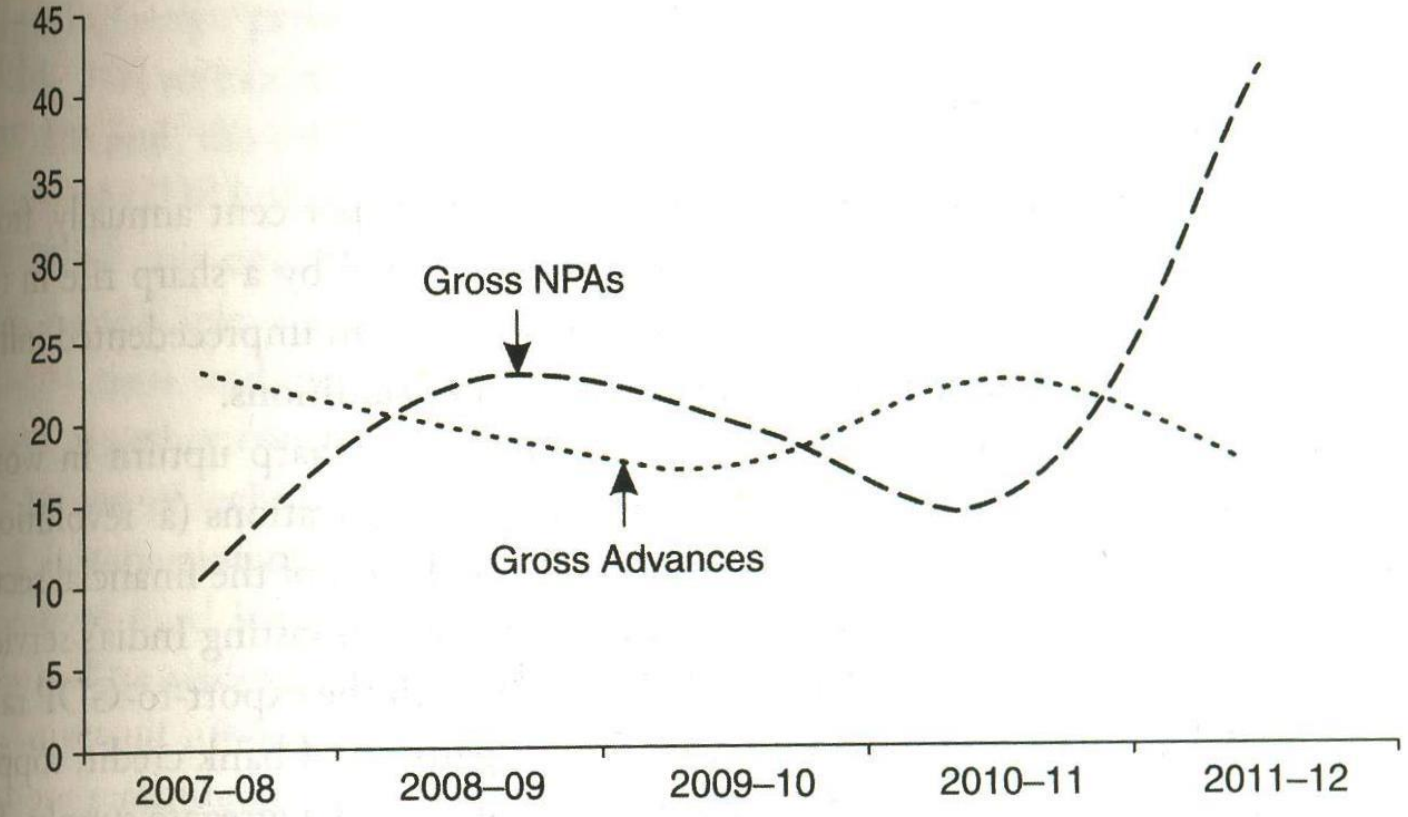
Source: *Handbook of Statistics on Indian Economy, 2011–12* (RBI).

FIGURE 6.9: Total bank credit by occupation (2001–09)



Source: *Handbook of Statistics on Indian Economy, 2011–12* (RBI).

FIGURE 6.19: Growth in banking sector's NPAs vis-à-vis advances



Source: RBI (2012).

- Credit-GDP ratio has increased from 55 to 65 %.
- Lending to infrastructure industry increased from 2% to 32 %. This is abnormal as return on infrastructure is low, and capital gets locked up. But sudden entry is due, lending has gone to telecom, highways, aviation.
- It is PSU banks who did infrastructure lending, state pushed PSU banks to this despite high degree of high risk and low return.
- Tarapore said India is sitting on one billion subprime.
- In the downturn, banking is going to be hit badly. Kingfisher is given a rescheduled loan, restructured assets of PSUs have gone up from 2 to 4%, but now when NPAs are restructured, there is going to be inevitable squeeze on credit and which in turn affects growth.
- Hence only way out is more reforms and more FDI, banks to be pushed further on the same basis.
- What went wrong is not acknowledged.

Table 7: Growth in Debt of Corporate Groups between 2007 and 2012 – An Illustrative List

Group Companies	Debt as on (in Rs Crore)		Compound Annual Growth Rate (in %)
	2006-07	2011-12	
Lanco group	1,700	29,300	76
Adani group	4,400	69,500	74
GVK group	1,700	21,000	65
Vedanta group	9,500	93,500	58
GMR group	3,700	32,900	55
Jaypee group	8,100	45,400	41
Videocon	6,300	27,300	34
Essar	24,600	93,800	31
Reliance	26,100	86,700	27
JSW	13,200	40,200	25
Total debt of 10 groups	99,300	5,39,500	40
Banking system loans	1,75,7000	42,89,700	20

The table is based on a report by Credit Suisse Group AG.

Source: Bhuma Srivastava, Livemint, 21 August 2012.

Conclusions

- Economic Reforms has changed the distributional character of the economy, but has not kept the economy on any sustainable radical growth path.
- The acceleration of growth was based on investment-led, FDI dependent growth rate, unaccompanied by employment, private consumption and productivity.
- Further, banking sector is likely causality with increased NPAs, which are about 8% of GDP. Any liquidation of these or other corporate debt is likely to cause detrimental effects on growth, thus making the future not very optimistic.

Readings:

- Peter Robertson (2010) EPW, Oct 2, Vol. 40 `Investment-led growth: Fact or Myth'.
- R Nagaraj (2015) `End of the Dream Run 2003-08: in Economic Growth and Distribution in India, edited by Pulapre Balakrishnan, OUP, New Delhi.

Economic Development and Strategy of Planning in India

India's Course of Development

- India was first country that became independent at the same time embraced liberal democracy with capitalism, among the post-colonial countries.
- India was fledgling capitalism with retarded development under colonial rule. Anti-colonial nationalism was ideological foundation.
- 1930 World Depression has eroded the credibility of capitalism. The two world wars that were fought for supremacy among imperialist countries made capitalism go on back foot.
- The intense workers struggles the Europe and rise of social democracy forced capitalists to offer concessions.
- The meteoric rise of Soviet Union with in a span of 15 years gave hope for an alternative system to capitalism.

Conceptual Shifts in Theory

- Adam Smith recognized the features of capitalist system.
- Ricardo, an ardent supporter of capitalist system, was worried over the prospect of falling rate of profits, due to conflict between rent versus profit.
- Marx, a critique of the capitalist system, speculated the prospect of falling rate of profit due contradictions in the systems of surplus expropriation and systems of profit realization.
- Several other Marxists have developed various other theories of crisis such as over production, underconsumption, disproportionality, overaccumulation.
- The liberal theory denied any such possibilities of crisis in the capitalist system.
- W.W.Rostow contemplated a historical transition to capitalism.
- Simon Kuznets proposed that capitalist transformation involves a rise in share of manufacturing and service sectors in income as well as employment; an initial rise in inequality and a gradual decline later on.

Global Conditions in early 20th Century

- The two world wars, besides having political reasons such as competing Nationalisms, the failure of Gold Standard as an international monetary mechanism, in consequent imperialist wars for colonies discredited capitalism as a model.
- The impressive rise of Soviet Union, which escaped ` World Depression', from a backward country to a superpower, made socialism, role of state and planning as popular institutions and strategies for rapid development.
- Keynesian economics highlighted the role of state and need to maintain full employment through the latter in any capitalist economy.
- Planning was also adopted during the post-war reconstruction in Europe.

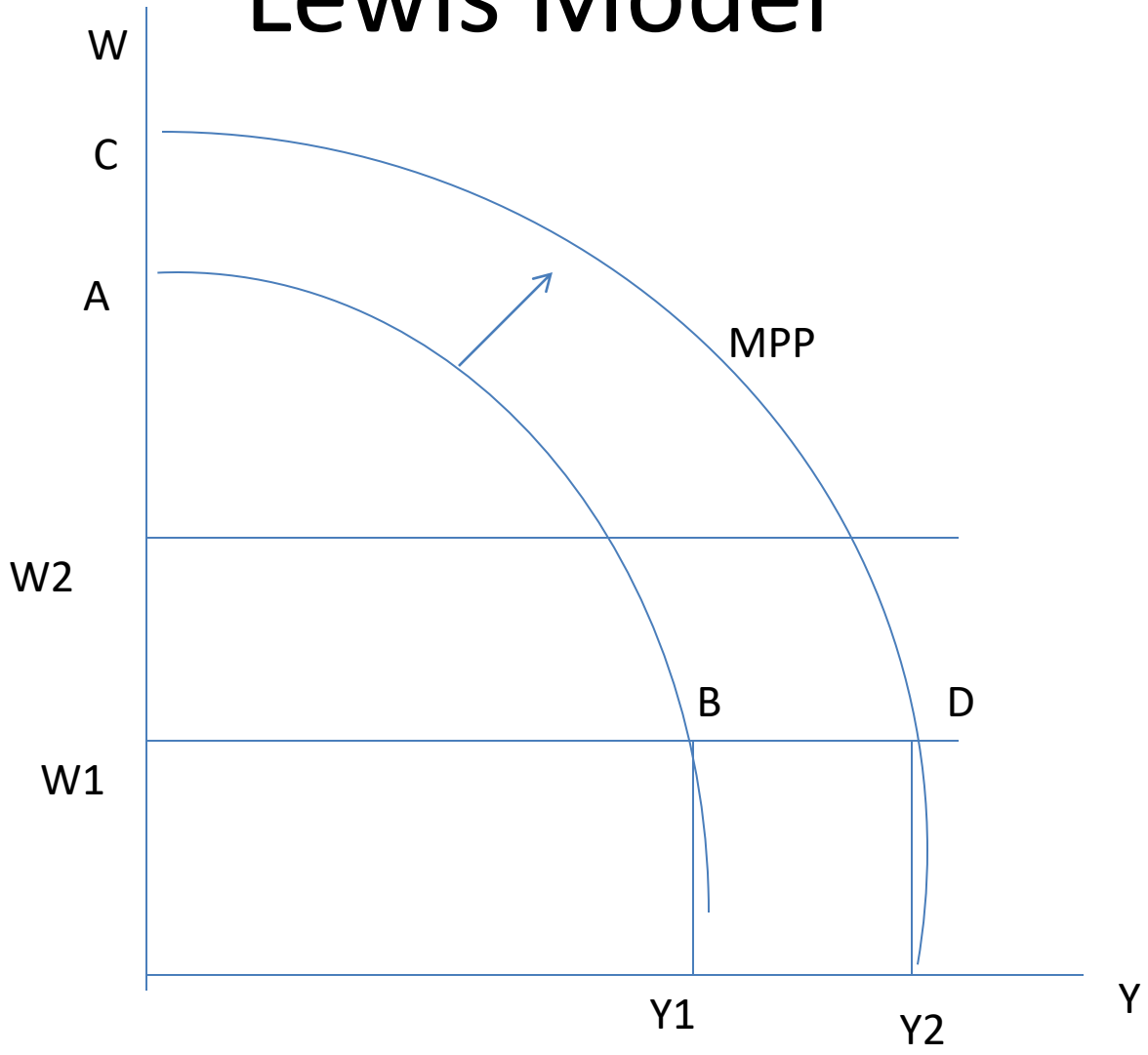
Development Economics

- Development Economics further envisaged new paths to rapid development through industrialisation.
- Rosenstein Rodan –emphasized the need for a strong starting up of range of industries (Big Push)
- Ragnar Nurkse emphasized the need to identify minimum doses of investment to push the economy out of the vicious cycle.
- Hirschman emphasised identification of those sectors which have maximum forward and backward linkages (unbalanced growth).
- Jan Myrdal cautions through his model of `backwash effects' for a regionally equitable growth.
- Latin American Structuralists emphasised the need for Import-Substitution Strategy against Export-led one.
- 19th Century experience taught self-reliance as moral objective.

Lewis Model of Growth with Unlimited Supplies of Surplus Labour

- The celebrated Lewis model envisaged that the investment in the modern (manufacturing + Service) sector would set automatic mechanism of growth and transformation.
- The surplus labour in agriculture would get attracted to the high productive-high wage modern sector, without diminishing agricultural output (hence no inflation), it ensures a constant wage, which assures a +ve profit and accumulation. Thus the model showed the possibilities of growth and transformation.

Lewis Model



Political Precursors to Planning in India

- In 1936 Avadi Congress adopted Planned Strategy and appointed Jawaharlal Nehru as the first Chairman.
- In 1947 a group of 21 leading businessmen in India, toured USA and submitted their plan called `Bombay Plan' that gave the responsibility of building infrastructure to state and rest to the capitalist sector.
- Communist leader M.N Roy prepared a `People's Plan' of socialist society that involved redistribution of land and progressive nationalisation of all industries.
- Gandhians came up with a `Gandhian Plan' with a focus on village development.
- Thus planning as a strategy was an accepted tool and there was a total consensus.

Indian Economy: Phases of Regimes

1. 1950-65 : Planning, Abolition of Intermediaries
2. 1965-80 : Mid-Sixties Industrial Stagnation, Green Revolution
3. 1981-91: Partial Liberalisation and Growth Acceleration and 1991 BoP Crisis
4. 1991-2003: Liberalisation, Structural Adjustment, Privatisation
5. 2004-15: FDI Inflow, High Growth, Global Recession, and Decline of High Growth

1950-65 Phase

- A Planning Commission was made as an advisory body with Prime Minister as Chairperson and Prof Mahalonabis, the legendary statistician, physicist and poet as vice chairman.
- Five Year is accepted time frame for each Plan, where the Plan is essentially a tool to allocate the financial resources pooled from state revenues and the banking system.
- The allocation is based on formula of the technical growth model, which uses the input-output economy-wide table as the basic tool.
- Input-output table is a matrix of input-output coefficients called technical coefficients that indicate the requirement the portion of each input needed to go into every output. With the matrix we can estimate the intermediate demand and final demand (based the aggregate output projected).
- The limitation of the input-output technique is that the tables are made only once in a decade and projections are subject to the deviation from the actual due to technical change.

Goals of Planning

- To accelerate rate of growth (to 5%).
- To achieve self-reliance in major areas of industrial and agricultural production (Import-Substitution Strategy).
- To accomplish rapid industrialisation.
- To eradicate mass poverty and unemployment (Social justice and regional development).
- To achieve structural transformation.

Second Plan: Mahalonabis Model

- Prasanta Chandra Mahalonabis was a legendary statistician and *anthropo-metrician*, known for `Mahalanobis Distance' , `cropping cutting method' and famous `salt solution.'
- He set up the **Indian Statistical Institute**, is considered as the father of Indian planning.
- He made the technical growth model for The Second Five Year Plan.

The Mahalanobis Model: Heavy Industry Strategy

- The model imagines two sectors in the economy, namely, capital goods sector (*i*) and consumer goods sector (*c*); former with lower ICOR but with a longer gestation.
- A higher relative share of capital invested in capital goods sector would produce a slower initial growth rate, but would soon accelerates and exceeds the alternative strategy of higher relative share invested in consumer goods sector.

Mahalanobis model Growth path

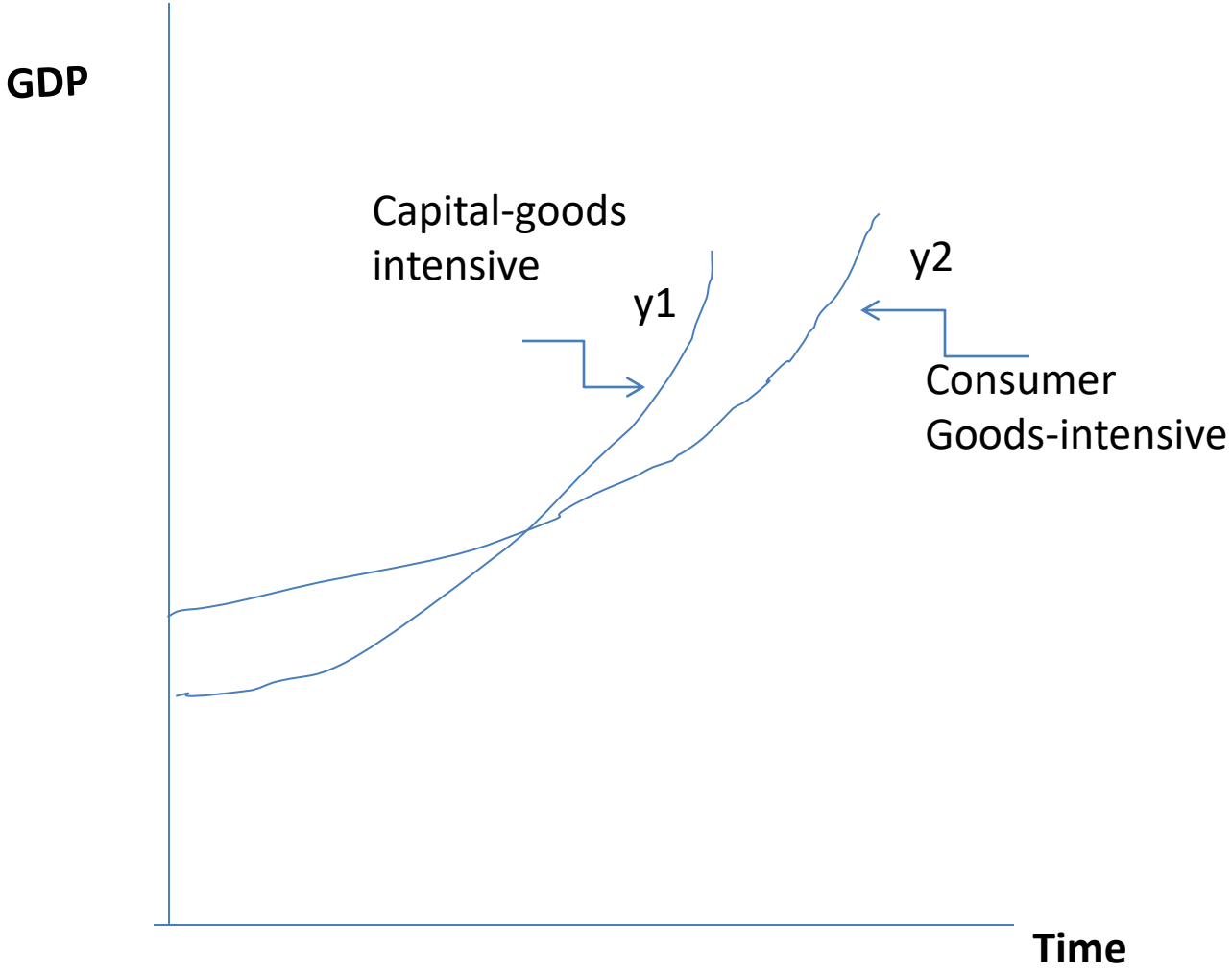


Table 1: The Trend Growth Rate of GDP (in 1948-49 prices)

Sector	1900-01 to 1946-47	1947-48 to 1999-2000	1950-51 to 1964-65
Primary	0.4	2.5	2.6
Secondary	1.5	5.5	6.8
Tertiary	1.7	5.0	4.5
GDP	0.9	4.1	4.0
GDP per capita	0.1	1.9	1.9
Population	0.8	2.0	2.0

The pre-1947 figure is for 'Undivided India' which includes the Indian princely states and Pakistan, but excludes Burma. Population growth is the compound growth rate.
Source: Sivasubramonian (2005).

Macro Indicators

	1950-64	1965-80	1980-90	1991-04	2004-15
GDP Growth Rate	4.1	3.2	5.8	5.6	7.2
Agriculture	3.1	2.3	3.9	2.1	3.4
Manufacturing	7.4	3.8	6.5	5.8	6.1
Service Sector	4.7	4.3	6.8	7.2	7.4
Investment/GDP Ratio	9.5	18	24.5	25.6	34

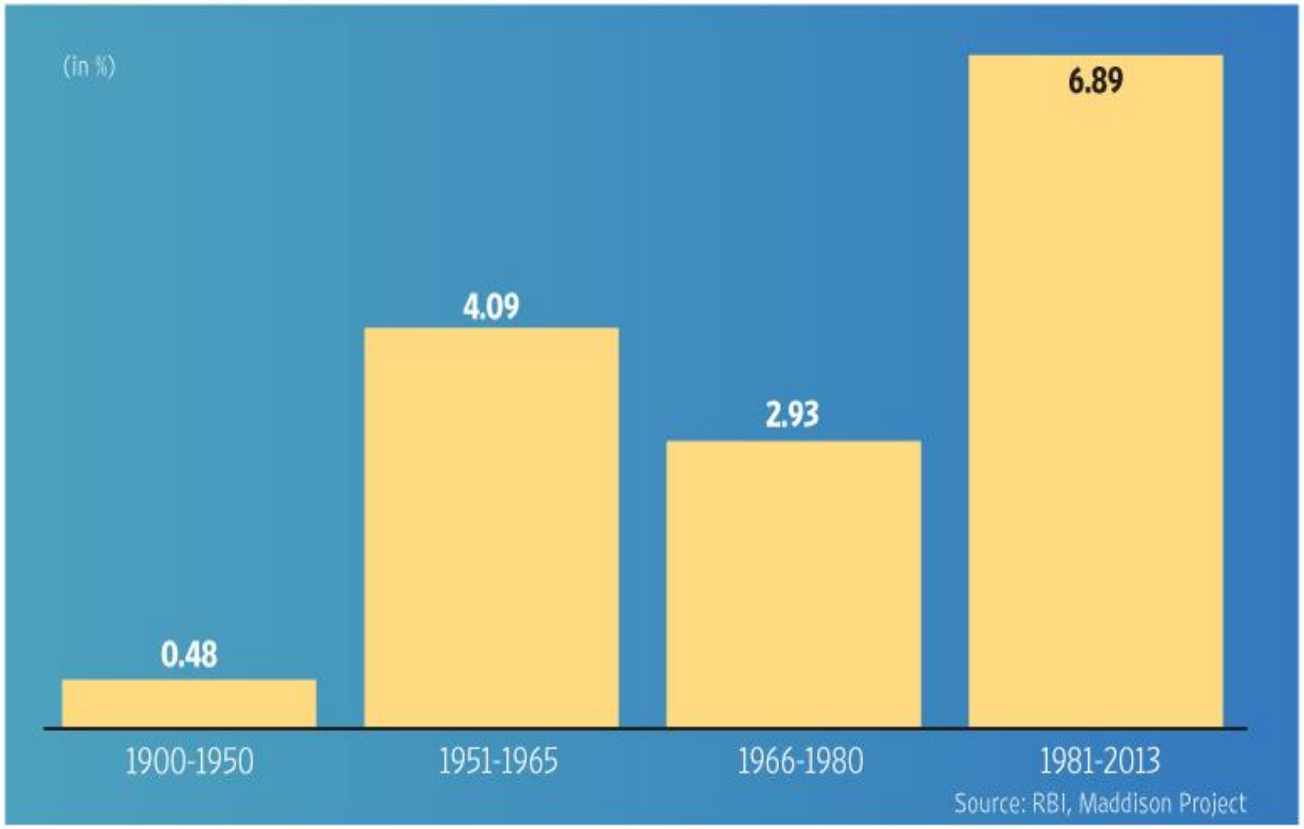
Industrial Growth Rates

	Industry	manufacturing	GDP
1951-65	6.9	6.9	4.0
1966-80	4.2	4.8	3.6
1951-80	5.4	5.3	3.6
1981-91	7.0	7.4	5.6
1981-2008	6.2	6.2	5.9
1992-2008	6.7	6.6	6.5
1951-2008	5.4	5.4	4.5

Changing Composition of Industry

	1950	1960	1970	1980	1993-94	2004-05
Basic Goods	22.33	25.11	32.28	33.23	35.5	45.7
Capital Good	4.71	11.76	15.25	14.98	9.3	8.8
Intermediate	24.59	25.88	20.95	21.33	26.5	15.7
Consumer	48.37	37.25	31.52	30.46	28.7	29.8
Durable		5.68	3.46	3.41	5.4	8.5
Non-Durable		31.57	28.11	28.11	23.3	21.4

AVERAGE ECONOMIC GROWTH IN THE RELEVANT PERIODS



Period 1951-66

- The growth achieved during 1951-66 was about 3.8 % against a target of 5 %.
- Agricultural output rose at 3% during 1950s but fell to 2.3% in mid-60s, averaging 2.8%.
- The 60s foodgrains growth was due to area expansion resulting form Zamindari abilition.
- Industrial output grew at 7.9% during 1950s, fell to 4.8% in mid-60s. However, industrial capacities were vastly improved in areas like metals, machine building, ship building, heavy chemicals, transport and communication.
- Mid-sixties unforeseen disturbances like two wars that diverted expenditures to defence, four major droughts that severely reduced foodgrain growth, population pressure, Korean war crisis that led to devaluation, ending of American aid, have all affected the growth performance. Nehru's death in 1964 and L.B.Shastri death in 1966 led to leadership vacuum.
- A Plan holiday was observed during 1966-69.

1965-73

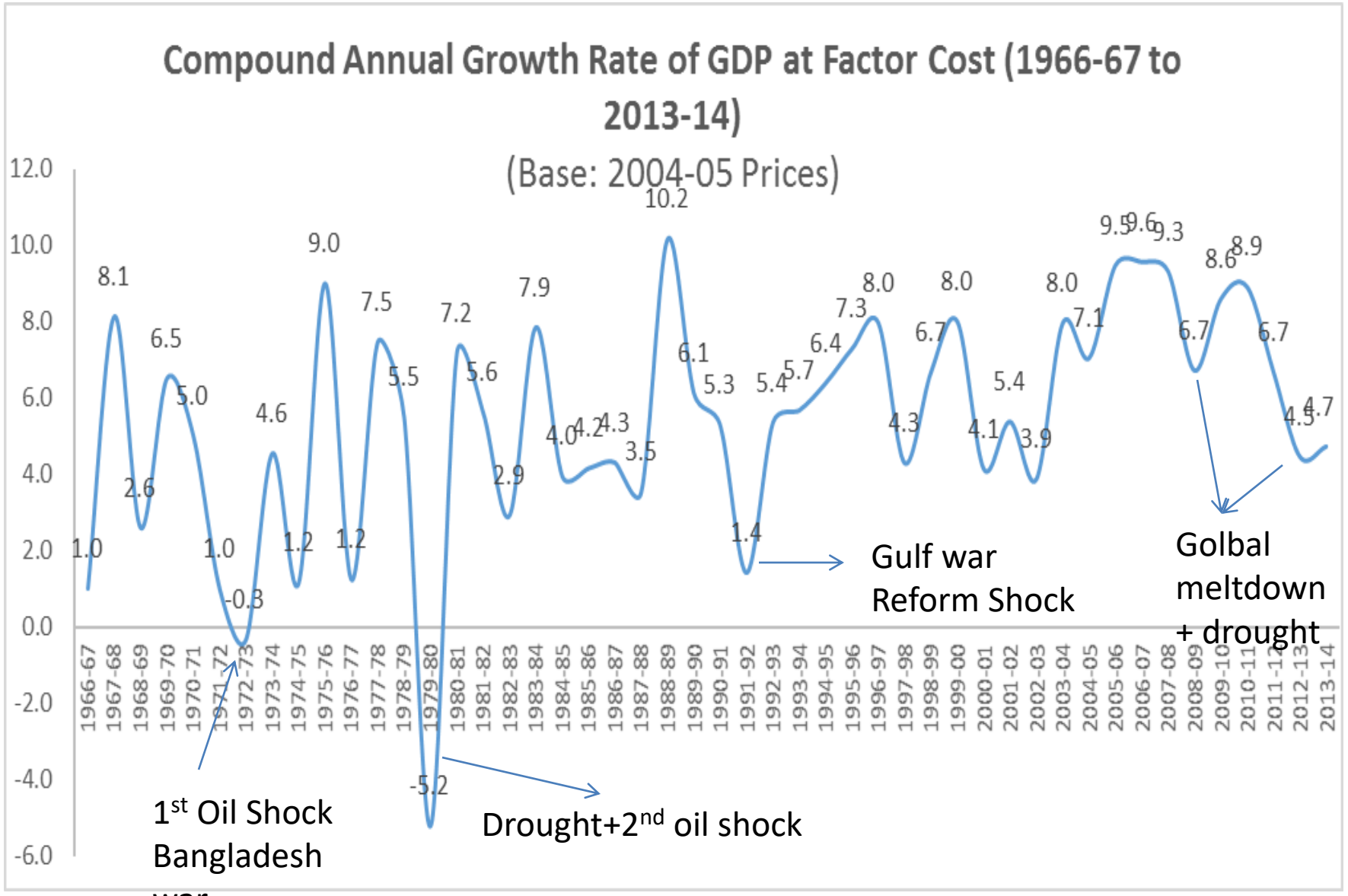
- The troubled times continued during 1965-73. Withdrawal of American aid from $1.3 to $ 1 bilion during the Nixon tilt in 1972 posed a major threat.
- Devaluation in 1966 did improve exports, while inflation spiraled to 25%. Fall in foreign exchange reserves proved costly for growth.
- Indira Gandhi's government (4th Plan) responded with restricting industrial growth with tightening licensing and holding down capacities through MRTP. Self-Reliance became the slogan.
- The silver lining was agriculture began responding to introduction of new technology.
- There was also severe unrest over growing poverty, it was realised poverty is not addressed through trickle down.
- Growth rate continued to be about 3.5, termed as `Hindu Growth' rate sarcastically by late Raj Krishna. The effects of FE shortage were apparent on economic growth and employment.

1974-84

- 5th Plan (1975-80) was formulated under difficult times of inflation, poor growth, BoP problems. 2-prongued strategy was adopted – i)drive against black marketers, and ii) to curb the demand to tackle the inflation rate of 30% in 1974.
- However, a wheat loan from Russia and bilateral trade led to recovery of industry. This has enabled India to withstand first oils shock in 1973, Bombay High oil production helped the second one in 1979.
- Through public investment in large dams, irrigation potential was increased that enabled proliferation of HYV adoption.
- Food grain production finally lifted from 83 mt in 1966 to 153 mt in 1977 and food imports were completely stopped.
- The 5th Plan growth rate increased to 4.5%.
- Efforts to boost exports through partial liberalization began paying dividends from 1981, thus making 6th Plan growth accelerate to 5.5 %.
- Manufacturing sector did not recover its momentum of 1960s.
- Even though poverty alleviation measures were introduced through special measures such as IRDP schemes, reduction through agricultural growth were more prominent.

1985-90

- The seventh plan growth recorded even better rate of 5.8 %.
- The partial liberalisation undertaken since 1981, export-promotion schemes, increased public expenditure at the cost of high fiscal deficit etc contributed to higher growth.
- India also resorted to commercial borrowing that made surge in imports, increasing the current account deficit.
- Collapse of Soviet Union in 1987 turned out to be a severe blow that led fall in exports. However, increased remittances from Gulf workers kept the BoP situation manageable.
- 1991 Gulf War and blocking of remittances from Gulf deteriorated foreign payment situation bad.
- India went for IMF conditionality loan which compelled it to undertake large scale liberalisation and drastic change in the controlled industrial policy.


Compound Annual Growth Rate of GDP at Factor Cost (1966-67 to 2013-14)
(Base: 2004-05 Prices)
12.0
10.0
8.0
6.0
4.0
2.0
0.0
-2.0
-4.0
-6.0
1966-67
1967-68
1968-69
1969-70
1970-71
1971-72
1972-73
1973-74
1974-75
1975-76
1976-77
1977-78
1978-79
1979-80
1980-81
1981-82
1982-83
1983-84
1984-85
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1997-98
1998-99
1999-00
2000-01
2001-02
2002-03
2003-04
2004-05
2005-06
2006-07
2007-08
2008-09
2009-10
2010-11
2011-12
2012-13
2013-14
1.0
8.1
2.6
6.5
5.0
1.0
-0.3
4.6
1.2
9.0
1.2
7.5
5.5
-5.2
7.2
5.6
2.9
7.9
4.0
4.2
4.3
3.5
10.2
6.1
5.3
1.4
5.4
5.7
6.4
7.3
8.0
4.3
6.7
8.0
4.1
5.4
3.9
8.0
7.1
9.5
9.6
9.3
6.7
8.6
8.9
6.7
4.5
4.7
1st Oil Shock Bangladesh war
Drought+2nd oil shock
Gulf war Reform Shock
Golbal meltdown + drought

references

- Chapter 1 Pulapre Balakrishnan *Economic Growth In India*, OUP, 2008
- PN Dhar *Indian Economy /: Past Performance and Current Issues* in Lucas and Papanek edited *Indian Economy: Recent Developments and Future Prospects, OUP 1988*

Major Constraints to Growth
Constraints 1950-80

- Incremental Capital Output Ratios have increased steeply by mid-sixties and continued up to Seventies.
- Inflationary pressures arising from domestic foodgrain shortages plagued the economy during 1950-74, until the Green Revolution was launched in 1966, the country became self-reliant by 1974-75.
- Tax collection remained poor.
- Foreign currency reserves remained modest, making it a constraint for importing.

Understanding Employment and Unemployment in India

Measurement

- CSO gives data on organised sector, while NSSO collects for informal labour.
- Data on employment and unemployment is collected by NSSO under two classification: First, on status of work. Second, extent of period of employment.
- If a person is engaged in one economic/non-economic activity for a longer period is considered as worker of **principal status;** and if for a part time in an economic activity as **subsidiary status** (mostly women and children).
- under three categories: Usual activity Status (US), Current Weekly activity Status (CWS) and Current Daily activity Status (CDS). The US employment means a person spent relatively longer period during the 365 days as the P**rincipal Usual Activity Status** of the person.
- A person is called as employed in case of CWS basis if he/she engaged in economic activity even for majority days in last one week. And if he/she is engaged majority of the at least one day in the preceding week is called as employed on the basis of CDS. Each of these categories are projected for entire workforce from a sample. Usual status employment is more reliable, the rest two depends on the statistical robustness of sampling.

Data Limitations

- Weakness of these is that even if one person is employed only for 6 months, he/she is considered as employed under US, if a person is employed only in that particular week would be considered under weekly status, if one day employed, would be considered employed under daily status. Hence we do have completely reliable statistics on employment and unemployment.
- Second, in a country where there are large number of small and marginal farmers exist, and good amount of disguised unemployment exists, these employment definitions make little sense. Because, under disguised unemployment, workers are seen to be employed for longer period since they have no other alternatives.
- Third, given seasonality in agriculture this data does not reflect the variations in employment.

Structure

- India has a total labour force of 46.85 crore (PS+SS) in 2004-06. out of this 34.57 crore are rural (73.8%) and 12.27 cr are urban (26.18%). Among rural workforce 21.92 cr are males and 12.6 are females; in urban 9.36 crore are males and 2.91 cr are females.
- Out of the total workforce, according to NSSO, 45.78 cr are employed (97.7%) suggesting an unemployment of 2.7% only. Within, it is distributed as 11.5 crore urban employment and 34.28 crore rural employment.
- 4.7% of the labour force are graduates and above, 5.8% are higher secondary, 11.1 are secondary and 47.8 % are literates.
- We have a rate of population growth of 1.93% per annum, labour force growth rate of 1.03% and 0.98% of employment growth rate.

Percentage Share of Employment by Industry

Sector	**1993-94**	**1999-00**	**2004-05**
Agriculture	**48.5**	**45.3**	**43.5**
Manufacturing	**15.4**	**15.32**	**17**
Construction	**3.78**	**4.78**	**5.33**
Service Sector	**32.32**	**34.6**	**34.17**
Trade, Hotel & Restaurant	9.88 (30.32)	13.78 (39.83)	12.75 (37.31)
Transport, storage & Communication	3.32 (10.27)	3.87 (11.18)	4.5 (13.17)

Employment Growth Rates

	US (PS+SS)		CDS	
	1983-94	1994-00	1983-94	1994-00
Agriculture	1.51	-0.34	2.23	0.02
Mining and Quarry	4.16	-2.85	3.68	-1.91
Manufacture	2.14	2.05	2.26	2.58
Elect, Gas, water	4.5	-0.8	5.31	-3.58
Construction	5.32	7.09	4.18	5.21
Trade	3.57	5.04	3.8	5.72
Transport, Commerce	3.24	6.04	3.35	5.52
Financial services	7.18	6.2	4.6	5.4
Community social services	2.9	0.5	3.85	-2.08
Total employment	2.04	0.98	2.67	1.07

Compound Growth Rate of Sectoral GDP, Employment and GCF

	Pre-Reform (1975-1989)			Post-Reform (1990-2004)			Overall (1975-2004)		
	GDP	Emp	GCF	GDP	Emp	GCF	GDP	Emp	GCF
Agriculture & Allied	2.60	1.52	0.14	2.55	-0.36	3.59	2.89	0.59	1.80
Manufacturing	6.14	1.39	5.98*	6.49	-0.37*	4.98	6.42	0.53	5.97
Service sector	5.63	2.57	4.94	7.75	0.52	5.66	6.69	1.50	5.50
Wholesale, Trade & Hotel	5.28	1.61	4.53	8.02	1.28	4.33*	6.44	1.40	2.47
Transport, Storage & Communication	5.65	1.80	4.07	9.83	-0.21*	3.96	7.18	0.71	5.01
Finance, Insurance & Real estate etc.	7.91	6.06	4.80	7.89	1.60	3.45	8.61	3.33	6.22
Community, social & Personal Services	5.60	2.48	5.99	6.94	0.52	9.90	6.04	1.52	6.09

. Employment and Investment Elasticity

Sector	**Pre-Reform (1975-1989)**		**Post-Reform (1990-2004)**		**Overall (1975-2004)**	
Dependent Variable: Log Employment	**LnEmp**	**LnGCF**	**LnEmp**	**LnGcf**	**LnEmp**	**LnGCF**
Agriculture & Allied	**0.39**	**0.08***	**-0.11**	**-0.10**	**0.20**	**0.15**
Manufacturing	**0.22**	**0.15**	**-0.05***	**0.14***	**0.08**	**0.09**
Service sector	**0.45**	**0.46**	**0.07**	**0.08**	**0.22**	**0.27**
Wholesale Trade, hotel	0.30	0.12	0.16	0.03*	0.22	0.09
Transport	0.32	0.23	-0.03	-0.03*	0.09	0.13
Finance, real estate	0.73	0.99	0.21	0.39	0.39	0.51
Community	0.44	0.37	0.08	0.04	0.25	0.22

- What we observe is that growth rate of employment has fallen from 2.04 to 0.98% in usual status and in current daily status too fallen from 2.67 to 1.07%.
- The decline is sharpest in agriculture and mining, there is boom in the construction activity. The service sector employment growth rate increased till 2000, but declined later.
- Employment rates declined during liberalisation period sharply compared to previous period. However, during 1999-05, there is an improvement in manufacturing, urban service sector, rural self employed. But much of the increase is only in rural self-employed.
- There is serious fall in the employment elasticity in all the three sectors, decline in agriculture is most prominent and manufacturing sector to follow.
- While GDP is growing at 8.78 percent, employment is growing 0.98 percent.

- Usually we expect that growth of income is necessary for employment situation to improve. However, this is only under conditions of constant capital-output ratios. Even when labour productivity increases, the demand for labour would rise faster. But if this accompanied by increased capital-labour ratio, then labour demand would rise much more slowly.
- **Compound Growth Rate of Sectoral Capital-Labour Ratio**

	Pre-Reform (1975-89)	**Post-Reform (1990-04)**	**Overall Period**
Agriculture & Allied	**2.03**	**2.20**	**1.81**
Manufacturing	**8.58**	**8.61**	**7.48**
Service sector	**1.01**	**3.76**	**2.35**
Wholesale, Trade & Hotel	8.93	2.41	4.65
Transport, Storage & Communication	1.95	5.04	3.75
Finance, Insurance & Real estate etc.	-3.95	2.21	-0.38*
Community, social & Personal Services	2.55	4.36	3.13

- At the aggregate economy level, output and employment rates are showing divergence, at the state level there is no one-to-one correspondence.
- A.P, Goa, HP, Karnataka, WB – has lower growth in employment despite a high SDP
- Assam, Bihar, Punjab, -have high employment with lower SDP rates.

Quality of Employment:

- We have seen that organised sector employment growth rate has fallen from 1.2% during 1983-94 to 0.53% during 1994-00 and -0.31 % during 2000-05. Public sector employment growth has fallen from 1.52% to -0.03 %. Private sector employment even though has increased from 0.45% to 1.87%, it did not compensate the absolute loss in organised employmnet.

- So when organised sector employment declined, but overall employment still increased, then what kind of employment increased. It is only informal sector employment, that too in self-employed in agriculture and employment in construction that increased.
- Given the dualism in the labour market, 93% in agriculture, 80% in manufacture and 89% in service sector is informal labour. This unorganised sector employment has increased from -1.73% during 1989-94 to 2.16% in 1994-00.
- The real problem is that of quality of employment. Given 33% of working poor below poverty line, in our country the low paying, insecure, unsafe employment is the problem.
- As far as real wages are concerned, there has been an increase over period. However, the rate of increase has fallen from 5% to 2.5% despite improvement in the labour productivity.

Table 1: Labour force participation rates

	Usual status (PS+SS)			Current daily status		
	1993-94	1999-2000	2004-05	1993-94	1999-2000	2004-05
Rural males	56.1	54	55.5	53.4	51.5	53.1
Rural females	33	30.2	33.3	23.2	22	23.7
Urban males	54.3	54.2	57	53.2	52.8	56.1
Urbanfemales	16.5	14.7	17.8	13.2	12.3	15

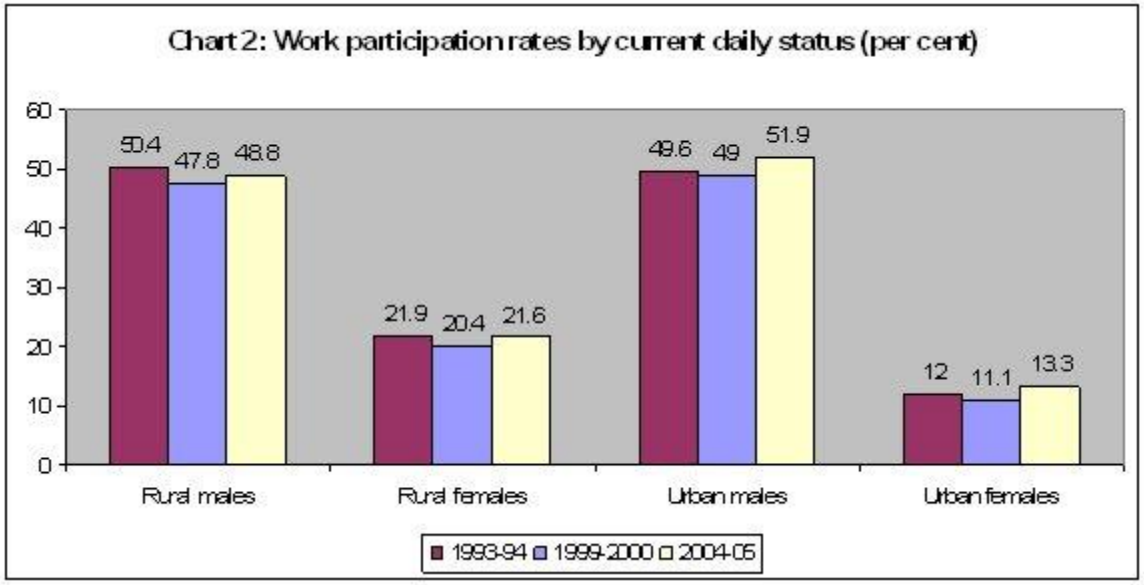


Chart 2: Work participation rates by current daily status (per cent)
60
50
40
30
20
10
0
50.4
47.8
48.8
21.9
20.4
21.6
49.6
49
51.9
12
11.1
13.3
Rural males
Rural females
Urban males
Urban females
1993-94
1999-2000
2004-05

FDI in India: Issues and Perspectives

FDI: Pre-Reform Stance

- Foreign Currency Reserves are crucial for modern development. Foreign trade is important and global exchange of technology would quicken the process of development. The logic of Globalisation and multilateral trade under WTO are based on the idea that global capital flows would promote greater global trade and development.
- Foreign capital covers host of entities such as the physical capital, financial capital, technological knowhow and management practices.
- However, during 1947-90 given the colonial experience as well as the contemporary global scenario, India was relatively restrictive about foreign investment. It was relying on bilateral and multilateral aid, on long term loans.
- FDI was permitted in limited quantities where India is deficient in technology through license agreements, technology transfer agreement and capital goods.

Pre-reform history

- Technology imports were preferred over financial and technical collaborations. Even technological licensing were subjected to restrictions on royalty rates and technical fees.
- FDI was permitted in designated industries, with joint ventures as the form with domestic partners, foreign equity was not to exceed 40% in total capital of the firm, of course with clauses on export obligation, promotion of R&D.
- FERA (1974) stipulated foreign firm to have an equity up to 40 % with exemptions at discretion, setting branch plants were disallowed, foreign subsidiaries were induced to gradually dilute their equity to less than 40%. Law also prohibited use of foreign brands, encourage hybrid domestic brands such as Hero Honda, Maruthi-Suzuki, Hindustan-Lever, Phillips India Ltd, etc.
- The policy essentially aimed at stabilising domestic supply at reasonable prices, to disallow foreign capital dominance and dependence.

Criticism of *Dirigism*

- The critics of *dirigism* have criticised that such restrictive policy retarded domestic technical capability (reflected in poor technical quality of Indian goods); loss of export opportunities of labour-intensive manufacturing in contrast to many Asian counterparts such as Taiwan, Hong Kong, South Korea, China.
- Moreover, such policy of restrictive foreign capital is said to have encouraged `rent-seeking' by domestic partners on imported technology with little effort to improve product quality, innovation, export effort (Ahluwalia 1985), eg., automobiles.
- But dumping aside these arguments, economist who worked on issues like technology, like K.Subramaniam, showed that such a policy reduced cost of technology of imports, enabled domestic partners to develop through `learning-by-doing', for eg., TELCO, BHEL, pharmaceutical industries.
- However, 1980 saw a gradual relaxation of rules on foreign investment, entry of Suzuki, Pepsico, all marked the shift.

The Analytical Perspectives

- Will the FDI necessarily benefit a nation? boost its GDP? create employment?, create export potential? Managerial potential?
- Neoliberal perspective of FDI takes a view that FDI is a source for: a)additional external finance, risk capital against debt-capital, b)augmenting fixed investment, potential to create output and employment. Like in Latin America, East Asia in 1980s.
- The crucial questions to the policy are how the benefits are spread between foreign firms and the domestic, what is the cost of foreign capital to the domestic economy. In case of domestic capital, the proceeds will remain in the country while for in case of foreign capital the proceeds will flow out.

Microeconomic perspective

Caves (1996) studied effects of FDI on output and employment.

1. In case, entry of foreign firms result in creation of domestic monopoly, then benefits of such investments are limited, unless checked by strong anti-trust laws.
2. Similarly, if foreign firms displace domestic firms, then also social benefits are marginal.
3. If foreign firms take over domestic firms to form monopolies then also the effect is the same.

- Industrial Organisation Theory also takes a view that foreign firms try to take firm-specific advantage – including market power. The foreign firms usually have an advantage in finances, technology; strength of domestic firms lies in cheep labour, location, marketing network. How does the both negotiate their roles will determine the outcome.
- So a social cost-benefit approach is a meaningful method to assess the potential effects of FDI.

- If we take this view, then countries should not blindly invite FDI, but should channel it into desired directions for the long term benefits. A world with unequal resources and technological capabilities, FDI should not lead to domestic de-industrialisation.
- Whether the technology spill-over happen depends on the nature and terms of FDI, but not automatically.
- The experience of several counties which followed open gates policy for FDI suggests that it is not necessary that technology spill-over, employment generation will happen. [Bruton, 1989].
- There are examples where FDI has created sweatshops making use of absence of labour laws, created informal sector jobs, and not capable of alleviating poverty. There are many cases of new international division of labour in which global production is turning to third world to exploit cheap labour and environment in totally unacceptable way.
- So rather than an unregulated open-door policy, a regulated approach r is desirable Sanjaya Lall (1989).
- Instead of importing foreign capital to get their technology, preferred option could be domestic firms offering financial investment, while technology is outrightly purchased from foreign firms.

Data, Trends and Issues in India

- Data on FDI in India is available on the basis of approved and realised by industry at state level.
- FDI is recorded under five broad heads:

1. RBI automatic approval route upto 51% equity.
2. Foreign Investment Promotion Board (FIPB) –discretionary approval over and above 51% foreign equity.
3. Acquisition of shares (since 1996)
4. External Commericial Borrowing (ECBs) – ADR, GDR
5. NRI deposits with RBI

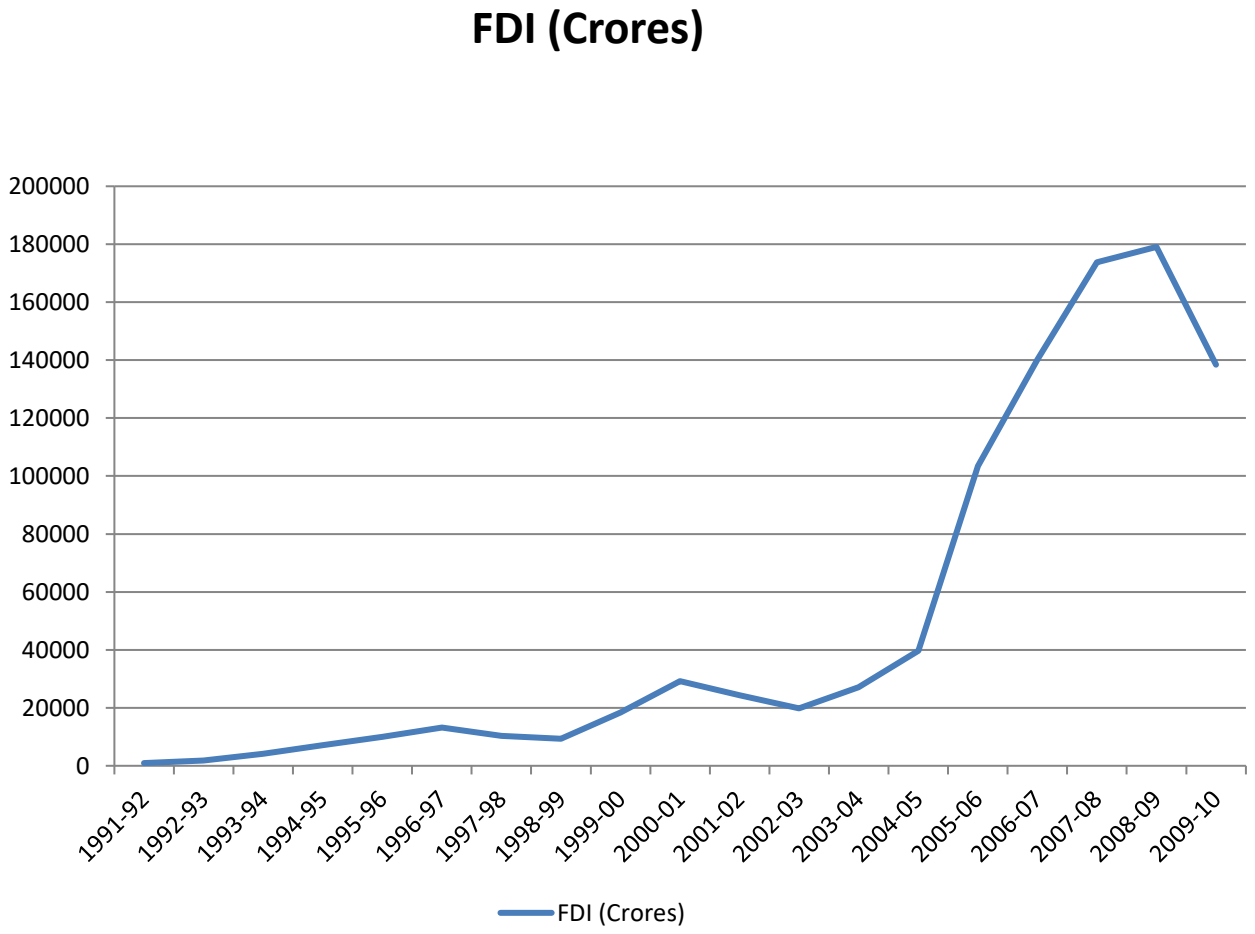
- Ideally FDI should get reflected in i)capital formation, ii)formation of new firms and factories, ii) increase in foreign equity holding in firms, iii) mergers and acquisitions.

Composition of Capital Inflows									
Item		1995-96	2001-02	2002-03	2003-04	2004-05	2005-06 R	2006-07 PR	2007-08 P
1		2	3	4	5	6	7	8	9
Total Capital Inflows (Net)									
US $ Million		**4089**	**8551**	**10840**	**16736**	**28022**	**25470**	**45779**	**108031**
of which:									
1	**Non- Debt Creating Inflows**	**117.5**	**95.2**	**55.5**	**93.7**	**54.6**	**84**	**63.3**	**56.9**
	a) Foreign Direct Investment **	52.4	71.6	46.5	25.8	21.4	34.9	48	29.9
	b) Portfolio Investment	65.1	23.6	9	67.9	33.2	49.1	15.3	26.9
2	**Debt Creating Inflows**	**57.7**	**12.4**	**-12.3**	**-6**	**35.2**	**41**	**63.4**	**38.9**
	a) External Assistance	21.6	14.1	-28.6	-16.5	7.2	6.9	3.9	2
	b) External Commercial Borrowings #	31.2	-18.6	-15.7	-17.5	19.4	10.8	35.9	20.5
	c) Short term Credits	1.2	-9.3	8.9	8.5	13.5	14.5	14.4	16.4
	d) NRI Deposits $	27	32.2	27.5	21.8	-3.4	11	9.4	0.2
	e) Rupee Debt Service	-23.3	-6.1	-4.4	-2.2	-1.5	-2.2	-0.4	-0.1
3	**Other Capital @**	**-75.2**	**-7.6**	**56.8**	**12.3**	**10.2**	**-25**	**-26.7**	**4.2**
4	**Total (1 To3)**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**
	Memo:								
	Stable flows +	**33.7**	**85.6**	**82**	**23.7**	**53.2**	**36.4**	**70.3**	**56.7**

Table 155 : Foreign Investment Inflows

Year	A. Direct investment		B. Portfolio investment		Total (A+B)	
	Rupees crore	US $ million	Rupees crore	US $ million	Rupees crore	US $ million
1	2	3	4	5	6	7
1991-92	316	129	10	4	**326**	**133**
1992-93	965	315	748	244	**1713**	**559**
1993-94	1838	586	11188	3567	**13026**	**4153**
1994-95	4126	1314	12007	3824	**16133**	**5138**
1995-96	7172	2144	9192	2748	**16364**	**4892**
1996-97	10015	2821	11758	3312	**21773**	**6133**
1997-98	13220	3557	6794	1828	**20014**	**5385**
1998-99	10358	2462	-257	-61	**10101**	**2401**
1999-00	9338	2155	13112	3026	**22450**	**5181**
2000-01	18406	4029	12609	2760	**31015**	**6789**
2001-02	29235	6130	9639	2021	**38874**	**8151**
2002-03	24367	5035	4738	979	**29105**	**6014**
2003-04	19860	4322	52279	11377	**72139**	**15699**
2004-05	27188	6051	41854	9315	**69042**	**15366**
2005-06	39674	8961	55307	12492	**94981**	**21453**
2006-07	103367	22826	31713	7003	**135080**	**29829**
2007-08	140180	34835	109741	27271	**249921**	**62106**
2008-09	161536	35180	-63618	-13855	**97918**	**21325**
2009-10	176304	37182	153511	32375	**329815**	**69557**

FDI Inflows in India in Post Reform Era



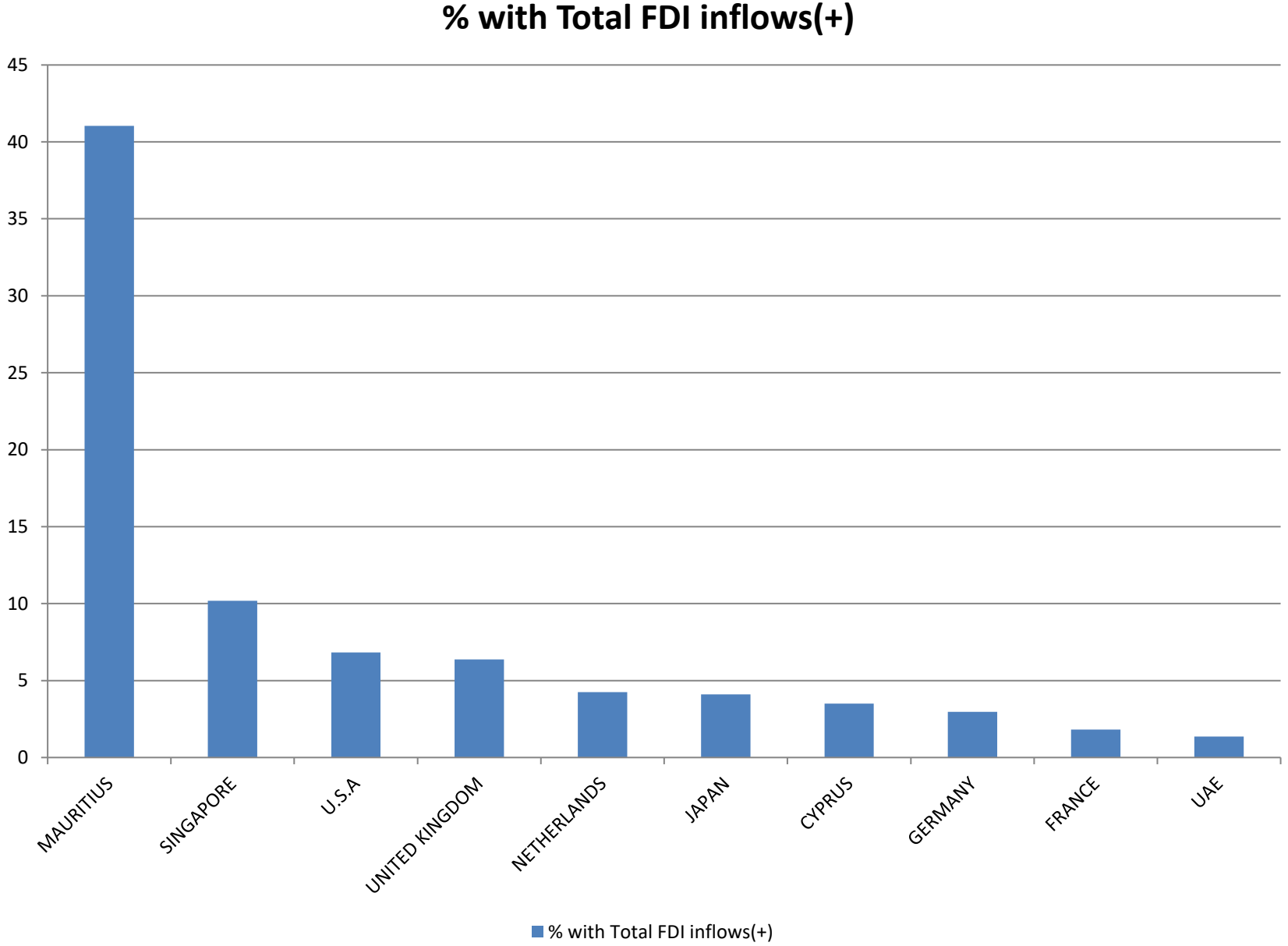
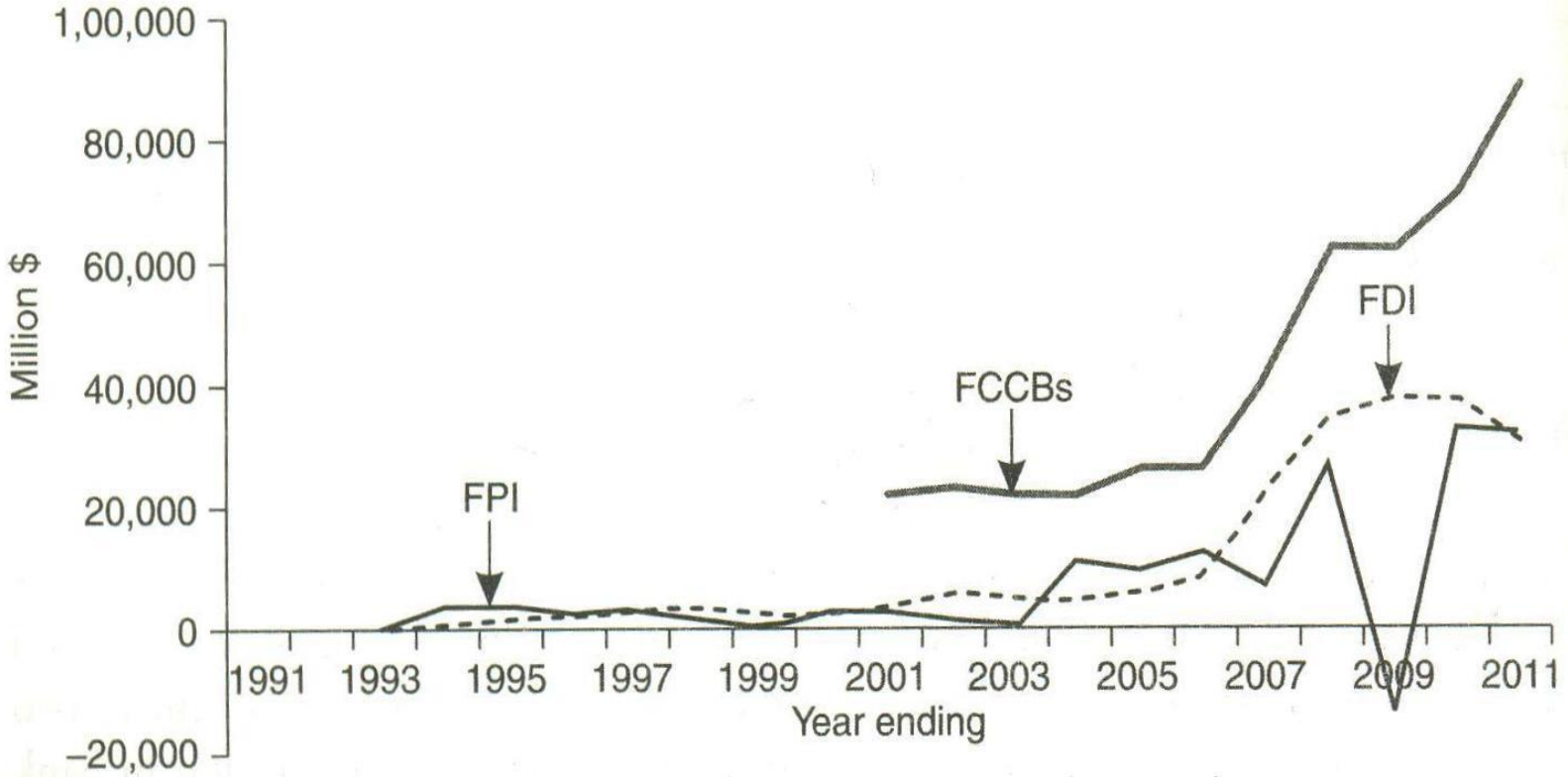
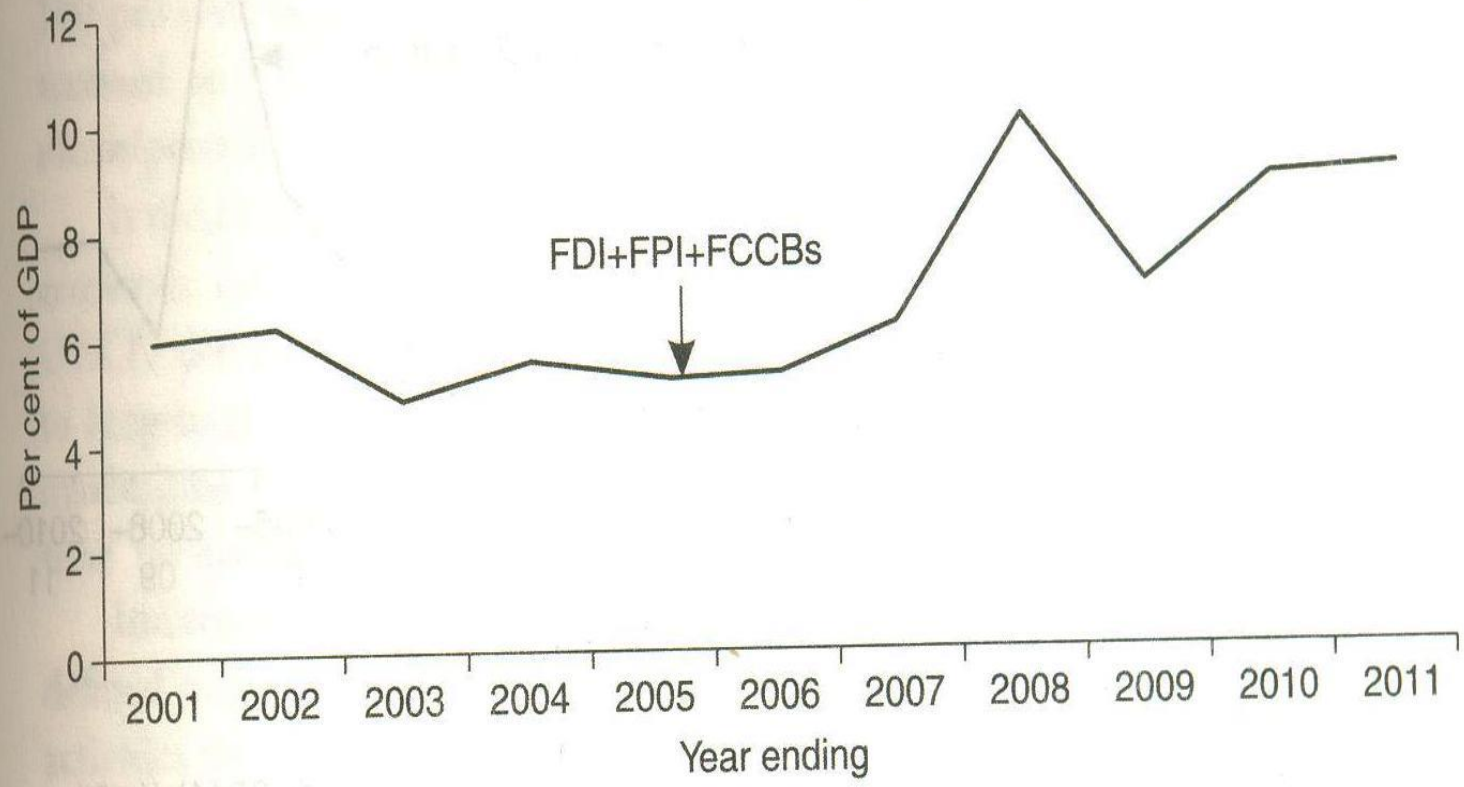

% with Total FDI inflows(+)
45
40
35
30
25
20
15
10
5
0
MAURITIUS
SINGAPORE
U.S.A
UNITED KINGDOM
NETHERLANDS
JAPAN
CYPRUS
GERMANY
FRANCE
UAE
% with Total FDI inflows(+)

FIGURE 6.10: Foreign capital inflows (1991–2011)



Source: *Handbook of Statistics on Indian Economy, 2011–12* (RBI).

FIGURE 6.11: Foreign capital inflows as a proportion of GDP (2001–11)



Source: *Handbook of Statistics on Indian Economy, 2011–12* (RBI).

Trends

- From the data, we understand that total FDI flown so far on Oct 2010 stands at $232 bn. Compared to $2 bn in 1990, we are in a comfortable situation. India and China are exceptions compared to rest of the developing countries which are net exporters of FDI while we are net recipients.
- The sectors that attracted FDI in India are electronic equipment, transport industry, service sector, telecommunications, fuel and power, food processing, drugs and pharma.
- 44% of FDI has come from Mauritius route, 8 % from US and 20 % from EU. Service sector in 2008-09 received 22% which is highest, computer hardware 12%, telecom 8%, construction 6%, real estate 6%, automobiles 4%.
- Mumbai received 33.5 %, New Delhi received 16.5%, Ahmedabad 6.87%, Bangalore 6.8%, A.P received 4.4%.
- The composition of FDI is 72% is long terms FDI, 2.5 % portfolio investment, 22% reinvested earnings, 2.5 % in other capital.
- FDI inflow between 1991-01 was meagre, but later on it increased at exponential rate.

India-China Comparison

- India did not receive FDI as much as China did. But in last five years, we received phenomenal inflows. From 2007-08 India received $ 32 bn when China received 45 bn. There are now similarities between India and China, in China's real estate is flooded by FDI. India too opened up.
- But China attracted lot of FDI into its manufacturing sector, where as India had a major share in services and real estate.
- Do countries that receive large inflows of FDI grow faster? Evidence is ambiguous. China is an example of success, Brazil is otherwise, where much of the FDI has gone into acquiring financial control of firms. In India, share of FDI in fixed capital formation is 2-3 %, much of GFCF is domestic. Yet contribution of FDI to growth cannot be denied.

FDI in India: Some Assessment

- Much of the FDI arrived into consumer goods markets such as electronics, hardware, automobiles, washing machines etc. The consumer choice has certainly widened.
- There was an apprehension initially that it would wipe out domestic firms, but in practice while some Indian firms disappeared but many became strategic partners and even competitors. On other hand, many consumer goods industries are reportedly running below their capacity, given the narrow market which easily gets saturated.
- FDI has finally contributed to accumulation of foreign exchange reserves. For quite some time many foreign firms did not bring much money instead started raising money from Indian market. This could be dangerous, which will ultimately lead to capital flight.
- FDI has not contributed much to growth of exports in India, evidence shows that FDI supported firms share in exports did not cross even 10 per cent. So they are aiming at Indian market.

- There is a large discrepancy between approval and actual. Bulk of the approvals is for infrastructure, telecom, automobiles and consumer durables; very little has gone into capital goods.
- In Telecom sector, more FDI is spent on imported equipment rather than on the manufacturing of the same.
- Much of the FDI has come into fully owned subsidiaries, whose patents are registered abroad. Most of them have not issued IPOs
- Larger share of funds are used for acquiring control rather than on capital formation.
- 42% of FDI has come to acquire managerial control over domestic firms (which can appear better than Brazil where it is 70%), 28% has come as portfolio investment. Only about 40% of FDI is of long terms in nature. There has been lot of mergers and acquisition activity since 1999.

- Whether FDI brought technology and caused technological spill-over is another issue. There is evidence that FDI has created some competition in some sectors, in some others not. This has created wider choice.
- In Automobiles, many firms like Hyundai and Ford have set up assembly units, they ship CKD kits and SKD kits. Later in recent times they set up complete production units.
- In several consumer goods, foreign firms have resorted to contract out actual production which gives some expertise to domestic companies.
- There is also evidence about a decline in competition due increased spurt in mergers and acquisitions. Overtime, specially in the recent times there has been a steady price escalations in several non-durables, due o monopolisation of industry.
- FDI role in creating employment is not very remarkable, since much of it came into capital intensive sectors.
- Overall, we can conclude that it eased out FE position, did not improve our exports, brought capital formation, evolved partnership, helped growth but not employment.

Recent Studies

- A Unit level study of 83 firms from Prowess data in India for 1991-2015, by Swati Verma (2015) in EPW showed that the net foreign exchange contribution after accounting for imports, foreign expenses etc is negative. She has reported that her data suggests that FDI has contributed to worsening of current account deficit.
- The persistent negative net impact on BoP is observed from technology intensive industries since 2003. A net outflow of FE from developing countries is observed from several international studies (Lall 1978; Smits 1988; Jansen 1995; Chudnovsky and Lopez 2004).
- G D Sandhya ,N Mrinalini, Pradosh Nath Vol. 49, Issue No. 30, 26 Jul, 2014 in EPW study noted that FDI has chased high growth areas rather stimulating low growth sectors like IT, auto, and pharma. They observed that FDI made use of infrastructure and human capital. Technology is brought only after ensuring patent protection.
- Mondal & Pant (2015) study indicated that while there is improvement in efficiency of firms, there is no positive change in R & D expenditures of domestic firms, who are becoming junior partners to Foreign firms by providing sales networks and production facilities.

Recent policy initiatives

- FDI is allowed virtually in all sectors of manufacturing except defence production.
- FDI in infrastructure did not take off, after a Enron fiasco. US is pressing to open up in nuclear power.
- Of late, there is increasing clamour to open more areas open for FDI, such as retail sector, agriculture, education, legal services, newspaper, health, insurance etc.
- Allowing FDI in retail can seriously affect small vendors and shop keepers. This is expected to increase investment in cold storages, supply chains etc, but can draw huge margins. It is not proved that retail trading is no longer profitable in India.
- FDI in education

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- Mondal and Pant (2015)
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Fiscal Consolidation in Post-Reform Period: Issues and Perspectives

Perspectives on Fiscal Imbalances

- Cropping up of fiscal imbalances between government revenues and expenditures since 1980s has been a sustained problem in Indian economy.
- Targets on fiscal deficits have been fixed by respective Finance Commissions and we also have a legislation, FRBM Act 2005, attainment of fiscal deficit targets has been a sacred goal.
- According to Neoliberal view, fiscal deficit leads to monetisation of debt, hence inflation, eroding real interest rate. This reduces investment and hence growth. This has no firm theoretical basis, but is founded on an empirical estimates for US, in India the evidence is always is in contrast, fiscal deficits only have a positive correlation with GDP growth, of course with inflation.
- Inflation, India has been a structural phenomenon, emanating from foodgrain prices, rather than demand-pull. Yet the establishment view is fiscal deficits are decried as undesirable and unsustainable.
- A related concern is the share of resources appropriated by the public sector. There is a view that downsizing government is an important part of fiscal restructuring.

Demonising Public Debt ?

- 11th Finance Commission argued to bring down FD from 9-8 % to 5-6%, and public debt-GDP ration from 65.2 % to 55%. 12th FC reduced the target to 3%, but due to 2008 crisis they could not, given the tax concessions that were given to the industry.
- It is important to have a clear idea about why fiscal scenario is worrisome and requires what sort of correction. It is important to understand the alternative modes of fiscal adjustment, it may still be arbitrary to fix any target without proper basis.
- Is it that the public debit-GDP ration really at uncomfortable level? Does it pose solvency problem to the solvency of the Treasury and viability of the economy?
- From a purely accounting view point public debt does not constitute any net liability of the economy as a whole, why because since financial assets are held by the rest of the economy exactly offset government debt. It is not like an individual debt.
- Even a large transfer in the form interest payment do not erode the community's consumption ability or investment ability. They why does this becomes issues of worry?
- 3 issues: the burden of public debt; will FD lead to high debt-GDP ratio?; and what are the bad effects of public debt?

Burden of Public Debt

- One reason is the when interest payments are very large, transfers to holders of government securities from the rest of the community can have an adverse impact on income distribution. Second, given the rates and structure of taxes, large interest payments simply mean a higher ratio of private disposable income to GDP. This may encourage private consumption at the expense of capital accumulation and provision of public goods and services. Wealth effect can lead to greater distortionary impact on the use of available goods and services.
- These adverse effects of large public debt can be outweighed by appropriate taxation. But taxes themselves may cause distortions in efficient allocation of resources.
- When governments are not able to raise adequate revenues public debt ratio can pose difficulties. You are raising present consumption to the loss for future generations. Hence comes the question of sustainability. Can the government resort to borrowing to meet consumption expenditure and interest payments?

Canonical views on sustainability

a) For any tax-GDP ratio, sustainability condition of borrowing is **interest rates on govt debt should be less than nominal GDP growth rate.** When this condition is satisfied, in spite of public debt, revenue deficit and interest payment rising over time, their ratios to GDP stabilise in long run.

b) Lowering of tax or enhancement of debt-financed govt consumption raises the long-run values of public debt-GDP and other ratios, but do not alter the sustainability condition (i.e., GDP rate> interest rate).

c) Under the canonical scenarios one need not worry about the govt's `inability' to provide some essential public services on account of high interest payments-tax collections, associated with large public debt. It can and not only provision of basic services but even the interest payments through borrowing, it only requires the sustainability condition to hold.

Some Caveats to this Model:

- An important problem with the canonical model is that it assumes the interest rate and growth rate to remain unaffected irrespective of the govt's fiscal stance – a difficult one. Larger interest rates are offered to attract public borrowing.
- At a given tax-GDP ratio, larger interest payment implies a larger disposable income-GDP ratio, this tends to raise consumption at the expense of investment, the growth rate of GDP gets reduced. It also can be shown that a large public consumption-GDP ratio larger than some critical value, public debt becomes unviable without increasing tax-GDP ratio. Critical values is given by r/y. As long as Public Consumption/GDP ratio exceeds r/y, borrowing is unsustainable.
- However, an increase in consumption need not have an adverse impact on the growth rate when the economy has excess capacity. In the neoclassical model, growth rate is independent of investment, but this is in a very long run; in the medium run investment does raise growth rates, even the endogenous theory of growth established this Harrod-Domar result.

- **Other Caveats:** Instead of debt-GDP ration, if the debt-private income is considered, the govt can factor-in the distortionary effects of taxes more realistically and works out a more reasonable ratio for sustainability. Here the growth rate should exceed the post-tax interest rates for borrowing to be viable.

Central Bank Holdings of Govt Securities

- It is commonly held that public debt refers to all financial liabilities of the govt, including that of Central Bank. But while examining the sustainability, govt securities held by central bank should not be counted, because it is an organ of the govt. Nor the interest payment to it. In India securities held by RBI were not insignificant, even though over period these have undergone.

Liabilities and Assets

- In developing economies, state is a development state; liabilities here also creates some assets. When borrowing meets some capital expenditure alone –how does the sustainability condition alters?
- Now the sustainability requires, the income growth rate to exceed the interest rate less returns on the assets. Loan financed capital expenditure should lead higher growth, hence lower debt-GDP ratio.
- But when borrowing meets capital expenditure + part of public consumption (public goods)+interest payments, the sustainability condition requires growth rate to exceed the (post-tax) interest rate minus returns on the assets.
- Even when borrowing is used to finance consumption and investment, the composition becomes important for its implications for the growth outcome. Cost of borrowing will in the long run be a weighted average of (a) post-tax interest rate and (b) the post-tax interest rate minus the return on government investment. Larger proportion spent on investment, lesser will be the cost.

Borrowing, Crowding-out & Crowding-In Effects

- Normally we may expect that when debt financed govt expenditure will raise interest rates and this would crowd-out private investment. However, if the economy operates with excess capacity, debt-financed demand, capacity utilisation, profits – all rise, as an expansionary policy can raise the GDP.
- What about the interest rate effect? First, crowding-in can materialise despite an increase in interest rates, second, interest rate effect depends on what kind of govt expenditure is in place. Third, most important, crowding-out argument usually ignores the increasing role played by the financial markets, i.e., stocks, mutual fund, pension fund etc. When expansionary fiscal policy improves investment sentiment, there will be an increase in the supply of funds in spite of debt financing of govt. So long economy has an excess capacity, govt expenditure is supported by borrowing, may thus raise private capital formation along with household expenditure.

- Once the economy has attained full employment, any increase in consumption or investment, no matter how it is financed will reduce private absorption. At full employment (a)both private consumption and private investment will decline, (b) higher the debt-reliance, larger the fall in private investment; (c) yet, the public investment will outweigh a fall in the private investment.
- However, the outcome depends on the composition of govt expenditure to improve infrastructure, education, health, law & order, administration will raise profits and aggregate demand.
- So far as the model financing is concerned, the use of SLR may produce some crowding-out effects. But monetised deficit raises aggregate flow of finances, this can create crowding-in effect.
- So net effect is therefore contingent on so many factors.

Fiscal Deficit: some unlearning

- Fiscal deficit as defined in India, is a gap between the aggregate expenditure and the sum of revenue receipts, proceeds from disinvestment in public sector undertakings, recovery of past loans and other non-debt creating receipts. The problem with this definition is that this clubs various kinds of expenditure and revenues which do not have the same implications for sustainability of a budgetary program.

Different Sources of Borrowings can have different effects:

- We already mentioned, govt securities held by central bank should not be regarded as part of public debt and since monetised debt produces crowding-in effect. Likewise, monetised deficit also does not lead to any interest burden, in a growing economy up to a point, it does not produce any inflationary impact. Thereby, fiscal deficit by itself does not indicate the extent or even a sign of crowding-out effect.

Disinvestment Path

- Much more misleading is the treatment of public sector undertakings and recovery of loans on the same footing as tax collections. When PSU shares are sold or recovers the past loans there will be some pressure on financial markets, it need not be different than public debt effect – i.e., crowding -in or -out effects.
- Second, unlike tax receipts, non-debt creating receipts like disinvestment proceeds reduces earnings of the govt by way of interest and dividends. From the viewpoint of budgetary viability, there can thus be a doubt that reduction of fiscal deficit through disinvestment cannot but be worse than tax financing. This is not to deny the chance of disinvestment backed by change in management, incentives and work environment in PSUs to contribute to budgetary viability. But such measures do not necessarily need disinvestment. The first best option certainly not be through disinvestment.
- The disinvestment in PSUs is indeed related to political economy of resource ownership rather than efficient use of resources.

Reduction of Govt Expenditure

- The three components of public expenditure, i.e., consumption, investment and transfers –all these have different implications for future receipts of govt. It is not aggregate expenditure, but it's composition is what matters. Reduction of capital expenditure than revenue expenditure is bad for GDP growth. Reduction of revenue expenditure to reduce revenue deficit means govt running away from its basic duties.

Budgetary Objectives with and without Tax Constraint:

i. Optimum distribution of full employment output between consumption and investment.
ii. Optimum balance between households and public investment
iii. Optimum division between private and public investment
iv. Equitable (post-tax) income distribution.

Budgetary Implications of these Objectives

a) An equitable distribution of income implies an optimum tax-transfer, presumed when marginal benefit on consumption, investment and private consumption are equal.

b) Govt revenue expenditure (defence, law&order, public goods etc) are to be fixed at a level where MSB=MBPC

c) Equi-marginal principle should also apply in division of aggregate investment between the public and private sectors. This requires optimal taxes and subsidies securing optimal composition.

d) All govt consumption expenditure and transfer payments should be met from revenue receipts (no revenue deficits) and public investment be met through borrowing. The test book principle instructs govt to target a zero revenue deficit and a fiscal deficit no more no less than optimum level of public investment plus net subsidy on public investment.

e) Non-tax sources: monetised deficit in limits has no interest implications, so under severe tax constraint this can be resorted to.

f) Borrowing from public: borrowing at lower interests through open market operations, rather than SLR, are useful.

g) Restructuring Govt Expenditure: many times emphasis is placed on capital expenditure reduction. But one should consider those which have positive externalities. It is easier to tax income generated though public investment than private investment.

Income Inequality and Poverty

- The above mentioned ways of budgetary borrowing can have positive effects on income inequality and poverty.
- In India studies have shown that poverty reduction has high correlation with improvement of agriculture, employment and education. Govt expenditure has a close relation with these. Food and fertiliser subsidies and farm credit tend to raise food grain output and reduce foodgrain prices. Social development has tremendous indirect effects.
- The current and capital expenditure for poverty elimination are larger than what is suggested under the first best solution. But the positive externalities support this approach.
- Larger expenditure on agriculture and poverty alleviation violates slightly the first best principles of allocative efficiency and loss to some GDP.

Changed Fiscal Stance in India

- **At the first sight, India's fiscal stance did not show any such alarming situation of creating domestic debt trap, neither before reforms nor later. The public debt-GDP ration remained around 65% for two decades between 1981-00, during 2005-10, it is brought down to 48%.**
- **[US has 119%, Portugal 95%, France 85%, UK 81%, EU 82%, Japan 220%, Greece 112%, Iceland 109%, Singapore 92%]**
- **Fiscal deficit remained as high as 10% in 1991, hovered around 8-9% during 1991-00, is also brought down to less than 3% in 2005-7, but went up slightly to 6.8% in 2010, due to 3G auctions bought down to 4.8%.**
- **Crucial condition of sustainability of deficit financing, ie., nominal growth rate always is at 14% safely above interest rate (10%). Hence sustainability is a non-issue.**
- **Before jumping to this conclusion, we should look at some parameter more carefully.**

Post-reform Fiscal Stance

- **Since 1995 public debt-GDP ratio was brought down but went up again during 2005-10.**
- **The public debt less RBI holdings of securities, call it Public Liability has showed a steep rise in 1990s, as RBI credit to govt became even negative.**
- **Moreover, the govt's Incremental Financial Liability less monetised deficit, (call it Fiscal Gap, which represents the increase in govt debt plus reduction in financial assets – a better measure than fiscal deficit). During 1991-98 fiscal deficit showed a downward trend, but fiscal gap increased. Thus contrary to widely held belief that reduction of FD per se did not contribute to the fiscal health of the economy.**
- **The fiscal deficits were rather harshly reduced during 1991-97 and 2000-08, mostly by reducing capital expenditure and disinvestment, because of which the interest burden increased. Capital expenditure is brought down from 6.8% to 1.6% in 2009-10.**
- **The revenue deficits went down much more slowly, hovered around 4% during 1991-00, went upto 6.8% during election years, but were finally brought down to less than 2 %. The interest burden has increased in 1990s and has come down during 2005-10.**

- The saving grace is that nominal GDP always remained above interest rate. But this is not good enough.
- The tax-GDP ratio has gone down from 20% to 16% during 1991-05. This shows a falling tax buoyancy in India.
- Even the primary deficit that rose in 1991-00 to 4% is brought down to negative figure in 2006, even though went up during 2008-10.
- With a falling tax-GDP ratio, means increase in disposable income (of the rich by double), and fall in fiscal deficits achieved by a 5% cut in capital expenditure-GDP ratio suggests a highly unequal fiscal stance taken during the reform period.
- Government has lost its teeth to address issues like eduction, health and agrarian distress since it has committed to reduce its revenues along with revenue expenditure, a much needed sacrifice for `fiscal restructuring'.

TABLE 5.1

Fiscal Profile of the Indian Economy (figures, unless specified otherwise, are as percentage of GDP)

	1990–1	1991–2	1992–3	1993–4	1994–5	1995–6	1996–7	1997–8	1998–9	1999–2000
Revenue receipts	19.7	20.7	20.3	18.0	18.5	18.4	18.1	17.9	16.2	17.8
of which										
Interest, profit, and dividend receipts	1.3	1.8	1.6	1.5	1.3	1.2	1.4	1.4	1.4	
Revenue expenditure	24.2	24.2	23.6	22.3	22.1	21.6	21.7	22.0	23.2	23.2
of which										
Interest payments	4.7	5.0	5.2	5.0	5.2	5.0	5.1	5.1	5.2	5.7
Social sector expenditure	7.7	7.5	7.3	7.2	7.1	7.1	6.8	7.1	7.3	5.1
Capital receipt	8.7	8.4	7.0	7.7	8.9	6.7	5.6	8.1	9.3	8.5
Fiscal deficit	10.0	7.4	7.4	8.3	7.1	6.6	6.4	7.3	8.9	9.9
Primary deficit	5.3	2.4	2.3	3.3	1.9	1.6	1.3	2.2	3.7	4.2
Monetized deficit	2.8	0.8	0.6	0.1	0.2	1.7	0.2	0.7	1.0	–0.2
Public debt[1]	65.5	64.5	64.1	65.4	63.3	61.5	60.0	62.1	62.0	65.1
Public debt held by RBI	16.6	15.2	13.9	11.6	10.0	10.3	9.1	8.9	8.7	7.7
Interest cost of government borrowing (per cent)[2]		8.8	9.2	9.5	9.3	9.2	9.7	9.5	9.9	
Incremental return on government capital disbursement (per cent)[3]		11.8	6.3	5.6	4.1	3.9	5.1	4.7	4.9	
Memo Item										
Nominal GDP (growth rate)	15.7	14.5	15.4	14.4	17.9	15.0	13.9	9.8	13.7	

Sources: Government of India (2000), Reserve Bank of India (2000, 2000a, 2000b).

Notes: Figures are for Central and state governments taken together.

[1] Public debt includes internal and external debt and other liabilities. Other liabilities comprise small savings scheme, PFs, and Reserve Funds and Deposits.

[2] Interest cost of government borrowing of a year = Interest payment of the current year/public debt at the end of the previous year.

[3] Incremental return on government capital disbursement = Change in interest, dividend, and profits as % of cumulative capital disbursement, both from 1990–1 till the year concerned.

TABLE 5.2

Indicators of Fiscal Sustainability—1990–2000 (figures, unless specified otherwise, are as percentage of GDP)

	1990–1	1991–2	1992–3	1993–4	1994–5	1995–6	1996–7	1997–8	1998–9	1999–2000
Public debt	65.5	64.5	64.1	65.4	63.3	61.5	60.0	62.1	62.0	65.1
Fiscal deficit	10.0	7.4	7.4	8.3	7.1	6.6	6.4	7.3	8.9	9.9
Nominal GDP growth rate	15.7	14.5	15.4	14.4	17.9	15.0	13.9	9.8	13.7	
Interest cost of government borrowing		8.8	9.2	9.5	9.3	9.2	9.7	9.5	9.9	
Growth–interest differential		5.7	6.2	4.9	8.6	5.8	4.3	0.3	3.8	
Public liability[1]	48.9	49.2	50.2	53.8	53.3	51.2	50.9	53.2	53.4	57.4
Incremental financial liability (IFL)[2]	10.8	9.5	8.5	9.1	8.5	7.3	7.1	8.0	9.6	
Fiscal gap[3]	8.0	8.7	7.9	9.0	8.3	5.6	6.9	7.3	8.6	
Revenue deficit	4.5	3.6	3.4	4.2	3.7	3.2	3.6	4.1	6.3	6.7
Capital expenditure	6.4	5.9	5.1	4.8	4.9	4.1	3.6	3.9	3.9	
Capital expenditure as percentage of IFL	58.8	62.6	60.5	53.0	56.9	55.9	49.8	48.4	40.4	
Net interest cost of government borrowing[4]		5.2	5.4	6.5	7.0	7.0	7.1	7.3	8.0	
Growth–net interest cost differential		9.3	10.0	7.9	10.9	8.0	6.8	2.6	5.7	
Non-interest revenue receipt[5]	18.5	18.9	18.7	16.5	17.2	17.2	16.7	16.5	14.8	
Primary gap[6]	3.3	3.6	2.7	3.9	3.1	0.6	1.8	2.2	3.4	

Sources: Government of India (2000), Reserve Bank of India (2000, 2000a, 2000b).

Notes: [1] Refers to public debt and other liabilities net of public debt held by RBI.

[2] Incremental financial liability = capital disbursement + revenue deficit.

[3] Fiscal gap = incremental financial liability – monetized deficit.

[4] Net interest cost of government borrowing = Weight of capital expenditure × (interest cost – interest return) + weight of revenue deficit × interest cost.

[5] This is the difference between revenue receipts and interest, profit, and dividend receipts.

[6] Primary gap = fiscal gap – interest payments.

Item 1			Average 1990-00	Average 2000-01 to 2008-09	2004-05	2005-06	2006-07	2007-08	2008-09
Central Government Finances (% of GDP)									
a)	Total Revenue Receipts		9.2	9.9	9.7	9.7	10.5	11.5	10.6 RE
b)	Total Expenditure		16	15.7	15.8	14.1	14.1	14.3 **	16.9 RE
c)	Revenue Deficit		3	3.2	2.5	2.6	1.9	1.1	4.5 RE
d)	Fiscal Deficit		5.9	4.7	4	4.1	3.4	2.7	6.1 RE
e)	Net RBI Credit to Centre		0.7	-0.5	-1.9	0.8	-0.1	-2.5	3.3 RE
f)	Interest Payments		4.2	4.2	4	3.7	3.6	3.6	3.6 RE
g)	Domestic Debt		48	58.5	61.4	60.4	59	57.7	56.6 RE

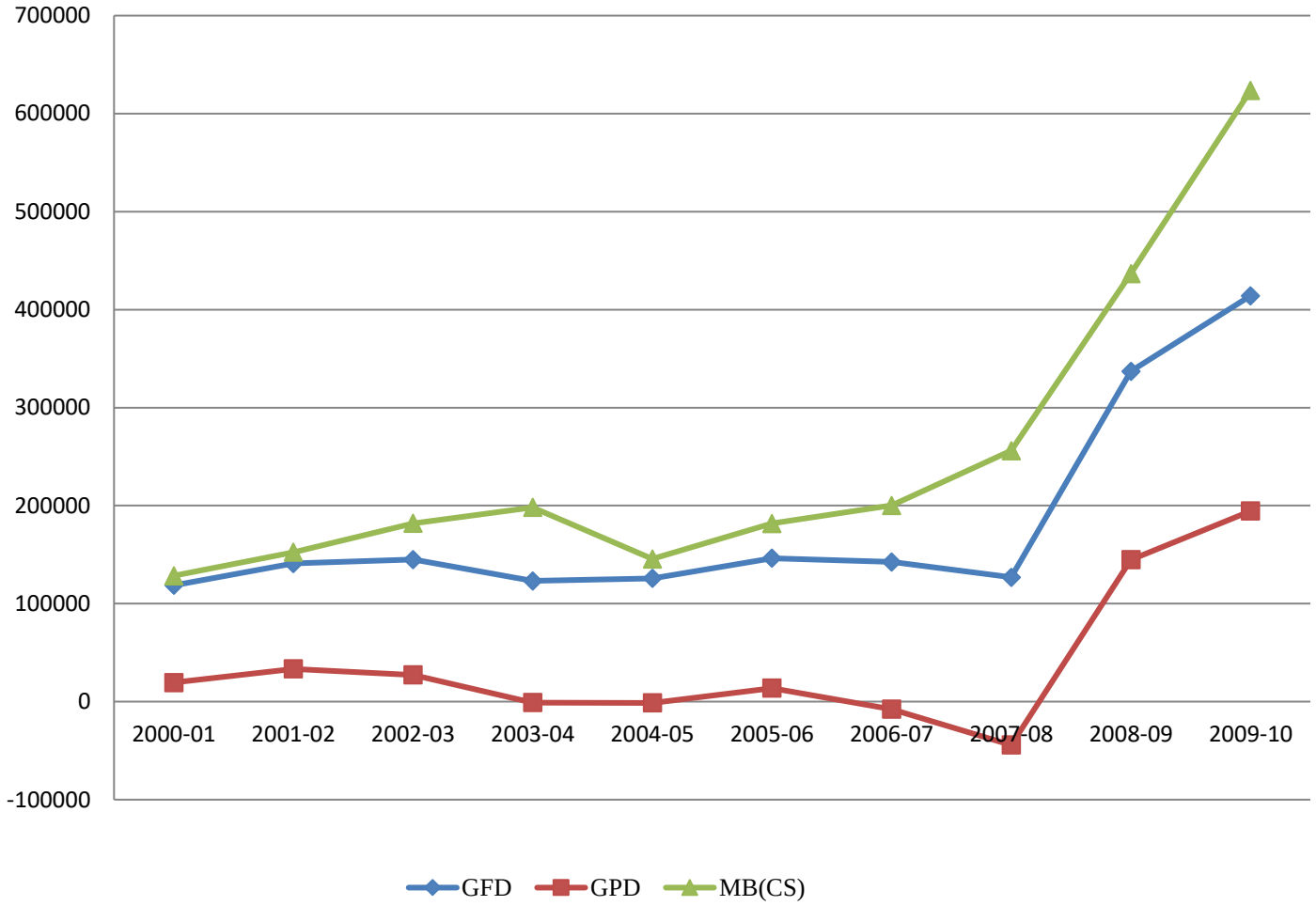
Table 3.2 : Receipts and expenditure of the Central Government

	2004-05	2005-06	2006-07	2007-08#	2008-09 (B.E.)	2008-09 (Prov.)	2009-10 (B.E.)
				(As per cent of GDP)			
1. Revenue Receipts (a+b)	**9.4**	**9.4**	**10.1**	**11.0**	**11.4**	**9.8**	**10.0**
(a) Tax Revenue (Net of States' Share)	6.9	7.3	8.2	8.9	9.6	8.0	7.7
(b) Non-tax Revenue	2.5	2.1	1.9	2.1	1.8	1.7	2.3
2. Revenue Expenditure	**11.9**	**11.9**	**12.0**	**12.0**	**12.4**	**14.2**	**14.6**
of which:							
(a) Interest Payments	3.9	3.6	3.5	3.5	3.6	3.4	3.7
(b) Major Subsidies	1.4	1.2	1.2	1.4	1.3	2.2	1.7
(c) Defence Expenditure	1.4	1.3	1.2	1.1	1.1	1.3	1.4
3. Revenue Deficit (2-1)	**2.4**	**2.5**	**1.9**	**1.1**	**1.0**	**4.4**	**4.6**
4. Capital Receipts	**5.9**	**4.3**	**3.5**	**3.5**	**2.8**	**6.0**	**6.6**
of which:							
(a) Recovery of Loans*	1.9	0.3	0.1	0.1	0.1	0.1	0.1
(b) Other Receipts (Mainly PSU Disinvestment)	0.1	0.0	0.0	0.8	0.2	0.0	0.0
(c) Borrowings and Other Liabilities $	3.9	4.0	3.3	2.6	2.5	5.9	6.5
5. Capital Expenditure**	**3.5**	**1.8**	**1.6**	**2.4**	**1.7**	**1.6**	**2.0**
6. Total Expenditure [2+5=6(a)+6(b)]	**15.4**	**13.6**	**13.6**	**14.4**	**14.2**	**15.8**	**16.6**
of which:							
(a) Plan Expenditure	4.1	3.8	4.0	4.1	4.6	4.9	5.3
(b) Non-Plan Expenditure	11.3	9.9	9.7	10.3	9.6	10.9	11.3
7. Fiscal Deficit [6-1-4(a)-4(b)]	**3.9**	**4.0**	**3.3**	**2.6**	**2.5**	**5.9**	**6.5**
8. Primary Deficit [7-2(a)]	**0.0**	**0.4**	**-0.2**	**-0.9**	**-1.1**	**2.5**	**2.8**
Memorandum Items				(Rs crore)			
(a) Interest Receipts	32,387	22,032	22,524	21,060	19,135	20,556	19,174
(b) Dividend and Profit	15,934	18,549	18,969	21,531	24,758	20,653	19,340
(c) Non-Plan Revenue Expenditure	2,96,835	3,27,518	3,72,191	4,20,861	4,48,351	5,56,521	6,18,834

Source : Union Budget documents.

 # Based on Provisional Actuals for 2007-08

Chart E India: Fiscal Deficit, Primary Deficit and Market Borrowings (in Rs crore)



Concluding Remarks

- For a given tax-GDP ratio, sustainability of debt financing depends on whether GDP growth is higher than the interest rate, also on composition of government expenditure, mode of financing, return on government's capital expenditure, extent of monetized deficit.
- Fiscal deficit is too hybrid concept and not give clues about sustainability of debt financing.
- In countries with large preexisting pubic debt and low growth rate, sustainability is an issue.
- Though Indian scenario does not suggest that we are heading towards an internal debt trap. In nineties, aggregate investment demand stagnated, tax-GDP ratio declined with a fall in public investment and rise in revenue deficit. During 2014-16 too investment stagnated, with no significant FDI coming. Reduction of public investment, reduction of fiscal deficit and public debt are mechanically followed.
- Considerable room exists on boosting public expenditure by raising tax-GDP ratio, resorting to moderate deployment of SLR, greater reliance on monetized deficit.

Readings

- Mihir Rakshit “Perspectives on Correcting Fiscal Imbalances in Indian Economy” in **Money and Finance in the Indian Economy**, Selected Papers, vol.II, Oxford University Press, New Delhi, 2009.
- Economic Survey 2009-10.

Public Sector Performance: Issues and Perspectives

Public Sector Performance

- The public sector in India defined in its broadest measure accounts for roughly around 25% of GDP. It increased from a mere 10% in 1960-61 to a quarter now.
- The GVA of administrative departments (what Adam Smith called sovereign duties), like law and order, general administration, defence, health, education) accounts for 8-9%.
- Natural monopolies like railways, postal system (called Departmental enterprises) account for 3-4%.
- Non-Departmental Enterprises, which are often referred as public sector enterprises (like BHEL, SAIL, ONGC, Banks, etc) account for 12-13 %.
- NDE can be divided into financial and non-financial services.
- Public sector provide for 65% of country's organised employment in 2010. It used to be 80% before reforms.

Different Perspectives

- This large share or contribution of PSUs to output and employment attracted attention from diverse quarters, the critiques raising an issue that there is no need for government to run hotels, airlines and textile mills, these are clearly private goods and state does not have a capacity to run profitably. Inefficiency is seen as emblematic of PSUs, state support to PSU has contributed to large fiscal imbalances and balance of payment problems (Tendulkar & Bhavani, Bhagawati, Joshi &Little etc)
- There are others who argue that , given the historical circumstances, state role was the only option for a rapid industrialisation, creation of employment. The public sector played a great complimentary role for development and still has wide and deep role to play for a stable and equitable growth.
- Without denying of any of these arguments, there are positions that take a view that public sector presence is desirable in strategic sectors on even some non-economic factors, and evolve institutional mechanisms to manage the conflicting aims such as making PSUs viable and at the same time making them immune from political interference. Many options like setting up holding companies, disinvestment, signing MoUs with management are tried with varying degrees of success.

- Since 1990s, public sector expansion is stalled with missionary zeal, many of state and central level PSU were closed down, those which are running with profits, their equity is sold in the stock markets. A corporate discipline is contemplated with change in the ownership profile, with a tacit prospect of eventual handing over of them to private market. However, experience and political expediency seem to have changed the stance to `private-public partnership'.

Performance of PSUs: A Factsheet

- Since Independence, the output of PSUs as a share of GDP has peaked in 1991-92 at 26.1%. More or less remained thereon.
- The output of PSUs, has particularly grew faster during 1978-92, gone up from 15% to 26%, suggesting that it has significantly contributed in accelerating the GDP growth in those years. In spite of growing import competition and industrial deregulation, public sector maintained its share in the output.

PSU performance

- In contrast, the public investment, after peaking in 1986-87 at 12.5 %, is halved to 6.4% in 2001-02, taking the ration back to 1950s level.
- Its indisputable that for 20 years, public sector managed to deliver roughly an unchanging share of output even when its investment share is drastically going down.
- Corroborating this evidence, the ACOR has declined from 7 in 1981-82 to 4.4 in 2002-03, suggesting an increase in productivity.
- A decline in ACOR mean a shift in investment to less capital-intensive activity, but the share of infrastructure (mining, power, gas, water, transport and communications) – which is capital intensive essentially, its share has increased from 33% in 1974-75 to 53.5 % in 2001-02, hence ACOR decline is genuinely due to increased efficiency, not by design.
- This is also consistent with findings on increased total factor productivity and – an increased output with decline in investment and employment, what Liebenstein called in X-inefficiency – has declined.

Figure 1: Public Sector's Share in Output and Investment

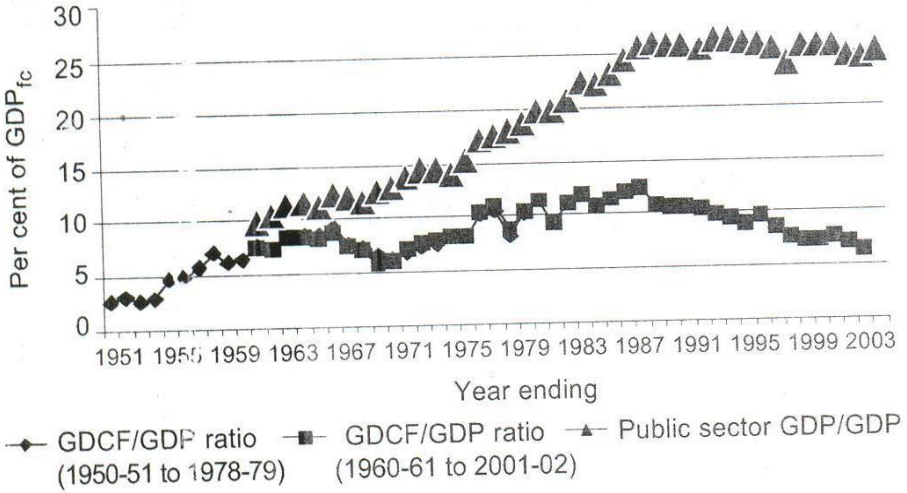


Figure 2: Composition of Public Sector Output

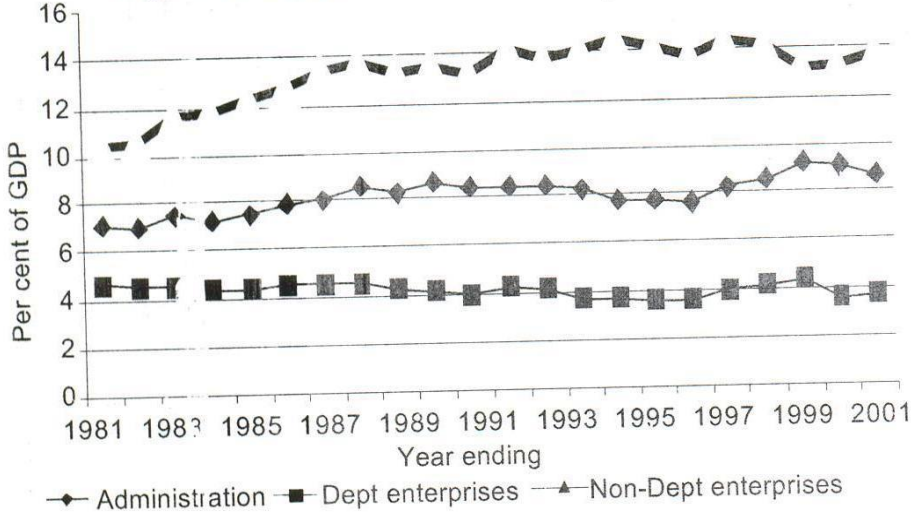


Figure 3: Average Capital-Output Ratio

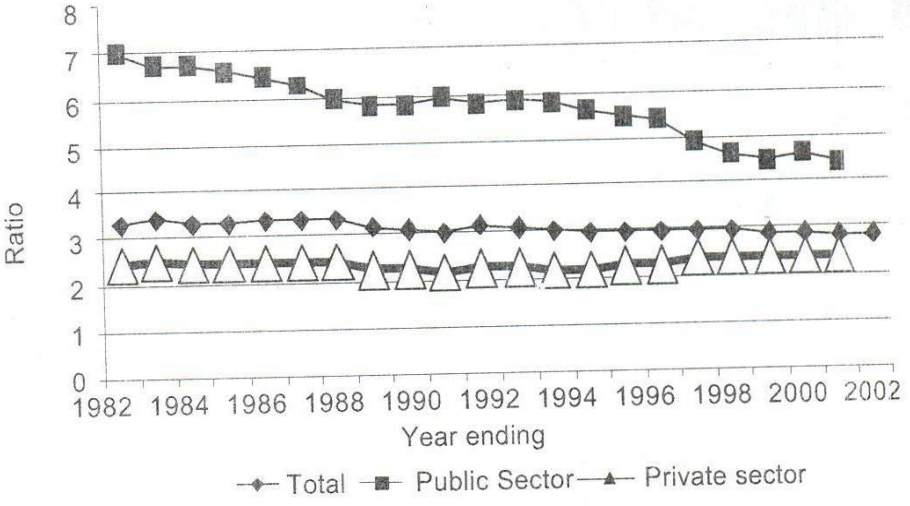


Figure 4: Composition of Public Investment

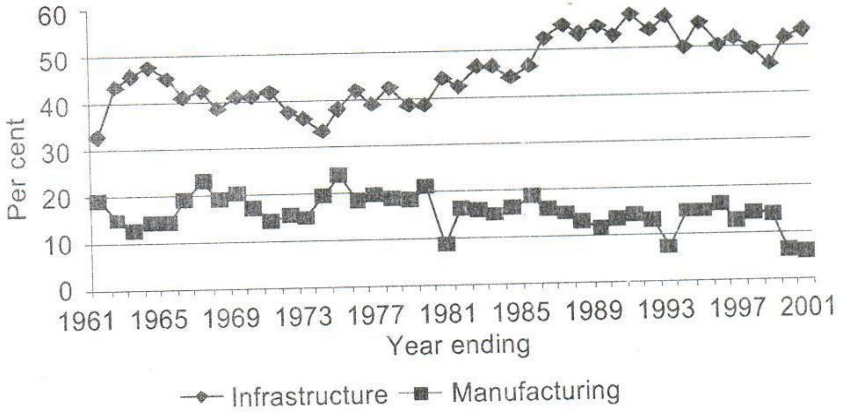


Figure 5: Infrastructure's Share in Public Sector Output

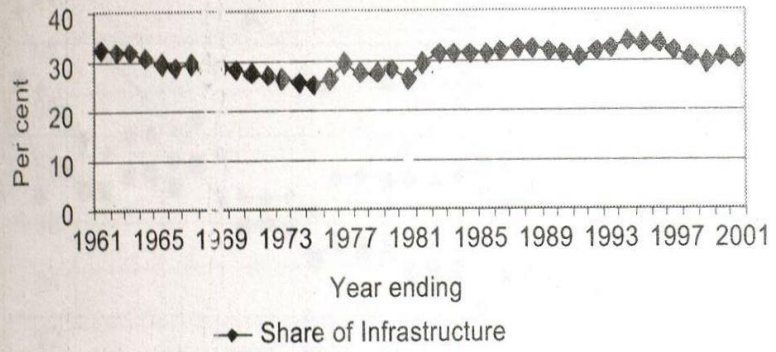


Figure 6: Manufacturing Sector Share in Public Sector Output

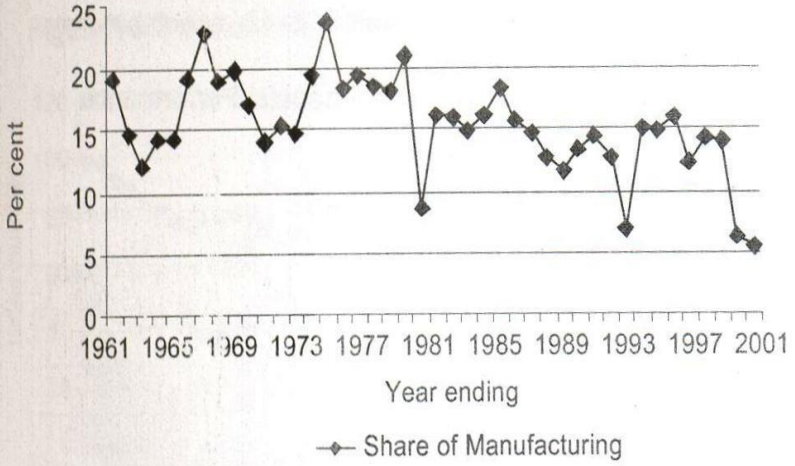


Figure 7: Public Sector Employment Growth

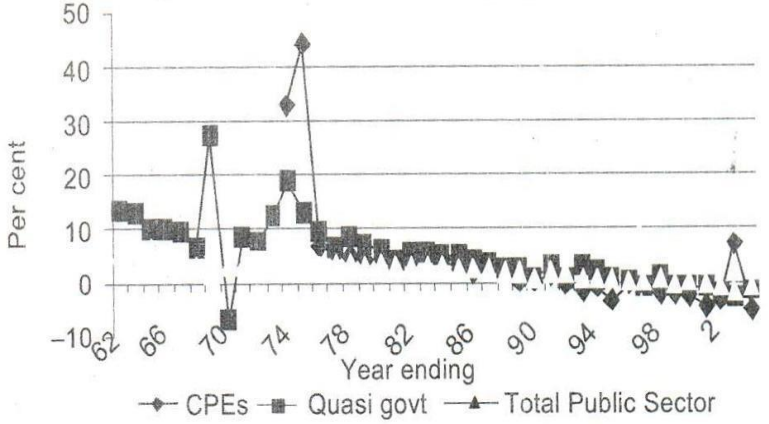
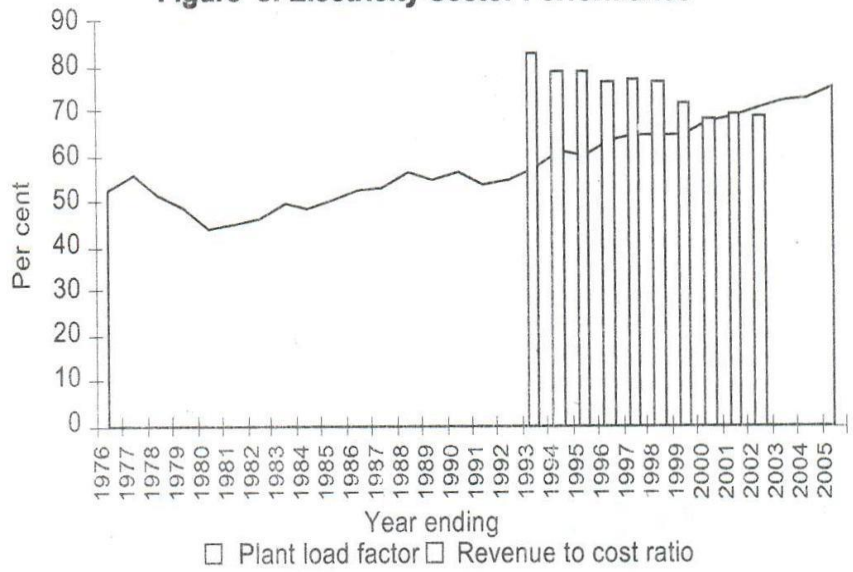


Figure 8: Electricity Sector Performance



3.1 : EMPLOYMENT IN ORGANISED SECTORS—PUBLIC AND PRIVATE

(Lakh persons as on 31 March)

	1991	1995	2000	2001	2002	2003	2004	2005	2006	2007	2008
1	2	3	4	5	6	7	8	9	10	11	12
PUBLIC SECTOR											
A. By branch											
1 Central Government	34.11	33.95	32.73	32.61	31.95	31.33	30.27	29.38	28.60	28.00	27.39
2 State Governments	71.12	73.55	74.60	74.25	73.84	73.67	72.22	72.02	73.00	72.09	71.71
3 Quasi-Governments	62.22	65.20	63.26	61.92	60.20	59.01	58.22	57.48	59.09	58.61	57.96
4 Local bodies	23.13	21.97	22.55	22.61	21.75	21.79	21.26	21.18	21.18	21.32	19.68
Total	**190.58**	**194.66**	**193.14**	**191.38**	**187.73**	**185.8**	**181.97**	**180.07**	**181.88**	**180.02**	**176.74**
B. By industry											
1 Agriculture, hunting etc.	5.56	5.39	5.14	5.02	4.83	5.06	4.93	4.96	4.69	4.75	4.71
2 Mining and quarrying	9.99	10.16	9.24	8.75	8.61	8.47	10.30	10.14	11.46	11.37	11.21
3 Manufacturing	18.52	17.56	15.31	14.30	13.50	12.60	11.89	11.30	10.92	10.87	10.44
4 Electricity, gas and water	9.05	9.35	9.46	9.35	9.23	9.13	8.74	8.60	8.49	8.49	7.96
5 Construction	11.49	11.64	10.92	10.81	10.26	9.48	9.32	9.11	8.94	8.66	8.52
6 Wholesale and retail trade	1.50	1.62	1.63	1.63	1.57	1.82	1.81	1.84	1.82	1.78	1.65
7 Transport, storage & communications	30.26	31.06	30.77	30.42	30.09	29.39	28.15	27.51	26.75	26.37	26.34
8 Finance, insurance, real estate etc.	11.94	12.83	12.96	12.81	12.30	13.77	14.08	14.08	13.90	13.69	13.47
9 Community, Social & personal services	92.27	95.04	97.71	98.30	97.35	96.09	92.76	92.52	91.76	90.90	88.54
Total	**190.58**	**194.66**	**193.14**	**191.38**	**187.73**	**185.80**	**181.97**	**180.07**	**178.73**	**176.88**	**172.84**
PRIVATE SECTOR											
1 Argiculture, hunting etc.	8.91	8.94	9.04	9.31	8.55	8.95	9.17	9.83	10.28	9.50	9.92
2 Mining and quarrying	1.00	1.03	0.81	0.79	0.68	0.66	0.65	0.79	0.95	1.00	1.11
3 Manufacturing	44.81	47.06	50.85	50.13	48.67	47.44	44.89	44.89	45.49	47.50	49.7
4 Electricity, gas and water	0.40	0.40	0.41	0.52	0.42	0.50	0.47	0.49	0.40	0.50	0.51
5 Construction	0.73	0.53	0.57	0.57	0.56	0.44	0.45	0.49	0.55	0.70	0.69
6 Wholesale and retail trade	3.00	3.08	3.30	3.39	3.35	3.60	3.51	3.75	3.87	4.10	2.72
7 Transport, storgage & communications	0.53	0.58	0.70	0.76	0.76	0.79	0.81	0.85	0.87	1.00	1.04
8 Finance, insurance,real estate etc.	2.54	2.93	3.58	3.70	3.91	4.26	4.58	5.23	6.52	8.80	10.96
9 Community, social & personal services	14.85	16.03	17.23	17.34	17.42	17.56	17.92	18.20	18.78	19.50	21.73
Total	**76.77**	**80.59**	**86.46**	**86.52**	**84.32**	**84.21**	**82.46**	**84.52**	**87.71**	**92.40**	**98.38**
BY SEX											
PUBLIC SECTOR											
Male	167.10	168.66	164.57	162.79	158.86	156.75	153.07	150.86	151.85	149.84	146.34
Female	23.47	26.00	28.57	28.59	28.87	29.05	28.90	29.21	30.03	30.18	30.4
Total	190.57	194.66	193.14	191.38	187.73	185.80	181.97	180.07	181.88	180.02	176.74
PRIVATE SECTOR											
Male	62.42	64.31	65.80	65.62	63.83	63.57	62.02	63.57	66.87	69.80	74.03
Female	14.34	16.28	20.66	20.90	20.49	20.64	20.44	20.95	21.18	22.94	24.72
Total	**76.76**	**80.59**	**86.46**	**86.52**	**84.32**	**84.21**	**82.46**	**84.52**	**88.05**	**92.74**	**98.75**
PUBLIC AND PRIVATE SECTOR											
Male	229.52	232.97	230.37	228.40	222.71	220.32	215.09	214.42	218.72	219.64	220.37
Female	37.81	42.28	49.23	49.49	49.35	49.68	49.34	50.16	51.21	53.12	55.12
Total	**267.33**	**275.25**	**279.60**	**277.89**	**272.06**	**270.00**	**264.43**	**264.58**	**269.93**	**272.76**	**275.49**

Source : Ministry of Labour & Employment, Director General of Employment and Training.

Note : 1. Coverage in construction, particularly on private account, is known to be inadequate.

2. Employment in private sector relates to non-agriculture establishments in private sector employing 10 or more persons. Employment in public sector relate to all estalishments irrespective of size.

3. Excludes Sikkim, Arunachal Pradesh, Dadra & Nagar Haveli and Lakshadweep as these are not yet covered under the programme.

4. Due to non-availability of data as per NIC 1998, information in respect of J&K , Meghalaya, Mizoram, Daman & Diu not included in total.

PSU employment

Fall in Public Sector Employment

- Public sector share in organised employment was 74% in 1980-81 and this has come down, yet it provides 65% of total organised sector employment in 2008.
- A bloated workforce, employed often on non-economic considerations in PSUs is opined by some as a reason for its efficiency. But the evidence suggests that despite such pressures the trend in growth rate in employment has declined from 6% in 1970s to a negative -1.0% in 2002-03, the negative figure continues to this date.
- The total public sector employment has declined from 190.57 lakhs in 1991-92 to 176.74 lakhs in 2008-09, a loss of 13.26 lakh jobs as a result of reforms.
- Interestingly, the female employment however has gone up from 23.47 lakhs to 30.4 lakhs during the same period – a rise of 7 lakhs, while 21 lakh males lost their job.
- Without denying the need to unload the over-staffing, what can be claimed that public sector employment growth is drastically reduced and it possibly contributed to its increased productivity.

PSU Efficiency

Improvement in Thermal Power Plants

- Gross inefficiency in power sector is widely held as the chief reason for the putative poor performance of PSUs.
- But the average plant load factor (PLF) for all the thermal power plants has witnessed an uninterrupted rise from 44.3 % in 1979-90 to 74.8% in 2004-05. Since the power sector roughly accounts for one third of total public investment, such an improvement can surely contribute to the overall productivity growth noted earlier. But whether physical parameters suggest improvement in financial indicators such as profitability? That depends on pricing.

Figure 9: Public Sector Saving

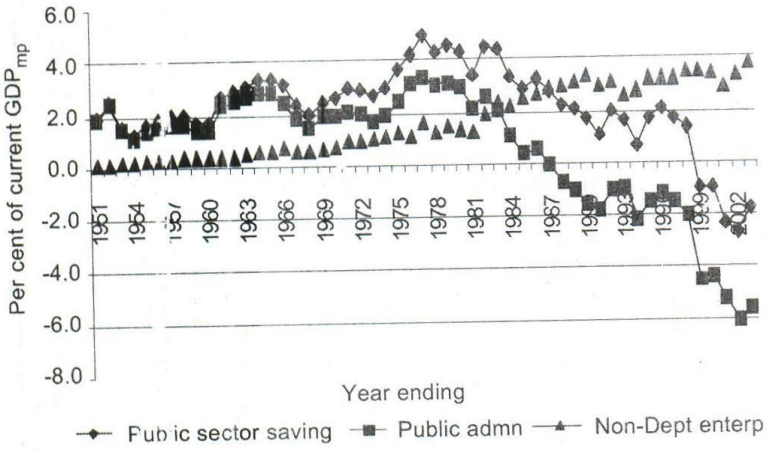


Figure 10: Disaggregation of NDEs' Saving

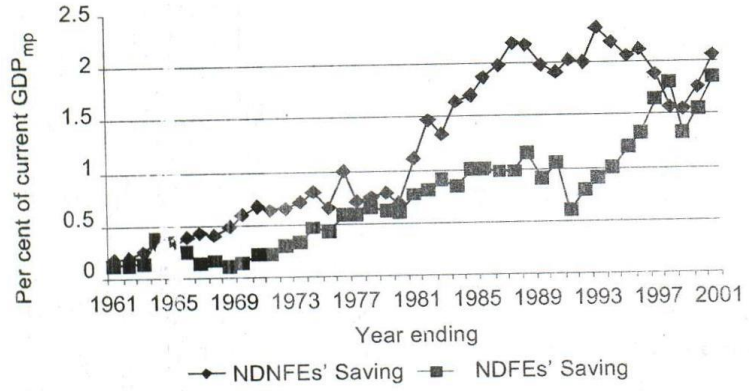


Figure 11: CPE's Profitability

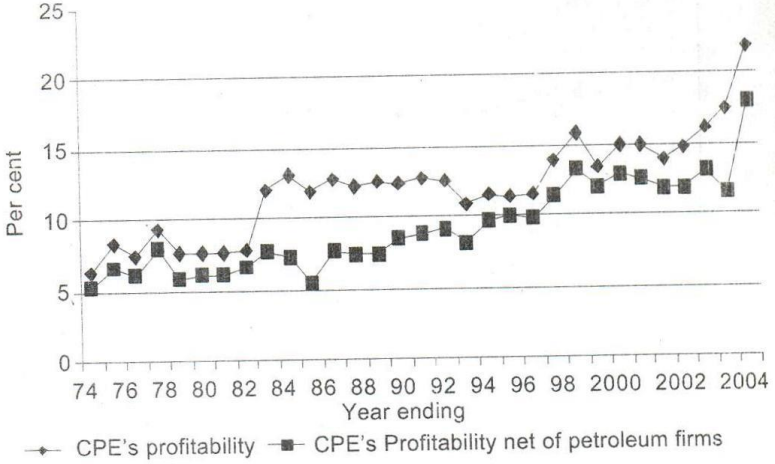
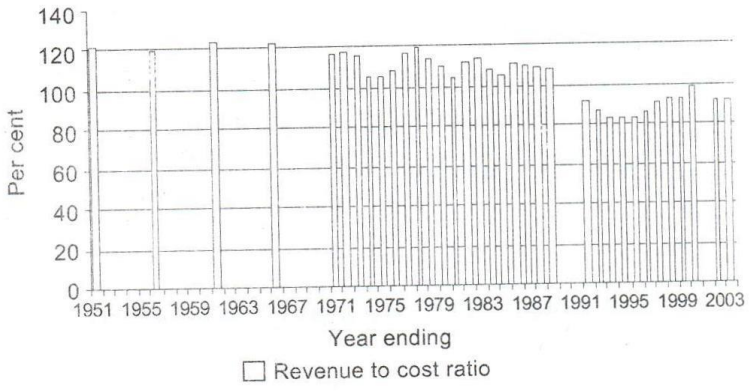


Figure 12: Indian Railway's Financial Performance



Public Sector Savings

- The public sector savings as percentage of GDP has peaked in 1976-77 at 4.9% and declined progressively thereon into a negative figure in 1988-89.
- But the share of non-departmental non-financial enterprises (NDNFE) savings share to GDS has risen rapidly during 1980-81 to 1994-95. In fact, the share of non-financial PSUs has been substantial since beginning for the first 4 decades.

Profitability of Central PSUs

- The considerations to be held before evaluating profitability of PSUs, the concept of net profit ration may not be appropriate. First, PSUs have to invest in not only plant and machinery, but also in social overheads (like roads, buildings that wont get any rents) they will have to provide massive amounts to depreciation. Second, PSU capital structure is not aimed at profit maximisation or shareholder's investment, but provision of goods and services for which markets are missing.
- Third, very often PSEs start with high proportion of debt provided in the beginning, once it commences production it starts with high debt-equity ratio. Finally, therefore, it is gross profits which is more relevant, not net.

- The gross profitability of central PSUs has increased from 8 % in 1970s to 21% in 2003-04 – a respectable figure by any reasonable evaluation.
- However, if you exclude petroleum sector, which has high mark-up ratio, then the gross profitability is lower, but still a rising trend is seen at 18%.
- Therefore, it is not the central PSUs responsible for any poor performance of NDNFEs. This leaves out utilities like power (SEBs), ports, irrigation and transport corporations. But these include administrative services, which account for sizeable share in plan expenditure, profitability analysis cannot be done.

Problem of Pricing

- Lets take the SEB's revenue-cost ratio since 1993-94, as a proxy for its financial performance. When its PLF has gone up from 44% to 74%, the revenue-cost ratio has actually declined from 82.2% to 75% during 1975-05.
- Similarly, the revenue-cost ratio of railways declined from 120% to 84% in 2003, but this turned into positive balance during 2007-08. similarly, the revenue-cost ration of RTCs have declined from 91.4% in 1991-92 to 88% in 2003.
- There could be three possible reasons for this fall in revenue-cost ratio, first, a relative faster rise in costs, second, an increase in inefficiency, and third, poor pricing or low recovery user charges. We have seen that the efficiency in PSUs actually gone up, hence it is not the principal culprit. Then the suspicion zeroes on poor pricing.
- If one sees the PSU's share in national income price deflator, its share in the last 40 years stood rock steady at 83%. The relative price never exceeded overall price level. This means that public sector prices rose slower than the overall price level, evidently affecting its financial position adversely. Due to equity considerations, PSU were underpriced that caused them losses which is a political decision, not an economic outcome.

Figure 13: RTCs' Financial Performance

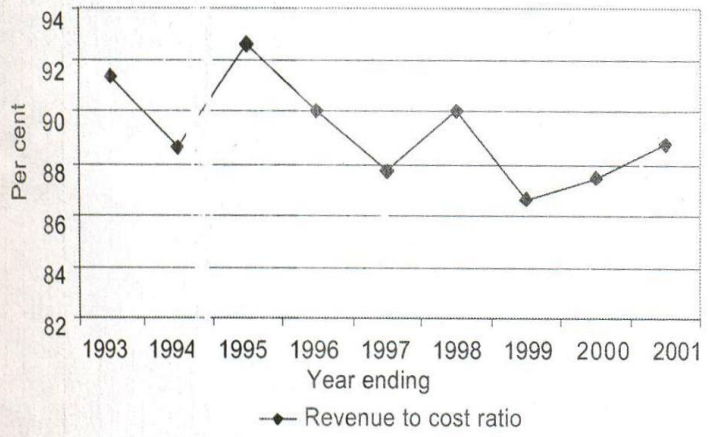


Figure 14: Ratio of Public Sector Deflator and GDP Deflator

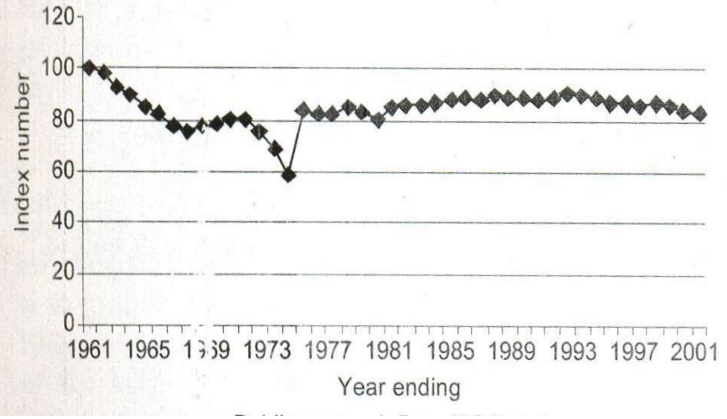
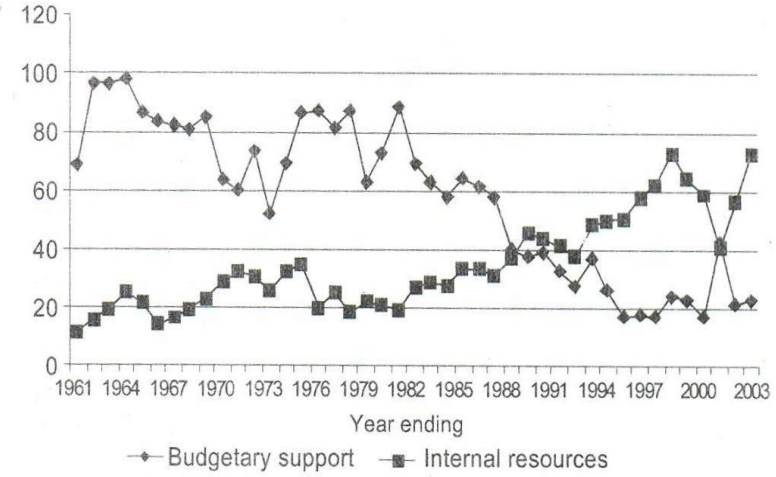


Figure 15: Financing of NDNFEs' Capital Formation



deflator output relative to the GDP deflator over the last 40 years since 1960-61.

II
Reasons and Implications

What accounts for the changes in the performance of the public sector? Arguably, the market-oriented reforms since the 1980s could have induced the desired effect. But, such an explanation would seem too facile to be taken seriously, in the absence of a casual explanation between the reforms and the observed

A Recapitulation

1. There is an improvement in the efficiency of resource use in public sector in aggregate terms since the second half of 1980s, with a corresponding fall in ACOR.
2. Improvements in physical efficiency in past may reflect in a fall in public sector employment growth.
3. Thermal power plants in India that account for the bulk of power generation show an uninterrupted rise in efficiency.
4. Despite these trends in rise in productivity, the financial losses seem to be due to poor pricing of utilities like transport, power, irrigation, etc.

Implications

- What accounts for this improved performance of public sector? Market oriented reforms might have contributed to some extent. But this explanation would be facile in the absence of a causal explanation between reforms and the desired effect. Given the financial losses at the end of 1980s, the threat of privatisation and retrenchment of workers arguably could have had positive effects.
- But there are other convincing answers, like in the post-reform period there is an increased autonomy, second, growing competition in the product market.
- The budgetary support to NDNFEs between 1960-05 has come down and share of internal resources (depreciation and net savings) rose, both as a proportion of GFCF. The budgetary support was 97.6% in 1963-64, it came down to 16.9% in 1996-97.
- The share of internal resources went up from 11.2 % in 1963-64 to 73% in 2002-03. Cost consciousness and competitive pressures might have led this improvement, yet this has not translated into an improvement in financial indicators, since pricing seem to be holding down.

- The problem of inadequate electrical pricing, incomplete metering of power usage and recovery of user charges are too well known problems. Railway finances were a victim of coalition politics and competitive populism. In case of RTC, profitable routes are opened for private participation, reducing RTC traffic which reduced its revenues. So appropriate pricing can take care of much of its financial losses.
- Alternatively, budgetary support can be extended by monetizing the debt, in the face of strong savings ratio, as is done by China. In the absence of any such measures, pricing is the only solution for recovery of losses. This is what Lalu has done, in the name of tatkal tickets and increasing freight fare he made railway budget viable.
- Infusion of foreign capital in public utilities is highly problematic with high risks, as realised by India in Dhabhol power plant issue. Nor any hasty exit of state in public utilities becomes an political option at a time democracy is being deepened

- The neoliberal reforms incorrectly diagnosed public ownership to be the main culprit for poor performance. One can accept that ownership changes could allow freedom to charge market-related prices to those who can pay. But most of public utilities like power, irrigation, transport have externalities, hence pricing cannot be conceived in terms of mere marginal terms, it is related to public policy, entrepreneurial freedom has little significance in these industries.
- Moreover, more than ownership, what is important is market structure. Hence public utilities, which are merit goods and have positive externalities, are better served to all with the pubic ownership.

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