Opportunities and Challenges for India in an Emerging Globalising Economy

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1. Introduction

"India's growth has been impressive--9.7 percent in 2006, 8.9 percent in 2007 and we are viewing at 8.4 percent in 2008. That is really an impressive growth pattern. It will be a good example for other countries in the region to see that flexible exchange rates could be very useful to manage a booming economy as is the case of India."

IMF MD: Rodrigo de Rato, 16 October 2007

"China is the most preferred investment location, followed by India, the US and then the Russian Federation and Brazil," it said. India's ranking in inward FDI performance index has also improved to 113 in 2006 from 121 in 2005."

UNCTAD: World Investment Report, 2007.

"…. The Indian economy can grow at 10 per cent in the coming decade with structural reforms; …country's stock market would outperform developed and emerging markets over the next five years. It also projected rupee to rise significantly against the US dollar."

Lehman Brothers: US Global Consulting Firm

The above-mentioned quotes make the picture very clear: India has come of age. Reforms are here to stay, albeit, often characterized by gradualism and hiccups!

India has been growing at 6 per cent plus rate since the late 1980s. In the last three years, the growth rate at 8 per cent has been even higher, approaching the East Asian levels. While skeptics argue that this shift merely represents a strong upswing in the business cycle, optimists see it as representing an upward movement in the trend growth rate. If optimists are right and an 8 per cent growth rate is sustained, possibly even accelerated, we can truly begin to see the emergence of a giant economy in India. Even at the 8 per cent rate, the economy will double in size in a matter of 9 years.

2. Performance of Indian Economy since 1990

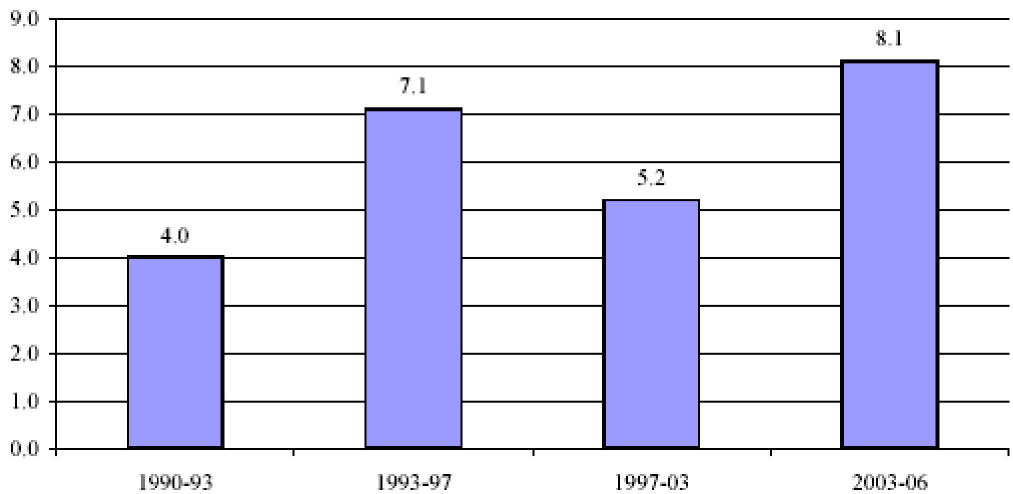
HIGHLIGHTS

i. High growth trajectory- GDP and Per Capita GDP.
ii. Integration with world economy
iii. Services sector revolution
iv. Low inflation (good monetary policy and exchange rate management)
v. Fiscal discipline

Let me discuss each in some detail.

(i) High Growth Trajectory:

India has crossed the so-called "Hindu Growth Rate" phenomenon and since the 1980s has shifted upward to a high growth trajectory exceeding 6 per cent as visualized by the following diagram. There are indications that the trend growth rate in India may be shifting upward yet again. During last three years Indian growth rates in GDP have been consistently higher than 8 per cent. Now it is expected that during the Eleventh Five-Year Plan (2007-2012) an annual growth rate of over 9 per cent could be achieved.

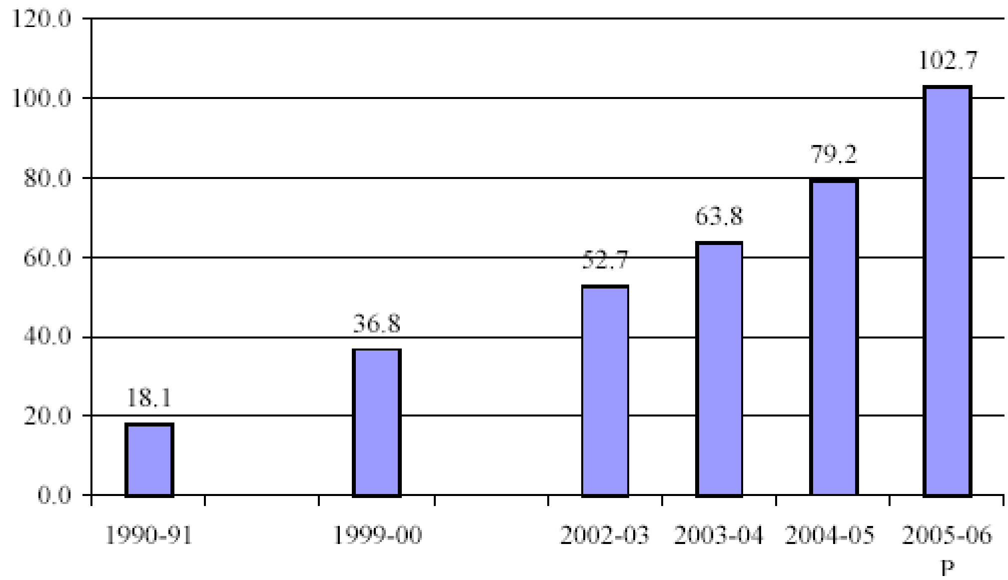


Source: Panagariya. A. "Transforming India" Paper presented at conference "India: An Emerging Giant" October 13-15,2006 at Columbia University. P.5

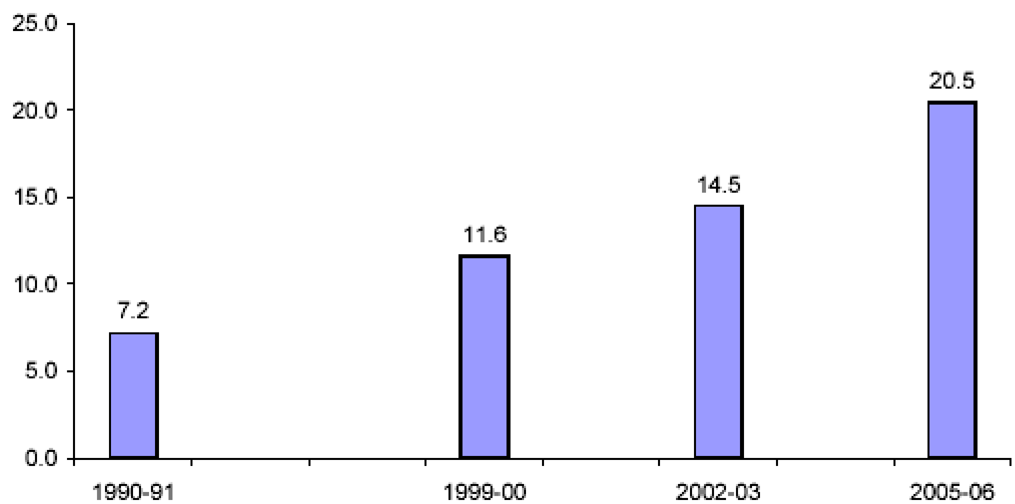
(ii) Integration with World Economy

Since 1991, India has transformed itself from one of the most closed large economies of the world to a relatively more open one, with trade (exports plus imports) as a percentage of GDP reaching 40 % in 2004 and 45% in 2005 from as low as 16% in 1990.

Fig 4 shows that in 1990-91 India's total exports in current dollars stood at $ 18.1 billion, which rose to $102.7 billion in 2005-06. Exports in 1990-91 did not double until nine years later in 1999-00. In the recent years, exports have almost doubled in just three years-from $52.7 billion in 2002-03 to $102.7 billion. Likewise, India's share in world exports rose from 0.5 per cent in 1990-91 to 0.7 percent in 1999-00 and further to 1 per cent in 2005-06.



Similarly, the export/GDP ratio stood at just 7.2% in 1990-91 rose to 11.6% in 1999-00. It was 14.5% in 2002-03 and 20.5 % in 2005-06. Thus the ratio has tripled in last 15 years. The rise in the ratio between 2002-03 and 2005-06 is especially remarkable since it has taken place in an environment in which the GDP itself has risen 16.4 % per annum in current dollars. This expansion clearly shows that Indian economy is now rapidly integrating into the world economy.



(iii) Services sector Revolution

Much of the overall export growth has been brought by the services exports since 1990s. Salient features of this revolutionary change are following:

a) Its share in GDP has risen to 55% in 2006-07 compared to 41% in 1990-91.
b) Goods exports about 1% of World's while Services exports 1.3% of world's in 2005-06.
c) In India Services contributes 30% (both exports and imports) while this share is around 20% in most countries.
d) Services exports grew by 16% during 1994-2005 significantly higher than world average (7.3%), even China (14.2%)
e) Highly diversified: IT and ITES now dominating capturing 49% of total services exports (cagr 28% 1999-2005) shares ¼ of total export earnings.
f) High comparative advantage in international trade (shown in Table1)

Table 1:Revealed Comparative Advantage Indices in Services in Selected Countries

Country	1994	1997	2001	2004
India	0.941	1.032	1.394	1.427
China	0.687	0.602	0.557	0.480
Brazil	0.493	0.514	0.691	0.582
Russia	0.547	0.708	0.506	0.503

Source: OECD (2007): "India's Trade Integration, Realizing the Potential", Nora Dihel and P. Kowalski, TD/TC/WP (2007) 6/REV1, Table 5, P.15.

The emergence of new policy of SEZs will be able to provide the platform for IT/ITES and BPO services sector to reap the dividends by capturing an even bigger and expanding share in growing international market of this sector.

(iv) Low Inflation and better Monetary and Foreign Exchange Management

Wholesale Price Index (WPI) is the measurement of price inflation in India. Historically inflation rates in India remained relatively low compared to other developing countries like those in Latin American countries. During 1991-96 average annual inflation was estimated at 10.6%, which showed a declining trend subsequently and fell down to half the level achieved in the earlier period to 5.1% during 1996-2001. In the period during 2001-06, an inflation rate of 4.74 was recorded. . The average inflation in 52 weeks ending on January 20, 2007 remained at 4.65%.

The low inflation rates was a combined impact of stable and active fiscal and monetary policies, and especially the performance of the RBI in managing the monetary affairs of the country and which have been appreciated by the IMF as well.

(v) Fiscal Discipline

At the beginning of the fiscal reforms in 1991, the fiscal imbalance was identified as the root cause of the twin problems of inflation and the difficult BOP position. The fiscal consolidation, which followed in response, in absence of a defined mandate, however, failed to sustain itself. For medium-term management of the fiscal deficit, and to provide the support of a strong institutional mechanism, the Fiscal Reforms ans Budget Management Act (FRBMA) was enacted on August 26, 2003 and the Act and the rules were notified to come into effect on July 5, 2004. According to the Rules, the Revenue Deficit be cut by half a percent each fiscal year and eliminated by April-end 2009, while the Fiscal Deficit be cut by 0.3 per cent each year to reach to no more than 3% of GDP by April-end 2009.

The revenue and fiscal deficit were 3.3 and 6.6 per cent respectively in 1990-91 have, as a consequence of the new institutional mechanism, have progressively reduced and now stand at 2.1 and 3.8 per cent respectively in 2006-07. The tax structure has been rationalized and moving towards achieving progression. The direct taxes as ratio to both total tax revenue and the GDP were 19.1% and 1.9% respectively in 1990-91 have progressed in tandem to achieve the levels of 47.6% and 5.1% respectively in 2006-07. The indirect taxes, a sign of regression and anti-social justice (putting more burden on poor) have come down significantly. Commodity taxes, which contributed very significantly at 78.4% and 7.9% respectively towards total tax revenue and the GDP in 1990-91, have progressively shown downward trend and they stood at 47.6% and 5.1% respectively in 2006-07. Similarly, the expenditure pattern has also been constantly rationalized and following the objective set by the FRBMA to reorient them towards creation of more productive assets. The plan expenditure as a proportion to GDP has risen from 3.8% in 1990-91 to 4.5% in 2002-03, before declining to 3.9% in 2005-06.

LOWLIGHTS

I Slow agricultural growth overburdened by heavy population
II Stagnant manufacturing growth
III Subsistent Economy with high poverty
IV Infrastructure bottlenecks 32 hours dilemma!
V Rigid and outdated labour laws and bureaucratic hurdles
VII Low FDI inflow

(i) Slow Agricultural Growth and Overburdened

Three points worthy your attention

a. 10% growth in GDP possible but only if agriculture grows at a rate of 4%
b. Acceleration in agriculture is essential to make growth more inclusive
c. 57% of labour force is dependent on agriculture while its share in GDP declined gradually over time and now stands ad 18%. Overwhelming burden of labour force on agriculture.

Agriculture needs much-awaited reforms. A moderate annual average growth of 3.0% in the first 6 years of the new millennium starting 2001-02, notwithstanding a growth of 10% in 2003-04 and 6% in 2005-06, agriculture and allied sector has continued to be a cause of concern. The structural weaknesses of the agriculture sector reflected in low level of public investment, exhaustion of the yield potential of new HVY of wheat and rice, unbalanced fertilizer use, low seed replacement rate, an inadequate incentive system and post harvest value addition were manifest in the lackluster agricultural growth during the new millennium.

To sustain poverty reduction, the government must return to reforms aimed at generating non-farm job opportunities for the rural poor. No high-income nation today employs even 10% of its labour force in agriculture. An essential element in modernization is the creation of conditions that lead the vast majority of the rural population to migrate out of agriculture into industry and services including food processing. It is only through a large reduction in the labour-to-land ratio that farmers will be able to achieve the standard of living comparable to those available in industry and services

The policy of the **Special Economic Zones (SEZs)** is very pertinent and relevant in this regard. It is worth mentioning here that the farmers are also willing to shift from farm to non-farm sector by selling their lands to SEZs promoters. As is exemplified by the remarks made by one of the leading advocates of farmers, Mr. Sharad Joshi, MP, who remarked, "…though farmers love their lands but in today's changed circumstances they are ready to sell their land for their own betterment. If given the option to sell their land, which amounts to their voluntary retirement from farming and by employing them in industrial activities in SEZs, they will have a better living."[1]

(ii) Stagnating Manufacturing Growth

a. Manufacturing sector, proper contributed nearly 15% in output, while just 11% in employment in 1999-00 and these shares are almost stagnant since then until now.
b. Less than 3 % of workforce in modern private sector
c. 90% workforce still in informal sector.
d. Economic census 2005: 42 million enterprises employing 99 million, just 1.4% employs more than 10 workers. Results: small size of enterprises, low wages and highly fragmented production structure of non-farm activity.
e. Only 10-25% of general college graduates suitable for modern employment.
f. Domestic R&D spending never exceeded more than 1% of GDP
g. Only 16% of Indian Manufacturing firms provide in-services training; firms that do so increased productivity by 28%.
h. The sectors most open to competition have increased R&D spending the most.
i. Despite India having the largest systems of higher learning, it may face a deficit of 0.5 million workers by 2010.
j. Doing Business Index developed by WB

(iii) Still a Subsistent Economy with high Poverty:

a. Illiteracy rates 46% women, 25 % in men

[1] CUTS International (2007) "An Assessment of Potential Costs and Benefits of SEZs in India" A Study commissioned by the Ministry of Commerce, Government of India.

b. 26% people living below poverty line with significant spatial variance across and within states.
c. Number of unemployed increased from 9.02 million in 1993-94 to 13.1 million in 2004-05, as a consequence unemployment rate rose to 3.06% from 2.62% during the same period.
d. 81 million out of 99 million workers employed in enterprises having less than 10 workers (i.e. informal sector enterprises). These enterprises contribute just 32.4% of GDP as against 1.4% of enterprises contributing 42% of GDP. Results: low level of earnings for informal sector workers.

(iv) Infrastructure Bottlenecks

India is known for and severely crippled by its poor, inadequate and quality-constraint infrastructures especially the roads-railways, ports, power, irrigation etc. The Economist survey on India "Can India Fly" states that a lorry traveling from Kolkata to Mumbai takes nearly 8 days with stoppage of 32 hours on various check points. Such sorry affairs cannot take India to the world class infrastructures.

A glimpse of how infrastructures affect economic growth and export growth can be obtained through Table 5.

Transaction	Location	Norm
Air Freight	Delhi Airport	
Export	2.5 days	Less than 12 hours
Import	15 days	Less than 12 hours
Containerized Sea Freight	Mumbai	
Ship Waiting Time	3-5 days	Less than 6 hours
Export Dwell Time	3-5 days	Less than 18 hours
Import Dwell Time	7-14 days	Less than 24 hours

Source: Roy and Bagai (2005, Box 2)

To improve infrastructures across board during the XI Five-Year Plan, the Planning Commission has estimated that an investment of Rs. 14,50,000 crore ($320 billion) would be required. These investments are to be achieved through a combination of public investment, public-private-partnerships (PPPs), and exclusive private investments. Investment requirements by 2012 estimated by the Committee on infrastructure, headed by the Prime Minister, in some of the key sectors are: Rs.2,20,000 crore for modernization and upgradation of highways; Rs. 40,000 crore for civil aviation; Rs. 50,000 crore for ports; and Rs. 3,00,000 crore (of which 40% is expected to come from the private sector through PPP) for the Railways.

V Rigid and outdated labour laws and bureaucratic hurdles

One of the significant reasons for low international investment, particularly the FDI is due to very rigid and outdated labour laws compounding with bureaucratic hurdles. As explained by the Doing Business index, developed by the World Bank, it takes 367 days in dealing with license in India as against 270 days in China and 150 days in OECD countries. Similarly difficulty in firing index was estimated 70 for India as against 40 and 27.4 respectively for China and OECD countries. Closing business in India takes on an average 10 years, while it takes just 2.4 years in China and 1.4 years in the OECD countries.

VII Low FDI inflow

Foreign investment inflow, which had remained sluggish for many years after initial liberalization in 1991, has also seen a major upward shift in the last three years. From just $6 billion in 2002-03, the total foreign investment into India has risen to $20 billion in 2005-06. Cumulative FDI inflows since August 1991 up to September 2006 were Rs. 1,81,566 crore or US$43.29 billion. Though direct foreign investment (FDI) too has received a boost in the past three years, the bulk of the foreign investment has taken the form if portfolio investment. China received FDI to the tune of $54.937 billion in 2004 while India received just one-tenths (i.e., $5.335 billion) that of China in the same year.

3. Strengths

(i) India's growth has been impressive--9.7 percent in 2006, 8.9 percent in 2007 and we are viewing at 8.4 percent in 2008. That is really an impressive growth pattern,"

(ii) India’s stock of scientists and engineers engaged in R&D is among the largest in the World.

(iii) Services Sector Revolution

(iv) A very low level of inflation below 4%.

(v) Demography, it is argued, will help raise the level of private savings from about 29% of GDP now to 34% over the next five to seven years. Investment will follow, so GDP will continue to grow at 8%, even if reforms stall. Nothing can sap the momentum unleashed 15 years ago.

(vi) 55% of population is below 35 years of age, so India will going to be young for nest 30 years.

(vii) A significant proportion of population is Middle Class whose income rising and consumption patterns changing leading to **Consumerism.**

(viii) Democratic institutions.

(ix) Political consensus regarding economic reforms.

4. India's Challenges

a. Job creation in India is not happening at a pace where the country can make serious dents in the poverty situation. Indian manufacturing in some areas is becoming globally competitive, but without creating jobs. In a country where millions are unemployed, capital is being substituted for labor. And it **will not happen unless manufacturing takes off**. While the services industry, most spectacularly IT and BPO services, have taken off, they do not – and can not – provide jobs to more than a small fraction of India's 400 million-strong workforce.

b. The strengths together with opportunities can bring huge dividends for India in the coming years. **Opportunities are emerging across the complete spectrum of IT services and software products.** Worldwide IT spending will exceed US$1trillion during the next decade and within India local demand will soar to US$20 billion over the same period. Indian companies with their high quality human resources at a competitive price are well placed to take a big bite of this IT and software services pie. And here is the result of what I have just mentioned. The TCS, the largest and highly respected IT and ITES Company worldwide has announced just last week only that it has been successful in capturing a contract worth $1.2 billion from the U.S.-based Nielsen Co. to handle some of its back-office work and Information Technology-related operations worldwide.

c. The World Bank's Study, "Unleashing India's Innovation" (October 4,2007) says, "Appropriate measures to stimulate innovation through **competition** can trigger a five-fold increase in India's gross domestic product (GDP) and make the growth process more inclusive. According to India's current GDP is estimated at around $ 1 trillion (Rs. 4,00,000 crore) While there are many islands of excellence in India's heterogeneous economy, the country could do much more to reach its full potential, especially by bringing the benefits of innovation to the poor. "India will especially benefit from fostering more inclusive innovation. This could be achieved by promoting more formal R&D efforts for the poor people as well as by improving the ability of informal enterprises to better use existing knowledge."

d. Though **investment environment has improves** in last three years, yet India stands at 113 place in FDI performance Index, which needs immediate attention, if India would like to climb still higher ladder of growth, which requires infrastructure improvement, which, in turn, requires huge investments.

e. **Human resources development**. A holistic approach towards entire spectrum of education is needed. Expenditures to the tune of atleast 6% of GDP has to be attained and a complete reorientation of courses, curriculum, vocationalization and private participation are some of the urgent issues on which government will have to concentrate on. Otherwise India is going to face huge shortage of right kind of skilled people as predicted by McKenzie Report.

5. Conclusion

In economic terms, India is still poor and small. It holds a sixth of the world's population but accounts for just 1.3% of world's goods and services, and 0.8% of foreign direct investment flows (compared with 6.6% and 8.2% respectively for China). At $728, its GDP-per-capita is less than half China's. Put as starkly as possible, Indian business will make a packet if the economy grows at 6% a year, but if the country is to catch up with China in the lifetimes of its youth population (and provide them with jobs), India needs to grow much faster. Otherwise, poverty will persist for decades and social tensions will mount.