

India's Economic Performance, Policies and Prospects

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The chapters in this volume provide a comprehensive review of almost all-important aspects of the Indian economy. They also convey much of the flavor of the current debate on economic issues in India, with its usual diversity of views. In this chapter I propose to examine what this review adds up to in terms of the present state and future prospects of the Indian economy and the evolution of economic policies in India.

A particular objective of this chapter is to provide the total perspective in which some of the recent initiatives in India's economic policy need to be viewed. These initiatives, usually characterized by the catchall phrase "economic liberalization", have been the special focus of international attention directed at India. They are certainly important, but they must be seen as once element of the total economic policy package, addressed especially at improving performance in the industrial sector. Economic policy must also deal with many other aspects of performance where the key issues do not relate to economic liberalization. It is also important to distinguish the Indian policy initiatives from the classical "liberalization packages" which are ardently advocated in many quarters. There are important differences in approach and perhaps also in underlying philosophy and these differences are brought out in this chapter.

Objective of Policy

Both performance and policy are in some sense best judged in terms of the objectives of development policy, the more so in an economy in which objectives have been consciously set in successive national plans. The broad objectives which have guided India's development strategy are listed below. Some of them are obviously common to all developing countries, but others are not so, at least not to the same extent.

1. Achievement of a high rate of economic growth leading to a sustained improvement in the levels of living of the population. This is obviously a common objective of all developing countries.
2. Reduction in inequalities and more especially an accelerated effort to remove poverty at a pace faster than would be achieved solely through the normal growth process. This objective too is commonly subscribed to in the plans of many developing countries, though the importance accorded to it varies, as do the policies adopted in its pursuit.
3. Development of a mixed economy with a strong public sector, especially in key areas of the economy. The creation of a public sector could be viewed as an instrument for achieving broader objectives of growth with equity, but India's development strategy has accorded such special importance to the public sector that it could properly be described as an independent objective of policy. The creation of a public sector was viewed not merely as an instrument to achieve other objectives. There was a more basic and widely shared sociopolitical commitment to the creation of a mixed economy, in which the state has a substantial direct control over important production sectors.
4. Achievement of a high order of "self-reliance" has been an important independent objective. The term itself is used in two senses. In one sense, self-reliance has meant that development must be financed as far as possible from domestic savings, avoiding excessive dependence upon external assistance. Self-reliance has also meant a conscious effort at developing a broad domestic production base and an indigenous technological capacity, both of which were felt to be essential requirements for building a strong industrialized economy.
5. Promotion of balanced regional development, with a narrowing of economic difference across regions. This has tended to be viewed not just as matter of promoting

economic growth but also more specifically as a matter of regional balance in the degree of industrialization.

6. Finally, these social and economic objectives were to be pursued in the framework of a constitutional democracy.

These broad objectives have been evident from the very early stages of Planning in India. Over time they have taken more concrete shape as distinct objectives. It is evident that some of these objectives involve a potential conflict or trade-off with growth, at least in the short term. The possibility of such trade-offs in the short run was always consciously recognized, though of course it is always relevant to ask whether in practice the trade-off was optimized.

How has the economy performed in terms of these objectives? A summary assessment is offered in the following sections, focusing especially on recent performance and identifying some key aspects of policy and future priorities as they emerge from recent experience.

Growth Performance

The rate of growth of the economy is the most commonly used measure of overall performance and it is appropriate to begin with this indicator. Up to about the mid-seventies, India's trend growth rate of G.D.P ignoring yearly fluctuations seemed firmly anchored at about 3.5 percent per year, unforgettably characterized by the late professor Raj Krishna as "the Hindu rate of growth". There is clear evidence that the economy broke through this constraint some time in the mid-seventies. The growth rate over the past ten years or so averages about 4.5 percent and this is an average over a period in which growth was accelerating. The underlying growth rate of the economy in the mid-eighties is nearer 5 percent per year. This is not high compared with growth rates achieved in earlier decades by the better-performing developing countries. Some countries have achieved annual growth rates as high as 10 percent over sustained periods, and many have grown at rates between 6 percent and 7 percent in the sixties and early seventies. But this comparison is not wholly fair in assessing recent economic performance in India.

An obvious point which has to be noted is that India is a relatively large economy and also among the group of low-income countries of the developing world. The size of the economy ensures that a process of averaging must be at work. India's "growth potential" cannot therefore be presumed to be equal to the fastest-growing developing countries, but closer to the average. More important, India's recent performance should not be assessed by comparing it with growth rates achieved by developing countries in an earlier period when the international environment was especially conducive to rapid growth. The growth potential of the developing world as a whole has slowed down since the mid-seventies, and when due allowance is made for this factor, India's recent growth performance and current growth prospects appear in a much better light.

In the period up to the mid-seventies India's growth rate of around 3.5 percent per year was much lower than the average of about 6.0 percent achieved by the developing countries as a whole. In the past ten years, however, India's growth rate has accelerated, while growth rates in most of the developing world have decelerated. India's growth rate in the period 1981-86 was almost 5 percent, when all developing countries taken together grew by only 2.5 percent. Admittedly the low growth of developing countries as a group was partly due to negative growth rates in the oil-exporting countries, but even if these countries are excluded, the category of non-oil-developing countries shows a growth of only 3.5 percent per year in this period. In fact, India's growth performance in the eighties is exceeded only by some of the fast-growing East Asian economies and China.

This raises the question whether the acceleration in growth is a temporary phenomenon or indicative of a more basic improvement in the economy's growth potential. The theme explored in this chapter is that India had indeed experienced a permanent acceleration in growth, accompanied by an increase in its underlying growth potential. A degree of

structural maturity has been achieved in both agriculture and industry, which not only has laid the foundation for sustained growth at 5 percent but also holds out the prospect of higher growth in future. The elements of this transformation and the policy framework in which it took place are discussed in the subsequent sections of this chapter.

Turnaround in Agriculture

A key element in the improvement in aggregate performance was improved performance in agriculture. This not only contributed directly to faster growth of GDP but also stimulated industrial growth through well-known linkages between the two sectors.

Conventional wisdom identifies the beginning of the Green Revolution with the introduction of the Mexican hybrid wheat in the late sixties. The new seeds quickly led to increased wheat yields in Punjab, where agroclimatic conditions were favorable and effective water management was readily possible. But this was only the beginning of the story. To achieve an agricultural turnaround, it was necessary to spread the Green Revolution more widely, both in terms of crops and also in terms of geographical regions. This required a comprehensive strategy for agricultural change requiring active Government intervention in many dimensions. It required a sustained effort at expanding irrigation with a shift from major to medium and minor irrigation. It was necessary to push the banking system into the rural areas to provide credit for the purchase of biochemical inputs needed for high-yielding varieties (HYVs). These measures were accompanied by a policy for providing effective price support at remunerative prices. It was also necessary to strengthen research to adapt high-yielding varieties to local conditions and to develop new varieties continuously. Varietal development is particularly important in the case of rice, which is grown in widely varying agroclimatic conditions in the Gangetic basin and which requires a correspondingly larger number of varieties to ensure suitability in different local conditions.

Agricultural policy evolved along these lines in the seventies, but it took time to have a noticeable impact. Although yields and production of wheat grew rapidly in Punjab from an early stage, this was not reflected in a convincing improvement in total agricultural performance until after the mid-seventies. With the usual lags in availability of data, and also the fact that it takes time before an upswing can be statistically established with confidence, there was considerable skepticism about agricultural performance even in the late seventies. Vaidyanathan found evidence that Indian agriculture may actually be decelerating, while Srinivasan cautioned that the Green Revolution was as yet only a wheat revolution.

By the early eighties, however, it became generally accepted that Indian agriculture had indeed entered a new phase, with a discernible acceleration in agricultural growth. The compound growth rate of production for all crops has increased from about 2.5 percent in the period 1950-51 to 1967-68, to about 3 percent after the mid-seventies. The compound annual growth rate of the index of agricultural production in the more recent period from 1980-81 to 1985-86 is about 3.2 percent. There is also clear evidence that agricultural production is becoming less vulnerable to variations in rainfall, itself an important aspect of agricultural performance.

The rate of growth achieved is still short of the 4 percent target growth of agricultural production in the Seventh Five-Year Plan (1985-90) but there are good reasons to believe that an acceleration to 4 percent growth is possible because of the structural and institutional changes which have taken place in the agricultural sector over the past ten years. The institutional system needed to deliver the necessary inputs has a much wider coverage today than it did ten years ago, but its full potential for increasing yields has yet to be realized. There has been an impressive increase in irrigation potential with the addition of about two million hectares of irrigation capacity every year. However, effective utilization of this capacity has lagged behind because of insufficient investment in the construction of field channels and drains and also because of inefficient water management practices. The area covered under high-yielding varieties shows an impressive increase from about 40

percent in 1980-81 to over 60 per cent in 1986-87, but while area coverage has increased, yields have not increased as much as could be expected. The banking infrastructure has also greatly increased its penetration of rural areas and is well positioned to provide rural credit for large parts of the country. All these developments constitute a structural transformation in the making—they have increased the production potential of Indian agriculture in a way which is not yet fully reflected in actual production.

Average yields in India are still well below yields achieved by many East Asian countries, although yields achieved in the best-performing agricultural states compare favorably. The inter-state variation in yields is a good indicator of the tremendous scope for further improvement in agricultural production. Rice yields are 3,200 kilograms per hectare in Punjab and 2,800 kilograms per hectare in Haryana. By contrast they are only 1,490 kilograms per hectare in Uttar Pradesh, 1,130 kilograms per hectare in Bihar and 1,560 kilograms per hectare in West Bengal. The area under rice in these States is very large. Even modest improvement in yields, narrowing the gap between what has already been achieved in the most productive areas in the country, could produce a large impact on overall agricultural growth.

Fortunately there are definite signs that the Green Revolution is indeed spreading to those areas, and yields are increasing in Uttar Pradesh and also Bihar. The task of agricultural transformation of these areas is not easy. It will require a tremendous improvement in the ground level functioning of the development administration to provide the farmer with the full package of support needed. But the process has definitely taken off, and further acceleration can be expected.

Industrial Performance and Policies

Rapid industrialization has long been viewed as the key to sustained growth and modernization of the economy. However, industrial policies were not framed solely by the immediate requirements of growth maximization. They were also influenced by active Government intervention in pursuit of some of the other developmental objectives listed earlier in this chapter.

The results present a mixed picture. In some respects the industrial sector can be said to have achieved the objectives set for it. A substantial public sector presence has been created, laying the foundations for a mixed economy. A high degree of “self reliance” has been achieved in the sense that a highly diversified industrial base has been created, catering to the domestic needs of the economy in a very wide variety of products. The entrepreneurial base of the economy has also been widened greatly, with the emergence of a number of new large and medium-scale industrial houses and a profusion of small-scale entrepreneurs. Finally, industry has spread into regions where industry did not exist earlier and into which it probably would not have gone for many more years but for government intervention.

Against these achievements there are some obvious shortcomings. Industrial growth has not been as rapid as was expected. After a promising early period in the fifties and early sixties, industrial growth slowed down considerably, and from 1964-65 to 1975-76 the index of industrial production showed a growth rate of only 4 percent per year and value added in industry grew at 3.5 percent per year. There is evidence of a gradual acceleration after the mid-seventies, through with considerable year-to-year fluctuations. In the most recent period 1981-82 to 1986-87, the index of industrial production (using the new index base 1980-81=100) shows an average growth rate of around 7 percent per year while value added growth is about 6 percent. This is definitely an improvement on past performance, but it still falls short of what is needed to take the economy beyond the current 5 percent growth of GDP. For the future, India should be aiming at an industrial growth rate of around 9 percent to 10 percent, with value added in the industrial sector growing at 8 percent to 9 percent.

Another major shortcoming in India's industrial sector is its lack of international competitiveness and consequent poor export performance. Export performance is obviously important in a situation in which the continued growth and modernization of the economy requires a substantial inflow of imported capital goods and other inputs into production. The industrial sector, which absorbs a large percentage of total resources available to the economy, must be able to earn the foreign exchange it needs from exports. This has not yet happened to the extent needed, and one of the major constraints is clearly lack of competitiveness in terms of both cost and quality.

These shortcomings of slow industrial growth and a high-cost uncompetitive industrial sector have been widely recognized in India and have led to critical reexamination of the industrial policy structure to see what corrective steps are necessary. The blame for slow industrial growth cannot, of course, be laid on policy alone. For example, it could be argued that the key to faster industrial growth lies in a more rapid pace of expansion in agriculture which would provide the stimulus for faster growth in industry. While this is undoubtedly true, a consensus has also emerged that the system of regulatory control that has evolved over time is not conducive to industrial efficiency and dynamism.

A number of official reports and academic studies have documented that problems created by a control system consisting of detailed, often multiple, regulation and scrutiny. This system has operated in a manner which hampered the ability of industrial units to take rational investment decisions, limited their ability to modernize existing capacities and even discouraged expansion of production beyond licensed capacity. It has also restricted competition which would have been a spur to improved quality and lower cost. Much of the problem arises because of the multiplicity of objectives to which industrial policy has been tailored, each involving an intervention which has an economic cost.

The catalogue of criticisms of the industrial policy are well-known. The original rationale for industrial licensing was to direct private investment into desired areas and also to avoid wasteful overinvestment. In practice, strict licensing often had the effect of limiting expansion by efficient units or entry by potential new units on the ground that adequate capacity had already been licensed. Inefficient producers were therefore effectively shielded from domestic competition. The objective of limiting concentration of economic power led to specially strict scrutiny and regulation of the expansion or investment plans of larger houses, with a view to ensuring that their activities were restricted to high-priority, technically more difficult industries. Consideration of maintaining regional balance often led to fragmentation of capacity, with a consequent loss of economies of scale. There was a tendency to license a larger number of small units spread over many States, where a single economic-scale plant would have been more efficient.

These and other sources of inefficiency undoubtedly contributed to the emergence of a high-cost industrial structure which slowed growth and reduced export competitiveness. Such a structure would obviously not have been sustainable in a more open economy, which allows competition from imports, but the trade policy permitted very little room for import competition. The objective of self-reliance should have meant self-reliance with efficiency. In practice, however, domestic production was protected from external competition with little regard to domestic resource costs. Protection, which should have been viewed as giving initial support for infant industries, which would in time outgrow the need for it, typically continued as an indefinite crutch, supporting industries whose costs of production were far out of line with international prices.

These problems prompted the establishment of various official committees in the early eighties to examine the structure of industrial and trade policies and make recommendations for change. On the basis of their recommendations a series of policy initiatives were taken in 1985 and 1986. The most important of these were the following:

1. The coverage of industrial licensing was reduced by delicensing twenty-five industries and eighty-two pharmaceutical products.
2. Where licensing remained in operation, procedures were simplified and industrial licensing was much more liberally operated. Furthermore, greater flexibility was provided to producers to expand capacity within existing licensed capacity. Provisions for allowing automatic expansion in licensed capacity, which existed earlier, were liberalized. For a number of products, licenses were "broadbanded" so as to cover similar products, thus allowing flexibility in varying the product mix.
3. The minimum size of assets beyond which a unit is declared a "large house" and subjected to specially rigorous scrutiny in licensing was increased from Rs 200 million to Rs 1,000 million.
4. Twenty-seven industries were added to the list of industries for which large houses are exempted from the special scrutiny normally required.
5. A list of industries was notified where economies of scale are important, and for these industries minimum economic scales of plant were specified. Existing units below these sizes will be allowed to expand freely up to the minimum economic size, and new units will be licensed only for these of higher sizes.
6. A number of items were earlier reserved for production in the small-scale sector, defined in terms of units with investment in plant and machinery below Rs 35 lakhs. In many cases, this investment limit was too low for efficient production of the reserved items. The list of reserved items has been reviewed, and a number of items have been deleted, or in some cases redefined, to enable larger-scale investment to be made for the production of a large number of items.
7. In the area of trade policy, the Government accepted the principle of shifting from quantitative controls to tariff controls. Implementation, however, was left to be determined in the light of practical possibilities. Some tariff adjustments have indeed been made along these lines.
8. No major change was made in the degree of import liberalization in 1985 and 1986, but it was reaffirmed that the liberalization that had earlier taken place over the first half of the eighties would stay in place. The affirmation that import policy would not be reversed was an important signal in a situation where the balance of payments was beginning to show strain.
9. A major step was taken towards rationalization of the indirect tax system in 1986 by introducing a modified value-added tax, covering a wide range of commodities. The system provides for adjustment of the duties paid on inputs against the tax due on output. Although tax rates on outputs were simultaneously raised to avoid any net reduction in effective taxation in the initial stages, it was nevertheless an important reform. The total burden of excise taxation on a commodity is now more apparent since earlier-stage duties are adjusted against the tax. This paves the way for restructuring of indirect taxation in the future. The Government has indicated that restructuring of indirect taxes will be attempted industry by industry.
10. Steps have also been taken to rationalize the structure of customs duties. The range of variation of tariffs for capital goods has been reduced. Tariffs were raised on a number of items earlier allowed at 55 percent duty and lowered on others where the tariff was 101 percent, and all these items now face a uniform duty of 85 percent (inclusive of a 15 percent countervailing duty which offsets the 15 percent domestic excise duty on capital goods). In addition, the customs duty structure for components and raw materials has been both lowered, and rationalized, for selected sectors. It has also been indicated that such restructuring will continue to be made sector by sector.

11. Finally, a number of measures were taken to improve the competitive position of exporters. The procedures for giving exporters access to imports at international prices were further improved in several ways and direct tax incentives for income from exports were strengthened. Some of these measures are applicable to all exporters, but others were aimed at particular export sectors. The customs duties on capital goods for certain industries deemed to have export potential (gems and jewelry, garments, leather, etc.) were reduced to 35 percent in an effort to bring the cost of production in these industries more in line with world prices.

It is too early to evaluate quantitatively the effect of the 1985 and 1986 measures on actual industrial performance. However, there is no doubt that they have contributed to a spurt of investment proposals in these years. The volume of industrial licenses approved in 1985 and 1986 increased very substantially and there was also a large increase in industrial investment proposals in the delicensed category as measured by the number of registrations. Moreover, because of the more liberal approach to technological modernization and import of capital goods for this purpose, the more recent investment proposals embody better technology than has been allowed in the past. Many of them also represent plant sizes which are nearer to economic levels of scale. The full impact of this investment boom and the associated qualitative improvements should be evident in the next few years when the capacities to be created by these investments come on-stream.

An important determinant of industrial performance in India is the performance of the public sector. The creation of a large public sector presence in the Indian economy was one of the explicit objectives of India's development strategy and the success in achieving this objective is evident. Public sector output today accounts for about 45 percent of the output of the organized industrial sector and 30 percent of total industrial output. Its alone ensures that an overall acceleration of industrial growth would require an improvement in public sector performance. This is all the more so since the public sector occupies a dominant position in key infrastructure industries such as power generation, coal, steel and crude oil production, and performance in these areas is crucial to the general level of industrial efficiency.

There can be no doubt that very considerable improvement is needed in public sector performance. The logic of undertaking large investments to create a public sector with a commanding presence implies that it will generate the necessary surpluses to be able to replace capital and finance investment for future growth. The record in this respect has been disappointing. There are heartening examples of very good performance by individual enterprises, but, equally, there are many cases of large and chronic loss makers. The overall generation of resources from this sector is well below the level assumed in the Plan. If the resources contributed by the oil sector are excluded, the performance of the other public sector organizations appears in a much poorer light.

There is no easy solution to the problem of improving public sector performance. Many of the public sector enterprises suffer from earlier noneconomic decisions, which are not always the fault of management. No simple formula will overcome these problems. Many are heavily overmanned, and it is not easy to lay off surplus labor. Some suffer from wrong technology choices or product mix decisions made earlier which impose a continuing burden on the enterprise. In some cases, public sector projects become unviable even before they commence production because capital costs are allowed to escalate to unreasonable levels on account of delays in implementation, usually because the unit was short of funds at the early stages. Still other loss-making enterprises in the public sector are actually former private sector units which had become financially unviable and were taken over by the Government only to protect employment. Each of these pathologies obviously calls for its own solution.

However, a consensus is emerging on one important issue, and that is the need to give management autonomy to public sector enterprises as a key requirement for efficient

functioning. There is no inherent reason why a public sector corporation should be inefficient, if it is run like a corporation. In particular, it must not be subjected to continuous interference from the Government or bureaucracy which demoralizes public sector management and dilutes accountability. Government should set out the corporate objectives of the enterprise and top management must be given the full degree of autonomy needed to achieve these corporate objectives. With this autonomy there must also be accountability. The performance of top management must be judged in terms of the achievement of agreed objectives. The Sengupta committee, which examined the functioning of public sector enterprises and submitted its report in 1985, had recommended that the objective of ensuring autonomy and accountability could be achieved by introducing a Memorandum of Understanding (MOU) which would be jointly agreed between the Government and the top management of the enterprises each year. The MOU would set out the objectives according to which the management performance would be judged and it would also specify actions expected by the public sector enterprise from the Government. As an experiment, the system of MOUs is being implemented for six major public sector enterprises beginning in 1987.

It is important to note that the "privatization" which is often recommended as the answer to public sector inefficiency is not on the agenda. Proponents of privatization obviously regard the public sector as inherently inefficient. No such assumption underlies the policy reform being attempted in India. On the contrary, the basic approach is that a public sector enterprise can be as efficient as any other corporate sector unit can be made to approximate the relationship between shareholders and a corporation.

The policy initiatives described above for improving industrial performance involve a considerable measure of deregulation and therefore may be called economic liberalization but they obviously differ in important respects from the usual liberalization packages often prescribed for developing countries and also undertaken in some cases (though with varying success). The familiar liberalization package focuses heavily on foreign trade liberalization and rationalization of protection. The usual formula is to recommend a first stage consisting of a switch from quantitative to tariff controls, followed by a phased reduction in both the variation in degrees of protection across sectors and also the average level of protection. The whole process is usually expected to be underpinned by an exchange rate depreciation. Often it includes a conscious policy of privatization of the public sector to overcome problems of public sector inefficiency. The differences in the Indian case are evident. Indian policy reform has focused much more on domestic industrial liberalization rather than foreign trade liberalization. There is considerable internal deregulation aimed at strengthening the more efficient domestic firms and encouraging them to invest and expand. This is expected to inject much more competition into the system, creating incentives for reducing costs. The internal liberalization has been accompanied by a policy of maintaining a sufficiently open access to imports to permit modernization and technological upgrading in Indian Industry, which again will reduce costs and promote international competition. As far as foreign trade liberalization is concerned, a broad direction has been given about the desirability of switching from quantitative controls to tariffs, but the movement in this area is limited and certainly does not include imports of final consumer goods. However, significant tariff rationalization measures have been implemented in several sectors. Finally, there is no question of privatization of the public sector. The focus is on management and institutional reform of the public sector to improve its efficiency.

An important feature of the process of policy reform under way in India is that it is gradualist. The system is being subjected to much stronger pressures for efficiency and modernization, but at a controlled pace. The rationale for this gradualist approach lies in the perception that the system should be subjected to pressure commensurate with its ability to respond. Pressures beyond this point is only disruptive.

Financing Development

An important aspect of performance, which has a direct bearing on the longer-term growth potential of the economy, is the ability to mobilize resources for investment. India's recent performance in this dimension is commendable. The rate of gross domestic investment in the economy, which increased only marginally from 17 percent in 1960-61 to 18 percent in 1970-71, then increased sharply thereafter to reach 24.7 percent in 1980-81. It has stayed at that level in the eighties. This investment rate is not high compared with rates achieved in the more rapidly growing middle-income countries, but it is much higher than the rates achieved in all the other low-income countries except China. What is more, the high rate of investment is being financed almost entirely from higher domestic savings, testifying to the success of self-reliance in this sense of the term. The gross domestic savings rate, which was 17 percent in 1970-71, had increased to 23 percent by 1985-86.

There is certainly need and scope for further increased the rate of savings and thereby also the rate of investment. But the levels already achieved, and their evident sustainability, reflect on important structural transformation in the economy in terms of its resource mobilization capability. Even if the investment rate is only maintained at around 24-35 percent, it should be possible not only to maintain the present 5 percent growth rate, but perhaps even to achieve some further acceleration. This is because all available evidence suggests that the incremental capital-output ratio is higher in India than in other countries. This points to the scope for increased efficiency in resource use, a possibility which is confirmed by recent studies of total factor productivity such as Ahluwalia and Goldar which show slower growth in these indices of industrial productivity in India compared with other developing countries.

An important feature of the increase in the aggregate savings rate is that it has occurred entirely because of the rapid growth in private household savings as a percent of GDP. The ratios of private corporate sector savings and public sector savings to GDP have remained more or less constant at 2 percent and 3 percent of GDP respectively, while private sector savings increased from 12 percent of GDP in 1970-71 to 18 percent of GDP in 1985-86. This rapid growth reflects the cumulative impact of a conscious policy of giving strong incentives for private household savings, especially in the form of financial assets. Following nationalization of the Indian commercial banks in 1969 (foreign banks were not nationalized) there was a massive expansion of the banking system spreading bank branches to all parts of the country, including also rural areas. The spread of bank branches definitely helped to mobilize private savings for investment in the organized sector. Interest rate policy was also geared to encourage household savings and for the past ten years or so, rates paid on term deposits with banks and other government-sponsored small savings schemes have yielded positive real rates of return for savers, especially for maturities of three years and above. More recently positive real rates of return have been available even for shorter maturities.

This favorable interest rate policy was reinforced by fiscal incentives for savings built into the direct tax structure which provide deductions from taxable income of the interest earned on a wide range of financial instruments. For certain types of long-term savings instruments, a deduction is also allowed for a part of the amount invested. These incentives, which have been steadily strengthened and expanded in the past ten years, have had the effect of raising the effective pretax return on eligible financial investments. They certainly encouraged the flow of savings into these investments and on the whole probably also stimulated total savings.

The institutional mechanisms for mobilizing household savings for productive investment have been further strengthened in the eighties by the remarkable development of the domestic capital market. Until about 1980 the volume of funds sought to be raised directly from the capital market through equity and bonds was only about Rs 500 crores per year. By 1986-87 this had increased more than tenfold.

This is an impressive rate of expansion by any standard and is indicative of a structural transformation taking place in an important area, which would have very important implications for mobilizing capital and allocating it efficiently. The process is as yet far from complete. The capital market remains thin and vulnerable to manipulation. It lacks adequate depth in terms of the existence of large numbers of active participants, including institutional investors. It is also inadequately regulated in terms of rules for full disclosure and restrictions on trading malpractices, including, in particular, insider trading. These limitations are fully recognized and a number of initiatives have been taken to overcome these problems. The Unit Trust of India, until now the only mutual fund operating in India, and hitherto a conservative income-oriented operation at that, floated a second fund aimed at capital appreciation. The State Bank of India is to float a second mutual fund to complete with the Unit Trust. The term lending financial institutions, which upto now have played only a limited role in the capital market, have been more active in it in the past two years. The 1986 and 1987 budgets liberalized the treatment of long-term capital gains on sale of shares so that the maximum tax on capital gains on shares is only 20 percent for shares held for more than one year. The Government also proposes to set up a National Securities and Exchange Board which will serve as an agency supervising the functioning of the stock markets and setting clear rules on issues such as disclosure, insider trading, etc, to protect the investor. It will also serve as a forum for the development and implementation of ideas aimed at developing a healthy capital market.

In the area of resource mobilization therefore, the economy has shown a reasonably good performance with important structural changes taking place which have strengthened its capability to mobilize and allocate resources efficiently. The principal weak area has been the generation of investable surpluses from the public sector. This weakness has been widely recognized and it is to be hoped that the various measures being taken to improve public sector performance will correct this problem.

Equity and Social Justice

Considerations of equity and social justice have been extremely important in India's development objectives and policies and any evaluation of performance must include these dimensions also. This is not an easy task because of the multidimensional nature of the equity and social justice objective. The concern with income inequality and the need to increase incomes and levels of living for the poorest sections of the population is the most commonly discussed aspect of this objective. However, there are several other dimensions also, which call for distinct policy interventions. These include provision of basic or "minimum needs" for the bulk of the population (not just the poor) relating to health, education, drinking water and sanitation, removal of social disparities arising from caste, providing equality of opportunity at various levels of education to promote vertical mobility, and reduction in regional disparity, avoiding concentration of economic power within the private sector. A quantitative assessment of progress in each of these dimensions is beyond the scope of this chapter, but some broad features of performance and policies can be documented.

A major problem in assessing performance in reducing inequality is the lack of reliable time series data on the distribution of income. The only robust conclusions which can be asserted is that the distribution of income in India, as measured by the usual indicators of inequality, is among the more equal in the developing world. There is also no evidence of any increase in income inequality over time. Data on the distribution of consumption are more readily available and these show a decline up to the mid-seventies followed by a period in which there is year-to-year fluctuation but no trend.

Success in reducing poverty is in many respects more important than trends in relative inequality, and this subject has been extensively investigated in the Indian literature, especially in the context of rural poverty, which is the bulk of the problem. A broad consensus is emerging. Studies have shown that up to about the mid-seventies the

percentage of the rural population living below the poverty line has fluctuated over time, but without any underlying trend. The percentage appears to have increased in years of poor agricultural performance (allowing for appropriate lags) and to have declined in response to good agricultural performance. It has also been argued that the behavior of prices and inflation has an important impact on the extent of poverty with rising prices being associated with an accentuation of poverty.

Although a clear trend does not emerge from the available data up to the mid-seventies, the more recent performance is more encouraging. There was perceptible drop in the late seventies in the percentage of population living below the poverty line and this appears to have continued into the eighties. The Planning Commission has estimated that the percentage of the rural population in poverty declined by 10 percent points in the Sixth Five-Year Plan period (1980-85) from 47 percent to 37 percent.

The pattern of no trend up to the mid-seventies followed by an improvement can be attributed to two factors. One is probably the acceleration in agricultural and nonagricultural growth which took place from the mid-seventies onward.

In the earlier period, overall growth, and especially agricultural growth, was so low that after allowing for population growth, there was only a very modest growth in per capita incomes. Per capita income in the rural areas probably grew at no more than 0.5 percent per year up to the mid-seventies. With per capita incomes growing so slowly it is not surprising that rural poverty was not much reduced. In the second period, growth in rural per capita incomes was definitely higher. If more rapid growth in nonagricultural income earned by rural households is allowed for, the growth in per capita incomes in rural areas in the more recent period could well be in the range of 1.5 percent or so. These growth rates are still only modest, but they represent a definite improvement on the earlier pattern. The regional pattern of growth in the eighties also indicates a shift which would have helped reduce poverty. There is an acceleration in growth in some of the very areas where poverty has been most concentrated, e.g., Uttar Pradesh and Bihar.

These developments suggest that the twin strategy of relying on accelerated growth, especially in agriculture, together with special programs aimed at directly helping households below the poverty line, can produce significant results in a reasonable period of time. The Planning Commission has estimated that the percentage of the population below the poverty line will have declined to 25 percent by 1989-90. The next decade should see a further sharp decline if not virtual elimination in poverty as measured by the standard that has been used thus far.

As noted above, progress in other dimensions of equity and social justice is not so easily documented because of lack of data. But there is no doubt that there has been commensurate growth in most of the other indicators of minimum needs and living standards also. Perhaps the most important recent initiative in this area is the announcement of a New Education Policy aimed at upgrading the quality of education at all levels and accelerating the spread of education. A beginning in implementing this policy is being made in 1987-88 with a massive increase of almost 120 percent in Central Government expenditure on educational programmes. The special focus on education, including adult education, has direct relevance not only for productivity of the labor force but also for equity and poverty removal.

Conclusion

It is appropriate to conclude this overview of India's economic performance and policies with a summary assessment of prospects. The past record shows an economy which has gained in strength and structural maturity in many dimensions. It has certainly emerged from the pattern of sluggish growth evident up to the mid-seventies, to a much better performance subsequently, especially in the most recent years. A growth rate of 5 percent is now definitely sustainable and could even be bettered in future if the considerable

unutilized potential built up from past investment in the economy is effectively exploited. There is considerable scope for reaping such benefits both in agriculture and in industry, with present levels of the rate of investment or modest improvements therein. The policy initiatives being taken in the industrial sector will help to bring about this outcome.

Management of the balance of payments will remain an important problem especially if the objective is to achieve a balance which can finance the sort of growth in imports that is needed to sustain technological modernization in increasing numbers of sectors of the economy. This points to the extreme importance of exports in the years on the industrial front and the changes made in policies towards exporters should help to strengthen India's export capability.

A major factor which will help stimulate virtuous cycles in the Indian economy in future is the expected slowdown in the rate of growth of population. With population growing at over 2 percent per year., much of the growth in production in the past has been absorbed by rising population. However, the prospect of a decline in the rate of growth in population is now at hand. Although fertility levels are declining, the age composition is such that the child-bearing population is expected to increase, and this will affect declining fertility for some time. Nevertheless, the rate of growth of population is likely to slow down from 2.2 percent expect a faster deceleration.

The combined effect of a modest acceleration in economic growth and a gradual decline in population growth would put the economy on a much faster pace of per capita income growth than experienced in the past.

Notes

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