CHAPTER 10

INDIAN ECONOMY

STATUS OF INDIAN ECONOMY: PRE INDEPENDENCE-PERIOD (1850-1947)

- India is believed to have had the largest economy of the ancient and the medieval world and controlled between one third and one fourth of the world's wealth. It was prosperous and self-reliant and had flourishing cities and self-sufficient villages.
- Village life featured a simple division of labour based on factors like race and class, with agriculture as the main occupation and skilled artisans contributing high-quality products for the global market.
- **'Arthashastra'**. Ancient Indian guide by ation, Chandragupta Maurya, emphasizing material well-being, agriculture, fair tax and true kingship prioritizing people's welfare, with seven vital state elements.
- The advent of the Europeans and the British marked a shift in the economic history of India.
- British colonialism shifted India's trade to raw materials during the Industrial Revolution, harming local industries with discriminatory tariffs, leading to the decline of Indian handicrafts and disrupting the traditional village economy.
- Higher production on account of industrial revolution in Britain necessitated raw materials and markets for finished goods for which India was made the target.
- This, along with adverse imperial policies towards Indian manufacturing and the ease of importing cheap machine-made goods decreased the competitiveness of Indian manufactures and reduced their domestic demand leading to a virtual destruction of the Indian manufacturing sector.
- The consequence of collapse of manufacturing sector was felt heavily on agricultural sector in the form of overcrowding on farms, subdivision and fragmentation, subsistence farming, low productivity, lower incomes and aggravated poverty.
- Colonial India experienced industrial growth from the mid-19th century, excelling in cotton milling, jute production, and various industries. By the early 20th century, it ranked twelfth globally in industrial output.
- Hindered by policies influenced by English producers, the expansion of producer goods industries. was limited,
- Despite industrial progress, India's economic transformation was modest, with the manufacturing sector contributing only 7% to the net domestic product by 1946.

INDIAN ECONOMY: POST-INDEPENDENCE (1947-1991)

- Post-independence, India faced rural poverty and illiteracy. Nehruvian policies focused on state-led industrialization and economic redistribution through centralized planning.
- The 1950s emphasized heavy industry, with the Industrial Policy Resolution of 1956 favouring public sector expansion. Foreign investment and trade policies shifted in response to a balance of payments crisis in 1958.
- The 'Hindu growth rate' averaged 3.5% from 1950 to 1980. In the mid-1960s, there was a shift towards agricultural priorities, leading to the Green Revolution.

- The period of 1965-1981 saw economic decline due to factors like the license-raj, external shocks, and equity-driven policies. The Monopolies and Restrictive Trade Practices Act of 1969 aimed at regulating large firms.
- Late 20th-century realization prompted a revaluation of policies, acknowledging that strict regulations hinder growth. There was a shift towards incentivizing openness for sustained rapid economic growth.

THE ERA OF REFORMS

1. Early liberalization efforts in the 1980s aimed at changing India's inward-oriented trade and investment practices.
2. These "reforms by stealth" included delicensing industries, introducing flexibility, raising MRTP firm asset limits, implementing MODVAT tax, and establishing SEBI, contributing to higher GDP growth.
3. Despite the positive impact, structural obstacles hindered growth. Private sector investments faced challenges from convoluted licensing, public sector reservations, and excessive government controls.
4. The MRTP Act and import controls created barriers, limiting the effectiveness of these reforms.
5. The 1980s reforms fostered confidence in policymakers regarding the efficacy of policy changes for sustained economic growth.
6. They laid the groundwork for the more comprehensive and organized reforms of the 1990s, emphasizing the acceptance of well-regulated competitive markets as drivers of economic development.

THE ECONOMIC REFORMS OF 1991

- India embarked on a bold set of economic reforms in 1991 under the Narsimha Rao government. The causes attributed to the immediate need for such a drastic change are:
- In the 1980s, fiscal initiatives for economic growth led to persistent deficits, financed by substantial domestic and external debt.
- The resulting high public debt and balance of payments strain were intensified by the Gulf War's impact on oil prices.
- With foreign exchange reserves critically low at $1.2 billion, economic reforms were prompted.
- Tightened import restrictions to address the crisis negatively affected industrial output, and India turned to the IMF for external borrowing, subject to stringent conditions.
- The fragile political situation along with the crises in the economic front ballooned into what may be called a **'crisis of confidence'**.
- The year 1991 marked a profound shift in Indian economic philosophy, moving away from the centrally directed and heavily controlled model towards a more market-oriented approach.
- This transformation was prompted by the collapse of the Soviet Union and China's success with outward-oriented policies.
- The comprehensive reforms in 1991, often referred to as **liberalization**, **privatization, and globalization,** had dual objectives: first, to reorient the economy toward market-friendliness, and second, to achieve macroeconomic stabilization by significantly reducing the fiscal deficit.
- Triggered by economic, fiscal, and balance of payments crises, the reform package focused on a core set of mutually supportive measures.

- These measures were categorized into **short-term stabilization actions,** addressing issues like inflation and balance of payments, and **long-term structural reforms** aimed at enhancing productivity and competitiveness by eliminating rigidities in various sectors of the economy.

THE FISCAL REFORMS

In 1991, escalating deficit levels prompted a need for fiscal discipline to address a crisis caused by excess domestic demand, increased imports, and a widening current account deficit. Radical measures were taken to augment revenues and curtail government expenditure, aiming to stabilize the economy by reducing the fiscal deficit.

Measures to this effect included:

1. Introduction of a stable and transparent tax structure,
2. Ensuring better tax compliance,
3. Thrust on curbing government expenditure
4. Reduction in subsidies and abolition of unnecessary subsidies
5. Disinvestment of part of government's equity holdings in select public sector undertakings and
6. Encouraging private sector participation.

In order to bring in fiscal discipline, it was essential to do away with the temptation to finance deficit thorough the easy path of money creation. Therefore, the government entered into a historic agreement with the Reserve Bank in September 1994 to bring down the fiscal deficit in a phased manner to nil by 1997-98.

MONETARY AND FINANCIAL SECTOR REFORMS

- In 1991, comprehensive monetary and financial sector reforms were implemented with a focus on efficiency and transparency. Notable measures included interest rate liberalization, the introduction of new private sector banks, and a reduction in reserve requirements like statutory liquidity ratio (SLR) and cash reserve ratio (CRR) in line with the Narasimha Committee recommendations.
- These reforms also aimed at fostering competition among public, private, and foreign banks. Additionally, liberalized bank branch licensing policies allowed flexibility in opening, relocating, or closing branches.
- Prudential accounting norms were introduced to ensure accurate financial reporting, on asset classification and provisions for bad debt.

REFORMS IN CAPITAL MARKETS

The Securities and Exchange Board of India (SEBI) which was set up in 1988 was given statutory recognition in 1992. SEBI has been mandated as an independent regulator of the capital market so as to create a transparent environment which would facilitate mobilization of adequate resources and their efficient allocation.

THE 'NEW INDUSTRIAL POLICY

✓ The 1991 New Industrial Policy aimed at substantial deregulation for a more competitive industrial economy.

- ✓ It ended the 'License Raj,' removing licensing restrictions for all industries except strategic ones.
- ✓ Public sector involvement was limited to strategic sectors, and the MRTP Act was restructured.
- ✓ De-reservation of goods for small-scale industries and liberalization of foreign investment were introduced.
- ✓ External trade was liberalized, shifting to a negative list approach, and tariff rates were significantly reduced.
- ✓ Rupee was devalued by 18%, and current account transactions became officially convertible at market rates.
- ✓ Disinvestment in public sector enterprises provided autonomy and professional management, reducing budgetary support.

TRADE POLICY REFORMS

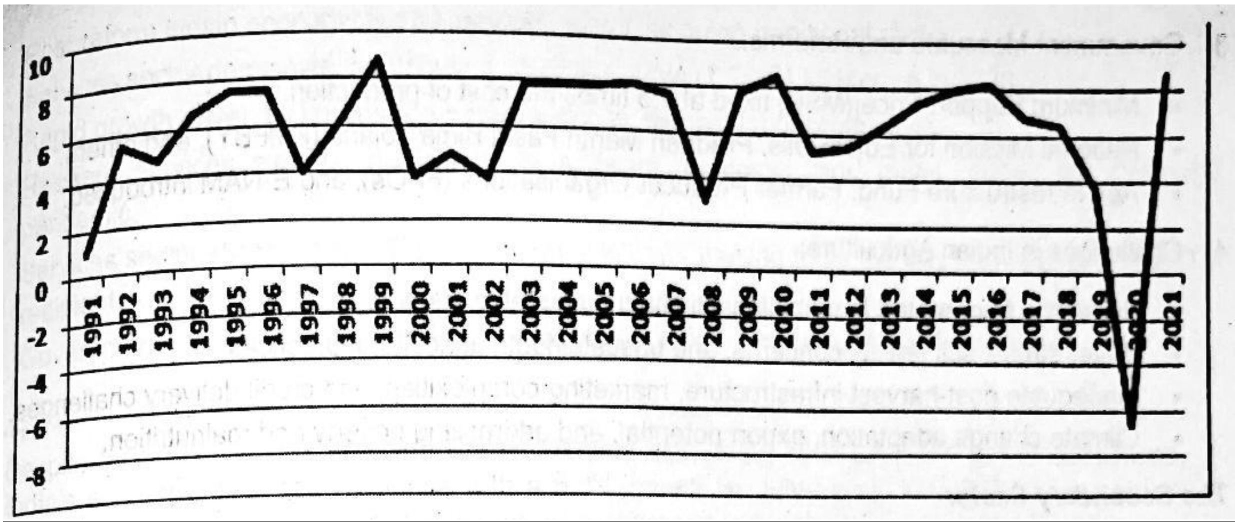
1. 1991 trade policy reforms aimed at dismantling import/export restrictions, simplifying tariffs, and removing import licensing.
2. Over 31 years, India integrated into the global economy, reduced government intervention, and witnessed private sector growth.
3. Easing trade controls enabled access to foreign technology and finance, and India now holds substantial foreign exchange reserves.
4. Reforms led to poverty reduction, increased competition in banking and insurance, infrastructure growth, and a decline in agriculture's value-added share.
5. Challenges include high fiscal deficit, inflation, and a debt-to-GDP ratio of 86% in FY21/22, higher than the average for emerging markets.

GDP GROWTH RATES POST 1991 REFORMS

Year	GDP Growth (Annual %)	Year	GDP Growth (Annual %)
1991	1.056831	2006	8.060733
1992	5.482396	2007	7.660815
1993	4.750776	2008	3.086698
1994	6.658924	2009	7.861889
1995	7.574492	2010	8.497585
1996	7.549522	2011	5.241315
1997	4.049821	2012	5.456389

1998	6.184416	2013	6.386106
1999	8.845756	2014	4.410228
2000	3.840991	2015	7.996254
2001	4.823966	2016	8.256306
2002	3.803975	2017	6.795383
2003	7.860381	2018	6.453851
2004	7.922937	2019	3.737919
2005	7.923431	2020	-6.59608
		2021	8.681229

GDP Growth (Annual %) – India from 1991 to 2021



Source: Extracted from GDP growth (annual %) - India - World Bank Data.

data.worldbank.org> indicator> NY.GDP.MKTP.KD.ZG

NITI AAYOG: A BOLD STEP FOR TRANSFORMING INDIA

1. NITI Aayog replaced the Planning Commission in 2015, emphasizing market-oriented governance and cooperative federalism.
2. NITI Aayog's objectives include fostering a shared vision with states, promoting inclusive development, and serving as a think tank for strategic policy frameworks and program evaluation.

The key initiatives of NITI Aayog are:

a. **'Life'** which envisions replacing the prevalent 'use-and-dispose' economy

b. The **National Data and Analytics Platform (NDAP)** facilitates and improves access to Indian government data

c. **Shoonya** campaign aims to improve air quality in India by accelerating the deployment of electric vehicles

d. **E-Amrit** is a one-stop destination for all information on electric vehicles

e. India Policy Insights (IPI)

f. **'Methanol Economy'** programme is aimed at reducing India's oil import bill, greenhouse gas (GHG) emissions, and converting coal reserves and municipal solid waste into methanol, and

g. **'Transforming India's Gold Market'** constituted by NITI Aayog to recommend measures for tapping into the potential of the sector and provide a stimulus to exports and economic growth

THE CURRENT STATE OF THE INDIAN ECONOMY: A BRIEF OVERVIEW

Indian economy based on the three sectors namely, primary, secondary and tertiary.

The Primary Sector

1. Agricultural is the largest source of livelihood. India emerged as a major producer, e.g., largest milk, pulses, jute, and spices producer and World's sixth-largest food and grocery market with retail contributing 70% of sales.
2. Agricultural Growth and Contribution:
    - Agriculture contributes 18.8% to Gross Value Added (GVA) as of 2021-22.
    - Agriculture and allied sectors recorded 3.5% growth in 2022-23.
    - Private investment in agriculture increased to 9.3% in 2020-21.
3. Government Measures and Reforms:
    - Minimum Support Price (MSP) fixed at 1.5 times the cost of production.
    - National Mission for Edible Oils, Pradhan Mantri Fasal Bima Yojna (PMFBY), and others.
    - Agri Infrastructure Fund, Farmer Producer Organisation (FPOs), and E-NAM introduced.
4. Challenge in India Agriculture:
    - Small and fragmented landholdings, limiting marketable **surplus.**
    - Water stress, soil fertility concerns, and unsustainable agricultural practices.
    - Inadequate post-harvest infrastructure, marketing complexities, and credit delivery challenges.
    - Climate change adaptation, export potential, and addressing poverty and malnutrition.

The Secondary Sector

1. Indian Industries Overview:
    - Contributes 30% to India's GDP, employee over 12.1 crores.
    - Encompasses diverse sectors: manufacturing, heavy industries, textiles, defence, tourism.
    - Informal sector share is over 50% of GVA.
2. **Industrial Growth:**
    - Manufacturing sector: 78% of total production.
    - Manufacturing GVA: US$77.47 billion in Q3 2021-22.
    - Core industries index: 142.8 (Sept 2022).

- Manufacturing PMI: 55.4 (Jan 2023).

3. **<u>Government Initiatives:</u>**
    - 'Make in India,' 'Ease of Doing Business, 'National Single Window System.
    - PM Gati Shakti National Master Plan, National Logistics Policy, PLI Schem.
    - Industrial Corridor Development, FAME-India Scheme, 'Udyami Bharat', PM MITRA.
4. **<u>Foreign Investments:</u>**
    - 100% FDI in various sectors, FDI reforms across defence, pension, e-commerce.
    - Abolishment of FIPB, introduction of Foreign Investment Facilitation Portal (FIF).
    - Total FDI inflow in 2021-22: US$58.77 billion.
5. **<u>Trade and innovation:</u>**
    - Remission of Duties and Taxes on Export Products (RoDTEP) 2021.
    - Focus on fostering innovation, start-up ecosystem, and strengthening IPR regime.
6. **Challenges:**
    - Infrastructure and manpower shortages, reliance on imports, and exchange rate volatility.
    - Challenges for the MSME sector in terms of credit availability.
    - Unsustainable cost structures in some industrial locations, inefficiencies in public sector industries.
    - Global supply chain disruption, inflation, and economic uncertainties.

The Tertiary Sector

- Post-reform Indian economy led by services sector, skipping traditional shifts.
- Services sector dominates, contributing 53.89% to GVA (7 96.54 lakh crore in 2020-21).
- Rapid growth driven by knowledge-based services, highest labor productivity.
- Resilient services exports, particularly in software, business, and travel, during the Covid-19 pandemic.
- Services sector attracts over 60% of FDI equity inflows, making India the seventh-largest global FDI recipient.
- Government measures, like liberalized investment policies, facilitate foreign investments.

Despite facing challenges from the Russia-Ukraine war, rising oil prices, and global disruptions, India's economy exhibited resilience with a 6.3% growth in July-September 2022-23, driven by robust private consumption and investment, as highlighted in the World Bank's India Development Update.