

**Discussion on the Case**

# India 2014: The Challenges of Governance















# Import Substitution Policies and Consequences

Policies	Consequences
Subsidies to agriculture and unproductive state-owned industry	Slow growth
Restrictive labour laws	Low productivity, goods not internationally competitive
Import substitution and extremely high import tariff	No investment compared to other Asian countries (21.7% of GDP in 1991 – Exhibit 3)
No FDI (kicked out Coca Cola etc.)	Corruption
License-quota-permit Raj: restrict domestic competition and industry expansion	Created groups opposed to reform: Employees in state-owned firms Domestic industrialists Bureaucracy
Government ownership of banks & industry	High government debt High inflation (14% in 1991) Persistent CA deficit (Exhibit 4); loss of reserves → BoP crisis necessitates IMF loan

# Washington Consensus Policies

<b>Internal stability</b>	<b>Improve productivity</b>	<b>External stability</b>
Fiscal discipline	Increase health and education expenditure	Competitive exchange rate
Tax reform	Secure property rights	Remove barriers to trade and FDI
Interest rate liberalisation	Privatisation & deregulation	

Q1. How has liberalisation worked for India?

Q2. What were the key strategy to achieve this growth acceleration?

# India's Growth Strategy

Resource Accumulation	Improving Efficiency
<p>Savings rate up from 21% in 1985 to 30% in 2010 (Ex. 3)</p> <ul style="list-style-type: none"> <li>• Mostly from private savings</li> <li>• Budget deficit going down 2003-08 (ex. 6)</li> <li>• Foreign savings: CA deficit up from -1.65% of GDP in 1991 to -4.8% in 2012 (calculations from Ex. 3 and Ex. 4)</li> </ul>	<p>GDP share moves from agriculture to high-value-added service sector (Ex. 3); manufacturing stays constant as a share of GDP</p> <p>Lifting restrictions on private sector scale and scope (end of "license permit raj)</p>
<p>I/GDP up from 24% in 1990 to 33% in 2013</p>	<p>Lowering tariffs leads to international competition, obtaining inputs and capital goods for industry</p>
<p>Lifting restrictions on foreign investment</p>	<p>Allow private sector participation in several sectors: banking, telecom, etc.</p>
<p>Importing technology and managerial talent from abroad</p>	<p>Maintain political stability during transition</p>
<p>Tapping diaspora for entrepreneurial talent</p>	
<p>Accessing external markets especially for sectors like software</p>	

# Assessing India's Political System

- Has India's political system been a help or a hindrance during this gradual reform process aimed at accelerating growth?
- Has the presence of coalition governments slowed down the reform process?
- Why has the Congress government, which depends much less on coalition partners after the 2009 election, nevertheless been unable to implement major reforms?

# **Services sector driven growth**

What does it mean to India?

# Bird's Eye View

- In the developed economies **2/3rd** of GDP comes from Service Sector
- In the less developed economies **2/5th** of GDP comes from Service Sector
- India is fast emerging as a emerging as a service sector based economy
- Services accounted for as much as 43 per cent of GDP in 1996-97

# Sector-wise Average Shares and Growth Rates

Period	GDP Growth rate	Agriculture & Allied		Industry*		Services**	
		Share in GDP	Growth rate	Share in GDP	Growth rate	Share in GDP	Growth rate
1951-52 to 1979-80	3.5	<b>46.7</b>	2.2	<b>14.5</b>	5.5	<b>38.6</b>	4.5
1980-81 to 1990-91	5.6	<b>36.0</b>	4.4	<b>19.7</b>	7.3	<b>44.2</b>	6.4
1991-92 to 1999-2000	5.8	<b>28.8</b>	3.0	<b>22.0</b>	6.0	<b>49.3</b>	7.5
2000-01 to 2013-14	6.7	<b>16.5</b>	2.5	<b>27.6</b>	7.6	<b>56.0</b>	8.5

\* Inclusive of mining and quarrying and electricity, gas and water supply.

\*\* Inclusive of construction

# The Services Sector

- In India's economy, the contribution of service sector is less, compared to many
- But, India is fast emerging ...
- As people grow richer, more demand for services arise
- India has a pool of cheap manpower
- But, leaping over manufacturing sector, and going for services may prove disastrous

Should we go for services-led growth?

# For the service sector

- Dependence of economic growth on the monsoons has clearly vanished
- Financial savings of the household sector has overtaken the savings in physical assets
- Higher rate of return in service sector
- Less capital-intensive

# Against the service sector

- Requires massive investment in communication overhauling of regulations to cut hassle
- “**Jobless growth**” of the services
- Over dependence on the foreign economy – trade and FDI have been important channels of services growth (Banga, 2005)
- Under utilization of vast natural resources
- Theoretically, service can contribute only less to the growth of the GDP
  - This is because unlike manufacturing, capital growth does not result in higher productivity in services because services are usually labour-intensive in nature (mostly in skilled-labour) (Think of salon services!)
  - Some counter examples to the above - New age communication services (IT-services), where spending on technological capital may result in improved labour productivity
  - Similarly, in banks (financial services) - increased spending on IT capital has helped in reducing the overall cost of operation

# Macroeconomic Implications of Service Sector-driven Growth

Does the service sector dominance promote

- stability of overall economic growth?
- unbiased growth?
- Sustainable growth?

# Services Growth and Urban-Rural Disparity

- Rural share in NDP dipped from 62% in 1970-71 to 48% in 1999-2000 and continued the trend thereafter
- Service sector has an **urban bias**
- No significant transfer of labour from agriculture to non-agri sectors
- The employment absorption pattern: the entire decline in employment in organised sector of industry is absorbed by services
- Increased output distributed favourably towards urban households: Increased household savings from 19% in the 1980s to 27% in 20014-15

# Sustainability of Services-led Growth

Whether services-led growth in India is sustainable or not, will also depend on its **inter-sectoral linkages with the other sectors**:

- In general, the services sector exhibits lower correlations with agriculture and industry
  - **For example**, high agri. produce of cotton, wheat etc. may result in lower raw material cost for industries such as textiles, food processing, etc.
  - These inter-linkages ensure that growth across sectors is **even** and that a rise in output/ productivity of one sector traverses to the other resulting in overall growth in the economy . For example, consider the precipitous fall in prices of IT goods in the 1990s, which resulted in fast penetration of IT based goods in the manufacturing sector
  - Productivity growth in IT hardware producing sector → lower prices of IT hardware → higher spending on IT in other manufacturing industries (and agri. sector) → higher productivity growth in the IT using sectors
  - This is an example of growth traversing across sectors

# Sustainability of Services-led Growth

## Does services sector exhibit these sectoral linkages in the economy?

- Perhaps not! - Economists are somewhat divided
- To the extent **services growth results in increased expenditure on producer services** - that enhances the efficiency of production by allowing higher level of specialisation in manufacturing, there is still a case **FOR** the services-led growth
  - Economists favoring services-led growth argue that India's service sector may be successful in creating its 'own demand' since higher use of services in the manufacturing sector has not only lead to higher output growth in manufacturing sector but also improved productivity in the manufacturing sector
  - Growth in services is found to be growth inducing and has led to higher productivity in the manufacturing sector in the 1990s (source: Banga, 2005)