RESTORING INDIA TO THE TRACK OF HIGH GROWTH, SOCIAL & ECONOMIC INCLUSION AND STABILITY

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INTRODUCTION

1. The title notes the three pillars that constitute the challenge of the present. However, the relative emphasis on each of the three has strayed in this speech from being equitable, which is largely a consequence of the limitations of length. Economic growth is imperative to create the necessary jobs and livelihood opportunities for our young people and take the Indian economy and her people to a higher level of income and standard of life. In recent times India has been feted as an economic power. This is somewhat anticipatory, in recognition of the potential that exists. It should be underscored that where India stands today[1], Sri Lanka had crossed over in 1999, China in 1997, Indonesia and the Philippines in 1988, Egypt in 1983, Thailand in 1982, Malaysia in 1971, Brazil, most of Latin America, Russia and South Africa yet earlier.

2. In 2012, as we identify with BRICS and G20, it is worth remembering that in these forums we are by far the poorest. In the BRICS group, our per capita income is 16 per cent of the average of the other four; in the G20 it is lower. The next higher nation in both lists is China and our per capita income is 26 per cent that of our northern neighbour. The use of per capita income as an indicator for relative prosperity may be questioned. However, it remains a crude and reliable metric for relative underdevelopment.

3. These differences also obtain for other measures of direct material inputs or well-being – be it electricity generation, energy consumption, access to safe drinking water &

[1] The comparison here is to per capita GDP at *constant* prices in US dollars

sanitation, health outcomes and housing. Till a couple of decades ago our record on literacy and the enrolment of children in schools was slow to improve. That has changed dramatically over the past three decades, even as questions on the quality of learning are rightly coming to the fore. Our broader population has just begun to get a taste of modern life and its amenities. To achieve well-distributed material modern amenities even at modest levels, we have a long distance to go. It is therefore grotesque, when the objective of economic growth is questioned in our context. The attitudes and preferences of the developed West are not so readily portable.

4. Economic growth is of course not an end in itself. It must lead to improved earnings and livelihood for the widest sections of the population. It must cater to the aspirations of the populace and especially that of the young. It must be balanced in terms of regional development. It must not only successfully result in the inclusion of economically weaker sections, but most particularly of those who historically have been at the social margins. Attention has to be paid where desirable outcomes are not necessarily generated by the prevalent social dynamic, such as in the case of women and children's health, gender equity and the protection of rights of marginalized sections. Social and economic outcomes must provide opportunities for advancement and cater to the willing, diligent and enterprising, which means that barriers to entry has to be whittled down and competition encouraged.

5. Stability has diverse dimensions but is a desirable objective from every perspective. The dire consequences of instability in external payments and on the fiscal front are in abundant evidence – in Europe, most recently. The global crisis of 2008 directly flowed from financial sector instability. The deep-rooted changes that are underway across the globe and which is shifting the polarity of the world will inevitably create new stresses and volatility in economic and financial conditions. In this situation, being well grounded in a domestically stable environment is prudent. The ability to maintain balance in regional economic development and in social and economic inclusion will

not only permit us to draw on the fuller potential of our economy and society, but it is of vital importance to generate social stability in all of its aspects.

GROWTH ACCELERATION POST 1991

6. However, one looks at the data, the fact of the acceleration of economic growth in the decades after the economic reforms of 1991 is inescapable. There was a setback in the second half of the 1990's for a variety of reasons – both domestic and international – but growth did pick up momentum in the early years of the next decade and ramped up to a level that most may not have expected. The Tenth Plan (2002-2007) period averaged 7.8 per cent growth, the highest ever and in formulating the Eleventh Plan (2007-2012), targeting of a 9 per cent rate of growth must have seemed to be par for the course with the last two years of the previous plan period having had 9.5 per cent growth.

7. The first year of the Eleventh Plan (2007-08) did produce 9.3 per cent growth, but the crisis of 2008, the drought of 2009 and the politics of 2010 and 2011 did slow things, notwithstanding fairly strong growth in both 2009-10 and 2010-11. That the average growth in the Eleventh Plan has turned out to be 8 per cent is testimony to the resilience of the growth dynamics of the country.

8. While that does not take away the hard reality of the depth of the slow down experienced in 2011-12 and in 2012-13, it is worth recounting because one too often hears the lament that India has so to say permanently shifted to a lower growth trajectory of 5 or 6 per cent growth.

9. Nothing is permanent – at least in life. The strong fail and the weak rise. Good performance can yield to the indifferent and vice versa. The only thing that is constant is endeavour. Not discounting the role of luck for the individual, in the case of nations

as a whole, changes in outcome are the consequence of concrete factors, of decisions taken and not taken, of execution well done or gone awry.

10. It was never inevitable that just because we got 9 per cent growth three years running, we will therefore continue to get 9 or at least 8 per cent growth. By the same token it is not inevitable that just because the economy has slipped for the most recent two years running, that is now its inevitable course. Indeed part of the problem in recent years arose from our success in negotiating the global crisis. We came out of it well and weathered the weak monsoon of 2009 and found that we were back to 8 plus per cent growth in 2009-10 itself [2]

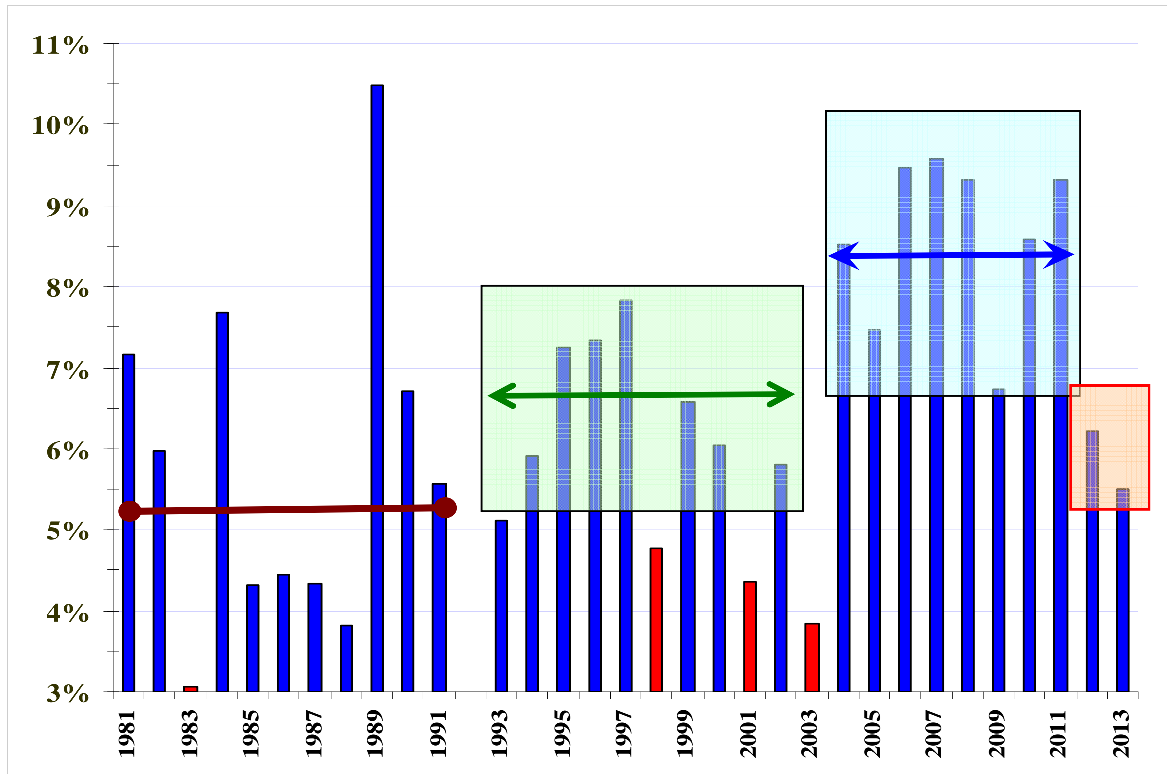
11. Little wonder that hubris set in. 'This was the Asian century' a voice in our head seemed to be telling us. 'It doesn't matter what we do, we will get 8, if not 9 per cent growth'; it's in the stars. 'We dine at the head table; ergo we must be economic hot shots'. Part of the problem is that many of our elites are fortunate to be able to have a lifestyle in India that is hard to distinguish from that of their counterparts in the developed West. That does not however change the material reality of India. Our national needs remain that of a poor developing nation.

12. The ramping up of the rate of growth in the past decade had some distinctive elements and was driven by a sharp pick up in domestic investment and savings rates. If we look over the previous three decades it is clear that not only did the rate of growth pick up, but also the variability of annual growth reduced sharply, testimony to the deepening of the economy and of its growth drivers. (see Chart 1)

[2] Upon release of Quick Estimates for 2010-11 on 31 January 2013, three days after the lecture was delivered, we find that we had notched 8.6 per cent growth in 2009-10 and 9.3 per cent in 2010-11.

Chart 1

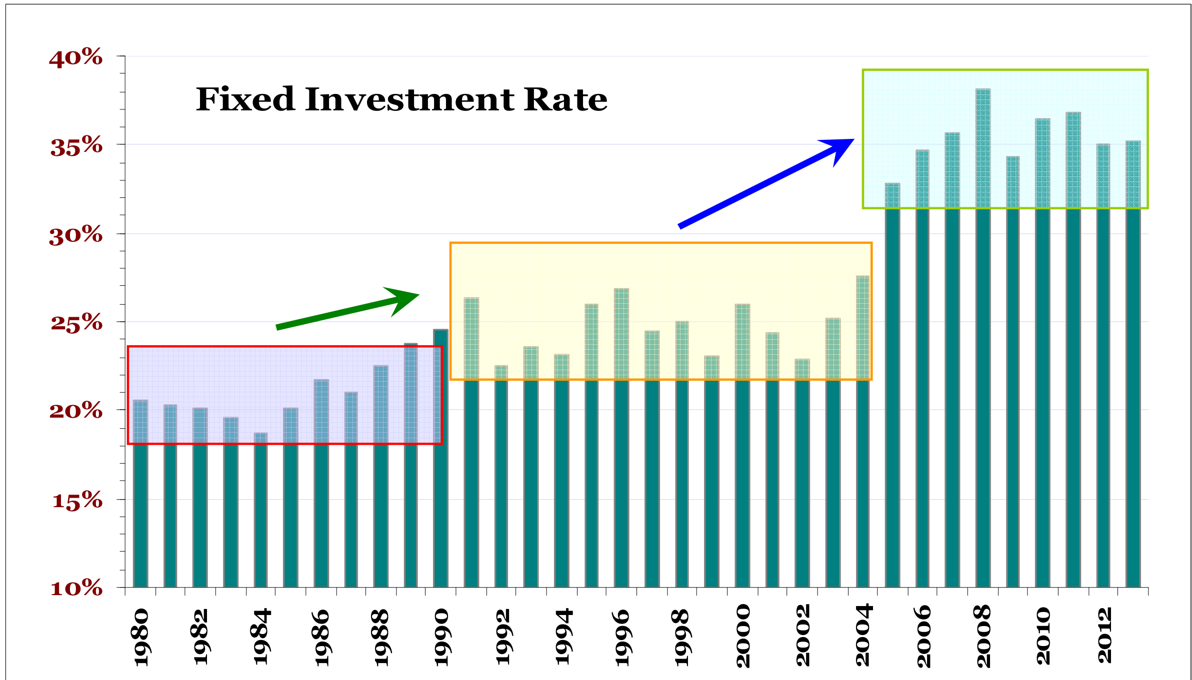
India – The Growth Record

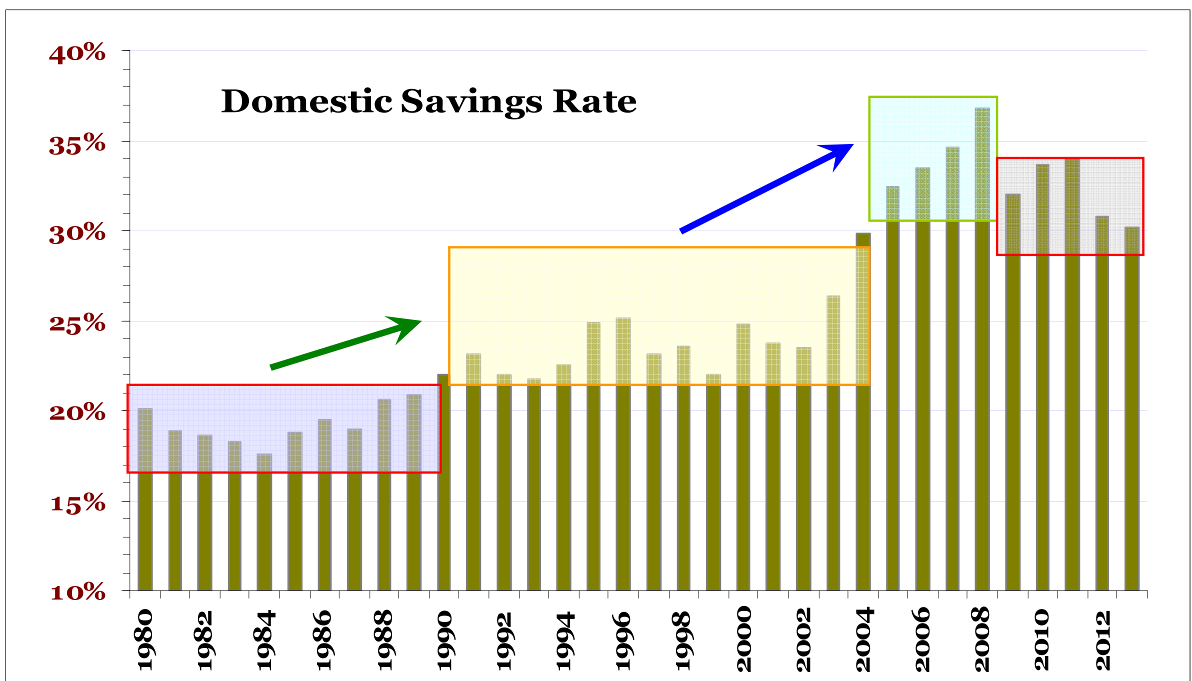


13. The investment rate picked up somewhat in the nineties and then again very sharply from 2004-05 onwards when it jumped to 33 from 28 per cent in the previous year. The fixed investment rate rose to over 30 per cent in 2005-06, peaking at close to 33 per cent in 2007-08. Though it has come off in subsequent years, it still remains over 30 per cent. The investment rate at about 35 per cent, lower than the peak of 38 per cent in 2007-08 but still high whether in comparison to our own history or in comparison with other emerging economies – except of course China. In parallel our domestic savings rates rose to well over 30 per cent, peaking at 37 per cent in 2007-08 and remains presently at over 30 per cent, notwithstanding the weakening of government and to some extent of corporate finances since 2007-08. (Chart 2).

Chart 2

India – The Investment & Savings Rates





14. The investment rate of 35 per cent in recent years, even if we were to knock off the 1.5 per cent *incrementally* immobilized in the form of deployment to gold holdings, is still high and comparable to that in 2005-06. Such a level of investment is not consistent with the growth of 6.5 per cent in 2011-12 and the 5.7 to 5.9 per cent indicated by the Finance Ministry for 2012-13. With inflation running at close to double digits, inadequacy of domestic demand was not a factor in limiting growth. We therefore need to understand how we got such a poor outcome in terms of growth.

15. In the past two decades there have been four separate episodes of growth slumps. The first was in 1991-92 when GDP growth plummeted to 1.4 per cent and that of the non-farm sector to 2.6 per cent. The second was in 1997-98, the third in 2002-03 and the fourth in 2008-09. Of these only in 1991-92 was the decline in growth across-the-board and that can readily be put down to the deep crisis in that year. So too, albeit to a lesser extent, the slowdown in 2008-09. In 1997-98 the sharp fall in farm output exacerbated the weakening in the industrial sector and in 2002-03 farm output fell so steeply that it swamped the improvement in non-farm activity. However, the decline in growth in 2011-12 and 2012-13, keeping in mind the level of the investment rate and fixed asset creation, appear to be unduly low, except relative to 1991-92, with which it ought not to be comparable.

16. An important clue is provided in the reversal of the magnitude at which fixed investment at constant prices grew year-to-year. A sharp uptick in the rate of growth in fixed asset creation in 1994-95, sustained in the next year kicked-off overall economic growth northwards. The same happened a decade later. In fact the median annual rate of growth in fixed capital formation in the years 2003-04 to 2007-08 was as high as 16 per cent. This slumped in 2008-09, recovered somewhat in 2009-10 and 2010-11, but

turned south once again in 2011-12 and possibly in 2012-13.[3] That is, the pace of new investments slowed down sharply in the recent two years.

17. Besides this, some commonsense things we do know. There are power projects that are running far short of capacity because of shortages of fuel, both natural gas and coal. There are manufacturing plants, especially in the south that are losing output on account of inadequate power availability, There are many large power and other infrastructure projects under construction that have been delayed on account of clearances being withheld. There are mines that are not functioning on account of closure orders. It should not then be a surprise that, even with the extant fairly high level of capital formation,[4] current output is growing much below what should have been the outcome.

18. When it comes to new projects and new commitments by the corporate sector the explanation for a dearth of enthusiasm is not hard to find. There is first, the global economic and financial situation, which does not exactly stir the fire of ambition, i.e. risk taking, in the heart of enterprise. Second, are the long delays in project clearance and the vitiated political atmosphere which has lowered expectations about decision making. Third, is the negative impact of the deterioration in general macroeconomic fundamentals – be it higher inflation, fiscal and current account deficits. Last, but not least, is the weakening of corporate profitability which has further aggravated the difficulty of raising equity by simultaneously weakening balance sheets and reducing valuations.

19. A few words on the last element. Investments do not increase when profitability is falling. Profit margins after dropping from 2007-08 levels, recovered a bit in 2009-10 and 2010-11, but slipped again in 2011-12. In the first half of 2012-13 there appears to have been a small improvement, but it remains to be seen if it is sustained in the full

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[3] We now know that at constant prices fixed investment in the private corporate sector declined by nearly 4 per cent and overall fixed capital formation rose by little over 4 per cent.

[4] The investment rate at constant prices in 2011-12 was nearly 38 per cent and that at current prices 35 per cent of GDP.

year. Stronger profits infuse equity and reduce debt, while supporting higher operational volumes. Profit erosion does the opposite. We can see that leverage has mostly gone up. What is interesting is that the sharp increase in leverage actually starts out from 2007-08 and relative to that point, the subsequent increase in 2011-12 has been small.

20. That probably should tell us something about the assets to which finance was committed in 2007-08: That they have not paid out as expected, that outside equity infusions which were anticipated (and were expected to replace part of the debt) did not materialize and has not since. It suggests that a large order of equity infusion is a necessary pre-condition to improve risk appetite. That can take many forms – from the inter-connected nexus of completion of projects and resultant revenue flow, to improved margins, to better valuations and outside infusion. Public policy cannot directly address profitability, but improved macroeconomics and helping project completion, can certainly assist in the cure

RETURNING TO THE HIGHER GROWTH TRAJECTORY

21. The two year slowdown in growth has been a harder knock for the Indian economy, compared even to the 2008 global crisis, or at least the immediate effects thereof. We have to dig our way out of the hole that we find ourselves in. It is true that the global environment is not supportive, but that is neither here nor there – it is quite beyond our control. Internally, the key displacement has been the souring of business sentiment, in conjunction with eroded profitability and higher leverage, which have impacted new investment commitments. That needs to be remedied, at least to the extent that it flows from the domestic framework.

22. First, economic policy-making must look to finding solutions that are driven from reform, i.e. are internally sustainable. The reform process that had got pushed to the side, in the hothouse climate that was created in the recent past, has now yielded to clearer-cut path clearing which must continue with pace. Second, a systemic solution to

the culture of delayed and denied clearances that have bogged down projects in the infrastructure space must be found and implemented. The recently constituted Cabinet Committee on Investments has the potential of doing exactly that – but like in everything, the proof of the pudding is in the eating. Macro-management must yield positive result in finding a better balance. Inflation is slowly cooling and fiscal policy is on the track of consolidation – politically hard and costly as it has been and was always bound to be.

23. On the external payments front we have to find sustainable solutions to reducing the current account deficit, while creating space for the flow of foreign capital – especially for long-term investors, both of the direct and portfolio varieties. Closer integration with both our economic neighbourhood in Asia and in the Indian Ocean region, as also with our other important economic partners has great potential to assist in the process of stabilizing external payments, besides improving access to both technology and markets and generating the valuable externality of self-conscious mutually beneficial co-existence.

24. The medium and long term path to improving the state of Indian economy and society lie in a dramatic overhaul of both our physical and social infrastructure. One without the other will not do. Our resources – financial, physical and organizational – are limited. Which is why, it is all the more important, that we remain vigilant in containing the demands for diversions of these scarce resources and pool what is available in a result-oriented and focused manner.

25. Until the 1970s, it was hard for most to accept that it may be possible to sustain high growth extended over any significantly long period. We could say that this was an era of growth “pessimism”, not “optimism”. Hence, global economic hierarchies were viewed as self-perpetuating and eternal for all practical purposes.

26. Per capita incomes in the industrialized nations of the West grew at a rate of between 1.0 and 1.8 per cent between 1820 and 1950, whichever time-slice one chooses to zoom in to. Britain was close to 1.1 and the US to 1.6 per cent over their 130 year-long journey from 1820 to 1950.[5] There was a pick up to 2.4 per cent in the post war period (1950-73), but it then eased down. In Japan, the post-war period saw very rapid growth in Japan, but that did not upset the contention as it was about reconstructing an already developed economy.

27. The rigours, political burdens and mediocre results of self-conscious "planned" economic development in the former communist world, did not also hold out promise for sustained fast growth, even for the "mixed" economy model. I say this with some 20/20 hindsight, as the rigours and the mediocrity of the results were not to be fully known till much later.

28. The fast pace of growth in South Korea, Taiwan, Hong Kong and Singapore (the so-called New Industrialized Countries or NIC) was seen as atypical. They were small, two of them city states, who also benefited from the particularities of geo-political support in the Cold War. That South Korea started out from a point worse-off than India, lacking in every element of developmental input, was surprisingly not seen to be material – at least from the viewpoint of growth pessimists, that is.

29. The "miracle" in South East Asia did begin to finally erode the scepticism, but the achievements were unfortunately tarnished by the currency crisis of 1997. The multi-decade and continuing explosion of growth in China finally and conclusively proved that very high rates of economic growth could indeed be sustained over a long time frame and that too only in a market-oriented framework. But success at this self-conscious development of the economy needs particular attention to detail and a felicity in implementing decisions and in executing projects.

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5 From the work of Angus Maddison, published as Monitoring the World Economy, OECD Development Centre, Paris, 1995.

30. As I have said earlier, in India, the available investible resources, the institutional and organizational capacity of the economy, remain available and adequate to support the return to a higher trajectory of growth. With somewhat adverse international conditions that could mean 8 per cent. With better conditions it should mean 9 per cent. These remain achievable targets and we must strive to realize them.

SUPPLY CONSTRAINTS & INFLATION

31. Analytically the emphasis in understanding the process of, and limits of economic growth, has focused on demand, as therefore has models of macroeconomic management. The underlying assumption being that supply would always be created to cater to such demand. Indeed it would tend to be in excess of incremental demand, leading thereby to the inevitability of competition, business cycles and in a later era, of the supposition that this property of competition is a public good in need of protection and regulation. The framework was appropriate for the industrialized west which took centuries to make the passage.

32. For developing economies, who because (a) slow transition was no longer an option in an integrated modern world and (b) they wished to make the transition quickly, the framework had to be necessarily different. This was indeed recognized early on and divergent approaches emerged in the post Second World War period which argued on the one had for the possibility and on the other, the impossibility of market-oriented self-sustaining development. The focus was somewhat limited, zeroing on quite correctly on investible resources, the capacity to pay for imports of equipment and other ingredients of modernization, technical education and on improving farm productivity. The challenges of building institutions, especially that of enterprise, and mediating between contending interests in a world where advanced country sensibilities were understandably dominant were not anticipated.

33. The advantages of having an open society is that it is so much better in fostering and giving space to enterprise – tiny, small and big. There is spontaneity about the process, and in the wake of large businesses, many small and tiny ones thrive. The rigidities in supply, particularly where there are governmental and/or regulatory action involved, can and do have the power to create persistent shortages.

34. Our experience of a hundred years has made the word "black-market" an indelible part of our lexicon. Started by our colonial masters at the onset of the First World War, rationing of foodgrain and restrictions on stocks and movement, was built on a deep distrust of the market, of the private sector and a touching faith in the probity, competence and alertness of the bureaucracy. Perhaps there was merit in the decisions taken a hundred years ago, perhaps not. Be that as it may, this approach became an ideology, till it began to be dismantled partly in the 1980s and substantively after 1991. Do we have a "black-market" in anything these days? That the answer is "no", should be cause for considerable satisfaction.

35. However, that does not mean that we lack in shortages. Since we are an open economy, by definition, the shortages are limited to non-tradeables. India has had power shortages ever since the early eighties, once we had crossed the *Laxman Rekha* of what Prof Raj Krishna once despairingly described as the "Hindu" rate of growth. The terms "power cut" and "load shedding" is also now an integral part of our lexicon. As indeed is "jam" and the various euphemisms for jumping the multiple queues that meander in the domains where citizen meets state. Power, roads, railways, ocean ports, airports, safe drinking water, sanitation, sewage treatment, urban transport, housing – all these are where India tries to make do without enough and that too of sub-standard quality.

36. Then there are the shortages of onions, tomatoes, potatoes and aubergines. Prices shoot up and we can do little. Is it that there is not enough output growth? On the contrary. Horticulture production has really taken off, growing by 5 to 7 per cent each year as farmers, even in remote areas, gain access through much improved road networks to a

burgeoning urban market. But the logistics are poor and the marketing system in dire need of reform as antiquated arrangements such as the Agriculture Produce Marketing Committee (APMC) Acts come in the way. Guilds are monopoly structures, which the APMC in fact is. Like guilds in the West once did, it solves the problem of scale economics (or rather the absence of it) and enforces standards and conduct. However, that time is long past and we need to be able to reform regulations so that the logistics, handling and storage system can be modernized, thereby reducing wastage, improving price realization for the farmer and lowering the delivered price to the consumer. The season for availability will also get extended, on account of the combination of better geographical network, modern storage and protected agriculture. The seasonality of “seasonal” produce can also largely become a thing of the past.

37. The result of these shortages has both directly and indirectly led to higher inflation. The direct consequence is obvious. The indirect path has been the result of the way Indian enterprise had of trying to negotiate the constraints imposed by shortages in infrastructure services and by the regulatory system. To compensate for inadequate grid power, diesel generating sets provide expensive captive power. Constraints in goods movement means higher transport costs and often higher inventory carrying costs. Inadequate municipal infrastructure is the plea for restricting the vertical growth of cities, which results in expensive and inadequate housing; in high real estate costs for commercial activity, including hotels and restaurants. Having the highest hotel tariffs in Asia, ex-Japan, is surely not a prescription for keeping the cost of doing business down or for encouraging tourism.

38. Therefore the upshot of perennial shortages has been inflation at a level higher than that of our comparator countries. In the 1980s and 1990s, India had average annual inflation of 9.1 and 9.6 per cent respectively, when the median inflation for 32 major emerging economies was 18.5 and 20.4 per cent respectively. So even as we had high inflation, we were placed much lower than the median; indeed we were in the first quartile in both

of the two decades.[6] More pertinently, the average inflation in China in these two decades was 7.5 and 7.8 per cent, lower than ours, but not by much. Several Latin American countries, including Brazil and Argentina suffered hyper-inflation in both decades, as did the transition economies in the nineties.

39. In the period between 2004 and 2012 our average inflation rate was 8.4 per cent, lower than it had been in the eighties and nineties. However, the world had changed and we were now over the median value of 7.5 per cent. The first quartile was much lower at 4.3 per cent. In China inflation averaged 3.1 per cent. Most of Asia and Latin American had inflation in the range of 3 to 5 per cent. In sum, 17 of the 32 major emerging countries had inflation rates lower than us and most of those that had higher were resource exporters like Venezuela, Iran and Angola.[7]

40. Our inability to stick with our targets of 5 per cent – which would have been as the record shows, quite appropriate – was the result of supply side rigidities, which in the face of surging income growth created enough granularity for inflationary momentum to build up. It would not be complete if one fails to mention that the political economy of pricing regulated products, where high current inflation was often used as a reason to defer price and distribution reform, only resulted in generating other distortions, that on the one hand reinforced some supply rigidities and accommodated wasteful use, while on the other, prevented the economy to adjust to changes in relative prices of energy in an efficient manner.

41. Relatively higher rates of inflation and recurring episodic bouts of spikes have been a heavy burden for the conduct of both monetary and fiscal policy. It has burdened our enterprises with higher costs. The erosion of profitability and of balance sheets, mentioned previously, derives considerably from this. Second order effects include

[6] In the eighties the comparison is for 29 nations, excluding 3 who are from the former Soviet bloc where inflation numbers for eighties are not available. The first quartile for 29 countries in the eighties and for 32 in the nineties was 9.6 and 9.8 per cent respectively.

[7] Average inflation as measured in terms of consumer price indices. From the World Economic Outlook database of the IMF, October 2012

weakening of our external payments situation by eroding export competitiveness, supporting a level of oil import higher than what would have been otherwise and encouraging a level of gold imports higher than it may been otherwise. The dynamic has been shifted in the wrong direction.

42. Which is why, it is vital that we ensure that the supply side rigidities, which have been such a distinctive part of the Indian landscape, must now begin to pass into history. If over the next four or five years we are able to make a sizeable dent in this, and there is no reason why we cannot, the greatest incomplete task of reform would have been finally achieved.

TRADE & OF CAPITAL FLOWS – THE REGIONAL ELEMENT

43. The increasing regional concentration of international merchandise trade is vitally important to understand. In 2010, the second largest regional trade block was in Asia (excluding the Middle East), amounting to $2.5 trillion, 62 per cent as large as that of the leading regional trade concentration in Europe ($4.0 trillion). Two decades back in 1990, intra-Asian trade had been a quarter the size of intra-European trade.[8] The proportion of Asian origin exports to other Asian markets increased to 53 per cent in 2010. Not only is the developing world, and Asia in particular, becoming proportionately more important in international trade, but the trade within the region and potentially that with Africa and Latin America holds the promise of further expansion and deepening.

44. The source and direction of capital flows are also slowly shifting. In 1990, 95 per cent of FDI outflows originated in advanced economies. In 2011 this had fallen to 73 per cent, even as the total value of flows rose from $242 billion to $1.7 trillion. On the destination side, the share of developing economies rose rapidly from 17 to 45 per cent between 1990 and 2011, of which the inflow into Asia increased over the two decades

[8] International Trade Statistics (2011) and that for previous years, published by the World Trade Organization, Geneva

from 11 to 28 per cent. The proportion of FDI originating in the developing world jumped from 4.5 per cent ($11 billion) in 1990 to 23 per cent ($384 billion) in 2011. The share of developing Asia on the destination side was 28 per cent of global inflows ($423 billion) and on the destination side 17 per cent of total outflows ($280 billion).[9]

45. There are major differences within the developing world in net national savings rate, as reflected in differences in current account balances. It is possible that there will be some mitigation in the magnitude of these differentials. However, it is likely that in the future, the magnitude of incremental savings arising in Asia and other developing economies will be proportionately larger than that which may reasonably be expected to arise in the advanced economies.

46. To a great extent Asia has come to become a major locus of capital flows with several centres acquiring considerable significance in financial intermediation. The shift in the polarity and geography of both capital flows and of its intermediation will be as powerful a dynamic as the shift in the geography of production and international trade.

47. Thus, the geography of global finance will change. The dominance of conventional centres in New York, London and Frankfurt will yield to centres in the developing world – most particularly in Asia. Hong Kong and Singapore already have acquired increasingly enhanced roles as centres of financial mobilization and fund raising activity. Asia is simultaneously a major source of savings as also of demand for investment financing. Skills have gradually become internalized and regulation and market structures seem to be supportive of these two island centres to expand very much more. We need to be able to figure out how India can fit into this changing landscape in a manner reflecting her aptitudes and needs.

FUTURE PROSPECTS

[9] World Investment Report (2012), UNCTAD, United Nations, New York and Geneva, 2012

48. We are at a momentous juncture in history where the greatest change in global economic polarity in the past 300 years is underway. Where economics sail, trade, investment and political power are inseparable companions. In 2000, as much as 80 per cent of world output arose in the advanced world and 20 per cent in the emerging. Just twelve years later in 2012, only 62 per cent of global income arises in the developed world and 38 per cent is generated in the developing world. By about 2021, the split is likely to be 50:50. The order and speed of change is indeed mind-numbing.[10]

49. Developing Asia has taken its share from 7 to nearly 18 per cent of world income. China and Russia have more than trebled their respective shares to 11.5 and 2.7 per cent. Brazil and India have nearly doubled their shares to 3.4 and 2.7 per cent respectively. The BRICS group has seen its share of world income rise from 8 per cent in 2000 to 21 per cent in 2012. By the end of the present decade, the share of China is likely to increase to 15 per cent, while that of India may go up to 5 per cent and the BRICS group to 28 per cent.

50. India with a GDP of about $2 trillion in 2012 was the tenth largest economy in the world, packed just behind Italy and Russia and poised to overtake both in 2013. By 2017, India may overtake France, the UK and Brazil to become the fifth largest economy in the world. In another five years India may pull past Germany and Japan, becoming the world's third largest economy.

51. China came from far behind to become the world's second largest economy in 2010. By 2017 she is likely to be two thirds the size of the USA and almost as large as the Eurozone. Sometime around 2025, China may overtake the USA to become the largest national economy and also larger than the 27 member European Union. It is a striking story and in many ways lights the way before our own course – both to the potentials and the pitfalls.

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[10] Data used here and subsequently is from the World Economic Outlook (October 2012) database of the IMF and from the United Nations portal on National Accounts Statistics. For future periods, the IMF projections up to 2017 are used. Thereafter the estimates are that of the author.

52. It should however be noted that even as the economic polarity of the globe is being shaken up, China and for that matter India too, will remain relatively poor countries in comparison with today's advanced economies. As a proportion of per capita incomes in the USA, in 2000, that of China was 2.7 per cent. This improved several-fold to 12.2 per cent in 2012. However, at $6,000 per head, China's income levels in 2012 are still modest, whether in absolute or relative terms. Even when in the middle of the next decade the Chinese economy is expected to exceed that of the USA, China's per capita incomes at $21,000 (2012 prices) will be comparable to where Slovenia, Greece, Portugal and Czech Republic are today. It will still be a quarter that of the USA and little more than half of that in Brazil. Another decade on and China's per capita incomes are not likely to exceed a third of that in the USA.

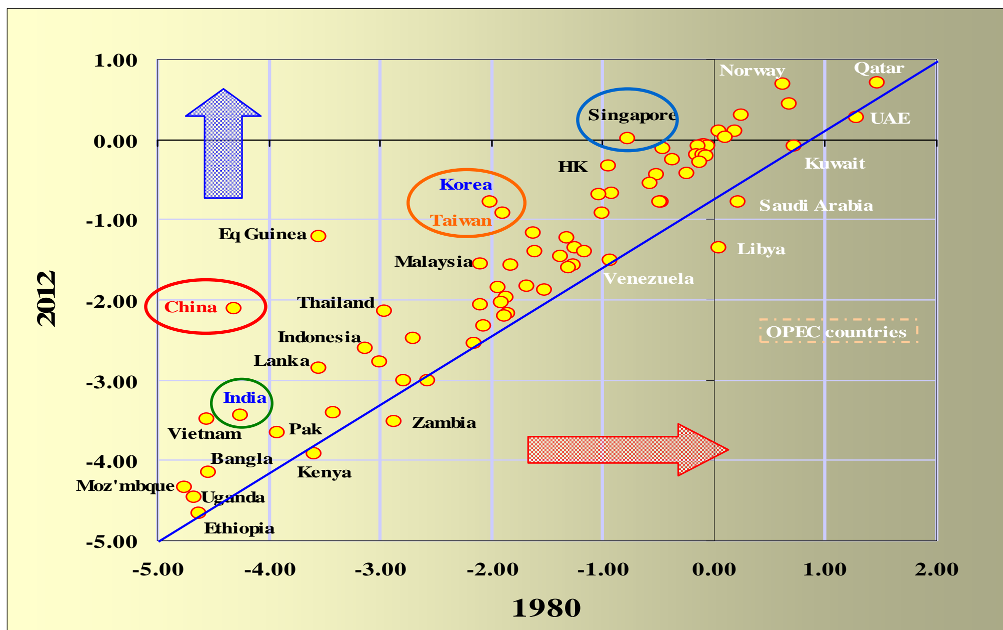
53. This is even truer in our case. From a mere 1.3 per cent of US per capita incomes in 2000, we have improved to 3.2 per cent in 2012. By the mid-2020s, our per capita incomes are likely to see a dramatic improvement from the current level of $1,600 to being in the range of $7,500 (at 2012 prices) – but it still will be only a tenth of what the USA level at that point in time is likely to be. Comparable to where Romania, Colombia and South Africa are today; and a third lower than where Brazil, Poland and Argentina are presently. The short point is that if we get our act together, we as a nation will be able to make considerable progress. But at the end of the next 15–20 years, we will remain at best a middle income country by today's standards, in the fourth decile of the distribution and 40 per cent below the median. For comparison in 2012, we are located in the third decile and 70 per cent below the median.

54. In recent years, the idea of a "Middle Income Trap" waiting around the corner to trap Asian economies with hubris-filled heads in the air, has gained some currency. Fundamentally it is an older debate about the growth process and what drives it. As is known the eighties threw up a considerable literature on "convergence" with the European project primarily in mind. Expanded beyond the European context it acquired "conditional" characteristics. The short point is that if the stock of capital and labour

were the only determinants of growth, it is not possible to explain differences in inter-country experience and therefore there must be other factors where nations and societies vary – as indeed they do. In the context of self-conscious organization of national growth, the focus on productivity enhancing elements – especially those that flow from human capital, organizational and regulatory structures, functioning of markets, scientific & technological research and innovative approaches to problem solution – are of great importance.

Chart 3

Changes relative to USA for 73 Countries – 1980 to 2012

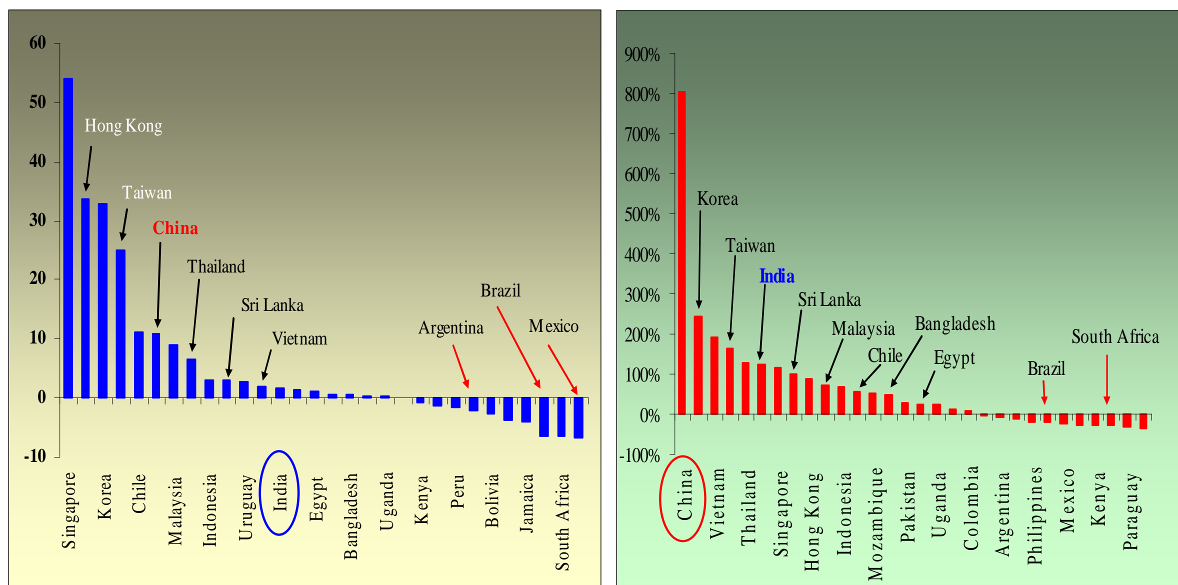


55. What has been the experience of countries in the past three decades? Expressing per capita income as a proportion of US per capita incomes, the distribution of individual countries presented at Chart-3 should be of some interest. We have the log values of the ratio for 1980 on the horizontal axis and that for 2012 on the vertical axis. Those lying over the diagonal have improved their relative positions and those lying below it have seen deterioration. Further those who have been able to move to the quadrant(s) above it

have improved their position the most,[11] as have those who have crossed over beyond the USA from having been below it (namely Singapore). In the former set are Korea, Taiwan, China and Equatorial Guinea. To a less pronounced extent and Malaysia, Thailand, Indonesia, Sri Lanka and India.[12] On the other hand, the group that has most noticeably slipped are the traditional oil exporters, underscoring the limits of resource-based economic expansion.

Chart 4
In NIC & the Emerging world, who moved and by how much

Change in Percentage Points **Percentage change**



56. The use of logarithmic values does not quite bring out the magnitude of change. From Chart-4, we can appreciate its truly incredible extent. Singapore was able to improve its relative position vis-à-vis the USA by as much as 54 percentage points from 46 to over 100 per cent. The relative movements of Korea, Taiwan and China have also been huge.

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11 A level of 5 per cent corresponds to –3.0, 10 per cent to –2.0 and 37 per cent to –1.0. Thus, China went from 1.4 to 12.2 per cent, Indonesia from 4.4 to 7.3 per cent, Sri Lanka from 2.9 to 5.8 per cent, while Thailand went from 5.2 to 11.7 per cent. India improved from 1.4 to 3.2 per cent.

12 Equatorial Guinea has benefitted from recent large oil discoveries and if experience is any guide it would follow the path of the traditional oil exporters in time. For some time the gains can be incredible: oil took Equatorial Guinea from $263 in 1995 to $14,855 per capita in 2012.

On the right-hand side, it is relative effort that is shown, which is dependent on the starting point. The experience of China is exceptional. India too fared reasonably well. However, all emerging countries did not gain as indeed the declines on the right side of both charts show. Most of these are Latin American, Caribbean economies and South Africa. In many ways the improvements in the past decade has restored some of the salience that they lost in the hyper-inflationary and debt-wracked years of earlier decades, especially that of the eighties.

INCLUSION – THE REGIONAL BALANCE

57. In the national interest economic growth must be broad-based across the States and regions of the country. Over the past three decades, the evidence suggests that this objective has been achieved to an extent and further that the process has been more pronounced in the past decade.

58. Using per capita incomes, and defining improvement as an unchanged or improved ratio vis-à-vis the all-India average, we would find that between 1980-81 and 2011-12, of the seventeen large States,[13] as many as eight definitely have improved their relative position. In the more recent period 2001-02 to 2011-12, of the twenty larger States, as many as twelve have improved their relative positions. Of the States which has seen erosion in their relative positions, most are in the northern and eastern parts of the country.

59. Further, in the past decade, several States with lower incomes have shown a sharp acceleration in growth, namely Bihar, Odisha, Rajasthan, Madhya Pradesh and to some extent UP as well. There is less of a widening of the divergence amongst lower income States, while in the higher income groups there is more. The median of growth rates for the larger 22 States in the Eleventh Plan period was 8.3 per cent, higher than the 7.9 per cent recorded in the Tenth Plan and much greater in previous plan periods. As many as

[13] Three new States were created in the period, namely Chhattisgarh, Jharkhand and Uttarakhand.

16 of the 22 larger states, which includes six that are traditionally considered to be low income, averaged growth in the Eleventh Plan period that was greater than the national average. Of the states that are traditionally considered weaker, only three had average growth in the Eleventh Plan lower than the national average. But, it must be pointed out that growth even in these three States ranged between 6.9 and 7.3 per cent.

60. The standard deviation for growth in these 22 states was lower at 1.6 per cent in the Eleventh Plan compared to 1.8 per cent in the Tenth Plan and 2.6 per cent in the Eighth Plan. The coefficient of variation (CV) which adjusts for the level of median growth shows that the Eleventh Plan had the lowest CV of 19 per cent compared to 22 (Tenth Plan), 27 (Ninth Plan) and 44 (Eighth Plan) per cent. The distribution of growth rates also showed significant improvement in favour of the slower growing states. The first quartile value for the Eleventh Plan was 7.3 per cent compared to 6.0 (Tenth Plan), 3.9 (Ninth Plan) and 4.4 per cent (Eighth Plan). In the Eleventh Plan period, of the seven smaller north eastern states (excluding Assam), five experienced average rates of economic growth that were higher than the national average.

INCLUSION – CONSUMPTION DISTRIBUTION & MEASURES OF POVERTY

61. Household consumption expenditure surveys conducted by the National Sample Survey Organisation (NSSO) forms the basis of our analysis about family consumption baskets and by extension of consumption poverty. The Planning Commission has traditionally been tasked to estimate poverty which it does on the basis of methodologies established by expert committees.[14]

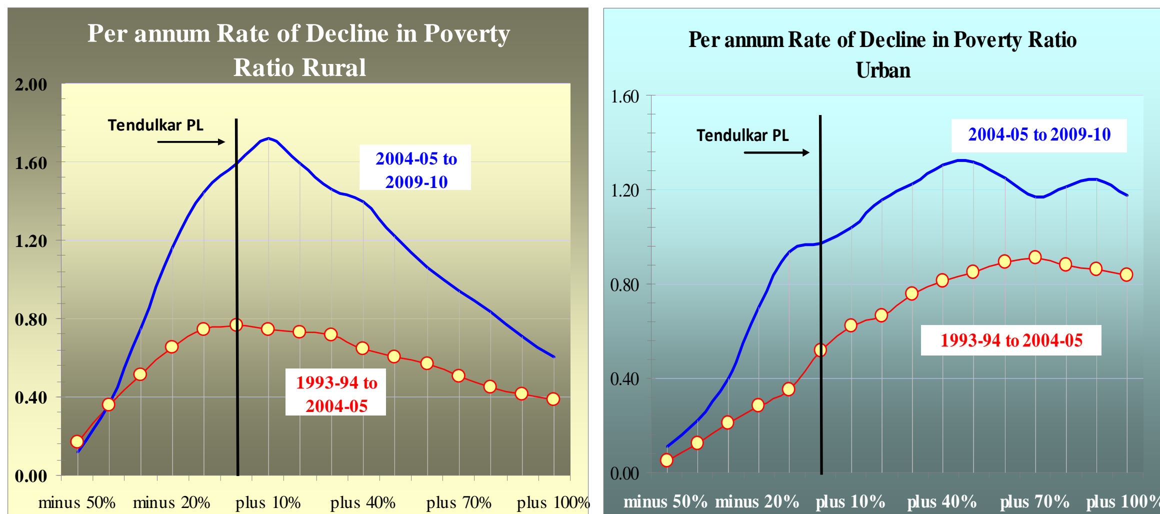
[14] Till recently the official estimate of poverty was based on the recommendations of the expert committee chaired by the late Prof. D. T. Lakdawala (1993). Over the years the findings on poverty made in line with the methodology of the Lakdawala Committee began to be criticized as being “too low” and not in line with the general advancement of the economy. In 2005, the Planning Commission appointed a new expert committee chaired by the late Prof. Suresh Tendulkar, which made several deep-rooted changes in the methodology for adjusting poverty lines to price changes and substantially revised upward the rural poverty line vis-à-vis the Lakdawala Committee, both for 1993-94 as well as for 2004-05..

62. What constitutes a "fair" poverty line has always been a contentious issue. This primarily flows from the fact that poverty, and in a broader sense deprivation, is a cultural construct specific to a point in time and space. It is not conceivable that the sense of what constitutes poverty should remain unchanged as society grows wealthier, incomes rise and modern amenities become widely available. Progress by its inherent nature does and should recalibrate the notion of what constitutes poverty and deprivation.

63. The methodology of the Tendulkar Committee was applied to the NSSO survey of 2009-10. It was found that the poverty ratio was just below 30 per cent for the country as a whole and had declined by 7.3 percentage points between 2004-05 and 2009-10. The annual rate of decline in this period was twice as large as that for previous period, namely 1993-94 to 2004-05.

Chart 5

Annualized Rate of Decline in Poverty Ratio – Comparison of two time periods



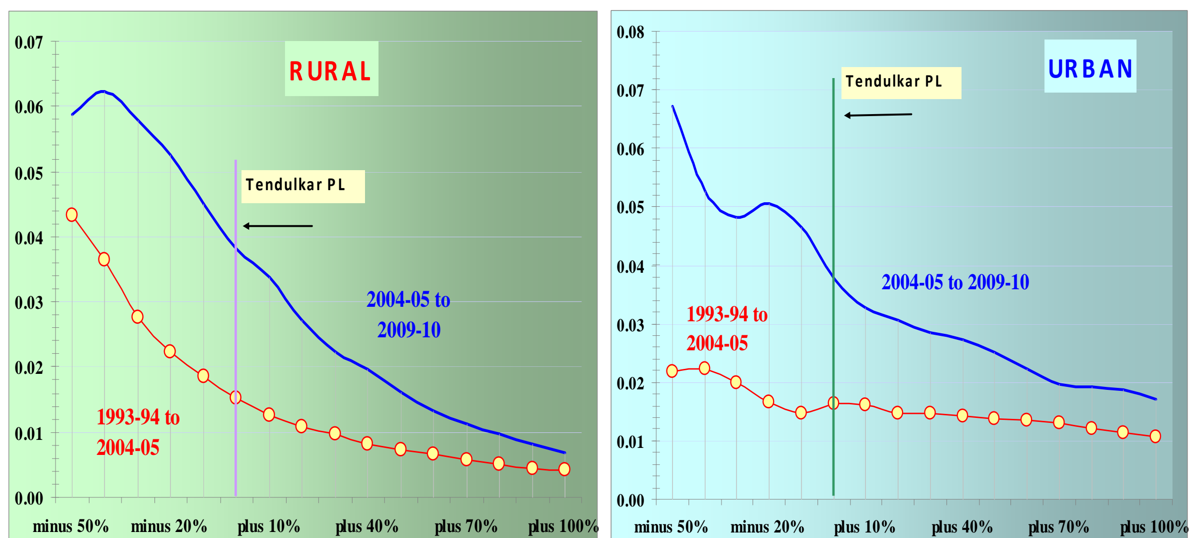
64. This finding was criticized by some for having used a poverty line described as being too "low". However, the finding that poverty has declined much faster in the period 2004-05 to 2009-10 is valid irrespective of where we choose to draw the poverty line. If we use the Tendulkar poverty line (PL), the decline in the period is found to be 7.3

percentage points. If we use a poverty line 30 per cent higher, the decline would be 7.8 percentage points. Likewise at a PL that is 50 per cent higher, the decline would be 6.5 percentage points. (Chart-5)

65. In fact, the pattern of decline in the poverty ratio for different levels higher and lower than the Tendulkar PL shows that the decline not only occurs at every level higher or lower than the Tendulkar PL, but that the decline is strongest at lower levels of PL, particularly in rural areas. This is clearly brought out in Chart-6, where the rate of decline is expressed in terms of the poverty ratio in the first period.

Chart 6

Annualized Rate of Decline in Poverty Ratio – Comparison of two time periods



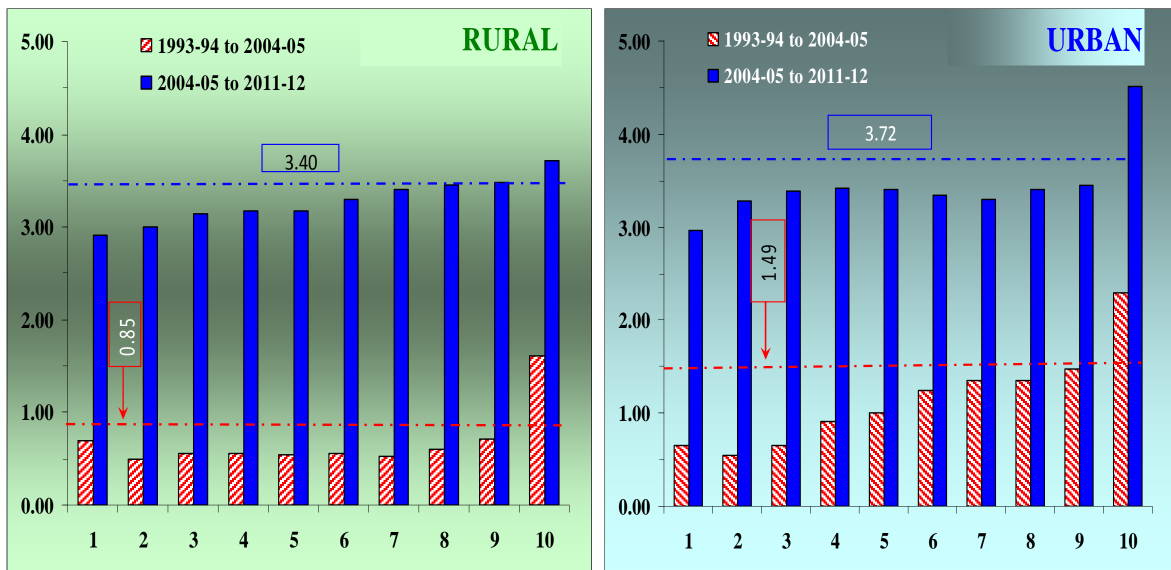
66. The NSSO has conducted large consumption surveys for 2011-12. The detailed unit level data is not available. However, the summary distribution at the all-India level for consumption expenditure which has been made available yields a most revealing picture. At Chart-7, we have presented the annualized change in per capita monthly consumption expenditures at constant prices. The rate of change between 1993-94 and 2004-05 is plotted together with that between 2004-05 and 2011-12 separately for rural and urban populations. On average for rural households, the rate of annual increase is

found to have improved from 0.85 per cent between 1993-94 and 2004-05 to 3.40 per cent for the period between 2004-05 and 2011-12. For urban populations, the figures are 1.49 and 3.72 per cent for the two periods.

Chart 7

Rate of Increase in MPCE$_{URP}$

Two periods 1993/94-2004/05 and 2004/05-2011/12



67. This is a massive order of improvement in household consumption expenditure and by extension in household incomes as well. Not only is the increase large at the average level, but the improvement is evident in every section of the population – from the poorest in the first decile, right through to the top. The magnitude of the improvement is also at comparable levels as between rural and urban populations.

68. The evidence of improved vertical inclusion unites many different dimensions of public policy, including improvement in rural and social infrastructure, improved farm output (income) growth, expansion of livelihood and other opportunities and capacities. The broad-based expansion of incomes and consumption at the end of the day is the eventual outcome that economy building is targeted at.

CONCLUDING COMMENTS

69. The opportunities that we as a people and a nation have to bring about a dramatic improvement in the living conditions of our 1.2 billion citizens, is immense. That is particularly true in respect of the young to whom we are duty bound to bequeath a society better than the one that we were born into. But it is not going to be smooth sailing.

70. I have tried to throw some light on the magnitude of the transformation that is underway, which will throw up both unprecedented opportunity and also challenges. To successfully cope with them will need investment in our own institutional capacities, innovative thinking and discipline in conduct. There will be many pitfalls along the way and we need to step with care and deliberation. Not all countries can win; some will lose out – some more, some less. So far we have stayed on the positive side of the ledger, though the gains of others show that we could have done better. And better we must do in the years and decades ahead.

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