UNIT 2 GROWTH AND STRUCTURE OF THE INDIAN ECONOMY

Structure

2.0 OBJECTIVES

As you go through this unit, you will be able to:

- identify the growth path of the Indian economy since 1951;
- differentiate the stages of growth through which the Indian economy has evolved;
- recognise the factors that contributed to rapid growth in different stages;
- become familiar with the structural change that the Indian economy has gone through post-independence; and
- understand the medium to long-term prospects of India's economic growth.

2.1 INTRODUCTION

Different sectors of the economy, such as agriculture, industry or services employ natural, human, and material resources and contribute to the aggregate flow of goods and services during a given time period which may normally be specified as a year. This aggregate flow of final (as distinct from intermediate) goods and services constitutes the national product of the economy. Alternately, if the economic activity comprising the aggregate flow of goods and services is measured in terms of the income earned by all the different factors of production (land, labour, capital, and entrepreneurship) employed in the production process during the year it is termed as national income. The national income, it may be recalled, can also be measured as the aggregate expenditure in the economy in terms of private consumption, government spending, investment and the spending on net exports. The production, income and expenditure methods are three methods of estimating Gross Domestic Product and other national account aggregates. The rate of growth of the national income when compared with the rate of growth of population indicates whether the economy is declining, stagnant or growing. It is only when the national income grows at a rate faster than the rate of growth of population that the per capita income shows a rising trend; the people are able to improve their living standards and the economy is able to add to its stock of capital, which along with technology and labour supports economic growth. However, economic growth does not necessarily improve every citizen's living standards, something captured by a much broader and complex issue of development. While the country has been performing well in terms of growth, it seems to be lacking behind in terms of development.

The Central Statistical Office (CSO) has been producing annual official estimates of national income and other national accounts aggregates of India since 1955 and publishing it annually in *National Accounts Statistics* (NAS). It is with the help of this data that we shall study the trend in India's national income over the last seven decades.

2.2 OVERALL TRENDS

Post-independence, India's economic development can be seen in terms of the following phases, each with its characteristic pace of advancement, policy guidance and attendant changes in the structure of the economy:

Phase I: 1950-1980

India's GDP increased at an annual average rate of 3.5 per cent.[1] During this period, population has also increased at an annual average rate of over 2.00 per cent. Therefore, the real per capita income has increased only at an annual average rate of 1 per cent. During the first decade, real national income went up by 3.8 per cent (1.8%), this rate came down to 3.5 per cent (1.2%) in the 1960s, and 3.1 per cent (1.1%) in the 1970s. During this phase, the nation followed the Socialist regime with the objectives of planning being—rapid industrialisation with emphasis on developing a strong investment goods sector, poverty alleviation, improving per capita incomes and an even distribution of income. Public sectors played a central role to the public sector. Import substitution, export subsidies and stringent restraints on technology and investment cooperation with the rest of the world— kept India somewhat a closed economy. Substantial controls on capacity expansion and licensing requirements for manufacturing industries were also part of the policy strategy.

Phase II: 1980-1990

A reversal of trend occurred during the 1980s: the average annual rate of growth increased to around 5.5 per cent. The socialist flavour of the Nehruvian policies was blamed for the worsening of the growth performance of the Indian economy by the 1970s for these policies are believed to limit the foreign competition and make domestic firms inefficient and also limit a productivity-enhancing structural transformation by restricting the possibilities of resource reallocation to more productive sectors. In contrast, post-1980 period featured several pro-business policies and reforms including import liberalisation, export incentives, exchange rate policies, and expansionary fiscal policy.

Phase III: 1990-2008

In the first three years of the 1990s, the GDP grew at 4 per cent annually. In the following four years, the growth rate jumped to 7.1 per cent but only to fall back to 5.2 per cent in the succeeding five years. The underlying trend growth rate during the decade was just over 6 per cent. However, subsequently the period 2003-08 saw the real GDP grow at 8.2 per cent annually. Meanwhile population growth rate stabilised at around 1.1% per annum. The sustained growth at 8 per cent plus resulted from many serious policy initiatives on the part of the government. Significant lowering of tariff and nontariff barriers (trade policy reforms) along with a major revamping of industrial policies, especially the withdrawal of industrial regulation and liberalisation of foreign direct investment (FDI) were introduced. These, coupled with favourable external environment in the form of rising exports and increasing inflows of foreign capital, set in motion three factors which can be described as three engines of growth.

One, consumption spending was a large contributor to the growth performance. Decreasing relative prices of many goods and services as a result of domestic and global competition, competitive pressures in retail finance and steadily rising incomes compound into a powerful force, even if each of the components may not be very large. *Two, investment* in new capacity was the second engine of growth. Investment activity is characterised by a certain lumpiness, which means

[1].Prof. Raj Krishna had believed that the economy was caught in the "low level equilibrium trap of slow growth" of 3.5 per cent annual growth rate. This came to be known as 'Hindu Rate of Growth'.

that capacity addition comes in spurts, exceeding immediate requirements but anticipating a subsequent catch-up in demand. Investment spending, consequently, goes up sharply at the beginning of a cycle and declines just as abruptly once the desired capacity has been created. The investment cycle was on upswing. Three, exports of both goods and services were the third engine of growth. India's merchandise exports got getting diversified geographically and, therefore, were not very vulnerable to localised business cycles. All these three engines gained an additional boost by what appears to be a sustained, across-the-board increase in productivity.

But this phase also shared one major *weakness* with the previous phase: labour-intensive manufacturing remained sluggish. The end to licensing and to the small-scale industries reservation in most labour-intensive products did not have the intended outcomes in this sector. The reasons for this are well-known (labour market rigidities facing large-scale producers, infrastructure bottlenecks and bureaucratic red tape). Unfortunately, without rapid expansion of the unskilled-labour-intensive industry, progress towards poverty reduction and transition to a modern economy will remain far slower than is feasible.

Phase IV: 2008-2014

The growth process slowed during 2008-09 in the wake of the global economic crisis, although some indicators of slowdown had made their presence felt even earlier. Global economic crisis resulted in (i) fall in inflows of foreign direct investment, (ii) rise in outflows on account of portfolio disinvestment, (iii) decline in export orders from developed market economies, as a result of which domestic investment, employment and consumption slowed down. The slowdown affected all sectors of the economy; growth rate in service sector during 2008-09 came down to 9.3 per cent, against 10.8 in 2007-08, in agriculture to 1.6 per cent from 4.9 per cent, and in industry to 3.9 per cent from 7.4 per cent. The decline in service activity could be attributed to lower demand for off-shoring and IT and IT-enabled services from the US and Europe, where several economies are grappling with debt problems. There was also an impact on financial services as banking activity slowed down on account of higher interest rates and investors were scared of parking their funds in stock markets. Real GDP growth rate slowed down to 6.5% per cent during 2011-12. It continued to be low on subsequent two years 2012-13 and 2013-14. Apart from the slow recovery in India's export destinations there were several domestic policy concerns including– ban on iron ore mining, cancellation of coal blocks, delays in environmental clearances, emergence of the Non Performing Asset (NPA) crisis and the consequent double balance-sheet problem that resulted in this slowdown.

Another major concern at this stage, though not entirely unexpected, was the sharp dip in the growth rate of private consumption. Four factors seem to have contributed to this slowdown. *First*, it could be due to the wealth effect, resulting from a decline in the asset (equity/property) prices. *Second*, the uncertainty in the labour market and some decline in employment in India's tradable sectors may have moderated the growth in consumption expenditure. *Third*, cutbacks in consumer credit by private banks, NBFCs and other lenders, because of their limited deposit base and difficulties in secondary market financing because of the knock-on effect of global financial market freezing. *Fourth*, during slowdown a dominance of precautionary motive may have induced consumers to either defer their spending decisions or shift to unbranded lower quality alternatives.

Similarly, the slowdown in the growth rate of gross fixed capital formation (GFCC) was an area of policy concern from the point of an early return to the high GDP growth path. Apart from the demand shock to the economy several reasons could have contributed to deceleration in growth of GFCF. *First*, surge in domestic inflation in the first half of 2008 reinforced the tightening of monetary policy. It affected the cost and availability of funds for investment. *Second*, since inflation was largely on account of metals and fuels, bulk of it was absorbed by industry, which affected its internal accruals and profitability, reducing the investible funds. *Third*, despite monetary policy becoming accommodative in the second half of 2008, decline in interest rates were not up to the industry expectations.

A significant stimulus package in three tranches was put in place by the government involving expansion in government spending and reduction in indirect taxes to boost domestic demand. By the end of the year 2008-09, India was rapidly returning to the buoyant years preceding 2008.

Phase V: 2014-2019 and 2019 onwards

During the period from 2014-15 to 2018-19, Indian economy registered an average GDP growth rate of 7.5 per cent. Several initiatives taken by the government to spur growth include — government following the 4 R approach of Recognition, Resolution, Recapitalisation and Reforms to strengthen banks and foster clean and responsible banking, simplification of the Labour Laws, bringing reforms in Corporate Affairs, introduction of e-Clearances, relaxing foreign direct investment rules, easing Know Your Customer (KYCs) for investors in Capital Markets, rendering more support to Non-Banking Finance Companies (NBFCs)/ Housing Finance Companies (HFCs) and Micro, Small and Medium Enterprises (MSMEs), introduction of indirect tax reform in the form of Goods and Services Tax (GST), introduction of Insolvency and Bankruptcy Code (IBC) for the speedy resolution of insolvency and bankruptcy cases of companies, Demonetisation to curb black money, corruption and counterfeit notes, which in turn opened gates for cashless economy, etc.

India's GDP growth moderated to 5 per cent in 2019-20 as compared to 6.8 per cent in 2018-19, amidst a weak environment for global manufacturing, trade and demand. The economic state of the Indian economy from 2019 onwards may be identified as 'pause phase'. During the pause phase the clouds over India's economic performance and prospects are getting bigger and darker. First, India's economic growth has slowed, aggregate investment has slackened and it could get worse. Second, inflation needs to be monitored. Third, the country's external imbalances are growing at a time when capital flows are becoming more volatile. Fourth, with investment momentum remaining significantly below its trend, the persistent weakness in consumption is a concern. Consumption has typically provided a steady and elevated floor for India's growth. Fifth, the sub-segment of "trade, hotels, transport and communications," which is typically an important source of resilience for the services sector, is slowing consistently. Sixth, growth in agriculture may take some hit. Seventh, the fiscal-monetary mix is completely out of work and there is hardly any flexibility on the fiscal front. More importantly, some fiscal responsibility will warrant spending cuts and revenue enhancement in order to shrink the fiscal deficit. Likewise, the RBI is expected to anchor expectations without offering one-or two-year forward guidance. Finally, the impact of Covid-19 pandemic on the Indian economy has been largely disruptive in terms of economic activity as well as a loss of human lives. Almost all the sectors have been adversely affected as domestic demand and exports sharply plummeted with some notable exceptions where high growth was observed. Tourism, Hospitality and Aviation were among the worst affected sectors. Consumption also got impacted due to job losses and decline in income levels of people particularly the daily wage earners. Greater uncertainty about the future course and repercussion of Covid-19 also made the financial market extremely volatile. There is likelihood that the three major components of aggregate demand — consumption, investment, and exports are likely to stay subdued for a prolonged period of time. On the supply side, shutdown of factories and the resulting delay in supply of goods from China affected many Indian manufacturing sectors. Some sectors like automobiles, pharmaceuticals, electronics, chemical products etc. faced an imminent raw material and component shortage.

Check Your Progress 1

1) What do you understand by 'Hindu Rate of Growth'?

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2) What are the reasons for the slowdown of the Indian economy after the year 2008 i.e., post-global financial crisis?

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3) How do you see the impact of the post-2014 policy measures on the Indian economy?

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2.3 STRUCTURAL CHANGE IN THE ECONOMY

The process of development requires structural change. The structural change of an economy takes place mainly along two dimensions: one is the changing sector-wise shares in GDP and the second is the changing share of the labour force, engaged in each sector. Other forms of changes encompassing the structural change include changing share of the organised and unorganised sectors as well as rural and urban sectors in output and employment, and also the share of consumption, goverment spending, investment and net exports in India's GDP. The share of public and private sectors may also be considered to reflect structural change in the Indian economy.

2.3.1 Composition of Gross Domestic Product

The composition of GDP of an economy explains the relative significance of the different producing sectors. When a country is in a state of underdevelopment, primary sector (agriculture and allied occupations) makes the largest contribution to the national income. As the country grows and gets developed, no matter how fast the primary sector grows, in keeping with the Kuznet's Law the contribution of the industrial and services sectors gradually increases. The explanation for this shift is as follows: Income elasticity of demand for agricultural products is relatively low; as a result, with rising levels of income, the demand for agricultural products relatively declines and that for industrial goods increases and, after reaching a reasonably high level of income, demand for services increases sharply. Accordingly, the shares of different sectors in the national product get determined by the changes in the pattern of demand. On the supply side, agriculture, being mainly dependent on a fixed factor of production, namely land, faces a limit on its growth and is subject to early operation of the law of diminishing returns. Industry, specially manufacturing, on the other hand, offers large scope for use of capital and technology, which could be augmented almost without limit with human effort. The same applies to services where application of technologies seems to offer much larger scope. Table 2.1 below brings out the on-going structural changes in India's GDP.

Table 2.1: Sectoral Distribution of India's GDP at Factor Cost (2011-12 prices) (%)

Sector	1960-61	1990-91	2000-01	2010-11
Primary	51.0	33.0	25.0	17.0
Secondary	18.0	24.0	24.0	24.5
Tertiary (Service)	31.0	43.0	51.0	58.5

Source: Economic Survery (Various issues)

Services sector is the largest sector of India. Gross Value Added (GVA) at current prices for Services sector is estimated at Rs. 92.26 lakh crore (54.40 per cent of total India's GVA) in 2018-19. With GVA of Rs. 50.43 lakh crore, Industry sector contributes 29.73 per cent, while, agriculture and allied sector shares 15.87 per cent.

This pattern of structural change in Indian economy has deviated from the development pattern of Western and South East Asian economies. Those economies experienced first a shift from primary to secondary sector and only in their advanced stage did they experience a significant shift in favour of tertiary sector. This pattern of development enabled them to transfer growing labour force from primary to secondary sector. In India this has not been possible because secondary sector has not expanded fast enough to absorb growing labour force. Although the manufacturing sector has grown at a fast pace the section's contribution less as compared to countries. The unskilled and uneducated rural masses have continued to struggle in the primary sector and those who have been forced out by economic, social and political factors have joined the urban slum sector. Moreover, the sharp increase in the share of tertiary sector in GDP in India has occurred at a much lower level of per capita income than that in the developed countries when they experienced a similar expansion. This pattern of growth underlines the link between the growing poverty and unemployment and the inadequate growth of manufacturing and building activity in the country. This failure in turn could be attributed to absence of structural attributes like a basic literacy in the workforce upon which further skills can be imparted, physical infrastructure (*i.e.*, power, roads, railways and access to ports), access to financial capital and, crucially, policies that encourage allocation of resources through export-oriented manufacturing.

2.3.2 Sectoral Share of Employment

There have been significant changes in the sectoral pattern of employment. The proportion of the work force engaged in the primary sector declined by 12 per cent between 1983 and 2004-05 and it showed faster decline between 2004-05 and 2009-10. Between 2009-10 and 2017-18, the share of employment in primary sector further declined to 44.6 per cent. In the Secondary sector, the share of employment increased from 21 per cent in 2009-10 to 24.4 per cent in 2017-18. However, the Tertiary sector has performed very well in employment as its share jumped from 25 per cent (2009-10) to 31.0 per cent (2017-18). This marks an important phase of structural transformation for the Indian economy, in which, the share and number of workers in agriculture has been declining with corresponding rise in employment in non-farm sectors. Among the non-firm sectors, service sectoris primarily driving the employment growth during 2009-10 and 2017-18.

Table 2.2: Changes in Sectoral Shares of Employment (UPSS) (Percentages)

		Primary	Secondary	Tertiary	All
Rural	1983	81.80	8.60	9.50	100.00
	2004-05	73.00	13.20	13.80	100.00
	2009-10	68.60	16.70	14.70	100.00
Urban	1983	15.60	32.60	51.80	100.00
	2004-05	9.40	33.30	57.30	100.00
	2009-10	8.10	33.80	58.10	100.00
Total	1983	68.90	13.30	17.80	100.00
	2004-05	57.00	18.20	24.80	100.00
	2009-10	53.80	20.90	25.39	100.00
	2017-18	44.6	24.4	31.0	100.00

2.3.3 Share of Organised and Unorganised Sector in Output and Employment

Another way to look at the structural change in the income is to look at the organisational pattern of the economy. The NAS divides the economy into two sectors: organised sector which is identified with a modern market economy and unorganised sector or traditional economy. The unorganised sector or traditional economy. The unorganised sector is defined to include "all unincorporated enterprises and household industries – other than organised ones and which do not maintain annual accounts and balance sheets." During the last couple of decades, organised sector has been growing faster than the unorganised sector. This trend has been facilitated by policies like reduction in excise duties and tariffs. It indicates growing modernisation in the organisation pattern of the economy.

However, notwithstanding all these changes and trends towards modernisation, the unorganised sector continues to dominate the economy with two-thirds of the National Domestic Product (NDP) and this is not due only to the agricultural sector. In fact, the unorganised sector is to be found not only in the unincorporated and individually-owned, if not also in the individually-operated, enterprises, in most other sectors of industrial origin, except, of course, public administration and defence. A basic change here could influence the economy considerably.

2.3.4 Share of Rural and Urban Sectors in Output and Employment

A classification of the economy between rural and urban areas is useful for a study of the organisational set-up of industries, the type of activities dominating the economic system in the rural and urban areas and the way of living of the population residing in areas categorised under the two groups. Information relating to rural-urban distribution of domestic product is available from various research surveys and studies, including those by the NCAER. During the last two decades the rural economy has grown much faster (7.5 per cent per annum) compared to urban (5.6%) on the back of strong growth in the rural non-farm sector. As a result, whereas in 1980-81, the rural sector accounted for 41 per cent of the GDP, in 2010-11 this proportion has been estimated at 51per cent, i.e., the rural sector is estimated to have overtaken the urban sector.

Growth in per capita income in rural India has been almost double compared to urban India, though on a much lower base. It would mean that the fruits of economic reforms are finally getting filtered down to rural areas.

Another important feature is that the rural economy is no more predominantly agrarian. Whereas in 1970-71, 73.8 per cent of the rural GDP got generated in the farm sector, this proportion has declined to 41.6 per cent in 2010-11, i.e., about 60 per cent of rural GDP gets generated in the non-farm sector. Moreover, rural India has been far more resilient in the face of the abrupt turn around in the economy than the rest of India. There are several reasons for this.

i) The government is no longer spending only on programmes that deliver the final product to the beneficiaries – whether in the form of subsidised food, electricity or building a dam to provide irrigation water to farmers – but has added a new dimension wherein funds are transferred to the beneficiary. This, in fact, gives the beneficiaries the freedom to spend the money and mitigate leakages.

ii) India's agriculture has been at the receiving end of a clutch of positive imperatives. Between 2004-05 and 2011-12, MSPs were raised for common paddy by 40 per cent and for wheat by 80 per cent, while inflation between these two periods rose by around 24 per cent.

iii) The global commodities boom has ensured new agricultural export markets that strangely seem insulated, even after the onset of a global recession.

iv) Farmers have hardly seen an increase in input costs, with the exception of higher wages for labourers in the recent past, ensuring that their surpluses are maximised.

v) Rural areas are now significantly more connected to the rest of India, largely due to fast spread of mobile phones and road network.

vi) Several thousand farmers across the country have benefited from the farm loan waiver scheme.

2.3.5 Share of Consumption, Government Spending, Investment and Net Exports in GDP

As per 'India Development Update' report released by the World Bank in 2018– the share of consumption in GDP has been consistently declining, particularly the Private Consumption, while the share of Investment and Exports has increased. While private consumption accounted for nearly four-fifth of GDP in the early 1970s, this share declined to about three-fifth in 2017. Despite its declining share, consumption growth has been a key driver of aggregate GDP growth, contributing on an average 3.76 percentage points to growth annually between 1971 and 2017. After a small increase over recent decades, government expenditure has stabilised at nearly 12 per cent of GDP. Equally salient is the steady increase in the rate of investment. The period 2004-2008 witnessed an investment boom with the Gross Fixed Capital Formation (GFCF) to GDP increasing from 30.7 per cent to 34.7 per cent in 2008. Post the global financial crisis, this ratio moderated to 31 per cent in 2013. The moderation in the GFCF to GDP ratio continued in the period from 2014-17. The ratio declined from 30.1 per cent in 2014 to 28.6 per cent in 2017. The ratio picked up to 29.4 per cent in 2018. Moderation in GFCF, a measure of fixed asset creation raises concerns about growth of output in the economy.

India has also become more integrated into the global economy, with its trade ratio– the ratio of exports and imports to GDP– adding up to about 40 per cent of GDP in 2017, five times the ratio of 7.6 per cent in 1971, yet lower than the peak ratio of 57 per cent in 2014. Exports as a per cent of GDP tripled from 7.3 per cent in 1991 to 22 per cent in 2007, and were 25.5 per cent of GDP in 2014. The contribution of net exports to growth has been muted, with import growth exceeding export growth in a majority of years.

2.3.6 Share of the Public and the Private Sector in GDP

As per 'India Development Update' report released by the World Bank in 2018– historically, public and private investment contributed approximately equally to total investment, but the role of public investment in growth has diminished over time. After peaking at 12.7 per cent of GDP in 1986-87, public and private investment started to diverge, with public investment accounting for only approximately 7 per cent of GDP in more recent years, compared to private investment exceeding 20 per cent of GDP.

Check Your Progress 2

1) Discuss the significant factors highlighting the structural change in the Indian Economy.

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2) Consumption spending as a component of national income has been contributing majorly to the economic growth in India. Do you agree?

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3) Discuss the reasons behind growing contribution of the Rural Economy in India.

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2.4 THE RISE OF TERTIARY SECTOR: COMPOSITION, CAUSES AND PROSPECTS

2.4.1 Composition of the Service Sector

A recent study divides the service sector into three parts. Group 1 comprises traditional services such as trade, transport, public administration, defence; Group 2 includes hotels, education, health and community and social services; and Group 3 is the modern services sector, including financial services, computer services, business services, communications, and legal and technical services. The share of Group 1 activities has stagnated, which is in accordance with the trend in the OECD (Organisation for Economic Cooperation and Development) countries. The rise in the share of Group 2 services too is in line with the trend. But what is unusual is the rapid rise in Group 3 services since 1990. Contribution of communications, business services, and financial services has in fact risen to the point where it contributes more to growth of GDP than manufacturing. In particular, communications, business services, financial services, education, health and hotels accounted for roughly half of total growth of the service sector in 2000-20.

2.4.2 Causes of Rapid Increase in Tertiary Sector

The tertiary, *i.e.*, the non-commodity sector, has been growing at a much faster rate than the commodity sector. This in essence means that income generated in the process of circulation grew at a much faster pace than that in the directly productive process, and thereby resulting in an increase in the share of the non-commodity sector. This trend can be attributed to a number of factors, among which the more important are as follows:

i) A very important factor has been the advent of information technology and the knowledge economy. This has enhanced the growth of the high productivity segment of the services sector as well as a variety of service activities involving low productivity activities catering to a large mass of people.

ii) A large part of the service sector consists of infrastructure such as banking, insurance, finance, transport and communication and social and community services such as educational and medical facilities. An urgent requirement of development is the proper expansion of infrastructure to cater to the needs of other sectors of the economy and the expansion of the social and community services for the well-being of the people.

iii) Public services grow more rapidly where national Governments have significant role in planning and production in the economy as a whole. In fact, the 'visible hands' of the modern governments as reflected in the government policies and in the expansion patterns of the national and international authorities during the last few decades are directed towards the creation of fast economic and social infrastructures.

iv) Operation of the demonstration effect as a consequence of the growing mobility due to expanding foreign trade, tourism and cultural and educational tours is another important factor.

v) Increasing urbanisation may be regarded as another cause of expansion of the service sector in the economy. In fact, urbanisation is closely associated with a rise in demands for infrastructure services such as communications, public utilities and distribution services. A substantial change in the private consumption pattern of the economy is observed with increasing urbanisation. Many new goods and services enter into the consumption basket.

vi) Tourism is becoming more and more international as knowledge is being spread through television and Internet, and modern technology has made air transport and hotel accommodations quite comfortable. Tourism in turn has promoted all types of services.

vii) With the increasing complexities of modern industrial organisation, manufacturing industries have become service oriented. This has been reflected in the increasing functions of accounting, finance, legal services, advertisement, marketing, public relations etc. Because of the prevalent labour laws, these services are being increasingly outsourced, so that growth in industry is actually being counted as growth in services.

viii) Another factor, albeit very important, has been the favourable international environment. The changing liberalised environment opened up immense possibilities for the exports of India's service sector. An important contribution has been made by the IT sector, as also entertainment industry, etc. India and the ASEAN, the 10-member regional grouping, moved closer to completing a bilateral trade pact, but finalising a free-trade agreement (FTA) on services and investment. The pact will enable free movement of professionals from here such as doctors, engineers, architects and management consultants across the ASEAN markets.

In addition to the above factors, an increase in the share of the non-commodity sector in the GDP can also be attributed to slow growth in the commodity producing sector. While a part of this is explained by difficulties inherent in bringing about a fast rate of growth in the primary sector, a part is undoubtedly due to the failure of the secondary sector and its major component, which is manufacturing and construction, to grow at the much faster rate that was necessary to give the commodity sector a comparable status with the non-commodity sector in the growth rate.

2.4.3 Prospects and Opportunities

Both domestic and international factors augur well for the growth of services sector in India.

A) *Domestic Factors.* Some of the important factors can be briefly stated as follows:

i) As real per capita GDP grows, demand for services increases more than proportionately and this, in turn, reinforces GDP growth itself.

ii) Within the services sector, demand for producer and government services, which constitute mainly intermediate consumption, have strong multipliers impacting on real GDP.

iii) The growth of such dynamic service activities, which are intensive users of communication and information technology, will generate employment opportunities on a rising scale.

iv) The process of economic growth has itself led to the emergence and expansion of new services such as advertising, publicity, marketing, etc. These sub-sectors provide essential service inputs to other sectors in the economy, thereby developing strong linkages with the rest of the economy.

v) Efficient delivery of services increases the productivity of both labour and capital in the economy as a whole. In general, services sector appears to be highly growth-inducing with positive externalities for other services, making services a catalytic agent of growth.

B) *International Factors*. Some of the recent global developments which provide opportunities for substantial growth are as follows:

i) The fastest growing segment of services is the rapid expansion of knowledge-based services, such as, professional and technical services. India has a tremendous advantage in the supply of such services because of a developed structure of technological and educational institutions, and lower labour costs.

ii) Progress in IT is making it increasingly possible to unbundle the production and consumption of information-intensive service activities. These activities– research and development, computing, inventory management, quality control, accounting, personnel administration, secretarial, marketing, advertising distribution and legal services– are performed in all economic sectors.

iii) Unlike most other prices, world prices of transport and communication services have fallen dramatically. The cost of communication is becoming independent of distance. India's geographical distance from several important industrial markets is no longer an important element in the cost-structure of skill-based activities.

iv) India does not necessarily have to be a low-cost producer of certain types of goods (*e.g.*, computers or discs) before it can become an efficient supplier of services embodied in them (*e.g.*, software or music). It is possible now to provide value added services without waiting to 'catch up' in technology for production of sophisticated equipment or products.

v) The decline in the share of manufacturing in the output of rich countries implies a relative decline in their demand for industrial raw materials and fuels. It means that growth in exports of developing countries in the future will depend less on natural resource endowments and more on efficiency in providing services and service-intensive goods.

vi) The aging of population in the developed world implies that the demand for services will continue to grow.

As a result of the above developments, the sources of comparative advantage of nations are vastly different now from what they were 50 or even 20 years ago. And, there are very few developing countries which are as well placed as India to take advantage of the phenomenal changes that have occurred in production technologies, international trade, capital movement and deployment of skilled manpower. It is now possible for India to take advantage of a virtuous circle of higher growth, higher capital inflows and higher domestic incomes and savings, which in sum can lead to further growth.

2.4.4 Limitations

However, the service sector, as at present, suffers from low productivity and quality in spite of fairly large investment in technology. The sector faces multiple challenges for sustained growth over the years. A number of services where India enjoys comparative advantages experience lack of clear policy thrust. A number of services in India are either predominantly associated with the Government or are not liberalised enough to ensure growth through organised private initiatives. Services like professional, legal, postal, accountancy and insurance need further liberalisation to harness their potential. Unless sustained efforts are put in to improve these, with the increasing importance of the services in wake of structural adjustment and liberalisation in the economy we may get into two alternate scenarios.

a) Economic and social position of workers in the service sector will steadily go down– since real incomes cannot be higher than productivity for any extended length of time. This means economic stagnation and consequent social tensions; or

b) The workers in this sector will use their numerical strength to get wages higher than their economic contribution justified. This will impoverish others– reducing everyone's income and increasing unemployment.

Further, the growth of service sector is constrained by slower growth in the manufacturing sector. While the inter-linkages between manufacturing and service sectors are two-way, the expansion of certain manufacturing activities boosts specific service industries. Many modern manufacturing companies outsource technical and business-related services such as research and development, financing, marketing, branding and logistics. Manufacturing industries such as mechanical and electrical engineering or even textiles depend crucially on services such as technical and design support, data processing, customer services, and advertising. As manufacturing firms grow and become more specialised, services tend to get more and more incorporated into their value chain.

Manufacturing expansion spurs the development of physical infrastructure such as roads, ports and railways, which are critical inputs to improve manufacturing productivity. In turn, demand for infrastructure-related services such as transportation, telecommunication and financial intermediation grows. Manufacturing growth, therefore, gives a boost to services. However, weaknesses need to be addressed. We are very poor in what service customers view to be the most important dimension– that of delivering on promises without being chased. Recent research on a major Indian corporation revealed that it spends around 40 per cent of its time on "following up" each other. This is par for the course around India. If that is correct, this weakness alone could wreck us.

2.4.5 Need for an Integrated Policy

The contribution of the services sector to the Indian economy has been manifold: a 57 per cent share in GDP, growing by 10 per cent annually, contributing to about a quarter of total employment, accounting for a high share in FDI inflows and over one-third of total exports, and recording very fast export growth. To make services-led growth more widespread and sustainable, it is important to systematically and simultaneously remove those constraints from which the sector suffers presently. To do this, a coherent integrated services policy (in line with the agricultural and industrial policies) needs to be developed. Reforms in services in India have evolved in an *ad hoc* manner rather than as part of an overall strategy. Consequently, the depth and pace of reforms lack uniformity across sectors. Given the strong inter-linkages between different services, opening a particular services sector may not yield results if not backed by corresponding reforms in other complementary services. Such an integrated services policy should also define the sequence as well as the pace of reforms to be undertaken simultaneously in different services. Liberalisation should be followed in a phased manner accompanied by social policies in sectors that have surplus labour so as to avoid creating unemployment and social unrest. This will go a long way in sustaining the dynamism of services-led growth.

Check Your Progress 3

1) Discuss in brief the causes of the rapid increase in tertiary sector in India.

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2) Discuss in brief the limitations from which the service sector suffers in India.

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3) Outline the need for an integrated service sector policy in India.

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2.5 MEDIUM AND LONG-TERM GROWTH PROSPECTS OF THE ECONOMY

In the medium to long-term, the expectation is that India's pace of economic development will pick up. There are two reasons for this expectation. *One*, given the momentum in the savings and investment rates and also the fact that India's demographic dividend is yet to peak and there is evidence that the savings rate for the working-age population of India, especially for those in the 30s and 40s, is high, investment rate could potentially improve. *Two*, the fraction of investment that is going towards building up infrastructure has been rising. The importance of infrastructure for sustainable and inclusive development is now well recognised and the government is seeking to give this a large boost. It is known that once an economy begins to operate close to potential savings and investment rates, sustenance of growth momentum requires productive improvements, which depends in tern depends on improvement in human capital on skill upgradation, technology and innovation in production. There are several initiatives underway to address these requirements as highlighted in the earlier section. Importantly, there is nothing preordained about India's economic rise– i. The sustenance of the growth story needs nourishment, not merely sound bites.

2.5.1 Major Policy Initiatives in the Recent Decades

2.5.1.1 Containing Inflation and Soaring Fiscal Deficits

Following an agreement between Government of India (GOI) and Reserve Bank of India (RBI), a Monetary Policy Committee (MPC) was constituted in February, 2015 with the mandate to target a headline inflation of 4 per cent, with a band of two percentage points on either side. The framework has been successful in containing inflation. Since April 2015, when the MPC was first convened, the monthly headline inflation has always remained within the band except for one month.

Discipline was also imposed on the Gross Fiscal Deficit (GFD). The Fiscal Responsibility and Budget Management (FRBM) Act of 2003, which got a new lease of life since 2016, determines the glide path for the ratio of GFD to GDP to reach an eventual target of 3 per cent. The ratio declined from 4.5 per cent in 2013-14 to 3.4 per cent in 2018-19. Other macro-stability indicators have similarly improved.

2.5.1.2 Beneficiary Focus and Targeted Delivery

In addition to re-establishing macroeconomic stability, the government also focused on last-mile delivery of basic services to the poor, on basic safety-nets, and on creating pathways for the benefits of growth to reach the bottom of the socio-economic ladder. The promulgation of the Aadhaar (Targeted Delivery of Financial and Other Subsidies, Benefits, and Services) Act, 2016 was one such initiative that opened a major pathway to this trickle-down. By assigning a unique identification number to every individual, the government now has the ability to provide targeted support. Presently, Aadhaar coverage stands at more than 90 per cent of the country's population.

Another pathway for the trickle-down is the Pradhan Mantri Jan Dhan Yojana (PMJDY), a financial inclusion initiative. The linking of mobile numbers with bank account numbers and subsequently Aadhaar, created a JAM (Jan Dhan, Aadhaar, Mobile) trinity that further secured Direct Benefit Transfers (DBT) to the intended beneficiaries.

Major schemes implemented under DBT include MGNREGS (Mahatma Gandhi National Rural Employment Guarantee Scheme), NSAP (National Social Assistance Programme), PMAY-G (Pradhan Mantri AwasYojna-Gramin), besides various scholarships and fertilizer subsidy schemes. A key initiative for last-mile delivery was the Pradhan Mantri Ujjwala Yojana (PMUY) that was launched in 2016 to to provide LPG connections to BPL (Below Poverty Line) families. In 2018, another effort to provide a basic safety net was launched through the Ayushman Bharat Yojana (ABY), which provides an insurance cover of Rs. 5,00,000 for cashless treatment to each of the 100 million BPL families at a nominal premium of Rs. 100 per month.

2.5.1.3 Infrastructure

The creation of physical infrastructure accelerated significantly during 2014-19. In April 2018, electricity finally reached every village in India with the effort to electrify every home still ongoing. The construction of national highways (NH) proceeded at a rapid pace with more than 20 per cent of the existing highway length of 132,000 km being constructed in the last four years alone. The UDAAN scheme was launched in 2017 to foster regional connectivity by extending flight connectivity to Tier-3 and Tier-4 towns in the country. The infrastructure of the North-Eastern states was a special focus and there has been a significant improvement in connectivity with the building of key bridges, and the expansion of railways/highways.

2.5.1.4 Federalism

Fiscal federalism strengthened significantly when the Fourteenth Finance Commission increased the share of states in the divisible pool of central taxes from 32 per cent to 42 per cent. Although central grants to states saw compensatory cuts, the shift empowers states to manage their revenues and expenditures independently. The launch of the GST (Goods and Services Tax) in July, 2017 added a new dimension to centre-state and inter-state financial relations. The GST Council experience provides key learning for implementing cooperative federalism in several other areas such as labour and land regulation. Niti Aayog has helped institutionalise cooperative federalism by setting up teams from both the states and the central government to jointly evolve strategies for addressing development challenges. States have also been involved in a friendly competition to improve their Key Performance Indicators (KPIs).

2.5.1.5 Corporate Exits

When the Insolvency and Bankruptcy Code (IBC) was introduced in 2016, it consolidated the insolvency resolution process into a single law by repealing/ amending multiple rules and processes earlier in operation. IBC set a time limit for closing of insolvency and bankruptcy cases within which assets of a defaulting borrower are auctioned to pay off the debt owed to lending institutions. Following the operationalisation of IBC since 2017, a significant number of non-performing assets have been brought under its ambit. In addition to the large sums recovered by creditors from resolution or liquidation, the introduction of a framework for exit has improved the overall business culture of the country.

2.5.1.5 Demonetisation

The government of India took a bold step to demonetise Rs. 500 and Rs. 1000 currency with effect from 8 November 2016 midnight. It was a major decision which had its impact on all sections of the society. It was aimed to reduce funds to terrorism, decrease the corruption rate, eliminate counterfeit notes, and open gates for a cashless economy. Through the demonetisation exercise, the government has been pressing hard to become a cashless economy and is encouraging more and more people to adopt the digital payments system for their transactions.

2.5.1.6 Goods and Services Tax (GST)

Implemented on July 1, 2017, the Goods and Services Tax (GST)is regarded as the biggest and substantial indirect tax reform since independence. GST has replaced a number of Central and State taxes, made India more of a national integrated market, and brought more producers into the tax net. It has subsumed all sorts of indirect taxes like Central Excise Tax, VAT/Sales Tax, Service tax, etc. and implement one taxation system in India. The main aim of GST is to create a single, unified market which will benefit in the development of country's economy. GST taxes only the final consumer. Hence the cascading of taxes (tax-on-tax) is avoided and production costs are cut down. The system is expected to improvise tax collections and boost up India's economic development and break all tax barriers between Central and State Governments.

Aided by all these features, the Indian economy rebounded back on high growth trajectory. While rest of the world was cooling off with growth rates slowing down, the Indian economy recorded highest-ever growth rates during the period 2014-19, clocking an average of about 7.5 per cent per annum. It is widely-accepted that India cannot meaningfully regain its economic momentum unless corporate investments are brought on track. The sort of demand stimulus that the government has preferred despite supply constraints will only add to inflationary pressures. Public investment cannot play a major role in the recovery unless there is a significant shift of public spending away from subsidies and towards asset creation. A private investment revival is thus the magic key. Unwinding the current policy tangle is key to reviving animal spirits.

2.5.2 The Challenges That Remain

GDP growth in India has followed an inverted U-shaped curve, accelerating from a low of 5.5 per cent in 2012-13 to a peak of 8.2 per cent in 2016-17 and then decelerated to 6.8 per cent in 2018-19.The GDP growth decline is due to rise in real interest rates, enforcement of tighter norms on Bank NPAs and implementation of the Indian Bankruptcy Code, decline in GFCF and other factors. Despite the promising growth trajectory that Indian economy has been experiencing and is believed to experience, there remain several challenges that need to be addressed to ensure welfare and development along with the sustained growth. These include:

2.5.2.1 Non-farm Employment Opportunities

Over the years, the rural non-farm sector has been gaining importance in providing gainful employment and additional income opportunities to the growing rural workforce. Yet the country is still struggling to move rural workers away from agriculture. More than 70 per cent of the rural poor are dependent on agriculture either as cultivators or as agriculture labour. Besides, livestock rearing is again a key livelihood of the poor. Thus, it becomes imperative to make rural non-farm activities lucrative enough to attract the growing rural workforce. For this, analysing the barriers of entry into this sector employment and the different activities undertaken in each state or region becomes important.

2.5.2.2 Demographic Transition and Dividend

According to United Nations Population Fund (UNFPA), demographic dividend means, "the economic growth potential that can result from shifts in a population's age structure, mainly when the share of the working-age population (15 to 64) is larger than the non-working-age share of the population (14 and younger, and 65 and older)".India has the largest proportion of young people in the world. The working-age population (15–64 years) constitutes 64 per cent of the population. The country has a distinctive 20 to 25 years' window of opportunity which needs to be exploited. Considering the fact the country's IT industry employs just 0.4 per cent of the workforce– with the vast majority of Indians doing low productivity jobs in areas such as transportation or construction– development of a labour-intensive manufacturing sector becomes vital for the country to take advantage of its rapidly growing population.

2.5.2.3 Urbanisation

India is urbanising at a much faster pace. As per World Urbanisation Prospect 2014, Revision report India is projected to add 404 million urban dwellers between 2014-2050. This will add additional pressure to the existing urban centres which are already in the grip of issues like house shortages, traffic congestion, air pollution, rising greenhouse gas emissions, poor public health, etc. resulting from tremendous demographic pressure, inadequate infrastructure and resources to cater, unplanned growth of the peri-urban sprawls characterise. Urbanisation in India is inevitable thus, the need for solving the various problems associated with it requires a combination of actions, starting with increased investment; strengthening the framework for governance, and most importantly capacity building for the people and the institutions engage in urban affairs. Along with this, the country needs to avoid excessive sprawl and address infrastructure bottlenecks, particularly in the transport, power and water sectors.

2.5.2.4 Poverty and Inequality

Poverty elimination has remained a major challenge right from independence and lies at the core of India's national development agenda to create a just and equitable society. Poverty has always been a matter of concern in the Indian economy. A significant part of the country and the population is deprived of access to basic health care, food, drinking water, sanitation as well as financial services, making the minimum standard of living out of their reach, largely due to long years of centralised development and inequitable distribution of income. Poverty is worsened by the relatively high level of income inequality. Hence, there has always remained the need of an attempt to eliminate poverty.

2.5.2.5 Environment and Climate Change

India is both a major greenhouse gas emitter and one of the most vulnerable countries in the world to projected climate change. The country is already experiencing changes in climate and the impacts of climate change, including water stress, heat waves and drought, severe storms and flooding, and associated negative consequences on health and livelihoods. With a 1.3 billion but growing population and dependence on agriculture, India probably will be severely impacted by continuing climate change. This calls for innovations, new technologies, and new approaches to economic development.

2.5.2.6 Infrastructure

India's ambition of sustaining its relatively high growth depends on one important factor: infrastructure. The country, however, is plagued with weak infrastructure incapable of meeting the needs of a growing economy and growing population. The corporate growth and investments can also be hampered if the government fails to close the infrastructure deficit, which some experts estimate costs 4-5 per cent of GDP due to inefficiencies. Also in order to fulfil Sustainable Development Goal number 9, India needs to develop quality, reliable, sustainable and resilient infrastructure, including regional and trans-border infrastructure to support economic development and human well-being, with a focus on affordable and equitable access for all.

2.6 LET US SUM UP

In this unit we have reviewed the growth profile of the Indian economy. For this purpose we have relied upon the national income data published by the Central Statistical Office of the Government of India. The analysis of the data has thrown some interesting facts which are briefly stated as follows:

- Over the last seven decades growth has maintained a rising trend.
- Although rising, the rate of growth has been relatively slow.
- The growth has been topsy-turvy; dramatic increase in some years followed by a sharp fall in subsequent years, e.g., the period 2015-19 followed by the year 2019-20.
- Medium and long-term prospects are bright; but the economy would have to bear the global fate. Growth rates are projected to fall over whole of the globe.
- Macro-economic stability is an essential prerequisite for achieving the growth needed for development.
- Growth does not trickle down; development must address human needs directly.
- No one policy will trigger development – a comprehensive approach is needed.
- Institutions matter, sustained development should be rooted in processes that are socially inclusive and responsive to changing circumstances.

We have also analysed the data to examine the changes that have taken place in the structure of the Indian economy over the last seven decades. This analysis has brought out a unique feature of India's economic growth: structural change in the Indian economy has deviated from the historical experience of other countries, to begin with, build up a strong agricultural base that laid foundations for rapid growth of industry. This resulted in evolution of a sound industrial base that served as a jumping pad for another transition: transition to a service/ commercial economy. India, on the contrary has made a jump from the first stage to the third stage. The result is an absence of a strong manufacturing foundation this has remains implications for removing poverty and unemployment.

We will address the issues in the subsequent units of the present course.

2.7 TERM - END EXERCISES

1) Examine in brief the different phases of growth of the Indian economy since 1991.
2) "The pattern of structural change in the Indian economy has deviated from the development pattern of Western and South Asian economies." Examine this statement.
3) The unorganised sector dominates the Indian economy. Do you agree?

2.8 KEY WORDS

Association of Southeast Asian Nations (ASEAN)	:	A regional grouping that promotes economic, political, and security cooperation among its ten members: Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand, and Vietnam.
Federalism	:	The distribution of power in an organisation (such as a government) between a central authority and the constituent units.
Fiscal Deficit	:	The difference between the total income of the government (total taxes and non-debt capital receipts) and its total expenditure.
Free Trade Agreement (FTA)	:	A treaty between two or more countries to facilitate trade and eliminate trade barriers.
Gross Fixed Capital Formation	:	As per RBI, Gross capital formation refers to the 'aggregate of gross additions to fixed assets (that is fixed capital formation) plus change in stocks during the counting period.'
Insolvency and Bankruptcy Code (IBC), 2016	:	The bankruptcy law of India which seeks to consolidate the existing framework by creating a single law for insolvency and bankruptcy to resolve insolvency in a time-bound manner.
Minimum Support Prices (MSP)	:	MSP is an agricultural product price, set by the Government of India to purchase directly from the farmer.
Unorganised Sector	:	As per 'Ministry of Labour and Employment'— Unorganised sector means an enterprise owned by individuals or self-employed workers and engaged in the production or sale of goods or providing service of any kind whatsoever, and where the enterprise employs workers, the number of such workers is less than ten.

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2.10 ANSWERS OR HINTS TO CHECK YOUR PROGRESS EXERCISES

Check Your Progress 1

1) See Section 2.2
2) See Section 2.2
3) See Section 2.2

Check Your Progress 2

1) See Section 2.3
2) See Sub-section 2.3.5
3) See Sub-section 2.3.4

Check Your Progress 3

1) See Sub-section 2.4.3
2) See Sub-section 2.4.4
3) See Sub-section 2.4.5