The Indian Economy in the New Millennium

The great promise that the process of economic reforms had held out, especially after the major reforms in 1991, was to a considerable degree met in the years of the new millennium. The future prospect of the Indian economy in 2007, the sixtieth year of the country winning independence from colonial domination, perhaps looked brighter than it had ever looked in its recent history. However, many of the problem areas confronted in the first phase of reform persisted and the related issue of the sustainability of the rapid progress made in several directions remained. A critical bottleneck was on the equity front with India's ranking in the global Human Development Index (HDI) actually falling even as the economy registered spectacular growth for several years. These issues, and the new problems that emerged as India integrated further with the global economy, constituted the challenges faced by the country in the new millennium.

The Breakthrough in Growth

The slowdown experienced by the Indian economy in the late 1990s, partially due to the East Asian and Southeast Asian crisis and a global slowdown, continued at the turn of the century. The first few years of the new millennium were turbulent with oil price hikes, the 9/11 terrorist attack in the US and a further global slowdown. Despite this, the Ninth Plan period, 1996–97 to 2000– 01, experienced an average GDP growth of 5.5 per cent per annum. Though the growth rate was lower than the Plan target of 6.5 per cent, it nevertheless demonstrated the post-reform Indian economy's ability to ride through crisis years without too much damage, maintaining growth rates well above the so- called 'Hindu rate' of 3 to 3.5 per cent which the country had got accustomed to.

The Tenth Plan too started off poorly with the first year, 2002– 03, recording a growth of only 3.8 per cent. This deceleration was essentially 'agriculture pulled' with agriculture and allied sectors showing a negative growth rate of 7.2 per cent that year. Indian agriculture, which was already experiencing a slowdown in the late 1990s, was faced with a monsoon failure in 2002–03, leading to a fall in agricultural production by 15.6 per cent. In fact the overall performance of the agricultural sector during the Plan period, 2002–03 to 2006–07, remained rather poor, showing an average growth rate of only 2.3 per cent, a rate significantly lower than the 3.4 per cent rate achieved between 1980–83 and 1992–95, or the rate achieved in the first five years of the new millennium (2001–02 to 2005–06) of about 3 per cent.[1]

However, despite the low GDP growth in the first year of the Tenth Plan and the poor performance of agriculture in the Plan period, the overall economy showed a robust growth with the GDP growing at an average of 7.6 per cent during the Plan period 2002–03 to 2006–07. Though it was slightly below the Plan target of 8 per cent, yet it was an unprecedented achievement. At no point in the past had the Indian economy sustained such a growth rate over a five-year period. A forecast made in 2004 that the Indian economy could achieve a growth path of 7 per cent annual GDP growth and 5.6 per cent per capita growth for the next twenty years no longer seemed a pipe dream.[2] Eminent economist Jeffrey D. Sachs had gone one step further and had, along with Nirupam Bajpai, advised the Indian prime minister as early as 2000 that he should look at the next decade as one in which 'India would double its per capita income' because, as he put it, 'A doubling of per capita income in a decade, as had been achieved by Japan in the 1960s, Korea in the 1970s, and China in the 1980s and 1990s, requires an *annual average growth rate of 7 per cent per capita for a decade, a rate of growth that we believed to be within India's reach*.'[3]

In fact the last four years of the Tenth Plan proved more than equal to these expectations, registering an impressive average growth of 8.6 per cent. This, and the fact that the Indian economy grew at 9.4 per cent during 2006–07 on top of the 9 per cent growth in the previous year (with per capita income growing at 8.4 per cent in 2006–07), raised the question whether the Indian economy was now ready for 'take-off' to a different growth trajectory of 9 per cent or more (with per capita growth of more than 8 per cent) as compared to the average of 6 per cent achieved in the 1990s.[4] The Planning Commission had in fact for the Eleventh Five Year Plan (2007–08 to 2012–13) set a target of an annual average growth of 9 per cent. Should India achieve that or more, then the transformation that Japan achieved in two decades, from the 1950s when it grew at an unprecedented rate of 8 per cent per annum per capita to catapult itself into becoming the second largest economy of the world, would appear replicable for India, with much more significant implications given India's much larger size.

The Indian economy was perhaps poised in the new millennium for a historic breakthrough. Angus Maddison's monumental work shows that India was the world's largest economy through the thousand years of the first millennium accounting for as much as nearly 30 per cent of the world's GDP. As late as 1700 India continued to be the largest economy in the world. After this, as India came under colonial domination, the share of the Indian economy in world GDP fell continuously and dramatically for over 200 years accounting for a mere 4.2 per cent in 1950 when India had just achieved independence. In the next fifty years the Indian economy was again beginning to slowly grow to a greater share of the global economy, reaching 5.4 per cent in 2001. This India was able to do by registering an annual growth rate of 5.12 per cent between 1973 and 2001, a growth rate second only to China's and much higher than the global growth rate of 3.05 per cent in that period.[5] Since then, as mentioned above, India had moved on to a much higher growth trajectory, growing, from 2003–04 onwards, at 8.6 per cent annually, nearly two to three times faster than the advanced economies including the US, Japan and the Euro area and way above the global growth rate of about 5 per cent.[6] If this growth rate was maintained, then the forecast that India would in the not-too-distant future overtake Japan to become the third largest economy in the world after the US and China could turn out to be correct.[7]

Is the Growth Sustainable?

It is necessary to examine certain other parameters of the economy in recent years to ascertain whether the high growth rates achieved were sustainable. A critical aspect in this connection is the savings and investment generated by the economy. A very good sign was the consistently increasing rate of Gross Domestic Savings and Investment as a proportion of GDP in the new millennium, bringing them close to the high East Asian levels. Gross Domestic Savings increased sharply from 23.4 per cent of GDP in 2000–01 to 32.4 in 2005–06 and the corresponding figures for Gross Domestic Investment were 24 and 33.8. In fact it was investment rather than consumption which became the main source of GDP growth in the high growth rate achieved during 2004–05 and 2005–06. The rising rates of saving and investment were powered by increases in the private and especially the private corporate sector. A new feature since 2003–04 was that the public sector began to show positive savings after showing negative rates for the previous six years. As a result, the public Saving–Investment gap somewhat narrowed and the impact on the aggregate Saving–Investment gap was more telling. In fact, for three consecutive years, 2001–02 to 2003–04, savings were in *excess* of investments, leading to the period 2000–01 to 2005–06 as a whole witnessing a marginal average annual *surplus* of about 0.2 per cent of GDP, instead of a Saving–Investment gap. A considerable change from the average aggregate gap of about 1.9 per cent of GDP between 1980–81 and 1990–91 which somewhat improved after the 1991 reforms to an average gap of 1.2 per cent of GDP between 1991–92 and 1999–2000.[8]

Apart from the virtuous cycle of higher growth inducing higher savings and the new dynamism of the private sector, it has been pointed out that the 'demographic dividend' in the form of high savings rate was going to continue as the already high proportion of the Indian population in the working age group 15–64, which stood at 62.9 per cent in 2006, was projected to go up to 68.4 per cent in 2026. In other words, a higher savings rate was likely to be *sustained* by the declining dependency ratio (ratio of nonworking population to working population), projected to go down from 0.62 in 2000 to 0.48 in 2025. By one estimate, 'this 14 percentage point decline in dependency ratio (would) translate into roughly an equivalent rise in private and aggregate savings, from about 25 per cent of GDP (in 2000) to 39 per cent (in 2025).'[9]

The fiscal deficit situation of the central and state governments began to show some improvement since 2003–04. The fiscal deficit issue had been a matter of much concern not only in the pre-reform period, especially in the 1980s, but continued to be a major bottleneck through the 1990s. The central government's fiscal deficit had come down from 6.6 per cent of GDP in 1990– 91 to 4.1 per cent in 1996–97 but again gradually crept back to 6.2 per cent by 2000–01. Not only was the fiscal deficit coming back to high unsustainable levels, the proportion of revenue deficits (consisting, *inter alia*, of interest payments, subsidies, defence expenditure, salaries, etc.) to total deficit was also rising, from 49.4 per cent in 1990–91 to 74.8 per cent in 1998–99, reaching a high of 79.7 per cent in 2003–04. This meant that less and less was being spent on capital asset creation. As we saw earlier the situation had become so bad that, by the end of the 1990s, the government itself was talking in terms of putting constitutional limits on the deficits incurred by the central and state governments due to their fiscal profligacy.[10]

Such a step was indeed taken with the passing of the Fiscal Reforms and Budget Management

Act (FRBMA) in August 2003. The Act and the rules were notified to come into effect from 5 July 2004. The Act was aimed at ensuring fiscal prudence. The rules of the Act required that revenue deficits be reduced by half per cent or more of the GDP every year and be eliminated altogether by 31 March 2009. The fiscal deficit was to be reduced by 0.3 per cent or more of the GDP every year and by 31 March 2009 it was to be no more than 3 per cent of GDP.

There was some success in reversing the trend particularly after the FRBMA came into effect in 2004. The central government fiscal deficit gradually came down from 6.2 per cent of GDP in 2001–02 to 4 per cent in 2004–05, to a budget estimate (BE) of 3.8 in 2006–07. Revenue deficits also fell from 4.4 per cent of GDP in 2000–01 to 2.5 per cent in 2004–05 and a BE of 2.1 per cent in 2006–07. This led to the revenue deficit as a proportion of fiscal deficit declining by 27 percentage points, from 79.7 per cent in 2003–04 to 57 per cent BE in 2006–07. The fiscal situation of the states also improved significantly. The fiscal deficit of states, having actually risen from 3.3 per cent in 1990–91 to 4.5 per cent in 2003–04, subsequently fell to 3.2 per cent in 2005–06 (revised estimate) and 2.6 per cent in 2006–07 (BE). The revenue deficits had also risen from 0.9 per cent in 1990–91 to 4.5 per cent in 2003–04 and subsequently fell to 0.5 per cent in 2005–06 and it was budgeted to be zero in 2006–07. The FRBMA-mandated targets for fiscal and revenue deficits were thus set to be achieved by the states two years ahead of schedule. The combined improvement in the central and state budget deficits led to the consolidated general government deficit, which had risen from 9.4 per cent of GDP in 1990–01 to 9.9 per cent in 2001–02, to fall to 7.5 per cent in 2004–05 and 6.3 per cent in 2006–07 (BE). It is significant that the 2006–07 figure was only marginally higher than the 6 per cent figure which the Twelfth Finance Commission had declared as a sustainable ratio of combined fiscal deficit to GDP, to be equally shared between the Centre and the states.[11]

On the revenue side of the fiscal equation, the government was unable to substantially raise the tax–GDP ratio. In fact, in the early years of reform, with the reduction in direct taxes (personal income tax and corporate tax) as well as indirect taxes (customs, excise and service tax), the total tax–GDP ratio fell from 10.1 per cent in 1990–01 to 8.2 per cent in 2001–02. Thereafter it slowly crept back to levels a little higher than in 1990–91, that is, 10.3 per cent in 2005–06 (provisional) and 10.8 per cent in 2006–07 (BE).

However, the overall revenue figures do not tell us about a substantial change occurring in the Indian tax framework. Despite drastic cuts in the rates, the total volume of personal and corporate (or corporation) taxes grew rapidly. Personal income tax as a proportion of total tax revenue nearly doubled from 9.3 in 1990– 91 to 17.1 per cent in 2000–01, with the BE for 2006–07 being 17.5 per cent. Corporation tax as a proportion of total revenue showed an even more dramatic increase, more than doubling from 9.3 per cent in 1990–01 to 19.6 per cent in 2001–02 and nearly tripling the 1990–91 figure by 2004–05 by reaching 27.1 per cent. The BE for 2006–07 was an even higher 30.1 per cent. Thus the proportion of direct tax (personal plus corporation) to total tax revenues increased from 19.1 per cent in 1990–01 to 47.6 per cent in 2006–07 (BE).[12] This was a significant change in a progressive direction which critics of reform need to note.

The problem, however, was on the expenditure side. About 86 per cent of the revenue receipts were committed to expenditure on interest payments, subsidies, pay, pensions and defence in 2005– 06. Interest payments alone, due to heavy government borrowing in the past (total government debt–GDP ratio had reportedly reached unsustainable levels of about 90 per cent),[13] used up over 38 per cent of total revenue and major subsidies another 13 per cent in 2005–06.[14] The pattern of fiscal profligacy powered by populist pressures in which governments, in order to meet various sectional demands, committed expenditures through subsidies (often in the name of the poor but not benefiting them), salary concessions, etc., a problem inherited from the late 1970s and 1980s, had continued through the post-1991 economic reform years (sometimes even been getting exacerbated) except for a brief improvement in the early 1990s under IMF pressure. As a result, government *capital* expenditure as a proportion of total revenue receipts and of GDP had actually started declining from 2003–04,[15] at a time when the need for Government investment in infrastructure (such as roads, ports and electricity), agricultural development, education and health was crying out for urgent attention. Despite some improvement in the fiscal deficit situation since the enactment of the FRBMA, analysts were agreed that India would have to introduce far greater discipline and not keep on hoping to offset government dissaving by the large overseas savings abroad. Also, government expenditure had to be directed and managed in a much better fashion if the country was to maintain the high growth levels it had begun to achieve.

A much more positive trend in the new millennium was the recovery of industrial growth, which had been facing a downturn since the late 1990s. The industrial sector picked up from a low growth rate of 2.7 per cent in 2000–01 to a double-digit 10 per cent growth in 2006–07. More important, it averaged a growth rate of nearly 8.8 per cent for five successive years ended in 2006– 07, at no point falling below 7 per cent. This was an unprecedented feat since 1951.[16] The Eleventh Plan (2007–12) target for annual industrial growth was 10 per cent.

Within industry, manufacturing was growing the fastest. It is significant that the capital goods sector which had slowed down at the turn of the century, even showing negative growth for 2001–02, causing much concern, bounced back to double-digit growth for the next five years, averaging about 13.5 per cent between 2002–03 and 2005–06. In fact the growth rate of the capital goods sector had not only caught up with the consumer durables sector which had been growing much faster between 1993 and 2003 but had overtaken it by 2005.

The services sector, which had been maintaining a high rate of growth since the 1980s (higher than industry), continued to do very well, contributing as much as 68.6 per cent to the total growth in GDP between 2002–03 and 2006–07. The rest of the contribution to growth came almost entirely from industry as agriculture grew slowly in this period. As a result of the long-term differential growth rates of these three sectors, the shares of these sectors in India's GDP altered considerably, with services accounting for 55.1 per cent, industry 26.4 and agriculture only 18.5 per cent in 2006–07.[17] The corresponding figures for the tertiary, secondary and primary sectors for 1950–51 and 1970–71 were 27.5, 13.3, 59.2 and 32.1, 21.6, 46.3 respectively.[18] The fact that the services sector, which constituted more than 55 per cent of India's GDP by 2006–07, was also the fastest growing had important implications for the maintenance of high overall growth rates for the economy.

Relationship with the External World

The changes in the new millennium with regard to India's relationship with the external world have been by and large very promising. The Indian economy since the economic reforms, which involved liberalization and globalization, was getting rapidly integrated into the global economy. One indicator of that was the rapid increase in India's external trade (imports plus exports in goods and services) as a proportion of India's GDP, rising from just above 10 per cent in 1974 to 15.71 per cent in 1990 as a result of the hesitant steps taken towards economic reform. Thereafter as a result of the reforms since 1991 it jumped to 32.6 per cent in 2004, more than double the 1990 figure. India's external trade as a proportion of GDP was 30.8 per cent in 2002, a proportion higher than that of the US's 23.6 per cent and Japan's 21 per cent, though as yet much lower than China's 54.8 per cent and South Korea's 69.1 per cent.[19]

India's exports, in merchandise or commodities alone (the services story is even more dramatic), appear to have moved on to an unprecedented high trajectory since 2002, growing, in US dollar terms, at over 20 per cent consistently for five years ended 2006–07. The average rate of growth for exports between 2002– 03 and 2005–06 was about 24 per cent and in the first nine months of 2006–07 it was 36.3 per cent. By 2005–06 India's exports had crossed the $ 100 billion mark, doubling in value in less than five years, a feat which took 23 years (1949–72) during India's early phase of independent development. Indian exports were growing faster than China's (the star performer in recent years) and at more than double the global export rate since 2005 (up to August 2006). As a result, India's share in global exports, which had fallen to a miserable 0.43 per cent in 1981, began to increase consistently, reaching 0.67 per cent in 2000 and crossing the 1 per cent mark in 2005. The targeted share for 2009 was 1.5 per cent.[20] It is important to reiterate that the exports growth was led by petroleum products, ores and minerals and manufactured goods, particularly engineering goods like machinery and instruments, transport equipment and chemical products, including drugs and pharmaceuticals.

While exports grew rapidly in the new millennium, imports grew even faster. The increase in the imports bill was partially due to the investment boom leading to the rise in the import of capital goods, and the high international petroleum prices. Petroleum products continued to be the largest item in India's imports, constituting over a third of the total imports in April– October 2006, followed by capital goods accounting for about 12 per cent of total imports. The negative trade balance in commodities was, however, to a great extent offset by the positive balance in invisibles due to the excellent performance of the services sector in exports. As a result, the current account deficit remained moderate at an average of 0.75 per cent of GDP between 2004– 05 and 2005–06, after having shown a surplus of an average of 1.4 per cent for the previous three years.[21] The moderate current account deficit, however, was easily compensated by rising capital receipts, as we shall presently see.

India's services exports have been growing rapidly and faster than merchandise exports in past few years. They were worth $4.9 billion in 1992, $25 billion in 2003 and $61.4 billion in 2005–06. The Economic Survey of the Government of India, 2006–07, summarized the recent experience in this sphere, stating that services 'exports have increased threefold during the last three years: in 2005–06 with a growth of 42 per cent, it reached US$61.4 billion. Growth has been particularly rapid in the miscellaneous service category, which comprises of software services, business services and communication services. In 2005, while India's share and ranking in world merchandise exports were 1 per cent and 29, respectively, its share and ranking in world commercial services' export was 2.3 per cent and 11 respectively. By growing faster than merchandise exports, services exports constituted almost 60 per cent of merchandise exports in 2005–06.'[22]

Within services exports, software exports showed tremendous buoyancy, growing at an annual compounded rate of 36 per cent between 1995–96 and 2003–04. The share of software in total services exports in this period rose from about 10 per cent to nearly half, 48.9 per cent. Impressive as this growth would appear, the potential for sustained future growth in this sphere was enormous as services accounted for more than 60 per cent of world GDP and trade in services had grown faster than in merchandise since 1985 and the market share of India in global IT spending was estimated at a mere 3.4 per cent in 2003–04.

Apart from software a relatively new development was the explosive increase in export of business services including professional services, which grew by 216 per cent in one year to reach $ 16.3 billion in 2004–05, and by 181 per cent in the first half of 2005–06 to reach a level of $ 15.4 billion, surpassing the value of software services exports. In offshore IT services and business processes outsourcing (BPO), India accounted for 65 per cent and 46 per cent of the global market in 2004–05. However, all countries put together were estimated to have tapped only 10 per cent of the potential offshore and outsourcing market. Therefore, the potential for growth for India, one of the largest players in this field, was enormous.[23] The transformation of India in this respect was truly remarkable. As Jeffery Sachs put it, 'Who would have guessed twenty-five years ago that impoverished India would burst upon the world economy in the 1990s through high-tech information services? Nobody.'[24]

However, the largest contributor to inflows of invisibles into India has been (since as early as the 1970s) remittances by Indian migrants abroad. This, to a great extent, compensated for the very large negative trade balance in commodities, and kept the current account deficits within manageable limits. In fact in terms of capital inflows these remittances in the current account were much larger in volume compared to the net inflows in the capital account based on foreign direct investment (FDI) and portfolio investment put together. These remittances, along with the number of migrants, have grown dramatically since the 1990s with the onset of the IT revolution. From an average annual inflow of about $2.5 billion between 1980 and 1990, they rose to an average of $7.4 billion between 1991 and 2000. The new millennium saw the average annual inflow rise to more than $17.5 billion between 2001 and 2004. In 2004 inward remittances into India were $21.7 billion, making India the highest remittance receiving country in the world, followed by China ($21.3 billion), Mexico ($18.1 billion), France ($12.7 billion) and the

Philippines ($11.6 billion). Out of total global remittances of $225.8 billion in 2004, India's share alone was almost 10 per cent. As a proportion of GDP, remittances into India increased from 0.7 per cent in 1990–91 to 3.2 per cent in 2003–04.[25]

A new feature of the nature of migration was that while earlier the bulk of the migration was of low-skilled Indian workers to the Gulf and the Middle East, increasingly, higher-earning, more technically qualified workers and professionals (especially in IT areas) were moving towards the West, the US, Europe and Canada. As a result remittances too were no longer mainly from the Middle East but were from the West. Indians living in the US alone were reportedly sending in about half the total remittances into India.[26] Various incentives and facilities for transferring funds to India as well as the robustness of the Indian economy and its capital markets had made India an attractive destination for repatriating money.

The flows into India on the capital account also showed an overall healthy growth in the new millennium. Capital account surpluses not only comfortably financed the deficit in the current account which had started appearing since 2004–05 but were leading to accumulation of increasing foreign exchange reserves, causing if anything 'problems of plenty'. Skilful monetary management was required, for example, to ensure that the rupee did not appreciate too much, and thereby affect India's competitiveness in the global markets. Foreign exchange reserves rose dramatically from $42.3 billion in 2000–01 to $185.1 billion in February 2007, a more than four times increase in just six years.[27] It was a sea-change from the earlier situation where foreign exchange reserves in 1980–81 were $5.8 billion and in 1990–91 a mere $2.24 billion.

Among capital flows, net FDI flows which had been consistently rising since the 1990s, averaging about $2.5 billion per year between 1995 and 1999, rose to an average of $3.7 billion per year over the next six years from 2000–01 to 2005–06. The rising trend continued during 2006–07. From April to September 2006 the net FDI according to provisional data had already reached $4.2 billion, almost twice the level for the corresponding period in the previous year. The FDI growth is significant compared to India's past record though it is still way below the levels achieved by China, which attracted net FDI several times more than the Indian levels clocking, for example, $49.3 billion in 2002.

While looking at net FDI coming into India one must keep in mind the relatively new phenomenon of outward FDI flows, which were reaching significant levels of about $3.2 billion in 2005–06. With Indian companies making major investments, mergers and acquisitions abroad, such as the recent (2007) much-talked-about acquisitions by the Tata group of the Anglo-Dutch-owned steel giant Corus for reportedly $12.2 billion, or aluminium firm Hindalco buying Canada's Novelis, Inc. for $5.9 billion, a qualitatively new process appears to have started unfolding.[28] It is claimed by one report that Indian companies could end up spending $35 billion in acquisitions and mergers abroad in 2007.[29] That Indian business was increasingly becoming global is seen from a December 2005 report that twenty of India's top hundred companies, ranked by market capitalization, derived more than 50 per cent of their revenues from sales abroad.[30]

Portfolio investments (PFI) constitute capital flows into the Indian capital market through foreign financial institutions (FIIs) and resources mobilized by Indian companies through American Depository Receipts (ADRs) and Global Depository Receipts (GDRs). It was only since 1992 that the Government of India permitted foreigners through FIIs to invest in Indian primary and secondary securities market, though with certain restrictions. Since then PFIs into India through FIIs have grown, averaging about $2.3 billion per year for the ten years from 1993 to 2002. Since 2003, net PFI into India increased manifold, 2005–06 seeing a record high of $12.5 billion. ADR and GDRs which were part of the PFI flows rose to $2.6 billion in 2005–06, up from $0.62 billion the previous year. The dramatic rise in foreign portfolio investment into India reflects the bullish sentiments in the Indian capital markets. The Indian capital market had matured beyond recognition. The market capitalization of the Indian stock market as a proportion of GDP rose from a mere 5 per cent in 1980, 13 per cent in 1990, 60 per cent in 1993 to 91.5 per cent in January 2007, reaching a figure comparable not only to emerging market economies but also to Japan (96 per cent) and South Korea (94.1 per cent).[31]

The rapid rise in PFI came with its costs: a greater vulnerability of the domestic economy to global financial fluctuations. But then this was one of the costs of participating in the globalization process and benefiting from it. The issue was how to protect the domestic economy from this instability. The gradual and careful manner in which the various regimes in power during the entire post-reform period have tried to deal with the issue of full capital account convertibility is evidence of the common concern that PFI should not have a destabilizing effect on the Indian economy.

A positive development in India's relationship with the external world was that its external debt levels were reaching more manageable levels and so was India's capacity to service them. On all counts of the four debt sustainability indicators, that is, debt-GDP ratio, debt service ratio, short-term debt to total debt ratio and concessional debt to total debt ratio, India's performance was creditable. India's external debt as a proportion of GDP fell from 28.7 per cent in 1990–91 to 22.5 per cent in 2000–01 and further to 15.8 in 2005–06. Equally significantly, debt servicing as a proportion of external current receipts, or the debt service ratio, which is a measure of a country's ability to service her debts without getting into a debt trap, also fell from a high of 35.3 per cent in 1990–91 to 17.1 per cent in 2000–01 to a comfortable 6.1 per cent in 2004–05.

India had moved down from the third rank of the top ten debtor countries in 1991 to eighth rank in 2004 in terms of total volume of debt. But more important, among these countries (see table 28.1) only China had a lower debt–GDP and debt service ratio than India in 2004, of 12.9 per cent and 3.5 per cent respectively, as compared to India's 17.9 and 6.1. The Indian figures compare extremely favourably with the debt–GDP and debt service ratios of other countries in this list of ten, such as Brazil (38 per cent and 46.8 per cent), Turkey (53.6 and 35.9), Indonesia (56.5 and 22.1) and Hungary (66.8 and 25.2). The debt service ratio for India, however, rose again to 10.2 per cent in 2005–06 mainly due to the one-off redemption payments of India Millennium Deposits. As for the proportion of short-term debt to total external debt, it was only 6.1 per cent for India, which was the lowest among the debtor countries, with China registering 47.2 per cent. Similarly, India was able to raise the highest proportion of concessional debt to total debt at 35 per cent, way above China's 15.5 per cent.[32]

Table 28.1: International Comparison of External Debt, 2004

No.	Country	Total external debt (US$ billion)	Debt to GNI	Debt Sustainability Indicators: Debt service	Short-term debt to total external debt	Concessional debt to total debt
1.	China	248.9	12.9	3.5	47.2	15.5
2.	Brazil	222.0	38.0	46.8	11.4	1.5
3.	Russian Fed.	197.3	34.7	9.8	17.6	0.0
4.	Argentina	169.2	117.4	28.5	16.2	0.8
5.	Turkey	161.6	53.6	35.9	19.7	2.9
6.	Indonesia	140.6	56.5	22.1	17.4	27.7
7.	Mexico	138.7	20.8	22.9	6.6	1.0
8.	India	122.7	17.9	6.1	6.1	35.0
9.	Poland	99.2	41.7	34.6	17.0	6.4
10.	Hungary	63.2	66.8	25.2	19.5	0.3

Source: Global Development Finance 2005, The World Bank, quoted in *Economic Survey 2006–07*, Government of India, p. 132.

The improved debt scenario underscores the point that since the reforms of 1991 India had got on to a higher-growth path with greater sustainability. Unlike the growth of the 1980s which was based on overborrowing and overspending leading towards a debt crisis and an unsustainable fiscal deficit, a much higher domestic savings rate, a somewhat improved fiscal deficit situation and a considerably improved external debt situation characterises the post-reform rapid growth of the Indian economy, particularly in the new millennium.

Is it Dependent 'Neo-colonial Development'?

Critics of economic reforms or the liberalization and globalization process have seen in this path of development a threat to India's sovereignty, of India moving towards virtually a neo-colonial direction of dependent development, abandoning the Nehruvian consensus of growth with self-reliance and equity. They argue that the opening up of the Indian economy and the pursuance of 'neoliberal' policies dictated by the 'Washington consensus' would lead to indigenous industrial stagnation if not de-industrialization, swamping of indigenous industry and economy in general by 'metropolitan' capital or multinational corporations, etc.[33]

None of these apprehensions appear to hold good. As discussed above, the Indian economy witnessed a major step up in its growth rate with a declining dependence on foreign debt or aid. Indian industrial growth had also picked up and it was not the typical 'neo-colonial' import-intensive consumer goods-based industrial development, but a diversified industrial development, including of capital goods industries. Foreign imports and foreign companies operating in India did not swamp indigenous industry and the Indian market. Despite a much higher inflow of FDI, foreign interests did not appear to have acquired substantial, leave alone dominant, control over the Indian economy. A study of a sample of large private sector companies showed that the share of foreign firms in total value added and total sales in Indian manufacturing increased from 9.5 per cent and 11.26 per cent respectively in 1990 to merely 12.63 per cent and 13.77 per cent in 2001. The study excluded from its analysis public sector manufacturing companies and the non-large private sector units where foreign capital presence was either nil or negligible. Thus if the entire economy was looked at, the share of foreign interests in Indian manufacturing would be even smaller.[34] Indian industry was in fact now not only successfully competing in the international market in highly competitive areas like the automobile industry (automobile exports grew at an annual average of 35 per cent for six years from 2000–01 to 2005–06, with the industry exporting about 18 and 16 per cent of its domestic production of three wheelers and passenger cars respectively in 2005–06)[35] and pharmaceuticals but was doing acquisitions and mergers of major global multinational companies.

The Indian economy and industry may not have grown as fast as that of China but, as has been argued, 'India's growth and exports have a much higher domestic content, domestic ownership and are sold under domestic brands. In an increasingly open economic environment, Indian firms have displayed the ability [to] internationalize their operations with exports and by investing in businesses abroad in a variety of manufacturing and service industries.'[36] The fact that (in 2003) India's FDI stock as a proportion of GDP at 5.4 per cent, and share of FDI inflows in gross fixed capital formation at 4 per cent, was only one-seventh and less than one-third the corresponding figures for China, and that mergers and acquisitions by cross-border investors were much higher in China than India, has led Baldev Raj Nayar to argue that 'China and India can indeed be regarded as two distinct growth models, the former driven by foreign capital and the latter principally reliant on local capital'.[37] Food for thought for those who counterpoise China's independence to India's succumbing to the 'Washington consensus'!

The fact that India was able to demonstratively profit by participating in the globalization process, including by opening its doors considerably to flows of foreign goods, services and capital, without being overwhelmed by it, and that China had continued to follow this path with greater enthusiasm and with remarkable success, further cemented the consensus around the need for change in the direction of economic reform that had emerged in India by 1991. Though much eroded, resistance to this, by now virtually globally accepted need for change, continued in a section of the orthodox leftist academia and a section of the cadres of the Communist parties, as the daring Communist reformer, chief minister of West Bengal, Budhhadeb Bhattacharya was to discover, much to his chagrin. While virtually all shades of political opinion now vied with each other for greater economic reforms, increased private investment including foreign investment, etc., it was not as if the challenges that the reform process faced when it commenced were all sorted out.

It is to these challenges that we shall now turn.

Challenges in the New Millennium

The greatest challenge that India continued to face was that of poverty. There has been much debate among economists on whether economic reforms had speeded up the process of poverty eradication or slowed it down. While there is general agreement that poverty did fall substantially between 1983 and 1993, from 44.5 per cent of the population living below the poverty line to 36 per cent, the controversy centres on what happened thereafter, particularly in the 1990s. Data generated by the 55th round of the National Sample Survey (NSS) showed that there was a sharp fall in poverty to 26.1 per cent in 1999–2000. The method used for conducting this survey was, however, not comparable to the one adopted in the earlier surveys and has added to the confusion on this question. The 61st round of the NSS fortunately generated separate sets of data for 2004–05, which were comparable to the 1993 data and 1999 data. The data that were comparable to the 1993 data show a fall in the poverty level from 36 to 27.8 per cent between 1993 and 2004–05. Using a method comparable to the one used in 1999–2000 the poverty figures fall from 26.1 to 22 per cent between 1999–2000 and 2004–05.[38]

Here again what is not disputed is that poverty did decline between 1993 and 2004–05 from 36 to 27.8 per cent. The debate centred on what happened in the 1990s, though there appears to be a consensus that poverty did decline quite rapidly in the new millennium, between 1999–2000 and 2004–05. Using various strategies to surmount the comparability problem, Angus Deaton argued that there was a 'very substantial poverty reduction in the 1990s' with rural poverty declining by 1.3 percentage points per year and urban poverty by 0.9 per cent per year between 1993– 94 and 1999–2000.[39] Sundaram and Tendulkar broadly endorsed this estimate, claiming further that there was 'greater point to point average annual reduction in poverty during the last six years of the 1990s than in the preceding ten and a half year period'.[40] Others like Himangshu, Mahendra Dev and C. Ravi have contested this.[41] They claim that poverty fell faster, at 1.1 per cent per annum between 1973 and 1988, compared to 0.6 per cent per annum between 1987 and 2005, and 0.7 per cent between 1993 and 2005.[42] However, they are agreed that most of the fall in poverty between 1993 and 2005 was accounted for by a sharp fall in poverty between 1999–2000 and 2004–05 suggesting that the 1990s was the 'lost decade of poverty reduction'.[43]

While the rate at which poverty decreased in the 1990s may be debatable, it is generally agreed that poverty reduction in the new millennium showed considerable improvement: 1.8 per cent per annum rural and 0.8 per cent urban by one estimate,[44] and 1.13 per cent rural and 0.73 per cent urban during the period 1999– 2005 by another estimate.[45] It is interesting that rural poverty showed a sharp decline in this period precisely when agriculture took a downturn. This could have been due to the increased growth of employment, particularly non-farm employment and a successful check on inflation, in fact a fall, compared to the earlier period, in the 1990s. Another, positive aspect is that the proportion of the very poor (those below 75 per cent of the poverty line) to the total poor showed a substantial decline from 55.2 per cent in 1983 to 43.2 per cent in 1993–94 to 36.5 per cent in 2004–05.[46]

However, despite the definite improvement in poverty levels, in the sense of the proportion of the poor falling, especially since the Indian economy moved on to a higher-growth path in the 1980s, the absolute number of the poor was still intolerably large in India, about 300 million in 2004–05. This made the size of the poor population nearly as large as what the size of the total Indian population was at independence (361 million in 1951). Clearly, economic growth was not fast enough. Also, rising inequality did not allow the benefits of growth to reach the poor adequately. One study shows that while the higher growth rates in the years 1993– 2005 made an important contribution to reduction in poverty, the rise in inequality in this period limited this process. It is calculated that, had the inequality levels (GINI) remained the same, then poverty levels would have fallen by 2.8 per cent more in rural areas and 4.3 per cent in urban areas over this period.[47]

India's chief failure still remained on the equity front. Illiteracy was rampant and over a third of the children aged between six to fourteen did not go to school. A very large percentage of those that did go, ended up learning very little, as recent studies have shown. (The tall claims of the government that after launching the Sarva Shiksha Abhiyan, into which considerable resources were poured in, a great degree of 'Sarva Shiksha' or universal education was achieved were widely disputed by scholars and activists.) This meant education, *the chief source of social mobility for the poor*, was not accessible to an astonishingly large proportion of the poor. While India experienced spectacular economic growth over the last couple of decades, shockingly, the benefits of this growth were barely reflected in improvement of the quality of life of the most vulnerable sections of society, particularly children of the poor, in terms of immunization, health and education.[48] The 2006 National Family Health Survey (NFHS 3) showed an immunization coverage of only 44 per cent—an improvement of only 2 per cent in the last eight years, compared to the 1998 NFHS 2 data. Similarly, 46 per cent of the children under three were underweight in 2006, again a fall of only 1 per cent in the last eight years.[49] It was small wonder that India's position in the global Human Development Index (HDI) had actually gone down from a lowly 124 in 2000 to 126 in 2004, Sri Lanka ranking much higher at 89.[50] Also, though there was rapid growth in industries and services, agricultural growth remained sluggish in the new millennium. This had serious implications for the poor as about 55 per cent of the total workforce in India was still engaged in agriculture though the share of agriculture in GDP had fallen to 18.5 per cent in 2006–07. Employment growth in agriculture faced 'a near collapse' between 1994 and 2005 causing severe distress in rural areas.[51]

Clearly, just growth, which from Jawaharlal Nehru's time was correctly seen as a necessary condition for equity, was not sufficient by itself. This was recognized at the highest level, with prime minister Manmohan Singh making repeated statements on the need for making growth more inclusive and for addressing the agrarian distress urgently.[52] However, what was true of the Nehru– Mahalanobis strategy of growth with equity is true for the post-reforms period as well: the benefits of growth, or of progressive legislation, etc., reach the poor only when there is popular mobilization from below. India had much higher growth rates in the last twenty years than it did in the first twenty years after independence, but in terms of the change in the lives of the common poor, perhaps the early period still stands out as more successful. The urgency of reaching the benefits of growth to the ordinary citizen in the new millennium cannot be overstated. The existence of democracy in India and the presence of a significant left ensured that the issue of poverty and equity was constantly foregrounded and no regime could ignore it. Yet, much more needed to be done.

Some grassroots level popular movements emerging from within civil society were showing the way. Movements in Rajasthan led by Aruna Roy and in other parts of the country have mobilized the poor for the right to information, and used this right to see that resources allocated for the poor are not misappropriated. Similarly, movements for the right to employment led to countrywide efforts to have employment guarantee schemes for the rural unemployed. Movements in Andhra Pradesh led by Shantha Sinha, through an organization called the M.V. Foundation (MVF), for protection of child rights, particularly children's right to education, mobilized the village community to protect and secure this right for their children in village after village, bringing over 300,000 working children to regular schools. This movement was spreading in other parts of the country. The right to food campaign has also been gaining ground. The issue remains of how to bring these diverse movements on to the national agenda. The day these movements get adopted by mainstream political parties and their millions of cadres would be the day of rejoicing for India's toiling millions.

The UPA government led by Manmohan Singh, responding to these urges, enacted the Right to Information (RTI) Act and the National Rural Employment Guarantee Act (NREGA), two very important measures in the direction of deepening India's democracy. The National Advisory Council chaired by Sonia Gandhi played a seminal role in foregrounding these issues and getting these legislations through.

The NREGA was notified in September 2005 and the scheme launched in February 2006. Two hundred backward districts were identified in the initial stage and all the districts of the country were to be covered under this Act within five years. In fact, as early as September 2007 the government announced the extension of the scheme to all districts in the country.[53] The Act provided that 'every State Government shall, by notification, make a scheme for providing not less than 100 days of guaranteed employment in a financial year to every household in the rural areas covered under the scheme and whose adult members volunteer to do unskilled manual work . . .'[54] The Act attempted to reach benefits to the most needy through 'self selection' without dividing the poor into caste and other categories, as is repeatedly done, not so much to reach benefits to the most needy, but to seek short-term political dividends on a communal or caste basis. In combination with the RTI Act, the NREGA had tremendous potential in ensuring that funds meant to reach the rural landless unemployed, one of the most vulnerable sections of society, did reach them (and did not get lost in the proverbial bottomless pit of corruption, callousness and unaccountability that has got created in the bureaucratic structure of the country) and that necessary rural infrastructure got built in the bargain. The short experience with the Act already shows that in areas where the poor were somewhat empowered through popular mobilization the Act was getting implemented far better than in other areas where they remain uneducated and unmobilized.

The setting up of the National Commission for the Protection of Child Rights and appointment of Shantha Sinha as its chairperson in early 2007 gave a glimmer of hope that the issue of child rights would be taken up in right earnest and the MVF experiment particularly in the sphere of education would be replicated on a national scale. So far the record in meeting perhaps the most insistent demand of the poor, a right to a decent education, has been dismal. For example, the right to education bill was not passed in 2007 citing financial difficulties!

In fact, the whole manner in which the education policy was being framed at a time when the world was moving towards a knowledge society where knowledge was increasingly becoming the key factor of production left much to be desired and could have critical economic consequences. It has now become commonsense knowledge among economists of all hues that rapid growth in primary and basic education as well as in higher education is critical in providing access to a better life to the poor, in sustaining high growth rates which require an enormous increase in educated manpower and in maintaining global competitiveness in research and development. The IT sector was already facing severe skilled manpower shortages which NASSCOM predicted was going to increase manifold in coming years. China's rapid progress in providing basic education widely and a very ambitious expansion of higher education reflected in a manifold increase in research papers produced and patents filed by Chinese scientists should have instilled an immediate sense of urgency for India in this respect. The setting up of the Knowledge Commission by prime minister Manmohan Singh was reflective of that sense of urgency but it could not make much headway. While the lasting impact in the education front during the NDA regime was the communalization of education, the recent (2006–07) initiatives led by Arjun Singh, Education Minister in the UPA government, of reserving 27 per cent seats for the backward castes in institutions of higher learning (significantly not in primary schools) appeared to be aimed more at playing 'backward caste' politics than at meeting either the needs of the millions of the poor who did not even get to see the face of a school, or of producing skilled manpower in sufficient numbers or of producing globally competitive research in various critical disciplines. The Knowledge Commission lost its thrust with critical members resigning from it in protest. Lack of urgent action in this area of education at various levels could create a major bottleneck which resurgent India can ill afford.

The challenge before the country in the new millennium, unlike in the early decades after freedom, was not so much of trying to achieve high levels of economic growth. The challenge was of effective governance that would harness this growth, create institutions and structures that would make this growth sustainable, and inclusive. The challenge was for civil society movements and political parties to ensure that the state apparatuses delivered and the growth that

India was witnessing translated into improvement in the quality of life of its vast millions. As an economist actively involved in making and commenting on India's economic reforms put it at the beginning of the millennium, 'if we have the will, and we are able to realise even half our potential in the next 20 or 25 years, India's poverty would have become a distant memory'.[55] There is today a historic opportunity for India to meet its tryst with destiny and not squander it in petty communal and caste squabbles and narrow gains for its political and bureaucratic elite.