POST–REFORMS INDIAN GROWTH: MIRACLE OR EUPHORIA?*

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ABSTRACT

The post-reforms period in India has been characterized by high growth rates, which have often been attributed to the reforms process and invoked as an argument for pushing reforms further. This paper critically examines the perceived *benevolent link* between market-oriented reforms and growth, as also the implications of reforms for social welfare. Among the major issues discussed in the paper are the following: (i) the sustainability of the growth momentum (ii) likely impacts of reforms on poverty and employment (iii) rising inequality in the wake of reforms (iv) possible adverse impact on the environment due to globalization and (v) the role of natural resource constraints. On several of these aspects, the situation is far less sanguine than made out by reform advocates in India.

1. RECENT GROWTH EXPERIENCE

The unprecedented high growth rates observed over the last two or three decades in several Asian countries have been the subject of extensive discussions at academic, business and policy fora. An influential section of opinion in the West (as well as within the Asian region itself), has attributed this economic surge to the triad of *marketization, democratization and globalization*, though this view, of course, has also been frequently (and fiercely) contested.

I think the perception of a benevolent link between free markets, economic growth, civil society and social welfare in general is largely attributable to one of the most influential intellectual developments of the last few decades viz. the ascendancy (or more accurately, the triumph) of what is called *neo-classical economics.* In recent years, however, neo-classical economics has spilled over its academic boundaries and entered the arena of economic policy in a big way. Nowhere is this influence more evident than in the area of policy making in LDCs (less developed countries) and EMEs (emerging market economies). Thus, the liberalization wave of the 1980s has had neo-classical economics as its intellectual mainspring, and neo-classical reasoning has underlain many of the recommendations of the IMF and World Bank on structural adjustments.

The theoretical case for either free markets or liberal trade policies improving social welfare in LDCs has never been established (the interested reader could refer to Ortuno-Ortin *et al (*1991) or Little (2002) for details). However, pro-reform policy makers in such countries often act as if the "benevolent link" alluded to above (see immediately

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preceding paragraph) was a settled issue, beyond any theoretical doubt, when in fact the issue is far more complicated and the benevolence or otherwise of the link between freer markets and economic development (and social welfare in general) is crucially conditioned by the institutions and historical circumstances of each individual country[i].

In the Asian region, in the past three decades, nations with market-friendly policies seem to have fared much better on many economic indicators than nations with socialistic orientations, but especially on growth rates (see Table 1). On the African continent, by contrast, reforms have hardly achieved much (with the exception of South Africa), at best perpetuating the *status quo.* Thus the empirical experience clearly points out that whereas selective and well-planned liberalization of markets can produce beneficial results on certain occasions, a blind foolhardy rush in the direction of markets is fraught with dangers and far from desirable. Several important issues need sorting out, even if one agrees on the necessity of reforms, and
even the most basic list of such issues, would minimally include the following : (i) the pace at which reforms should be introduced (ii) the sequencing of reforms (iii)the political feasibility and social justice aspects of reforms (iv) the revised role of important State institutions (like the Central Bank and Planning Commissions) and the public sector generally (v) the likely strains on the federal polity in the wake of reforms (vi) the reconciliation of affirmative action policies with market principles and (vii) above all the issue of whether and to what extent markets should be allowed to evolve naturally and to what extent their development must be supervised and guided by the state itself. Certainly on these details, in an ideal scenario, each country would work out its own road map, using nationally available expertise (i.e. economists and other social scientists thoroughly familiar with local conditions). Instead what has happened is the emergence of a uniform reforms blueprint prepared under the aegis of multilateral institutions, based on the so-called Washington Consensus, which is designed as a standard sized hat "to fit all heads".

In the early years of liberalisation in India, some serious thinking seemed to have been evident in guiding the economy in a particular direction. However, the frenzy of privatisation, financial liberalisation and opening up to multinationals which has been witnessed in recent years in India, hardly bears the impression of a carefully thought out long-term strategy guided by national interest but seems a hastily put up patchwork quilt, with at least one eye on what will be acceptable to the IMF and the World Bank.

Several key factors enter the reckoning, when one considers the question of whether economic reforms in any particular country, are likely to be associated with greater social welfare. Of the myriad of these factors, the most relevant in the Indian context, appear to be the following :

(i) the sustainability of the growth momentum
(ii) likely impacts on poverty and employment
(iii) rising inequality
(iv) possible adverse impact on the environment
(v) natural resource constraints

Each of the above issues is now taken up for discussion.
Apart from these issues, the perennial issue of corruption has always been with us, and contrary to the pious expectations of the reform advocates, corruption has not

diminished with the move towards markets and has actually become more deeply entrenched (see Nachane (2006)). Newer issues are also emerging in the current Indian context such as the degree of "autonomy" of domestic policy, the freedom of the press from vested interests, the quality of public opinion and socio-political stability. However, without denying the importance of these broader issues, I keep them outside the purview of the present paper.

2. SUSTAINABILITY OF GROWTH

The Indian economy has experienced unprecedented high growth rates in the last three years (8.5% in 2003-04, 7.5% in 2004-05, 8.4% in 2005-06, and 8.9% in the first quarter of 2006-07). Reactions to the Indian *growth miracle,* have ranged from the wildly euphoric to the distinctly skeptical. It is often difficult for the dispassionate reader to unravel a coherent pattern from the welter of confusing and contradictory evidence presented in the literature. The growth controversy revolves around several intertwined issues, on each of which we briefly touch below.

The first issue revolves around when exactly did the *growth miracle* occur. This is not of mere statistical interest, for if the vital structural break is located in the 1990s then a major role in the growth spurt could be assigned to the reforms, whereas earlier breaks would, in some measure, emasculate their contribution. Econometrically speaking, the most dependable study seems to be Wallack (2003), which locates the sole significant break in Indian GDP as early as 1980[ii]. However, even if the growth acceleration dates back to the 1980s, as is well known, the growth impulses during this decade proved abortive. A number of explanations have been advanced as to why this growth phase proved transient. A popular explanation (especially favored by the liberalization advocates of the 1990s) is the view emphasized by DeLong (2001) and Panagariya (2004) that the growth impulse of the eighties decade was fragile and unsustainable, because the reforms undertaken lacked depth and did not go far enough. A more plausible explanation runs in terms of a constellation of unfavorable circumstances emerging at the end of the 1980s including the poor agricultural performance in two successive years (1986-87 and 1987-88), fiscal slippage (gross fiscal deficits in excess of 7% from 1984-85 to 1990-91), an over-valued exchange rate and a current account deficit which coursed through the 3% (of GDP) barrier in 1990-91, leading to the well known currency crisis of 1991. The contra-factual question as to whether the macroeconomic imbalances could have been avoided if the reforms had been more extensive remains an issue for further investigation.

While few would question that the growth rates experienced in the reforms phase (post – 1991) were historically high (by Indian standards), a section of opinion maintains that the rates could have been even higher. The view most favored by international multilateral agencies is that Indian reforms did not go far enough and (by implication) higher growth in the future is contingent upon accelerated reforms – a view enthusiastically espoused by the McKinsey Report on India (2001). Balakrishnan (2005) by contrast, faults the high real interest rates over the period 1995-2000 and the decline in budgetary support to capital formation in agriculture, for what he regards as a lackluster growth performance[iii]. The failure of macroeconomic policies, especially on the fiscal front, when supplemented with an older explanation (Khan (1994)) emphasizing governance problems as sources of low growth in the South Asian region, could provide a reasonably satisfactory explanation of why the 1990s did not witness a "Rostowian take off" into a high selfsustained growth phase. The McKinsey prescription is only a partial one and could be fraught with the danger so tellingly underlined by Rodrik and Subramanian (2004) " .. it is important for India to avoid the mistakes that Latin America made in the 1990s by hastily embarking on an overly ambitious agenda of economic liberalization and privatization that runs ahead of the supporting institutions or the productive ability of the economy"(p. 1596).

The crucial issue of growth sustainability in India has been examined from at least three distinct angles. Firstly, it has been done by delving into the sources of economic growth. Unel (2003) estimated an average annual growth rate of 1.8% in TFP (total factor productivity) for Indian manufacturing over the period 1980-1991, accelerating sharply to 2.5% over 1992-1998[iv]. Other studies by contrast report declining TFP growth rates as between the two periods (Trivedi et al (2000), Goldar & Kumari (2003), and Goldar (2004)). Goldar (2004), for example, records a decline in the TFP growth rates from 0.92% (1982-1991) to 0.65% (1992-2000). Using slightly different methods, Bosworth et al (2006) note a significant decline in the contribution of TFP to manufacturing growth in the post-reforms period (1993-2004) as compared to the decade (1983-1993), while for the services sector an exactly opposite trend is in evidence. Of the other major studies, the conclusions of Sivasubramonian (2004) are broadly in agreement with those of Bosworth et al (2006) and Goldar (2004), while Sengupta's (2005) study attributes a major role to the foreign trade effect in explaining the high post-reforms growth phase (p.5)[v].

Apart from the sources of growth, the composition of growth has also received a fair amount of attention in the literature. One of the most remarkable features of India's recent growth experience relates to the spectacular showing by its service sector. During the last decade (1994-95 to 2004-05), this sector has recorded an average annual rate of growth of 7.9%, much in excess of those recorded in the agricultural sector (3%) and the industrial sector (6.5%) (see Banga (2006))[vi]. Today, the share of the services sector in India's GDP is around 55%, with much of this increase being at the expense of the agriculture sector's share. Opinion on the long-term prospects of such service-led growth differs sharply. Critics of the *services-led growth* thesis in India have included Mazumdar (1995), Arunachalam & Kumar (2002) and most notably Acharya (2002). The criticism focuses on three special aspects of services growth viz. its dependence on growth in the other sectors (especially manufacturing), its low employment potential and its concentration in a few selected sub-sectors (construction, hotels & restaurants, communication, finance, insurance, real estate and business services)[vii]. Hansda (2002) is probably the most systematic analysis of service-led growth sustainability in the Indian context, using an input-output framework. Based on Rasmussen linkage indices, he finds substantial backward linkages of the services sector with the rest of the economy, though the forward linkages are only moderate[viii]. The strong backward linkages reflect the crucial dependence of sustained growth in the services sector on the rest of the economy (especially manufacturing) growing in tandem[ix].The fact that infrastructure services constitute an important component of the services sector (see endnote (v)), when taken in conjunction with the strong backward linkages and modest forward linkages alluded to above, while not in conflict with the frequently voiced concern in India about infrastructure being a bottleneck to growth, serves to underline the limited growth potential of a strategy of building infrastructure ahead of demand (as in the frequently cited U.S railroad experience of 1870-1910).

There is also a third perspective on the recent growth experience, viewing it not as a secular trend but as a strong cyclical upswing. In Nachane (2006), I have sought to interpret the upward movement as a consumption boom, riding on the back of the newly acquired prosperity of a metropolitan upper middle class. Several factors could be viewed as contributing to this boom, including a taxation scheme with very little progressivity at the top of the income scale, a spurt in consumer bank credit, burgeoning portfolio capital inflows which have given rise to increased wealth effects via market capitalization of equities, and abundant liquidity at historically low levels of real interest rates (see Table 2). The consumption boom has now spilt over into an asset prices boom (especially in the stock, bullion and housing markets). The resemblance to the Japanese consumption boom of 1986-1992, is anything but superficial. There are thus strong instability risks attached to the current high-growth phase, with the possible threat of a long drawn-out deflation (as in the Japanese aftermath which extended over the full decade 1992-2002).

So far we have focused on examinations of the sustainability issue from a purely economic perspective. But the issue may also be viewed in a broader framework. If growth is not broad based, if it has little impact on poverty, if it pays insufficient attention to the long-term issues such as environment and natural resource limitations, and if the benefits of growth are increasingly cornered by a minuscule section of the population, the consequent social tensions and political instability will inevitably frustrate the growth process. It is to an examination of some of this broader issues that we now turn.

3. UNEMPLOYMENT & POVERTY

The ultimate touchstone of reforms is the success it has in making a dent on the deeply entrenched poverty in India. The measurement of poverty is a complex issue, and up-to-date estimates on reliable poverty measures are rarely available. International comparisons of poverty levels are fraught with even more serious problems. The standard concept of poverty is the percent of population below a threshold (poverty line), usually based on a minimum level of nutrition in a benchmark year with allowance for some non-food expenditure and deflated by an appropriate cost of living index. Poverty estimates in India are based on the consumer expenditure surveys carried out by the NSSO (National Sample Survey Organization)[x]. After the reforms three quinquennial surveys have been carried out viz. the 50th NSS Round (1993-1994), 55th NSS round (1999-2000) and 61st NSS Round (2004-2005). As a benchmark pre-reform comparison point, we use the results from the 43rd NSS Round (1987-1988). Results are presented in Table 3[xi].

The fact that all-India poverty ratio has increased as between 1999-2000 and 2004-2005 is largely a reflection of the fact that the results of the 55th NSS Round are not comparable with the results of the 50th round. The methodology of the 61st Round is however comparable to that of the 50th Round (and hence not with that of the 55th Round). Thus the dent on poverty is nowhere comparable in the post-reforms period to what reforms enthusiasts were prone to claim earlier. Instead of declining by nearly 10% over a 6 year span, it has actually declined only by 8% over an 11 year span. Thus the average annual decline in the poverty ratio is a meager 0.7%, and not 1.6% as thought before. Considering that the rate of population growth in the last decade has been around 1.8%, the decline in the poverty ratio translates into an annual addition to the absolute number of the chronically poor by about 0.2% (roughly 2 million people over the post-reforms period). So much for the “trickle down” effect, much touted in the official pronouncements!

Chen & Ravallion (2004) in their well-known comparative study on world poverty, using the international poverty line definition ($1.08 a day per person at 1993 PPP), obtain significantly higher estimates for the HCR than shown in the above table (for the year 2001 for example their HCR is 34.7%). Poverty in India has been consistently higher than that in South Asia generally, whether measured by the HCR or by Poverty Gap Indices[xii].

The aggregative measures of poverty do not enlighten us about important issues such as

i. The intensity of poverty.
ii. Its concentration in particular regions.
iii. Its distribution by occupation, sex, caste and religion.

Only very detailed studies can throw light on such issues which are fraught with tremendous social and political consequences. Attempts to deal with these aspects are only now commencing (e.g. Radhakrishna & Ray (2005), and Radhakrishna & Panda (2006)).

Juxtaposed with the issue of poverty is that of unemployment. Possibly, unemployment is ultimately likely to prove the Achilles' heel of the reforms process. It is now unequivocally accepted that the move to market friendly policies globally, has reduced the employment elasticity of growth (% increase in employment for a 1% increase in growth rate), in LDCs, in ex-socialist countries as well as the OECD group of countries. Even in China spectacular growth has co-existed with an urban unemployment problem. The aggravation of the unemployment problem occurs through several channels, the main ones for the LDCs being the following:

1) A decline in the terms of trade (ratio of export prices to import prices) owing to the low level of demand for LDC exports in the advanced countries.
2) Corporate restructuring and mergers & acquisitions.
3) Rapid growth of labour-saving technologies, mainly introduced into LDCs by multinationals.
4) The global spread of new technologies has brought in its wake a new underclass of "the learning-disabled" consisting of the least educated older workers. This class is not only unemployed but also "unemployable" - in the globalised world there is no room for the totally unskilled worker.

Advocates of the free market, typically contend that although new technology displaces labour, it also lowers costs and prices, and hence expands the demand for labour in the long run. But it should be emphasized that with each successive wave of technology, the new demand is going to be for increasingly skilled workers. In the absence of a suitable education and training policy, the already displaced labour cannot be absorbed - only a skill-job mismatch situation develops with an excess demand for highly skilled workers co-existing with a vast army of the long-term unemployed.

Empirical analysis of unemployment in India is beset both by data problems as well as a multiplicity of measurement concepts. At least four concepts are currently in use viz. UPS (usual principal status), UPSS (usual principal and subsidiary status), CWS (current weekly status) and CDS (current daily status)[xiii]. The unemployment rates (unemployed as a fraction of the workforce) are presented in Table 4 below, whereas employment growth rates of select sectors is presented in Table 5 (with a breakdown between the organized and unorganized sectors).

Both tables underscore the failure of the Indian reforms process to tackle the unemployment issue with any success. The unemployment rate (all-India) shows an appreciable decline over the pre-reform period (1983 to 1993-1994), but then rises again very sharply over the post-reforms period (1993-1994 to 1999-2000). The conclusion applies with similar force to the rural unemployment rates, and also (but with considerably less force) in the urban case. The sectoral story mirrors the broad pattern exhibited by the aggregate unemployment rates. Employment growth (in both the organized and unorganized sectors) has decelerated sharply in the aftermath of reforms. As in the decade prior to reforms, the unorganized sector continues to grow faster than the organized sector in the post-reforms period[xiv]. This growth has been accompanied by an increasing *casualization* of labour (see Deshpande & Deshpande (2001)).

From a futuristic perspective what is a dangerous portent is the declining employment elasticity of growth across sectors. This is evident from Table 6, which shows a steep fall in the employment elasticity in the post-reforms period in all sectors except transport, storage & communications, and finance, insurance, real estate & business services. In the remaining sectors (accounting for nearly 94% of the total employment) employment elasticities have registered moderate to steep declines. If the overall employment elasticity of 0.13 (obtained over the period 1993-1994 to 1999-2000) is taken as obtaining in the near future then even an 8% rate of growth will increase employment by a mere 1%[xv].

4. INEQUALITY

Inequality is possibly one of the most neglected dimensions of the liberalization programme. It becomes one of the crucial factors determining long-term sustainability of the reforms programme , because of the following three features (Birdsall (2005)).

1. Inequality not only inhibits growth in countries with weak markets and governments, but could even contribute towards making both (governments as well as markets) weak in the first place.
2. It undermines good public policy, by undermining collective decision making and social institutions critical to healthy societies (the so-called “vanishing middle class” syndrome).
3. A cross-country correlation analysis reported in Birdsall (2005) indicates a low but positive correlation (0.33) between inequality (as measured by the Q5/Q1 index- the ratio of the income accruing to the bottom 20% and top 20% of the population) and the poverty headcount ratio ($ 1 per day threshold)[xvi].

In a large federal set-up such as India’s, inequality has at least two major dimensions viz. regional inequality between states and interpersonal inequality.

The study by Ahluwalia (2002) (covering 14 major states) showed a sharp increase in the Gini coefficient from 0.175 (1991-92) to 0.233 (1998-99), based on the SDP (state domestic product) per capita[xvii]. Deaton & Dreze (2002) reiterate similar conclusions but based on per capita consumption across states. Thus the process of economic reforms in India does seem to have had a noticeably adverse impact on regional inequality. This has the potential to create political tensions in a society where regional loyalties have traditionally been powerful. There is already in evidence a marked reluctance on the part of the advanced states towards the concept of *equalizing fiscal transfers to backward states*, via the mechanism of the Finance Commissions.

Interpersonal inequality has attracted a great deal of attention from policymakers and academics alike. For India, the central features from major studies such as Mundle & Tulasidhar (1998), Ravallion and Datt (1999) and Jha (2000) are that in the 1990s there has been a moderate rise in both rural and urban inequality (in contrast to the two previous decades when inequality remained constant), accompanied by a decline in urban poverty, but the widening of the rural-urban income gap has implied a significant increase in overall inequality.

Three explanations have been advanced to explain the re-emergence of income inequality in the 1990s in countries embarking on neo-liberalization programmes, viz.

(i) <u>Traditional Causes:</u> A reinforcement of traditional causes of inequality such as land concentration and unequal access to education and health.
(ii) <u>Technological Change</u>: This explanation of inequality lays stress on the differences between wages of skilled and unskilled workers, emerging in the wake of technological progress. Technical progress generates scarcity rents for skilled workers, thus increasing the wage spreads (between the skilled and unskilled). However, every major technological innovation creates a new class of skilled workers, rendering part of the older skilled workforce, semi-skilled.
(iii) <u>Domestic & External Liberalization</u>: A great deal of literature has emerged around the disequalizing impact of liberalization and globalization. Since this process has several facets, we discuss each of them briefly.

So far as *trade liberalization* is concerned, the so-called *Wood thesis* (based on standard factor price equalization assumptions) leads us to expect a narrowing of wage differentials in LDCs & EMEs (see Wood, 1994), a conclusion hardly borne out by the empirical data available. One plausible explanation of this phenomenon revolves around the inappropriate choice of technologies in LDCs. The import of First World technologies in LDCs often leads to a scarcity rent for skilled labour, aggravating wage inequality (see Lindert and Williamson (2001)). Rodrik (1997) stresses an alternative line of explanation in terms of the political economy of distribution in a world of mobile capital and immigration inflexibilities.

In assessing the distributive impact of globalization on LDCs, a key factor is not usually accounted for. This refers to the domestic policy changes (including labour market reforms, tax reforms and privatization) which have to be initiated to render the country an appealing destination for foreign investors.

Labour market reforms typically involve relaxation of safety norms, reducing job security, and weakening of collective bargaining mechanisms. These have obvious impacts on wage dispersion (though once again we encounter a consistent dearth of quantitative estimates).

Tax reforms have been characterized by a rolling down of corporation taxes and taxes on trade, with a corresponding rise in indirect taxes. This has been accompanied by a reduction in the progressivity of direct taxes, especially at the top end. While there is no denying that the excessive marginal tax rates on high incomes and wealth obtaining in the 1960s and 1970s had a dampening impact on effort incentives, the current flat rate of 30% for the top income slabs (with a surcharge of 10%) has had adverse impacts on social equity. The savings from the top income brackets seem to have largely flown into asset markets (equities, bullion, and real estate), which are currently experiencing a long upward swing. The rising real estate prices in particular (they rose by about 40% last year alone) are putting a squeeze on the urban middle class and poor, where mortgages often account for about 35% of a median family's income[xviii].

Privatization, where it has occurred on a significant scale, has often led to rapid concentration of national assets in the hands of a small elite, high service charges by the privatized utilities, employment restructuring and erosion of regulatory control. Such a combination of factors has considerable potential for an unfavourable distributional impact.

Domestic *financial sector reform* tends to raise the share of financial services in the GDP. In the last decade or so, there has also been a marked relative rise in financial sector salaries as compared to salaries in the manufacturing sector (even after correcting for standard conditioning factors such as education levels, hours worked, non-salary incentives, etc.). This relative rise is partly in the nature of quasi-rents to finance specialists (in a situation of a rapidly evolving financial system and financial instruments), and partly an *internalization* of unprotected intellectual property rights for financial innovations[xix]. Another factor contributing to inequality is the redistributive impact of the budget which in a largely deregulated financial environment could transfer labour incomes to holders of state bonds.

The *liberalization of cross-border direct investment flows*, as well as bank loans and portfolio investments, has 3 potential consequences for inequality. Firstly, there is the "disciplining" effect on domestic policy, involving tax reforms and restraints on organized labour, which have already been discussed above. Secondly, capital inflows are likely to lead to real exchange rate appreciation, which shifts resources to the non-tradeables sector and encourages sub-contracting and wage cuts in the tradeables sector to preserve profit margins (see Taylor (2000)). Thirdly, increasing openness of the capital account increases the vulnerability of the domestic economy to financial crises (Caprio & Klingebiel (1997)). These crises have pronounced disequalizing effects, especially in countries with weak institutions and social safety mechanisms[xx].

Empirical evidence on inequality is extremely scanty in the Indian context. It would have been interesting to examine whether the *a priori* expectation (in view of the above discussion) of an increase in inequality consequent to reforms is borne out by the data. The only evidence of this nature that seems to be available is that due to Radhakrishna & Panda (2006) but this is limited to four Indian states. Nevertheless as seen in Table 7, our *a priori* expectations are only partially borne out. The Gini index (measured in terms of the monthly per capita expenditure) shows an increase for the urban sector in two of the four states, while there is a noticeable decline for the rural sector in all four states.

Needless to say, unless supplemented by data on more states, much cannot be read into these conclusions. Additionally, an explanation of the observed trends in terms of underlying causal factors is also awaited.

5. ENVIRONMENT & NATURAL RESOURCES :

Environment is an issue, which has received relatively little attention in India as yet. Environmental degradation in India, is proceeding apace at an alarming rate, as is happening elsewhere in the LDCs.

Ray & Chaudhury (2004) have identified 17 major *dirty industries* in India[xxi], which between themselves account for about 13% of the total industrial units in the country and for about 5.65% of national income. Globalisation is likely to accentuate the process further owing to the following factors:

I. There is some evidence of shifting of some "dirty industries" (i.e. pollution creators) to South Asia. The significantly lower environmental standards in this region (than those obtaining in developed countries), create an implicit incentive for MNCs to locate their high polluting units here (the so-called *regulatory moral hazard* problem). Further, most LDC governments in South Asia, in their anxiety to attract FDI may not be fully sensitive to this problem and the Indian government is no exception to this tendency.

II. The intense lobbying for transgenic crops in India could also be a potential environmental hazard, the full impact of which is not known yet.

III. As we have noted earlier, there has been a marked growth in the unorganised sector. While pollution is a common feature in both organised and unorganised units, the latter are far more difficult to monitor and control, and may often lack the resources to initiate pollution abatement measures (see Ray & Chaudhury (2004))[xxii]. The WTO has introduced several environmental measures in the last Round (1994). The standard LDC grouse against these measures is that they can often be used as a protectionist measure by developing countries against their exports[xxiii].

Thus, whereas several aspects of globalisation seriously threaten the environment of LDCs, the WTO measures in this regard are not only inadequate to handle these threats, but are often misapplied by the developed countries themselves as new protectionist barriers.

On the natural resources front, the situation is to say the least alarming. To illustrate the looming crisis in this vital dimension of long-term social welfare, let me take up the issue of water. As per international norms (see Report of National Water Commission (2002)) a country is deemed *water-stressed* if annual per capita water availability falls below 1700m^3 and *water-scarce* if this availability goes below 1000m^3. In India, the latter threshold was breached in 1991, when annual per capita availability fell to 816m^3. Since then the availability has been declining precipitously, falling to 672m^3 in 2001, and projected to fall to 495m^3 by 2025. What makes the situation a frightening one to contemplate is that access to water is extremely unequal, so that the per capita figure is hardly reflective of the privations experienced by innumerable underprivileged households across vast tracts of the country. Urgent measures to overcome this situation are needed (see Kumar et al (2005)), but would need a sharp reorientation in the priorities of the present government.

6. FACE OF THE FUTURE

The recently released approach Paper to the XI th 5-Year Plan (henceforth AP for short) provides an indication of the long-term economic strategy of the current government. Three distinct features emerge from this document :

(i) aggressive thrust towards market-oriented policies
(ii) an expression of belief in the *demographic dividends* theory
(iii) recognition of the fact that growth needs to be made more *inclusive.*

Each of these points is elaborated below.

Market Orientation: The market thrust of the current government has never been in doubt. In recent months, however several measures have been proposed, designed to operationalize this thrust. The AP assigns a crucial and hitherto unprecedented role to private investment (and FDI)[xxiv] in the country's future growth, and lays great stress on the concept of Public Private Partnership in those sectors where public presence is inevitable. Shortly after the publication of AP, the decks were cleared for the freer movement of foreign capital with the Second Capital Account Convertibility Committee announcing a move towards convertibility by 2009. Finally, in what is viewed as a major step towards attracting private investment, a new policy initiative on Special Economic Zones (SEZs) was announced. As we have seen in the earlier part of the paper, the move towards markets has resulted in a significant improvement in the growth performance, but has made little impact on poverty, and has aggravated inequality (both interregional and interpersonal). A large part of the reason could be that while the advocacy of reforms has based itself on the professed merits of markets and competition, actual economic policy has been *pro-business* rather than *pro-markets* (i.e. one in which state actively intervenes to protect and promote entrenched business interests, rather than one in which efficiency, competition, free entry and consumer interests dominate)(see Kohli (2006) and Rodrik & Subramanian (2004) for the Indian case and Rajan & Zingales (2004) for a more general discussion) .

Demographic Dividends Theory: The AP makes an explicit reference to the *demographic dividend* laying stress on ".. the important potential strength arising from our demographic trends". While it is not uncommon in India to hear some strong votaries of liberalization waxing enthusiastic on the *demographic dividends* theory, this is the first time one finds an official endorsement of this doctrine.

The theoretical framework for this doctrine lies in the neo-classical models of the Solow-Swan vintage, with additional factors like human capital, education and training grafted on (Barro & Sal-I-Martin 1995). Bloom & Williamson (1998) tested this model econometrically for East Asia, concluding that East Asia has enjoyed a long *demographic dividends* phase over the years 1960-2010, which is now drawing to a close. They also project that this boom will shortly commence in South Asia. Proponents of this theory in India conveniently forget three important qualifications to this theory. Firstly, that the neo-classical nature of the underlying model presumes labour to be a binding constraint[xxv]. One is not sure whether such *labour supply optimism* can apply universally irrespective of the specific labour market dynamics characterizing each country. Secondly, there is also a potentially negative impact of population growth on capital intensity. A rapidly growing population needs large investments for supplying basic needs (such as housing, roads, schools etc.), so that (unless the supply of machinery is assumed infinitely elastic) capital intensity in industry is likely to decline at least in the short run. Thirdly, one cannot ignore Bloom & Williamson's (1999) warning that "this effect was not inevitable : rather it occurred because East Asian countries had social, economic and political institutions and policies that allowed them to realize the potential created by this transition". The contrast between East Asia and Latin America, where economic performance has differed sharply in spite of similar demographics, is a telling manifestation of this caveat (Bloom & Canning 2004).

If the *demographic dividends* doctrine signals a back-pedalling on the population policy front, then it is a cause for serious alarm. Future employment growth is going to rely increasingly on skilled labour (under the current liberalization policies), and the human resource requirements of imparting such skills are formidable. With the trend towards exploitation of scale economies and increased capital intensity in manufacturing, and the move to get India Inc. on a big scale into traditional sections of the unorganized service sector, it may prove difficult even to preserve the existing levels of employment, so the question of absorbing huge unchecked additions to the potential labour force simply does not arise. According to a study reported in the *Business Standard* (16 August 2006), 30% of India's 716 million labour force is likely to be unemployed in 2020, and about 85% of these unemployed are likely to be in the 19-25 years group. Even the most sanguine official projections envisage a growth of only 10 million jobs every year, implying about 8 million annual additions to the unemployment pool. Coupled with the emerging severe constraints on natural resources (see the discussion on water above) the so-called demographic dividends theory is nothing more than a prescription for disaster.

Inclusive Growth: One heartening feature of the AP has been a tacit recognition about the urgency of tackling unemployment and poverty. Chapter 5 of the Paper (rather poetically titled "Bridging Divides : Including the Excluded") offers several palliative measures of which two seem most appealing viz. paying special attention to labour intensive manufacturing sectors and the NREGP (National Rural Employment Guarantee Programme). However it is in evaluating these solutions that the sectoral composition of growth assumes importance. One needs to distinguish between sectors like construction and tourism, which have considerable employment and income generating potential, but which do not produce basic consumption goods, and sectors like food processing and textiles which partake of both features. But for a pro-poor growth strategy, merely placing additional incomes in the hands of the poor is not enough, the production of basic goods needs to be strengthened too. A strategy of income generation for the poor decoupled from increased basic goods production could most likely lead to inflation and /or trade deficits. If one looks at the very recent period (2003-05) the fastest growing sectors have been construction, hotels & restaurants, communication, finance, insurance, real estate and business services, none of which would figure prominently in the poor man's consumption basket.

The AP accords key roles to CSOs (civil society organizations) and PRIs (Panchayati Raj Institutions) in rural development and poverty alleviation. There is no denying that, in principle, the idea is indeed appealing as a step in the direction of decentralization.

Equally undeniable is the fact that several CSOs have had an excellent track record. Yet, given the wide differences in the scope of activities, levels of commitment, ideological affiliations etc. of the CSOs, without an effective regulatory and coordinating mechanism (and perhaps also a rating mechanism) how the system will work in practice is anybody's guess. Even more fundamentally, there is a creeping suspicion that entrusting CSOs with the major part of the responsibility for social and community welfare, is an escape route for the government to abdicate its traditional role in this regard. Needless to say such an abdication would be premature and fraught with serious long-term social consequences. Thus, in conclusion, the Indian reforms story is far from being the unalloyed success, that it is often painted to be, in official circles and in sections of the media and academia. While there is certainly room for comfort in the fact that Indian growth rates have exhibited acertain buoyancy in recent years, there is hardly any ground for complacency. It is also true that the HDI (human development index) has risen from 0.438 in 1980 and 0.513 in 1990 to 0.602 in 2003. But this improvement fails to impress, when the HDI level and Rank (127) is compared with the levels in other countries (for the same year) such as China (HDI 0.755, Rank 85), Mexico (HDI 0.814, Rank 53), and Singapore (HDI 0.907, Rank 25). As we have exhaustively discussed above, there are fundamental problems on the poverty, inequality and unemployment fronts, which the government has not only failed to address, but on which the government does not even have a well-planned long-term strategy. Past experience has shown the futility of expecting a mere acceleration of economic reforms to alleviate these problems in any significant manner. The *trickle down effect* in particular seems to be both protracted and slow. If bold and imaginative initiatives are not undertaken at this stage to address these issues, rising societal tensions and political compulsions will inexorably force backtracking on reforms, as has happened in some Latin American countries in the recent past. Another worrisome feature is that the long-term has become a serious casualty in the way reforms have been conducted in India in the last few years. On the one hand, the government is reluctant (for ideological reasons) to invoke the older methods of perspective planning, and on the other it is finding it difficult to devise a market based pricing strategy for natural resources usage that will correct for the inherent *present consumption bias*. It is therefore more than probable that the current splurge may not continue for ever and the future could well turn out to be considerably less happy and more tumultuous, for a majority of Indians, than what hard-lined reformers in the government, financial press and academics would have us believe. After all, (in spite of what Keynes once famously said, and which our current policymakers seem to have wholeheartedly accepted in the literal sense) not all of us dead are in the long run.

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TABLE 1
GROWTH RATES (%) FOR SELECT COUNTRIES IN ASIA (1980-2003)

COUNTRY	1981-1990	1991-1997	1998-2003
INDIA	**5.6 (5.4)**	**5.3 (5.7)**	**5.7 (5.5)**
CHINA (MAINLAND)	8.9 (8.8)	10.3 (10.2)	8.0 (7.8)
CHINA (HONG KONG)	6.3 (6.2)	5.5 (5.3)	2.2 (2.4)
SINGAPORE	6.9 (7.5)	8.4 (8.2)	2.7 (2.2)
BANGLADESH	3.9 (4.0)	4.5 (4.5)	5.0 (5.0)
INDONESIA	5.3 (5.4)	6.7 (6.8)	4.0 (3.9)
KOREA	8.3 (8.3)	6.7 (6.8)	3.9 (5.4)
MALAYSIA	5.8 (6.2)	8.8 (9.0)	2.7 (3.4)
THAILAND	7.6 (7.3)	6.5 (7.6)	4.7 (4.9)
PAKISTAN	6.0 (6.0)	4.1 (4.2)	3.5(3.3)
SRI LANKA	4.2 (4.3)	5.1 (5.1)	3.8 (4.6)

Source: International Financial Statistics, IMF

Note: The figures in brackets represent the winsorized growth rates (i.e. calculated by omitting the highest and lowest observations over each sub-period).

TABLE 2
REAL INTEREST RATES IN INDIA

YEAR	INFLATION (%)	NOMINAL INTEREST RATE (%)	REAL INTEREST RATE (%)
1996-97	9.4	11.84	2.44
1997-98	6.8	9.00	2.20
1998-99	13.1	9.00	-4.1
1999-2000	3.4	10.00	6.6
2000-01	3.8	9.79	5.99
2001-02	4.3	10.58	6.28
2002-03	4.0	7.41	3.41
2003-04	3.9	6.10	2.20
2004-05	3.8	5.44	1.64
2005-06	4.4	5.43	1.03

Notes: (i) Inflation is measured as the annual point-to-point change in the CPI (Industrial Workers), while the interest rate is taken as the annual gross redemption yield on 15-year dated government securities.

Source: **Handbook of Statistics on the Indian Economy (Reserve Bank of India) 2005-06**

TABLE 3
POVERTY MEASUREMENT - HCR (HEAD COUNT RATIO)

	1987-1988	1993-1994	1999-2000	2004-2005
Rural	39.1%	37.3%	27.1%	22%
Urban	38.2%	32.4%	23.6%	21.6%
All-India	38.9%	36%	26.1%	28%

Source: Sen & Himanshu (2004), Tendulkar (2006), Radhakrishnan & Panda (2006)

TABLE 4
UNEMPLOYMENT RATES % (CDS BASIS)

	1983	**1993-1994**	**1999-2000**
ALL-INDIA	8.30	5.99	7.32
RURAL	7.96	5.61	7.21
URBAN	9.64	7.19	7.65

Source: NSSO Various Rounds

TABLE 5
SECTOR-WISE EMPLOYMENT GROWTH (CDS BASIS)

	ORGANIZED		**UNORGANIZED**	
SECTOR	**1983-1994**	**1994-2000**	**1983-1994**	**1994-2000**
1.Agriculture	0.02	-1.00	2.23	0.03
2. Mining & Quarrying	-1.91	-1.30	3.68	-2.40
3.Manufacturing	2.58	0.87	2.26	2.95
4. Electricity, Gas & Water Supply	-3.55	0.51	5.31	-17.00
5. Construction	5.21	-0.69	4.18	5.85
6. Trade, Hotels & Restaurants	5.72	1.43	3.80	5.79
7. Transport, Storage & Communications	5.53	0.21	3.35	7.59
8. Finance, Insurance, Real Estate & Business Services	5.40	1.27	4.60	8.30
9. Community, Social & Personal Services	-2.08	0.8	3.85	-3.56
All Sectors	**1.07**	**0.56**	**2.67**	**1.12**

Source: Planning Commission (2002), Hansda & Ray (2006).

TABLE 6

SECTOR-WISE EMPLOYMENT ELASTICITIES (CDS)

SECTOR	SHARE OF EMPLOYMENT (1999-2000) (%)	PRE-REFOPRM PERIOD 1983-1984 TO 1993-1994	POST-REFORM PERIOD 1993-1994 TO 1999-2000
1.Agriculture	56.7	0.48	0.01
2. Mining & Quarrying	0.67	0.61	-0.49
3. Manufacturing	12.11	0.32	0.20
4. Electricity, Gas & Water Supply	0.34	0.48	-0.52
5. Construction	4.44	1.27	1.00
6. Trade, Hotels & Restaurants	11.15	0.67	0.38
7. Transport, Storage & Communications	4.05	0.55	0.56
8. Finance, Insurance, Real Estate & Business Services	1.38	0.49	0.68
9. Community,Social & Personal Services	9.16	0.63	0.02
All Sectors	100	0.36	0.13

Source: Planning Commission (2002)

TABLE 7

GINI RATIOS FOR FOUR STATES
(BASED ON MONTHLY PER CAPITA EXPENDITURE)

States	1983-1984		1993-1994		1999-2000	
	Rural	Urban	Rural	Urban	Rural	Urban
Bihar	0.256	0.301	0.221	0.309	0.208	0.318
Orissa	0.267	0.296	0.243	0.304	0.242	0.292
Rajasthan	0.343	0.304	0.260	0.290	0.209	0.281
Tamil Nadu	0.325	0.348	0.308	0.344	0.297	0.398

Source: Radhakrishna and Panda (2006)

ENDNOTES

[i] The force of this statement becomes evident , when we review the varied Latin American experience. Chile by all accounts, is usually rated as the most successful reformer in the region. Over a six-year period beginning 1987, approximately 1.5 million people emerged from the poverty trap, with the proportion of people below the poverty line declining from 46.6% to 30%. Simultaneously, unemployment was drastically curtailed from 10.8% in 1987 to about 5.3% in 1992 (Barrera, 1998). The Argentine story, marks a sharp contrast, however. Here, ever since the inception of liberalization in 1975, income inequality and poverty have markedly deteriorated. The poorest 30% of the population received 11.4% of the national income in 1975 but only 8.9% in 1993. Correspondingly, the share of the richest decile rose from 46.6% to 51.6% (Starr, 1999). The Mexican case also replicates several key aspects of the Argentine case (Lustig, 1992).

[ii] A later break (1992-1993) is discerned for two important components of the GDP viz. (i) trae, transport, storage & communications and (ii) public administration, defense & other services.

[iii] The second part of Balakrishnan's explanation seems acceptable, but the first part about high real interest rates (or what he calls as *missing monetary policy*) is sensitive to the particular interest rate he has taken as representative of the cost of credit viz. the PLR (prime lending rate of banks). The PLR moves sluggishly and is often out of alignment with market interest rates. Besides, sine 1994, it has served a a minimum lending rate only for loans upto Rs. 2 lakhs. For loans above this limit, no minimum lending rates apply and a substantial amount of credit is made available at sub-PLR rates. Balkrishnan's conclusions (about real interest rates) do not carry over when other rates are used (see Table 2).

[iv] A study done by Tata Services (2003) is also broadly in agreement with Unel's results, though it posts slightly lower TFP growth rates of 0.68% (1982-1993) and 0.97% (1994-2000).

[v] The TFP (as a measure of growth performance) is subject to the general criticism that it excludes macroeconomic factors such as the strength of aggregate demand and the rate of capacity utilization. Additionally, at a disaggregated level, the TFP fails to account for sectoral compositional shifts. These caveats need to be borne in mind, while interpreting the above results.

[vi] To avoid confusion, it may be useful here to list the major components of the Industry and Services sector. Industry comprises (i) mining & quarrying (ii) manufacturing and (iii) electricity, gas & water supply, while Services comprise (i) construction (ii) trade (iii) hotels & restaurants (iv) transport (railways & other) (v) storage (vi) communication (vii) finance, insurance, real estate and business services and (viii) community, social & personal services.

[vii] In addition there is a fourth aspect which does not seem to have attracted much attention in the Indian context viz. that increasing tertiarisation can trigger an aggregate productivity slowdown in the economy, due to what Baumol (1967) has termed the "cost disease" effect, whereby productivity lags wages in the services sector. Evidence in support of this phenomenon for the U.S. economy is reported in Triplet & Bosworth (2000).

[viii] As is well known, these concepts were introduced into the development literature by Hirschman (1958). Backward linkages reflect the demand for inputs of a given activity, while forward linkages reflect output utilization (i.e. the extent to which outputs from a given activity will be used as inputs in other activities) (see Drejer (2002))

[ix] This conclusion is more in conformity with the view expressed by Acharya (2002) and others above, rather than the contrary view espoused in OECD (2000) that it is manufacturing activity that flows to countries with adequate services infrastructure.

[x] There are annual surveys based on a *thin* sample of 4 households per village/urban block as also the quinquennial surveys based on a *thick* sample of 8 to 10 households per village/urban block.

[xi] The poverty line used in the Table is as per the recommendations of an Expert Group set up by the Planning Commission in 1993. It uses a base poverty line of per capita consumption of Rs. 49 per month (rural) and Rs. 57 per month (urban), based on the recommended daily intake of 2400 calories (rural) and 2100 calories (urban) . Adjustments are made to this base by using the CPI for agricultural workers in case of the rural line and the CPI for industrial workers for the uirban poverty line.

[xii] The Poverty Gap Index refers to the proportionate shortfall of income of all the poor from the poverty line as expressed in per capita terms (for the entire population).

[xiii] For detailed explanations of the various concepts involved, please see Hansda & Ray (2006))

[xiv] According to one estimate, the unorganized sector accounted for 91.66% of the total employed labour force in 1999-2000.

[xv] Or putting it more graphically since the work force is growing at about 1.2% annually, a 9.5% growth is necessary to keeping the growing workforce employed, without adding to the existing unemployment backlog.

[xvi] Since this is a cross-country study, one cannot take the evidence as supportive of any causal nexus between inequality and poverty . It does however show up that poor countries are also likely to be highly unequal societies.

[xvii] The Gini coefficient is a measure of inequality, with higher values of the coefficient indicating greater inequality.

[xviii] Because of the lack of availability of reliable data on the real estate sector, these figures should be treated as indicative.

[xix] An anonymous referee has suggested that the high levels of relative pay may be accounted for by the *fiduciary role* that finance managers play with regard to huge financial assets, so that large salaries are in the nature of *side payments* to restrain moral hazard and thievery. I am not sure how well this argument applies to the Indian situation, where because of strong regulation and supervision of the financial system the scope for moral hazard is severely circumscribed.

[xx] Galbraith & Lu (1999) for example, document that in Latin America financial crises raised inequality by 73% and in the Asian crisis inequality rose by 62%. Diwan (2000) also notes the marked permanent decline in labour shares following financial crises.

[xxi] The 17 industries include aluminium, caustic soda, cement, copper, distillery, dyes, fertilizers, pesticides,leather, iron & steel, pulp & paper, sugar, zinc, chemicals, plastic, wood & wood products, and electricity.

[xxii] As an illustration, it may be mentioned that thousands of small units in metropolitan centres burn scrap material at night, emitting semi-toxic gases, a phenomenon which the local authorities are helpless to control.

[xxiii] Thus, for example, the EU bans imports of furs from animals caught with leg-hold traps and the U.S. bans inputs of tuna and shrimp on the grounds that trawlers routinely kill protected species such as sea-turtles and dolphins.

[xxiv] Of the projected investment rate of 32% (of the GDP) over the 5th Plan period, 22.2% is supposed to come from the private sector and only 9.8% from the public sector. FDI is expected to be around 2.4% of the GDP.

[xxv] Even in more sophisticated neo-classical models with *equilibrium unemployment*, the demographic dividend can only be transitional.