What Has Happened since 1991? Assessment of India's Economic Reforms

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This preliminary and partial assessment of India's orthodox reforms initiated in mid-1991 shows a mixed outcome so far: overcoming the liquidity crisis, the economy has broadly got back to the growth charted in 1980s, with a modest yet statistically significant slower growth of the secondary sector. The investment-GDP ratio has improved, however, with unfavourable compositional changes; social sector spending has been maintained as allocations for defence and economic services were cut. The fiscal correction has been mainly due to a reduction in public investment and expenditure. Industrial recovery is partial and uneven; and public sector output and profitability improved despite the policy shocks, though their sustainability seem suspect.

FACED with rising inflation and a balance of payment crisis in mid-1991, India's new (minority) government introduced a fairly comprehensive, orthodox, policy reform package – with currency devaluation as its centrepiece.[1] A sudden drying up of inward remittances and the west Asian markets because of the Gulf war, and the collapse of the Soviet economy – then India's largest trading partner – were the proximate economic causes of the crisis. Moreover, domestic political instability accentuated the economic troubles, as critical decisions got postponed and fiscal discipline loosened.[2] Collapsed Soviet Union and rapidly advancing Chinese economy with a greater use of market co-ordination formed the international background for initiating these policy changes.

Attributing the crisis to unsustainability of the previous policy regime, the reforms tried to consciously fashion the new policy as close to the 'Washington consensus' as permitted by domestic conditions [Williamson 1990]. Long-time critics of India's development strategy widely welcomed this change. For example, for Behrman and Srinivasan, the reforms meant getting rid of an internationally discredited statist development paradigm. To quote them, "The dethronement of the dominant paradigm and elevation to a higher status, if not enthronement, of openness, competition and the market in development is best illustrated by India, the earliest articulator of, and the last among major developing countries to abandon, the dominant paradigm" [Behrman and Srinivasan 1995: 2468].

Over the last six years, these initiatives have generated an intense debate and considerable popular resistance. The desirability of the reforms and their effects remain contentious issues, and opinions continue to be divided. To illustrate, Kirit Parikh thinks "...the reforms have put the Indian economy on a higher growth path... With more sensible policies, we have an opportunity to accelerate our growth further and take off into a high growth trajectory" [Parikh 1997: 1151]. However, Arun Ghosh believes "...in no sector or manner has the NEP [new economic policy] succeeded" [Ghosh 1997: 1139].

This study tries to assess some aspects of the reforms, focusing mainly on a few macro-economic indicators, and the industrial, corporate and public sectors.[3] This attempt is preliminary for many reasons. The reforms were reasonably comprehensive, but we do not yet have adequate information to take a definitive position on many features. Moreover, since many structural aspects of the policy changes are micro-economic in nature, their effects will take some more time to yield measurable results.

For such an assessment to be meaningful, it is perhaps necessary to appreciate the 'initial conditions' of the reforms. India's 1991 balance of payment crisis came after an 11-year period of (relatively) improved and stable growth performance, lower inflation and a steady decline in the proportion of population in poverty. The reforms were preceded by policy changes in 1980-81, associated with a $5 billion IMF credit that India took after the second oil shock. Continuing these, in mid-1980s, there was a deregulation of industry and trade, diversification of financial sector and promotion of stock market [Narasimham Committee on Controls 1984; Raj 1986; Patel 1987].[4] While this period witnessed giving up of prudence that characterised India's long-term macro-economic policy [Bardhan 1991], Burgess and Stern (1993) have called the 1980s as an ambitious decade that witnessed a rapid rise in revenue expenditure. Thus, in some respects, the 1991 initiatives represent continuation of the move toward greater market co-ordination of economic decision-making. Therefore, there is a need for caution in attributing changes to these initiatives as evidence reported might be capturing results of earlier efforts.

For the assessment, we follow the 'before and after' approach, as we now have some reasonably sound aggregate data for comparable lengths of time. This method could have some limitations. Analytically, such a comparison may be inappropriate, if the economic performance before the reforms was considered unsustainable.[5] Empirically, in this method we would be artificially truncating a longer trend. Since we (mostly) use average of annual growth rates, they might exaggerate short period fluctuations. Such averaging could at times understate the recovery of economic magnitudes after stabilisation. Therefore, we describe the magnitudes (and changes in them) with considerable care.

I
Analytical Debate: A Synoptic View

Structural adjustment is defined as "a process of market-oriented reforms in policies and institutions, with the goals of restoring a sustainable balance of payments, reducing inflation, and creating conditions for sustainable growth in per capita income. Structural adjustment programmes generally start with a conventional stabilisation programme, intended to restore the viability of the current account and the budget, but they are distinguished from pure stabilisation programmes by the inclusion of a set of microeconomic-institutional policy reforms" [Corbo and Fisher 1995: 2847].

As there is a widespread appreciation of strengths and shortcomings of the orthodox reform programme, we will not repeat them here.[6] However, what is perhaps missed in much of the recent India debate on reforms is the consensus that has emerged in the literature, based on experience over last two decades, and on some recent advances in economic theory. Lance Taylor said, "...There has been a convergence of views over the past 10 to 15 years about initiatives that are likely to self-destruct, as bold programmes of both orthodox and heterodox intellectual persuasions have failed spectacularly" [Taylor 1993:40]. Dornbusch considers, "There are plenty of examples now of

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heterodoxy gone wrong. And there are examples of failed orthodoxy" [Dornbusch 1993: 2]. For instance, there is considerable consensus on the need for fiscal balance, though there are no definitive views on how to achieve it. To quote Lance Taylor once again, "Fiscal equilibrium is desirable, but can be devilishly difficult to attain...Reducing a fiscal deficit is always tricky in political terms; in some corners of the world, distributional conflicts make it wellnigh inconceivable" [Taylor 1993: 87].

Responding to some of the criticisms against the orthodoxy, John Williamson has recently updated the consensus (Washington Consensus II) to incorporate the importance of social spending, social insurance and safety nets [Williamson 1996]. Commenting on the modified consensus, Dani Rodrik said, "The equity and social dimensions of policy are now returning to centrestage in the wake of the less than thrilling consequences that market-oriented reforms in Latin America and Eastern Europe have produced along these dimensions" [Rodrik 1997: 413].

More fundamentally, the question still remains, whether the orthodoxy offers an adequate analytical frame to understand the development process of an agrarian, labour surplus economy like ours. Bhaduri (1993) argues that it does not. He shows that development of such an economy involves a rise in the output per worker. This can be decomposed into an (i) increase in participation rates, (ii) changes in sectoral composition of the workforce, and (iii) sectoral labour productivities. Since about two-thirds of India's workforce is still in agriculture, with an unchanging workforce participation rate, and substantial inter-sectoral labour productivity differentials, a development strategy that tries to raise the participation rates and shift workforce away from agriculture can secure large economywide productivity gains.

To quote Bhaduri, "...in the presence of substantially under-utilised labour, an extensive growth strategy may still form an essential element in the early phase of development process...indeed *there is something strange about so much attention being paid to 'efficient allocation of resources' and the price mechanism while ignoring the blatant inefficiency of massive under-employment*" [Bhaduri 1993: 11] (emphasis added).

II
Assessment

Macro-Economic Performance

On average, the Indian economy grew at 5.3 per cent per year during the first five years since the reforms (1992-96), compared to 5.9 per cent during 1986-91 (Table 1a).[7] Primary and secondary sectors' annual growth rates since 1991-92 were lower at 2.5 per cent and 6.3 per cent, compared to 3.7 and 7.4 per cent respectively during 1986-91. The tertiary sector, with about two-fifths share in the GDP, grew fastest in the 1990s (6.8 per cent per year). Within this sector, 'trade, hotel and restaurant' witnessed a sizeable rise (1.7 per cent) in its annual growth rate, from 6.5 per cent (Table 2).

Admittedly, these estimates are sensitive to yearly variations – an unavoidable problem in comparing growth rates over relatively short time spans. We estimate trend equations – for 1981-91 and 1981-96 – to find out if the growth rate in the second period is very different from that during 1981-91 (Table 3). Since the trend growth rates for 1981-96 are broadly similar to those for 1981-91, we can reasonably infer that the economy continued to grow at roughly the same rate in 1990s as it did in the previous decade. To ascertain if there is a discontinuity in the trend since 1991, we re-estimated the trend equations with a dummy variable. This was not statistically significant for all the cases, except for the secondary sector.[8] Thus, the GDP and the primary and tertiary sectors maintained their growth rate in the 1990s. Though modest, the secondary sector witnessed a statistically significant slowing (0.4 per cent) since 1991, from 6.8 per cent per year during 1981-91.

The economy has become more open – share of merchandise imports plus exports in current GDP at market prices has gone up to 17.6 per cent in the 1990s, up from 12.4 per cent during 1986-91 (*Economic Survey, 1996-97*). This did not mean a faster growth of the traded goods sector, specially manufacturing (more later). Inflation up to 1996, however measured, is higher in the 1990s, although all signs suggest it has distinctly slowed down since then (Table 1b). Balance of trade is less unfavourable than in 1980s, and foreign exchange reserves are adequate for 5-6 months of import re-

Table 3: Trend Growth Rate of GDP and Its Principal Sectors

(Per cent per year)

Years	Primary	Secondary	Tertiaty	GDP
1980-81 to 1990-91	3.5	7.0	6.7	5.6
1980-81 to 1995-96	3.3	6.5	6.6	5.4

Note: Trend growth rates are estimated using log-linear trend equation. All the growth equations are statistically significant at least at 5 per cent significance level.
Source: *National Accounts Statistics*, various issues.

Table 2: GDP Growth Rates – Disaggregated Trends

(Per cent per year)

Industry (1-digit NIC)	1981-85	1986-91	1992-96	1981-96
1 Agriculture and allied	5.5	3.3	2.3	3.7
2 Mining	8.1	9.2	4.4	7.3
3 Manufacturing	6.2	7.5	6.4	6.7
4 Electricity, gas, water	7.9	8.9	8.5	8.5
5 Construction	4.8	6.3	3.8	5.0
6 Trade, hotel, restaurant	5.4	6.5	8.2	6.7
7 Transport, comm, etc	6.4	7.3	6.9	6.9
7.1 Railway	3.0	4.8	2.6	3.5
7.2 Other transport	7.3	8.4	6.7	7.5
8 Financial institutions, real estate, etc	5.3	8.0	7.3	6.9
8.1 Banking, insurance	8.6	13.8	10.4	11.1
8.2 Real estate	3.6	3.5	3.5	3.5
9 Services	5.2	6.7	4.6	5.6
9.1 Pub admn and defence	6.5	7.2	3.6	5.9
9.2 Other services	4.1	6.3	5.5	5.3
GDP	5.7	5.9	5.3	5.6

Source: *National Accounts Statistics*, various issues.

Table 1a: GDP and Its Sectoral Growth Rates, 1981-96

(Per cent per year)

Avg of Years	Primary	Secondary	Tertiary	GDP
1981-85	5.8	6.1	5.4	5.6
1986-91	3.7	7.4	7.1	5.9
1992-96	2.5	6.3	6.8	5.3
1981-96	4.0	6.6	6.5	5.7

Source: *National Accounts Statistics*, various issues.

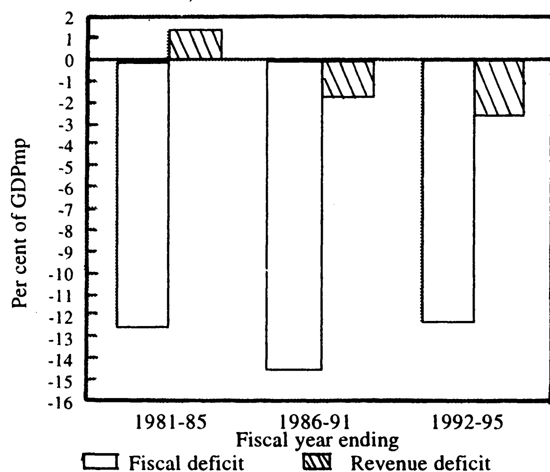
Table 1b: Trends in Prices, 1982-96

(Per cent per year)

Avg of Years	GDP Deflator	WPI	CPIiw
1982-85	8.5	6.6	8.7
1986-91	8.4	7.3	9.3
1992-96	9.8	10.1	9.7
1982-96	9.1	8.1	9.4

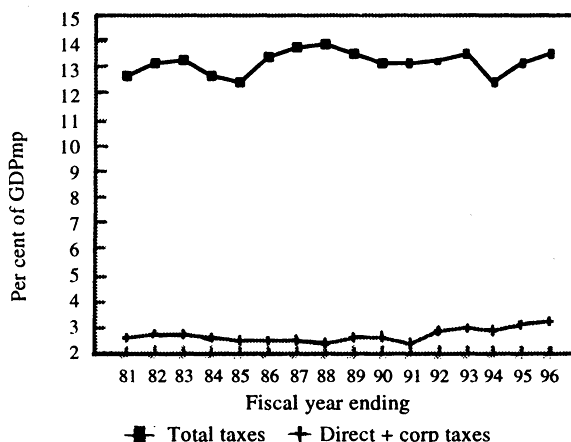
Note: CPIiw refers to consumer price index for industrial workers.
Source: *National Accounts Statistics* and *Economic Survey*, various issues.

Figure 1: Fiscal and Revenue Deficits of Non-Financial Consolidated General Government, as Per Cent of Current GDP at Market Prices



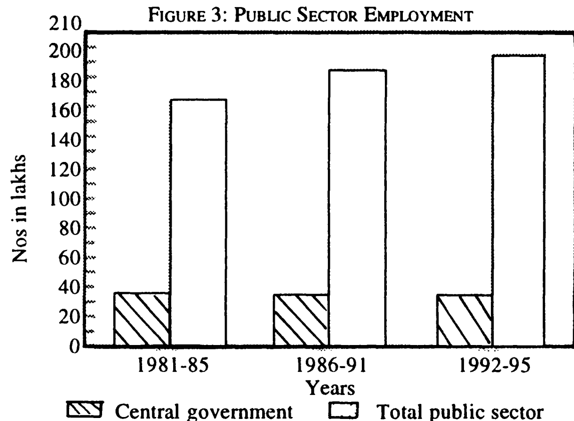
Source: National Accounts Statistics, various issues.

Figure 2: Tax Revenue, as Per Cent of Current GDP at Market Prices



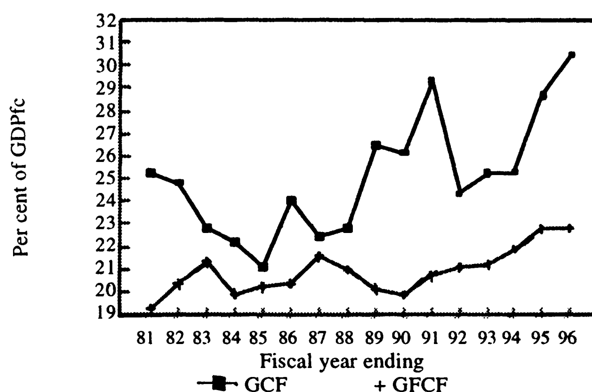
Source: National Accounts Statistics, various issues.

Figure 3: Public Sector Employment



Source: Economic Survey, various issues.

Figure 4: Investment Performance: GCF and GFCF as Per Cent of GDP



Source: National Accounts Statistics, various issues.

quirement [World Bank 1997]. In relatively open financial markets, whether the present level of reserves is adequate to withstand an external shock is debatable – with a variety of non-resident repatriable deposits continuing to account for the majority of the reserves.

India's fiscal deficit, however measured, has also narrowed; but the revenue deficit, the main cause of concern as it means borrowing for current consumption has, if anything, deteriorated (Figure 1). The tax-GDP ratio has stagnated around 12-13 per cent in the 1990s, despite an improvement in direct and corporate taxes. They barely compensate for the fall in indirect tax revenue that resulted from tariff cuts and accompanying rationalisation of excise duties (Figure 2). Interestingly, during the nine years since 1987-88, while the GDP rose 5.5 per cent a year, the tax-GDP ratio declined a half percentage point. Thus, faced with a growing need to borrow for consumption, and a stagnant tax revenue, government tried to rein in public finances by cutting mainly public investment, and to a lesser extent, public spending (as proportions of GDP). The anticipated reduction in government employment to save current spending did not occur (Figure 3).[9]

Certainly, India has been able to quickly recover from the 1991 crisis, and the stabilisation effort that followed. Economic growth during the 1990s is close to that during the previous decade, though with a somewhat changed composition.[10] A deep cut in public investment and a modest reduction in public expenditure are broadly consistent with a priori expectation and comparative experience [Corbo and Fisher 1995]. Then, the question arises, who and which sectors bore the burden of these adjustments? Has private (including foreign) investment come into the industries 'vacated' by the public sector? Do these aggregate trends suggest that the economy is on a sustainable growth path? In other words, what is the quality of adjustment?

This study will address some of these questions. We take a closer look at public spending and investment performance in the aggregate; and then at three interrelated sectors that have been the focus of structural reforms, namely, industry, public and corporate sectors.

Social Sector Spending

Has there been a significant cut in social service spending since 1991? This is a vital question, as it affects the largest segment of the population – the poor. Since the orthodox reforms adversely affected poor in many countries, there has been a concern of a similar effect in India also. Moreover, many studies based on meagre and preliminary budgetary data have found adverse effects of the reforms on these spending [Baru 1993; Guhan 1995; Seeta Prabhu 1996].[11] We now take another look at this question using *National Accounts Statistics* data for four years since 1991-92 that is complete and consistent.

Tables 4 and 5 respectively show disaggragated trends in (a) economic and purpose classification of expenditure of administrative departments, and (b) government final consumption expenditure, as proportions of (i) total expenditure and (ii) GDP (all at current prices). As noted earlier, government expenditure as proportion of GDP has declined, from 11 per cent during 1986-91 to 10.1 per cent during 1992-95 (Table 5). However, the sum of spending on

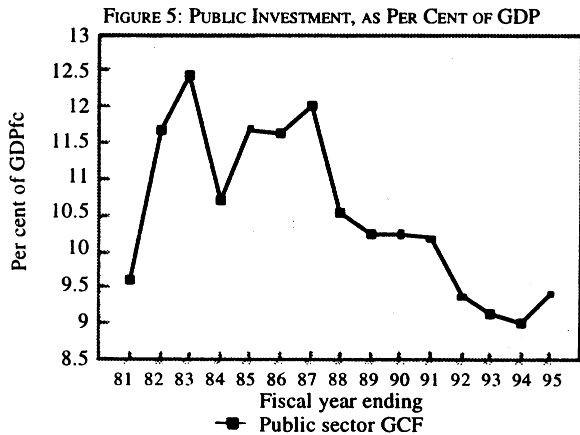


FIGURE 5: PUBLIC INVESTMENT, AS PER CENT OF GDP

Source: National Accounts Statistics, various issues.

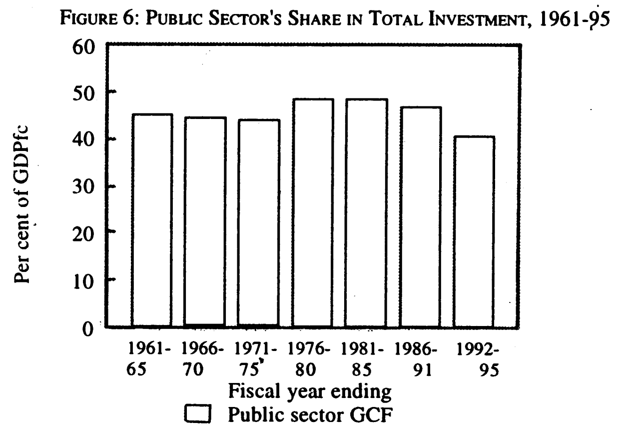


FIGURE 6: PUBLIC SECTOR'S SHARE IN TOTAL INVESTMENT, 1961-95

Source: National Accounts Statistics, various issues.

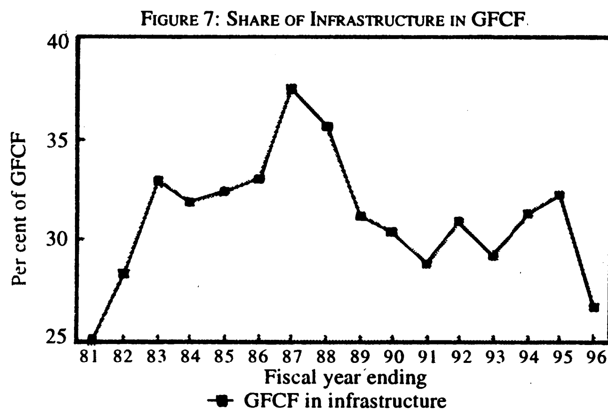


FIGURE 7: SHARE OF INFRASTRUCTURE IN GFCF

Source: National Accounts Statistics, various issues.

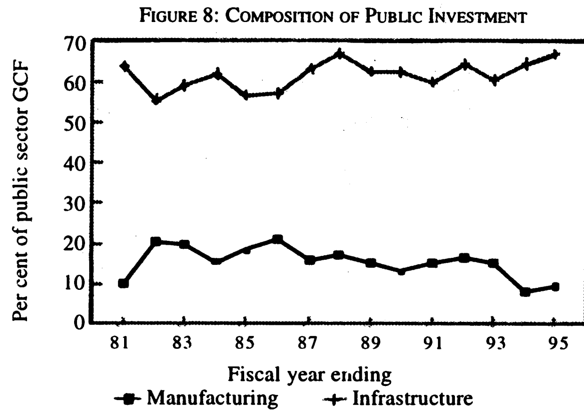


FIGURE 8: COMPOSITION OF PUBLIC INVESTMENT

Source: National Accounts Statistics, various issues.

health, education, housing and social services has remained constant at 2.9 per cent of GDP during 1992-95. The same measure as a proportion of total government final expenditure rose from 26.2 to 28.1 (Table 5). Sectors that witnessed bulk of spending cuts are defence and economic services. Government final consumption expenditure on defence fell from 4.1 per cent of GDP during 1986-91 to 3.3 per cent during 1992-95 (Table 5). In the same period, current expenditure of administrative departments on economic services fell from 6 per cent to 5.2 per cent of GDP (Table 4).

Thus, contrary to earlier apprehensions, social spending, averaged over four years since the reforms, did not suffer, as defence and economic services bore bulk of the adjustment burden. Why are our results different from the earlier studies and popular perception? It is largely because our information includes centre's as well as states' spending, and we have data for more years. It is perhaps true that during stabilisation, there was, in fact, a significant cut in social service spending. As Guhan (1995) showed, actual expenditure on rural development and social services declined by 0.4 per cent of GDP between 1990-91 and 1992-93. As the economy recovered, this expenditure appears to have been restored.[12]

TABLE 4: ECONOMIC AND PURPOSE CLASSIFICATION OF EXPENDITURE OF ADMINISTRATIVE DEPARTMENTS
As Proportions of (i) Total Expenditure and (ii) Current GDPfc

(Per cent of total in current prices)

Average of Years	Gen Public Service		Defence		Edu and Health		Edu + Health + Soc + Husg Service		Econ Service		Total Exp as Per Cent of GDPfc
	1	2	1	2	1	2	1	2	1	2	
					Current expenditure						
1981-85	16.0	2.5	19.6	3.0	25.7	4.0	32.2	5.0	30.2	4.7	15.5
1986-91	15.1	2.9	21.2	4.1	24.2	4.7	31.3	6.1	30.7	6.0	19.4
1992-95	17.9	3.2	18.8	3.4	25.4	4.6	33.4	6.0	28.8	5.2	17.9
1981-95	16.1	2.8	20.0	3.6	25.0	4.4	32.2	5.7	30.0	5.3	17.7
					Capital expenditure						
1981-85	7.8	0.7	0.2	-	2.2	0.2	12.2	1.0	30.2	6.6	8.5
1986-91	7.7	0.6	0.2	-	2.8	0.2	16.5	1.2	30.7	5.6	7.5
1992-95	5.6	0.3	0.4	-	3.1	0.2	21.5	1.2	28.8	4.1	5.7
1981-95	7.2	0.5	0.3	-	2.6	0.2	16.4	1.2	30.1	5.2	7.3

Notes: (1) As per cent of expenditure of the administrative departments; (2) As per cent of current GDPfc. Row totals do not add up to 100 as some expenditure items are excluded.
Source: *National Accounts Statistics*, various issues.

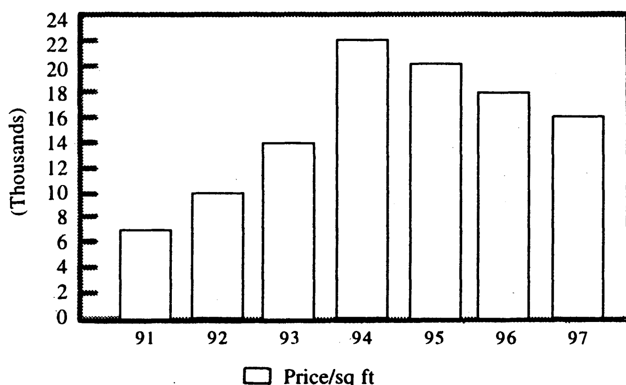
TABLE 5: GOVERNMENT FINAL CONSUMPTION EXPENDITURE BY PURPOSE
As Proportions of (i) Total Expenditure, (ii) Current GDPfc

(Per cent of total, at current prices)

Average of Years	Gen Public Service		Defence		Edu and Health		Edu + Health + Soc + Hsg Service		Econ Service		Total Exp as Per Cent of GDP
	1	2	1	2	1	2	1	2	1	2	
1981-85	22.9	2.1	33.1	3.0	21.1	1.9	26.5	2.4	15.3	1.4	9.1
1986-91	22.0	2.4	36.9	4.1	21.1	2.3	26.2	2.9	13.5	1.5	11.0
1992-95	24.4	2.5	32.9	3.3	22.2	2.3	28.1	2.9	13.5	1.4	10.1
1981-95	22.9	2.3	34.6	3.5	21.4	2.2	26.8	2.7	14.1	1.4	10.2

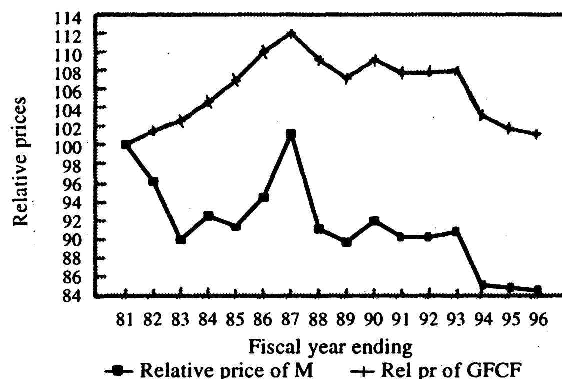
Notes: (1) As per cent of government final consumption expenditure; 2: As per cent of current GDPfc. Row totals do not add up to 100 as some expenditure items are excluded.
Source: *National Accounts Statistics*, various issues.

FIGURE 9: REAL ESTATE PRICES IN MUMBAI, PER SQ FT OF BUILT AREA



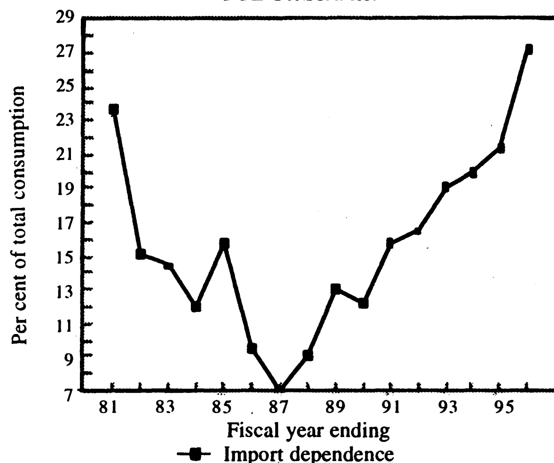
Source: HDFC, Mumbai.

FIGURE 10: CAPITAL GOODS PRICES, RELATIVE TO GDP DEFLATOR



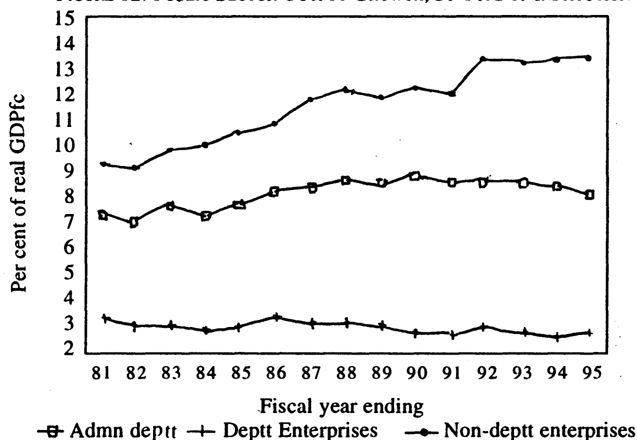
Source: National Accounts Statistics, various issues.

FIGURE 11: IMPORT DEPENDENCE: SHARE OF IMPORT IN TOTAL POL CONSUMPTION



Source: Economic Survey, various issues.

FIGURE 12: PUBLIC SECTOR OUTPUT GROWTH, BY TYPE OF INSTITUTION



Source: National Accounts Statistics, various issues.

INVESTMENT PERFORMANCE

Contrary to a priori expectation, and comparative experience, India's physical investment ratio improved after the reforms [World Bank 1988]. Gross fixed capital formation (GFCF), as a proportion of GDP, rose from about 20 per cent in 1989-90 to about 23 per cent in 1995-96 (Figure 4). However, the GFCF growth rate after the reform is lower at 8 per cent, 1 per cent less than before (Table 6). Agriculture, mining, registered manufacturing, (non-rail) transport and communication, and banking and finance improved their GFCF growth rates, while unregistered manufacturing, electricity, gas and water witnessed a decline.

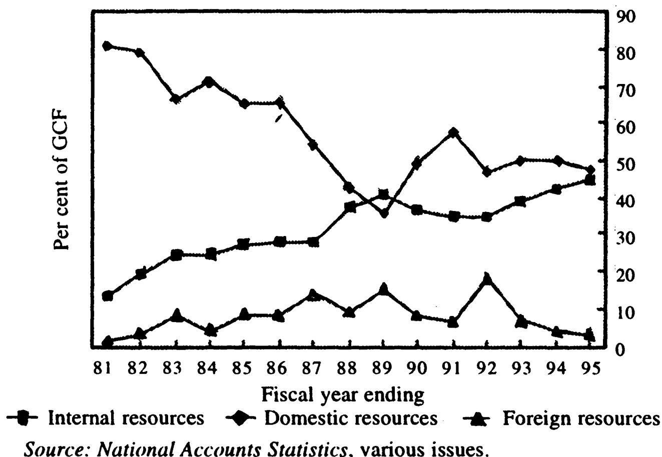
As noted earlier, public sector gross capital formation (GCF), as percentage of GDP, came down sharply after the reforms (to around 9 per cent), although the decline started a little earlier, in 1987-88 – from around 12 per cent (Figure 5). Public sector's share in GCF during 1992-95 (40.4 per cent) is lower than any five-year period since 1960-61 (Figure 6). Infrastructure's share in GFCF reduced sharply – from 37 per cent in 1986-87 to 26 per cent a decade later (Figure 7). However, public investment's composition continues to grow in favour of infrastructure (irrigation, mining, utilities and transport), while the manufacturing sector's share steadily declined, to around 10 per cent (Figure 8).[13]

Along with the public sector, the share of household sector has also declined by 4 per cent since 1991, to about 30 per cent of the total GFCF (Table 7). Decline in physical investment shares of public and household sectors is compensated by a rise in that of the private corporate sector (corporate sector, hereafter). Thus, by kind of organisation, the corporate sector has emerged as the economy's 'leading sector' since the reforms, accounting for nearly 45 per cent of machinery and equipment investment. The corporate GFCF growth rate nearly doubled, to 18 per cent per year during 1992-96. However, much of it has gone into the tertiary sector (probably in finance) as the growth rate of GFCF in registered manufacturing rose only 3 per cent. Thus, contrary to a priori expectation, structural adjustment seems to have propelled investment in non-traded goods sector.

While a strong physical investment growth during an orthodox reform process is a (pleasantly) surprising development, its changed composition – away from infrastructure and (unregistered) manufacturing – could adversely affect potential output and export growth, as the corporate sector is a net importer. Decline in household physical investment in general, and unregistered manufacturing in particular, perhaps reflects the high interest rates and a decline in the banking sector's 'priority sector' lending.[14]

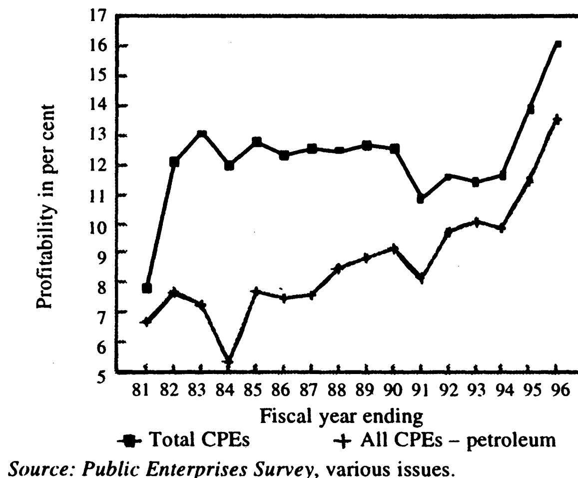
There is perhaps more to the investment performance than recorded in these aggregate trends. Since 1991, the office of the Controller of Capital Issues (CCI) was abolished, investments by non-resident Indians (NRIs) and foreign institutional investors (FIIs) were allowed in the corporate sector, and (larger) Indian firms could now secure long-term low cost resources from international capital markets. As we know, the Indian primary stock market boomed, and the supply of long-term loanable funds to Indian (large) firms rose sharply. They, perhaps, partly explain the recent corporate investment boom. But, is it commensurate with this sector's access to investible resources? Probably not. Reportedly, a sizeable proportion of these funds was diverted elsewhere, as the ratio of GFCF in

Figure 13: Financing of Public Sector Enterprises' GCF



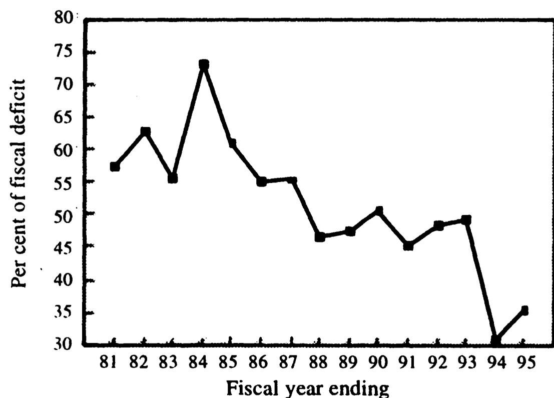
Source: National Accounts Statistics, various issues.

Figure 14: Profitability of Central Government Public Sector Enterprises



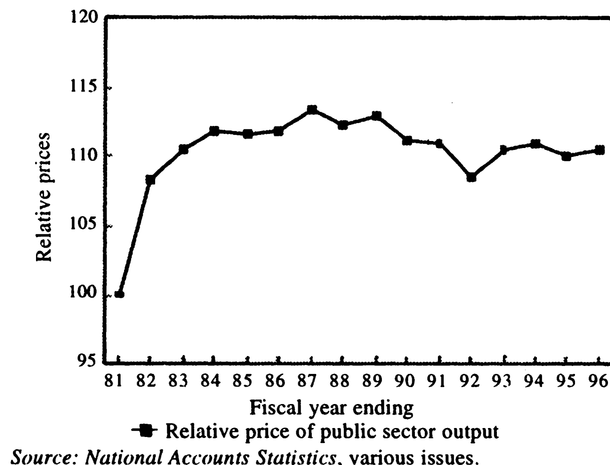
Source: Public Enterprises Survey, various issues.

Figure 15: PSEs' Share in Fiscal Deficit of Non-Financial General Government



Source: National Accounts Statistics, various issues.

Figure 16: Public Sector Deflator, Relative to GDP Deflator



Source: National Accounts Statistics, various issues.

manufacturing to supply of long-term funds came down significantly during 1992-96.[15] Then, question arises, where did the rest of the resources go?

Preliminary information suggests they went into (i) intercorporate investment and (ii) real estate.[16] The availability of low cost, untied funds perhaps fuelled the property boom of 1992-94 (Figure 9). These are evident from the rise in the corporate sector's non-operating profits in the last few years that boosted corporate results.[17] Another investment avenue was probably financing of mergers and takeover, precise dimensions of which are yet to be analysed. Though speculative, these propositions could form working hypotheses for understanding the effect of the reforms on domestic investment activity. While definitive evidence on these tendencies might be hard to get, the experience with such reforms elsewhere suggests the plausibility of a similar trend in India too.

A sizeable part of investible resources has been used for trading existing capital stock leading to speculative activities. Such asset price bubbles certainly do not augur well for the economy's real sector in the long run. If this tentative proposition is valid, then our assessment of the effects of the reforms on investment activity leads to a more cautious conclusion.

Foreign Direct Investment: Though realised inward foreign direct investment (FDI) in India is only about a fifth of the approved amount (at Rs 95,690 crore) during 1992-96, it nonetheless represents a significant jump over the previous decade.[18, 19] Even ignoring the much debated FDI composition – potato chips versus computer chips, for the moment – popular (and official) concern seems to have ignored some vital issues. To what extent FDI represent capital formation? Despite access to large long-term resources, foreign firms' share in fixed asset formation in corporate sector remained a merge 10 per cent in the 1990s [CMIE 1997]. Moreover, compared to Indian firms, foreign firms use a smaller share of their investible resources in physical investment: during five years since 1991-92, the ratio of gross fixed assets to total uses of funds for foreign private sector was less than that for Indian private sector by about 13 per cent [CMIE 1997]. Therefore, we suspect that a sizeable proportion of FDI represents a rise in, and acquiring of, managerial control in existing firms, effects of which on efficiency are debatable.[20] Such transactions of existing assets by foreign controlled firms do not represent rise in the economy's potential output and investment demand. So, the effects of such investment on the real sector is likely to be limited.

Industrial Growth Performance

What has happened to industrial output since the reforms? In principle, trade and industrial policy reforms, by removing (reported) anti-export bias, are expected to move resources into the tradable goods sector (specially manufacturing) and raise its growth rate.

After the (expected) sharp negative growth in the first two years of the reforms, industrial growth recovered after 1993-94 or so. Table 8a suggests that the annual growth rate of manufacturing sector, measured by index of

industrial production (IIP), during six years since the reforms is lower (6.4 per cent) than that during 1986-91 (8.9 per cent).[21] This is broadly consistent with *National Accounts Statistics* estimates: total manufacturing growth rate is lower at 6.6 per cent during 1992-96, compared to 7.5 per cent in 1986-91 (Table 8b). Growth rate of unregistered manufacturing – which, if at all, is marginally included in the IIP – suffered more, as it declined by a quarter, to 5.7 per cent per year.

The decline in the growth rate is evident across IIP's all use-based categories, except intermediate goods industries. Consumer durable goods (weightage: 2.6 per cent) continued to grow the fastest, although slower than before.

The capital goods sector suffered most, as its growth rate fell nearly 60 per cent, to 6.4 per cent per year. By two-digit industry groups, annual growth rate of electrical machinery fell from 20 per cent during 1986-91 to 6.4 per cent during 1992-97 (Table 8c). This happened, as noted above, not because of a fall in (physical) investment rate, but perhaps because of import competition – as the tariffs on capital goods were substantially reduced. The flip side of it is that capital goods have become cheaper: investment goods prices, relative to the GDP deflator, specially of machinery and equipment, have fallen since late 1980s (Figure 10).[22]

Thus, contrary to the widely held view, the manufacturing growth rate since the reforms is lower and its composition uneven.[23] Though these trends suggest a fairly quick recovery from the stabilisation efforts, the recovery is nevertheless partial. In principle, unregistered manufacturing – representing labour-intensive traded goods sector – is expected to improve its growth performance. This did not happen.

While manufacturing output growth recovered, though partially, the mining sector decelerated, largely representing a decline in petroleum production. This sector's annual growth rate came down from 5.5 per cent in 1986-91, to 3.5 per cent in the post-reform period; thus, the dependence on imported oil nearly doubled since 1991, to about 28 per cent of domestic consumption (Figure 11).[24]

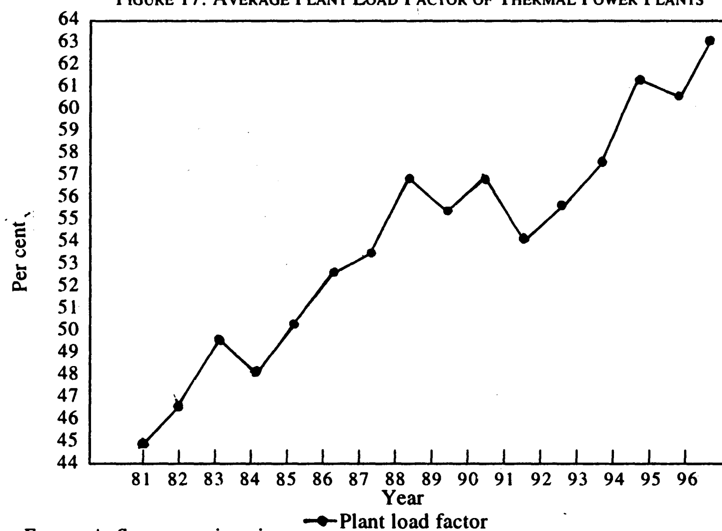
Public Sector Performance

As part of the stabilisation effort, public investment and expenditure ratios are expected to fall; they did so in India, as noted earlier. However, interestingly, public sector output growth and surplus generation improved in 1990s. The public sector's share in GDP rose 1.3 per cent, to 24.8 per cent during 1992-95. Share of public sector in manufacturing rose – a sector that witnessed rapid fall in tariffs, abolition of non-price protection measures and raise in domestic competition (Table 9). In institutional terms, much of this growth occurred in non-department enterprises as their share in GDP steadily rose, while administrative departments and departmental enterprises (mainly railways and communication) recorded growth rates less than that of GDP (Figure 12).

Along with output growth, public sector's internal resource generation ratio also improved (Figure 13) and, correspondingly, external finance's (domestic and foreign) share in capital formation declined.[25] A sharp rise in profitability (gross profit as percentage of capital employed) of central government public sector enterprises (PSEs) – even excluding petroleum enterprises – is also evident (Figure 14). Moreover, PSEs' share in fiscal deficit of non-financial consolidated general government declined (Figure 15).[26] These improvements are not because of a faster rise in public sector prices.[27] In fact, price of public sector output (relative to GDP deflator) did not rise in 1990s (Figure 16).

At least so far, in the aggregate, public sector has clearly withstood the 1991 policy

Figure 17: Average Plant Load Factor of Thermal Power Plants



Source: Economic Survey, various issues.

Table 6: GFCF Growth Rates by Industry, 1982-96

(Per cent per year)

Industry (NIC-1digit)	1982-85	1986-91	1992-96	1982-96
1 Agriculture	(–) 1.3	1.6	6.7	2.5
2 Mining	25.8	6.2	11.9	13.4
3 Manufacturing	10.7	8.0	9.1	9.4
3.1 Regd mfg	13.0	8.2	11.2	10.4
3.2 Unregd mfg	5.9	7.8	5.9	6.6
4 Electricity	7.5	8.9	4.8	7.1
5 Trade, hotel, etc	9.3	8.2	2.8	6.7
6 Transport and comm	11.4	6.4	8.8	8.8
6.1 Railway	5.2	4.5	4.9	4.9
6.2 Others	12.9	5.8	7.4	8.2
7 Banking, finance,	2.6	9.8	8.7	7.5
7.1 Banking and finance	19.8	30.1	23.6	25.2
7.2 Real estate	1.4	7.2	3.6	4.5
8 Public admin	4.4	1.8	3.9	3.2
9 Other services	5.7	6.9	2.0	5.0
10 Total	4.0	9.0	8.0	7.3

Source: *National Accounts Statistics*, various issues.

Table 7: Proportion of GFCF by Institutions and by Type of Assets

(Per cent of total)

Average of Years	Total GFCF			GFCF in Machinery and Equipment		
	Public Sector	Corp Sector	Household Sector	Public Sector	Corp Sector	Household Sector
1981-85	49.9	18.6	31.5	43.1	30.1	26.8
1986-91	46.7	18.7	34.6	40.9	27.4	31.7
1992-96	37.8	32.0	30.2	33.4	44.7	21.9
1981-96	44.9	22.8	32.3	39.4	33.6	27.1

Source: *National Accounts Statistics*, various issues.

shock, and continues to improve its performance.[28] This can be illustrated by a steady rise in physical efficiency of thermal power plants, most of which are in the public sector. The average plant load factor of thermal power plants rose nearly 10 per cent in six years in 1990s, continuing the trend of the previous decade (Figure 17). However, since public investment has been cut severely, it is a moot point if the improvement can be sustained.

III
Summary and Conclusion

This study has tried to understand what happened to the Indian economy since the orthodox economic reforms were initiated in mid-1991. It is preliminary, as we have looked at evidence for only 4 to 5 years since the reforms were made, and many tendencies might confound the effects of earlier initiatives. Therefore, attributing changes mainly (or solely) to the 1991 policy changes may, at times, be simplistic. This attempt is partial as well, since we have examined only a few, though important, aspects of the reform package, and only some sectors of the economy.

Nonetheless, our attempt offers a sober, yet significant picture of the changes that have occurred. After stabilisation, the economy got back on the growth path charted in the 1980s. The secondary sector shows a modest, yet statistically significant decline in its growth rate since 1991-92. The fiscal balance appears better, at the expense of a deep cut in public investment, and to a lesser extent, public spending. Borrowing for consumption (the revenue deficit) has gone up, as the much publicised reduction in public employment to reduce current spending did not occur; the tax-GDP ratio has stagnated in 1990s, though direct and corporate taxes collection improved.

Contrary to much apprehension, there was practically no fall in social service spending ratios, as the axe fell mainly on defence and economic services. Whether economising on defence spending is the best way to correct the fiscal imbalance is something that cannot, perhaps, be judged on economic considerations alone.

Again, contrary to a priori expectation, the economy's aggregate investment ratio improved since the reforms, though the physical investment growth rate is 1 per cent lower than in the pre-reform period. Moreover, its changed composition is certainly a cause for concern.

Manufacturing sector growth recovered from the adverse stabilisation effect. But the average growth rate for six years since the reforms is clearly lower than the pre-reform period. Moreover, the recovery is uneven, with a sharp decline in the growth rates of capital goods and unregistered manufacturing (accounting for about 40 per cent of gross manufacturing value added). Capital goods growth rate fell, with the fall in tariffs. But, capital goods prices have also fallen, relative to the GDP deflator. Therefore, we need to weigh the price advantage against the learning effects foregone.

Public investment witnessed a deep cut. Yet public sector output growth and profitability improved, public sector enterprises' share in the fiscal deficit of (non-financial) consolidated general government has also come down. These trends evidently suggest a better resource utilisation, reducing much criticised high incremental capital-output ratio in public sector. However, we cannot be sure if this improvement can persist after the deep cut in public sector's potential output growth.

If India's post-independence economic experience is any guide, then the decline in

Table 8b: Manufacturing Sector Growth, 1981-96 – *National Accounts* Series

(Per cent per year)

Average of Years	Total Manu-facturing	Registered Manu-facturing	Unregi-stered Manu-facturing
1981-85	6.2	7.7	4.1
1986-91	7.5	7.5	7.6
1992-96	6.6	7.1	5.7
1981-96	6.8	7.5	5.9

Source: *National Accounts Statistics*, various issues.

Table 8a: Industrial Growth, 1982-97 – IIP Series

(Per cent per year)

Average of Years	Index of Industrial Production (IIP) Mining	Mfg	Elec	Total	Use-Based Classification of IIP Basic Goods	Capital Goods	Inter-mediate	Cons Goods	CD Goods	CND Goods
Weights	11.46	77.11	11.43	100.00	39.42	16.43	20.51	23.65	2.55	21.10
1981-85	12.7	5.7	8.9	7.0	8.7	6.3	6.0	5.3	14.4	4.0
1986-91	5.5	8.9	9.1	8.5	7.3	14.9	5.8	7.6	13.4	6.4
1992-97	3.5	6.4	6.9	6.1	6.6	6.4	6.1	5.4	9.2	4.5
1981-97	6.5	7.2	8.2	7.2	7.4	9.6	6.0	6.2	12.1	5.1

Note: Cons–Consumer goods; CD–consumer durable goods; CND–consumer non-durable goods.
Source: *Economic Survey*, various issues, *Economic and Political Weekly*, Vol 32, No 29, July 19-25, 1997.

Table 8c: Manufacturing Growth Rates by 2-Digit Industry Groups, 1982-97 – IIP Series

(Per cent per year)

NIC Code	Industry Group	1982-85	1986-91	1992-97	1982-97
20-21	Food	5.1	5.8	4.2	5.1
22	Beverages, tobacco	2.9	(–)0.2	10.4	4.4
23	Cotton textiles	0.9	4.6	5.6	3.7
25	Jute	1.0	(–)1.0	(–)1.9	(–)0.2
26	Other textiles	(–)1.0	3.1	(–)0.7	1.2
27	Wood	23.0	(–)0.9	2.8	6.8
28	Paper	7.5	6.4	7.7	7.4
29	Leather	10.6	4.1	3.3	6.1
30	Rubber	10.4	2.3	2.9	4.8
31	Chemicals	9.4	9.1	6.2	8.5
32	Non-metallic minerals	8.7	6.0	6.7	6.9
33	Basic metals	2.1	6.7	10.8	7.1
34	Metal products	1.7	3.6	4.3	4.0
35	Machinery	6.3	5.5	5.3	6.1
36	Elec machinery	10.7	20.0	6.4	14.6
37	Transport equipment	7.1	5.5	11.0	8.4
38	Others	9.5	13.7	(–)1.6	8.8

Source: Same as above.

Table 9: Public Sector's Share in GDP by Industry, 1981-95

(Per cent)

Avg of Years	Ag	Mining	Mfg	Regd Mfg	Elec, Gas, Water	Const	Trade, Hotel	Trans-port, Comm	Bank-ing, Finance	Other Service	GDP
1981-85	2.1	98.8	12.4	21.1	93.3	16.8	5.3	52.9	83.7	42.2	20.3
1986-91	2.1	115.2	14.1	23.1	92.5	19.2	4.5	46.9	85.8	44.3	23.5
1992-95	1.9	109.4	14.8	23.6	94	18.6	3.0	41.7	80.5	41.3	24.8

Note: Since mid-1980s, there is an anomaly in the GDP estimates for mining sector: public sector GDP is greater than GDP of the sector as a whole. This is apparently because of different methods uses for estimating the GDP in public and private sectors.
Source: *National Accounts Statistics*, various issues.

TABLE 10: WORKFORCE DISTRIBUTION AND LABOUR PRODUCTIVITY

Sector	Workforce Distribution in 1977-78 (per cent)	Percentage Change in Workforce Distribution			Real GDP Per Worker (Index)
		1983 over 1977-78	1987-88 over 1983	1993-94 over 1987-88	
Primary	71.22	(-) 4.22	(-) 2.20	(-) 1.40	100
Secondary	12.10	1.60	1.70	(-) 0.80	386
Tertiary	16.70	2.20	0.80	2.30	381

Source: *National Sample Survey*, various reports; *National Accounts Statistics*, various issues.

public investment could have severe consequences for sustaining the 5.5 per cent annual growth rate that we have recorded since 1980-81.[29]

In sum, the good news (so far) is that there is no major, unqualified, bad news. In the aggregate, many of the potentially adverse effects of such orthodox reforms were avoided. The picture that emerges is, as is perhaps often the case – the proverbial half filled glass – permitting selective use of evidence to buttress one's preferred view. But overall, do the favourable changes call for a celebration of a higher and sustainable growth path, led by private initiative?

Probably not, as our closer look shows some dark clouds in the horizon. Some of the adverse effects were avoided at the expense of a better fiscal balance. Many of the favourable features are secured at the expense of the future: (potential) growth and export possibilities. Therefore, it is hard to believe that the economy has been put on a more sustainable path. Further, such an assessment is based on not only what is achieved in the 1990s, but what has been missed out: the lost growth potential by (implicitly) viewing the problem in the orthodox perspective.

Posing the problem as Bhaduri did, as discussed before, we find some unfavourable developments that might have something to do with the increasingly market-oriented policy perspective in the recent years. Recent employment statistics show that in 1993-94 still nearly two-thirds of Indian workforce was in agriculture [NSS 1997]. Interestingly, the intersectoral shift in the workforce from agriculture to non-agriculture has slowed down during 1988-94, and the secondary sector's share has also come down. Since labour productivity in the non-agriculture sectors, in 1993-94, is nearly four times that in agriculture, slowing down of the workforce transformation implies an immense loss of (potential) productivity gains. This potential loss perhaps far outweighs the efficiency gains (possibly) secured by eliminating 'little triangles' of price distortions.

If this assessment is correct, then we need to ponder over how to regain the lost momentum of workforce transformation and better utilisation of surplus labour that is at the heart of equitous growth in a large agrarian economy like ours.

Notes

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1 In many countries, in recent years, new political regimes have initiated similar policies by discrediting previous governments on past economic failures. Haggard and Kaufman find, "Incoming governments ... have capitalised on honeymoon periods and the disorganised or discrediting of the opposition to launch ambitious new reform initiatives" [Haggard and Kaufman 1992: 30].

2 Whether these proximate causes were significant is debatable. Bhagwati and Srinivasan (1993), and Joshi and Little (1994) dismiss these to argue that the crisis was mainly 'made in India', due to the unsustainable policy regime of the 1980s. However, characterising the 1991 episode as merely a liquidity crisis, Arjun Sengupta has questioned the necessity of initiating such a complete package of reforms. To quote him: "What is novel about the economic reforms of 1991 is the timing and the fact that it was introduced as a package of measures to meet a specific liquidity crisis for which such an elaborate package was really not necessary" [Sengupta 1995: 40].

3 This effort is motivated by the concern that I G Patel expressed about the new initiatives. He said, "...indeed, so great is the area of agreement that the new economic policies themselves are in danger of becoming a new ideology or orthodoxy – and surely, that is the time to watch out, to look more closely at things and options ..." [Patel 1992:40].

4 Some commentators believe that industrial reforms in 1991 were quite superfluous, as much of it was already done in 1985 [Mani 1992].

5 Unsustainability of a policy regime refers to size and growth public debt. Analytically and empirically, this is a very debatable issue, except when GDP growth rate is lower than interest rate (both in nominal or real terms). Despite much analytical refinememt, Evsey Domar's following much quoted comment is still valid: "If all the people and organisations who work and study, write articles and make speeches, worry and spend sleepless nights – all for fear of the debt – could forget about it for a while and spend even half of their efforts trying to find way of achieving a growing national income, their contribution to the benefit and welfare of humanity – and to the solution of the debt problem – would be far greater" [Domar 1957: 64].

6 The essence of the orthodox reforms is an abiding faith in the power of markets in (static) efficiency in allocation of resources, a deep distrust of state intervention, and 'sound money'. The following list broadly summarises the Washington consensus:
(1) balanced budget, with deficit of a few per cent of GDP, spending controls and broad based taxation with low marginal rates;
(2) sound macro-economic policy with some limited social safety nets;
(3) price reforms, positive real interest rates and weak and stable exchange rates;
(4) trade and investment liberalisation;
(5) privatisation of state-owned enterprises; and,
(6) deregulation of markets, including the labour market.

7 Unless otherwise mentioned, variables in this study are at constant (1980-81) prices; growth rates are average of annual percentage change over the pervious year; years refer to fiscal year ending, for example, 1992-96 refers to period 1991-92 to 1995-96; and GDP refers to GDP at factor cost.

Our estimates of average growth rates suffer from the well known problems of yearly fluctuations and terminal years chosen. To reduce their misinterpretation and permit a balanced judgment of these numbers, we provide estimates for 1981-85, and for the entire period, 1981-96.

8 We estimated $\text{Log } Y = a + bt + D(t)$, where D is 0 up to 1991, and 1 for 1992-96.

9 Contrary to the popular view, growth rate of public employment steadily came down, close to zero, during the 1980s. This trend was not sustained in 1990s, clearly suggesting the absence of a political consensus on this, and the minority government's inability to take hard decisions, despite much public rhetoric.

10 Based on 1995-96 growth rate of 7 per cent, there is much popular, including official, optimism about India entering into a higher trend growth rate after the reforms. In 1980s, when the trend growth rate was about 5.5 per cent, in three years annual growth rate was over 7 per cent. We have to be cautious against such 'opportunistic biases', to borrow Gunnar Myrdal's phrase. He had warned, "The fact that conceptions about reality ...are influenced by the interests as commonly perceived by the dominant groups in the society ...and that they so come to deviate from truth in a direction opportune to these interests..." [Myrdal 1970: 21].

11 To quote Guhan, "In the final outcome, what is of concern is that the GDP ratio of outlays at both [centre and states] levels taken together has declined in the first four years of adjustment" [Guhan 1995: 1096-97].

12 These aggregates, though very important, probably hide more than they reveal. Since the reforms, there was a greater emphasis on wage employment generation, rather than self-employment and asset creation programmes. Moreover, there has probably been a proliferation of 'schemes' to suit political ends. To quote Guhan again, "...one cannot escape the conclusion that the centre's anti-poverty portfolio is riddled with much needless confusion and complexity in its conceptualisation, design and administration. ...this is to be attributed to the use of a limited set of instruments for promoting diverse multiple objectives... and, at the same time,

some pocket money for members of parliament" [Guhan 1995: 1099].

13 Much of the widely held opinion against public investment is in manufacturing, as it is believed to represent investment in inefficient import substituting industries [Joshi and Little 1994]. Such criticism has little basis since the manufacturing sector's share in public investment has been small and declining, as evident in the same figure.

14 This result is consistent with findings based on a cross-country analysis. Greene and Villanueve (1991) find, for a sample of 23 less developed countries, over 1975-87, a negative and statistically significant effect of real interest rates on investment.

15 The ratio of corporate gross fixed capital formation to long-term sources of finance (primary capital mobilisation, 'euro issues', and development finance institutions' disbursements) came down from 121 per cent during 1986-91, to 64 per cent during 1992-96.

16 All intercorporate investment may not be undesirable. If firms take minority stake in suppliers' and distributors' firms, such investment could have long-term positive effects, as has been widely documented in Japanese industry. But if intercorporate investment, mediated by 'finance companies', is used as a vehicle for hostile takeovers, and other measures that reduce competition, or divert resources for unproductive activities, then such investment may have undesirable consequence. More important, if inter-corporate investment is ill regulated, finance companies could take advantage of the widely noted imperfections in the financial markets – as is feared to have happened recently in India – leading to socially undesirable results.

17 ICICI's annual study of financial performance of its 675 assisted companies supports our contention. Although this report emphasises year to year variations, the underlying point is that non-operating profits were a dominant influence. To quote the report, "Other income rose by 23.4 per cent in 1995-96 compared to 35.8 per cent in 1994-95...Therefore, other income, which was a significant factor in influencing profits in 1993-94 and 1994-95 did not play a major role in 1995-96. The major sources of other income in the past were interest on inter-corporate deposits (ICDs), dividend receipts, profit on sale of investments, lease rentals, investment in units and sale of real assets. In 1995-96, a dormant secondary capital market militated against a substantial rise in other income through sale of investments. However, some cash-rich companies were able to earn large other income by lending in the ICD market at high interest rates" [ICICI 1997].

18 This estimate is based on the comprehensive data on FDI collated in *Economic and Political Weekly*, May 10, 1997 (p 987).

19 Realised FDI being a small fraction of approvals is not peculiar to India. For China, the ratio is about one-third [computed using data in Table 3 of Broadman and Sun 1997].

20 Effects of corporate takeovers on efficiency is a much contested issue in economics. Appreciating limitations of this mechanism of corporate control, a significant professional opinion holds that the developing countries should avoid replicating this anglo-saxon institution. To quote Ajit Singh, "The important question is whether the evolution of such a market [for corporate control] would be conducive to Indian industrialisation and for fast economic growth. The review of the analysis and evidence on the markets for corporate control in the US and the UK indicate several drawbacks, particularly from the perspective of Economic Development...A developing country like India simply cannot afford the burden of an extremely expensive and hit-and-run system of management change which takeovers represent" [Singh 1997:35-36].

21 Index of industrial production (IIP) with 1980-81 as the base is widely used to assess the recent industrial production trends. Primary information for construction the index is voluntary reporting of output by firms above a certain size. Quality of the index has been widely questioned for some time now. One suspects that problem has become acute after the recent policy changes since the firms now have little incentive for timely supply of this information. Therefore, we suspect that the index has increasingly become unrepresentative. However, for lack of anything better, we still use these estimates, with great caution.

22 K N Raj repeatedly emphasised that developing capital goods industries in Indian planning was precisely to cheapen these goods which will in turn, reduce prices of final consumption goods. In 1970s, when GDP growth rate did not pick up despite significant rise in domestic saving and investment, he attributed it partly to growing relative price of capital goods, [Raj 1986]. This has now happened after import liberalisation.

23 Arvind Virmani's recent study illustrates the popular perception: "The manufacturing sector has shown the greatest improvement in performance. The growth of manufacturing (GDP at factor cost) is likely to average about 8.9 per cent during the Eighth Plan period. This is 1.2 per cent higher than during the Seventh Plan period, 1.9 per cent points higher than during 1980s. It is not a coincidence that it has seen the most extensive reforms" [Virmani 1997: 2064].

24 Decline in domestic petroleum production was partly due to 'over exploitation' of certain oilfields in late 1980s. But it was a short-term problem. More enduring reason was perhaps the cut in public investment.

25 These estimates are for non-departmental non-financial enterprises. This is probably the most comprehensive category of public sector enterprises, as given in *National Accounts Statistics*. For a discussion on merits of using this data source, refer to Nagaraj (1991).

26 Computed using *National Accounts Statistics*, this comprehensive measure of the deficit, includes not only the central government but also the states and public sector enterprises. For details see, Nagaraj (1993).

27 Bardhan (1993) sought to ignore our contention of improved public sector enterprise performance in 1980s, by suggesting that it was largely due to a faster rise of PSEs prices. The development in 1990s, vindicates our earlier position as PSEs profitability has improved, despite a fall in their relative prices.

28 World Bank believes the singular achievement of the 1991 reforms is its success in reducing public sector's role in the Indian economy. To quote its latest official assessment: "The declining role of the public sector since the start of the reform programme in 1991, both as producer of goods and services and economic regulator, is one of India's most fundamental change since independence" [World Bank 1997:i].

True. If this were the real agenda, then the reforms were quite a success. But, perhaps, PSEs proved their critics wrong by improving their output growth and financial performance, suggesting that they have been – at least so far, in the aggregate – able to withstand the policy changes.

We have not assessed if public sector's role as an economic regulator has declined; if yes, is it desirable. Probably it is not, as the 1997 *World Development Report* argues.

29 Studies on India's macro-economic performance clearly brings out centrality of public investment, most of which has been mainly on infrastructure [Nayyar 1994; Pandit 1995]. Unless this stylised fact has been undone, India surely faces an infrastructure supply constraint.

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