India: A Juggernaut On The Move

India celebrates 60 years of Independence on August 15, 2007. It is now the second fastest growing major economy, after China. It has also caught media attention because companies like Tata Steel acquired Corus; India is now the second largest investor by number of projects in London; and Mr L.N. Mittal - an Indian - owns the largest steel company in the world.

In this special issue we look at why India previously lagged behind economically but is now moving ahead fast. But, to appreciate where India is today one needs to understand its history and the policies that shaped its economic journey post Independence.

Was It Always Poor?

- Despite modern day images of poverty and deprivation India was a very rich nation, like China, until around 1700. Christopher Columbus set out to discover India in 1492 because of tales of wealth. According to Angus Maddison, the noted Cambridge economic historian, around the 17th century India and China accounted for about 50% of world output. Europe accounted for 20% and the USA was not born.

- Invasion by different European countries in the 17th & 18th century dramatically changed India's destiny. Colonisation for nearly 200 years economically impoverished India, but also brought many benefits which India counts as positive legacies e.g. the English language, a civil service, a uniform judiciary, commercial and legal practices and railways. Award-winning William Dalrymple writing in Time magazine (13 August 2007) sums up “In 1600, when the East India Company was founded, Britain was generating 1.8% of the world’s GDP, while India was producing 22.5%. By 1870, at the peak of the Raj, Britain was producing 9.1%, while India had been reduced for the first time to the epitome of a Third World nation, a symbol across the globe of famine, poverty and deprivation”.

1947: Independence

- Indian politicians then had no first-hand experience of governing. Hence, ruling the country was a learning curve. India’s first Prime Minister, Jawaharlal Nehru, chose Democracy modelled on Westminster. His economic thinking was formed in the “hungry thirties”. The Wall Street crash of 1929 plunged the U.S. into a deep recession while Europe later faced World War 2. Western capitalism and imperialism were viewed with suspicion as being exploitative and inappropriate for India. The Soviet Union however presented an economic model that appealed in terms of autarky. Self - sufficiency and fear of economic dependence on foreigners after two centuries of overseas rule shaped early thinking at Independence.

- India at handover was a rural and impoverished country with 90% of the population living in villages. From 1900-1950 economic growth had been just 1% p.a. In the first census taken in 1951, the population was 320m, with literacy at 17% and average life expectancy of 32 years. Nehru modelled the economy on Soviet socialist lines of central control and state-run heavy-industry firms dominating the economy to avoid reliance on the West. His plan for a state dominated closed economy was blessed by Britain’s post-war Labour government. India’s relations with Britain at Independence were cordial and friendly. Both share warm relations even today.


- In order to promote self sufficiency policies of high import tariffs and duties, controls on production through licenses, public sector monopolies and isolating India to the outside world were followed. Although such policies seemed appropriate then, in retrospect Nehru’s policies seemed idealistic and served India poorly. The unintended results were a clogged economy. Poor economic growth resulted because the economy was stifled by licensing, socialist red tape, excessive bureaucracy and regulation (“the license Raj”). Many state run monopolies were run by bureaucrats with little commercial experience.
Corruption was nurtured. Private industry was starved of badly needed funds that went to state-run firms, often loss makers. Poor allocation of scarce resources to unproductive channels resulted. Competition was curbed and consumers fared badly.

- The period from 1950-1980 saw average annual economic growth rise to 3.5%, higher than the 1% during British rule. However, with population growth averaging about 2%pa per capita income rose very slowly. The decade from 1981-1991 saw some loosening of red tape and introduction of first generation reforms; GDP rose to a more respectable 5.4% p.a., but still below peers, especially the Far East Asian “tigers”. India lagged economically; and as a result also in human development indicators.

1991: THE TURNING POINT

- A Balance of Payments crisis in 1991 pushed the country to near bankruptcy. In return for an IMF bailout, gold was transferred to London as collateral, the Rupee devalued and economic reforms were forced upon India. That low point was the catalyst required to transform the economy through badly needed reforms to unshackle the economy. Controls started to be dismantled, tariffs, duties and taxes progressively lowered, state monopolies broken, the economy was opened to trade and investment, private sector enterprise and competition were encouraged and globalisation was slowly embraced. The reforms process continues today and is accepted by all political parties, but the speed is often held hostage by coalition politics and vested interests. Economic growth in the decade from 1992-2002 rose to an annual average of 5.9%. Better than before, but not fast enough for the huge “catch up” required for removing poverty and raising living standards.

2002 ONWARDS: THE ECONOMY ACCELERATES

- The latest annual GDP growth figure of 9.4% to March 2007 suggests a structural shift upwards in the $1 trillion economy, the second fastest growing major economy after China. The average annual growth rate for the last 4 years has accelerated to 8.6%, despite very poor infrastructure which the Government estimates reduces GDP by about 1.5-2% annually. The forecast growth for next year is 8.5 - 9%. However, recent growth has largely been urban and not shared by all sections of society as a staggering 250m people still live under the poverty line of $1 a day.

- Cumulative economic reforms, increasing globalisation, cheap credit, rising incomes, a higher investment rate of 35% and a growing educated middle class that fuels consumption have contributed to recent higher economic growth. Foreign exchange reserves stand at $229 bn vs $1.5 bn in 1991. Foreign investors regard India as a “cannot ignore market” and want to participate in the gains offered by the fast growing economy. The Indian juggernaut has many wheels and this makes its journey more sustainable; if one or two tyres puncture it will not land in an economic ditch.

- Importantly, favourable demographics will fuel consumption in India’s large domestic market and drive future economic growth. This will be aided by a shift in mindset among the younger generation to consume rather than save as their parents did. In about 10 years roughly half the population will be under the age of 25 years. This demographic dividend is expected to last for 30 years. In comparison, Japan, China (one child policy of 1960s) and Europe face an ageing population.

- There is a new confidence in India as the economy does well and captures the attention of the world, especially investors. This is despite the huge problems the country faces inter alia, poverty, non-inclusive sharing of economic growth, poor infrastructure, poor rural healthcare and education, corruption, discrimination, bureaucracy and the caste system.

- A confident corporate India increasingly acquires companies overseas as it embraces globalisation aggressively now.

OPTIMISTIC FUTURE

- As the country completes 60 years of Independence huge challenges still lie ahead. But, there is a new confidence and optimism in the people about the future as strong economic growth improves lives. This confidence is also manifesting itself in non-economic fields, e.g., art, “Bollywood”, R&D and other scientific fields, including space travel. India contributes the third largest peace keeping force in the U.N. and aspires for a seat on the Security Council of the U.N.

- So, what will keep the economy on a sustainable high growth path of around 8% pa for several years ahead? Rising incomes, a growing educated middle class, an increasing investment rate, rising FDI and a demographic dividend should help consumption led growth. Continuing economic reforms and an improving infrastructure will further aid the economy. Risks include domestic politics (e.g., coalition governments), geo-politics, social unrest if economic gains do not become more inclusive, global economic slowdown, environmental degradation, oil and external shocks.

- In an update this year to its original 2003 BRICs report, Goldman Sachs upgraded India’s sustainable economic growth from 5.7% to 8%. It suggests that India’s GDP will overtake the UK by 2015 and the U.S. by 2042 to be the second largest global economy after China and India’s influence on the world economy “will be bigger and quicker” than implied in the 2003 report.

- This is a journey of catch up; the journey will not be without its ups and downs. But, India is a juggernaut on the move!