Asian Economic Policy Review JCER

doi: 10.1111/aepr.12239 *Asian Economic Policy Review* (2018) 14, 1–17

India's Economic Reforms: Achievements and Next Steps

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This paper reviews the impact of India's reforms since 1991 on the performance of the Indian economy. It shows that the reforms definitely achieved a significant acceleration in growth and they also succeeded in reducing poverty. However, they have been less successful in generating good quality jobs. There was progress in providing better access to education, health services , and clean drinking water and sanitation, but less than was hoped. The area where performance has been most disappointing is environmental sustainability. The paper concludes by identifying some of the critical policy challenges in the years ahead.

Key words: economic reforms, employment, inclusive growth, India, poverty

JEL codes: N00, E01, I31

Accepted: 11 July 2018

1. Introduction

This paper presents an assessment of India's economic policies focusing on the reforms initiated in 1991 and their subsequent evolution over time, through successive governments. Section 1 describes the main features of the 1991 reforms and shows how they were significantly different from the 1980s. Section 2 identifies the areas where reforms have succeeded, as well as those where achievements have fallen short of targets. Section 3 presents a brief assessment of the critical policy challenges that need to be addressed if the Indian economy is to realize its full growth potential over the next decade and more.

2. The Reforms of 1991

For three decades after gaining Independence in 1947, India followed an economic strategy with a strong bias in favor of the public sector, strict government controls over private sector investment, and insulating the economy from the rest of the world

I am grateful to Utkarsh Patel for extremely careful research assistance. Thanks are also due to the participants in the Asian Economic Policy Review conference in Tokyo where this paper was presented, and especially to the discussants M Chatib Basri and Hideki Esho. Needless to say the errors that remain are entirely mine.

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through a combination of import licensing and high tariffs. Foreign investment was discouraged, and the import of technology was strictly controlled.

The economy performed reasonably well under this control system in the first 15 years 1950–1951 to 1964–1965, when the rate of growth of gross domestic product (GDP) (at factor cost) averaged 4.1% per year. This was lower than the plan targets of 5%, but much better than the growth rate in the pre-independence period. Besides, other developing countries were not performing much better. However, the inefficiency of the system became evident in the 1970s, when India was seen to be growing much more slowly than other countries in South East Asia. It became more starkly evident in the 1980s, when China's dramatic reforms began to show results.

A process of liberalizing the control regime had started in the first half of the 1980s, under Prime Minister Indira Gandhi, and was intensified in the second half of the decade under Prime Minister Rajiv Gandhi. However, these changes were incremental rather than structural. In essence, the basic control system remained in place, but it was made more flexible at the margin. Industrial licensing continued, but some industries were exempted from industrial licensing. Existing enterprises were allowed an automatic expansion of approved capacity every 5 years to allow them to undertake debottlenecking, and new licenses were given for larger-sized plants in order to exploit economies of scale. Import licensing continued, but several items were made freely importable and this list was slowly widened. Foreign technology continued to require government approvals, but these were given more freely.

The real break with the past came in 1991, when a new Congress led coalition government, under Prime Minister Narasimha Rao, with Dr Manmohan Singh as Finance Minister, had to deal with an exceptionally severe balance of payments crisis. The country had gone through two unstable minority governments in the previous 18 months which had failed to manage the balance of payments. Foreign exchange reserves had run down to $1.1 billion by the end of June 1991, barely enough for 2 weeks of imports, and there were widespread fears that India might be forced to default on its external debt payments. The new government moved decisively to contain the crisis through a classic stabilization program consisting of a reduction in the fiscal deficit and a currency devaluation. It also initiated a program of structural reforms to raise the growth rate to something nearer the true potential of the economy. To support these efforts it negotiated a International Monetary Fund (IMF) loan in 1991, along with structural assistance loans from the World Bank and the Asian Development Bank.

2.1. Stabilization and reforms

The stabilization component of what was attempted in 1991 was conventional but very effective. India was able to end the IMF program much earlier than expected (see Ahluwalia, 2016). The structural reforms were a distinct departure from the incremental changes attempted earlier. They signaled a clear shift toward a much more marketoriented economy, with a much larger role for the private sector and greater openness to trade and foreign investment. The reforms were consciously designed to be a holistic mutually reinforcing set of changes that could achieve the desired transformation. This can be seen from the following summary of the major changes.

1 Industrial licensing, which was earlier applicable for all industries except a defined list, was now abolished for all but a handful of industries. This meant investment in new plants and capacity expansion in existing plants could now be undertaken for a very wide range of industries without any approval from the central government. Since the location of industries was previously specified in the license, the abolition of industrial licenses meant that location was left to investors to decide, setting the stage for different states to compete with each other to attract private investment.
2 The list of 18 industries earlier reserved exclusively for the public sector was reduced to 8, and this was further pruned later. This effectively ended the earlier perception that the public sector must "occupy the commanding heights of the economy".
3 Earlier, the Monopolies and Restrictive Trade Practices (MRTP) Act provided that all investments by companies with total assets exceeding Rs 1 billion needed special scrutiny to ensure that it would not increase concentration of economic power. These restrictions were abolished and the MRTP Act was to be used to check anti-competitive behavior.
4 Foreign Direct Investment (FDI) was earlier allowed only in a defined list of high priority industries and each application needed to be cleared on a case-by-case basis, with foreign equity limited to 40%. FDI was now freely allowed up to 51% in this list and higher limits were considered on the merits of each case. The government also announced that it would seek foreign investment pro-actively in areas where it could make a major contribution.
5 Foreign technology agreements, which earlier needed individual approval, became eligible for automatic approval provided royalties and technology fees were within specified parameters.
6 There was a very substantial liberalization in trade policy. Capital goods, raw materials, components and other intermediate goods needed for production were made freely importable against tradable import licenses called Eximscrips, which were issued to exporters at 30% of the fob value of exports (40% for some items). This system was quickly replaced by a system in which all items except consumer goods could be freely imported using foreign exchange purchased from the market. (However, consumer goods remained on the banned list, and were finally liberalized only in 2002).
7 A Committee on Tax Reforms was appointed, under the chairmanship of Raja Chelliah, to make recommendations for the reform of both direct and indirect taxes. It recommended a switch towards a regime of low tax rates with a broader base, a reduction in the number of indirect tax rates, and a gradual reduction in customs duties to expose Indian industry to competition from abroad. The reduction in import duties was made possible by the devaluation in 1991 and the subsequent shift to a flexible exchange rate.

8 Financial sector reforms were seen as an essential accompaniment to industrial liberalization, and a Committee on the Financial System was appointed under M. Narasimham to make recommendations in this area. It recommended liberalization of controls over the interest rates charged by banks for different types of loans, a reduction in preemption of credit via high statutory liquidity requirements, and the introduction of tighter prudential and supervisory norms in line with the Basel I requirements that prevailed at the time. It also recommended abolishing government controls on capital issues in the stock market and on pricing of these issues, leaving both to be regulated by a statutorily empowered Securities and Exchanges Board of India.

9 In 1992, qualified foreign institutional investors (FIIs) were allowed to bring in capital to purchase shares in listed companies through the stock exchange. There was a cap of 24% on the total equity in an individual company that could be held by FIIs. While liberalizing portfolio equity flows, short-term bank debt, which had been the source of destabilizing movements in many countries, remained under strict control.

The holistic nature of the 1991 reforms is evident when we consider the package of measures introduced and their mutually supportive nature. Removing controls over investment without liberalizing import controls would only have shifted the point of control to the import licensing authority as investors would have to queue up for import licenses. Equally, liberalizing imports and lowering import duties were only feasible if the exchange rate was made flexible to take the brunt of any excess demand for imports. Financial liberalization was critical to support private sector expansion.

There was much speculation at the time on whether the reform agenda was thrust upon the Indian government by the IMF as part of its assistance program. I have argued in Ahluwalia (2016) that the ideas implemented in the reform had been extensively discussed domestically, well before the crisis, and while they figured in the conditionality associated with the Fund's assistance, the IMF was not the principal driver. It would be more accurate to say that reformers in the government saw the crisis as an opportunity to implement changes that were being discussed earlier, but were politically not acceptable. The fact that the IMF program ended in 1994, but the reforms continued is proof that the reforms were home grown.

There were missing links in the reform agenda reflecting political sensitivities. Reform of the public sector was barely touched. Privatization was simply not politically acceptable across the political spectrum and all that the government was willing to say was that public sector enterprises (PSEs) would be given greater managerial autonomy to improve their financial performance. However, little was done to make this a reality. It was also said that irremediably loss-making PSEs would be closed down, but this was never attempted. The only new initiative was that 20% of the equity of profit-making PSEs would be sold to mutual funds and other financial institutions in the hope that the induction of nongovernment shareholders would increase the commercial orientation of PSEs.

Another area which was left untouched initially was the policy of reserving certain items for production in the small-scale sector. Almost 900 items, including simple consumer goods such as electronic toys, garments, shoes, electric kettles, and many household goods were reserved for production only by small-scale units. Since these were precisely the items which had a strong export potential, the policy of reservation prevented upgrading products to bring them up to export quality. The policy was meant to protect employment, but over the longer run it prevented India from tapping world markets and creating better quality employment from export orientation. This weakness in the policy was known, but there was no attempt to change policy in this area because it was felt to be too sensitive politically.

2.2. Gradualism and continuity over time

India's reforms have often been called gradualist rather than of the "big bang" variety. Gradualism had the obvious disadvantage that the reforms took a long time, and the flow of benefits was therefore delayed. However, they had the advantage of making small changes to begin with and allowing time to build a broader consensus across parties. Making policy changes in a democratic polity poses special challenges. Democracy is not a consensual form of government. It is an intensely competitive and adversarial form, in which political parties in opposition will engage in heated criticism of those in power. However, while criticism from the opposition is essential for democracy, economic actors also want assurance that policies that have worked well, will not be reversed every time there is a change of government.

It can be argued that India's gradualist approach helped build a consensus across political parties that enabled the reforms to continue, even as the political parties running the government changed. The United Front (UF) government, which followed the Narasimha Rao government which initiated the reforms, was in power from 1996 to 1998. It was a coalition which included the Communist Party of India, but it also had as Finance Minister P. Chidambaram, a former Congress party member who had an impeccable record as a reformer.[1] Chidambaram's presence in the UF ensured that the government continued to implement many of the tax reforms initiated in 1991. He continued the process of reducing import duties and articulated the objective of bringing customs duties down to East Asian levels by 2000. The UF government also pushed for opening the insurance sector to new private players, with foreign insurance companies allowed to have up to 26% foreign equity. However, this was strongly opposed by the BJP. The government started the process of reducing the number of items reserved for the small-scale sector by taking out 15 items in 1997. It also tried to introduce a more rational approach to public sector reform by setting up the Disinvestment Commission and asking it to recommend transparent ways of selling off PSEs, including the possibility of handing over some PSEs entirely to the private sector.

The UF government was succeeded by the National Democratic Alliance (NDA) coalition led by the BJP which was in power from 1998 to 2004. It continued the process of tax reforms including the reduction in customs duties. More importantly, it continued the policy of openness to foreign investment, setting to rest the fears of many who felt that while the BJP was pro-domestic business, it would be anti-FDI. It introduced legislation opening the insurance sector to new private insurers with foreign insurance companies allowed to hold 26% foreign equity, an initiative it had strongly opposed when the UF tried to do it. It also lifted the ban on imports of consumer goods in 2002.

The Congress-led United Progressive Alliance (UPA) government, with Manmohan Singh as the Prime Minister, was in power from 2004 to 2014. Since Manmohan Singh was the architect of the 1991 reforms, it was expected that reforms would continue and they did, albeit in a gradualist manner. A major signal of continuity was that the government undertook a commitment to fiscal consolidation implied by the Fiscal Responsibility and Budget Management Act, which was passed by the previous government a year earlier. The combined fiscal deficit of the central and state governments declined sharply between 2003–2004 and 2007–2008 which created a supportive macroeconomic environment for private investment. The gradualist process of reducing import duties continued and at the end of the period the peak rate of duty was reduced to 10%. The scope for FDI was expanded to increase the percentage of foreign equity in Telecom from 49 to 74%, and in airlines from 26 to 49%. FDI in retailing was also opened up, initially for "single brand retail". Department stores engaged in multibrand retailing were opened up much later, but subject to onerous conditions.

The UPA also launched an ambitious program of infrastructure development through Public Private Partnerships (PPPs). The infrastructure deficit had become a major constraint holding back India's economic performance, and a massive increase in investment was needed. This could not be done using budget resources alone, because there were too many other claims on the budget. The strategy adopted was to rely on PPP wherever possible. The effort was very successful for several years, with PPP projects in roads, ports, airports, and power generation. However, it soon ran into implementation problems because of delays in receiving environmental clearances, and an inability to handle disputes efficiently. Reviving the momentum of this particular reform should have high priority for the future.

Another important initiative of the UPA was the creation of Aadhar, a biometric identity verification system to cover all residents. This was to be used to promote financial inclusion and facilitate direct transfer of benefits in government subsidy schemes. This was started by the UPA, but has been greatly expanded by the NDA government that followed.

The UPA government also began the process of getting the states to agree to an integrated goods and services tax in which both the center and the states would tax goods and services with full provision of input tax credit. This was an important step in reform of indirect taxation. It needed a Constitutional Amendment since the center cannot tax beyond the production stage, whereas a value added tax requires an unbroken chain extending to the retail stage. A bill was introduced in parliament, but could not be passed during the tenure of the UPA due to opposition from BJP-ruled states.

The current government under Prime Minister Narendra Modi took office in 2014 and its 5-year term runs up to 2019. There are sharp differences between the government and opposition parties on social issues, most especially on growing incidents of violence against minorities and the dalits, which are widely attributed to aggressive Hindu nationalism and majoritarianism. However, the economic policy of the government is not very different from the gradualist reforms attempted by earlier governments. Perhaps the only initiative which does not fit into the description of continuity was the surprise demonetization of the two highest value notes (Rs 1000 and Rs 500) announced in November 2016. The move was officially justified on the grounds that it would help uncover hidden cash hoards from income that had escaped taxation, discourage counterfeiting and terrorist financing, reduce cash transactions in the economy and thus would discourage illegal and tax-avoiding activity. There is now a growing consensus that this initiative has proved to be much more disruptive than the government expected and has not contributed much to the other stated objectives.

On other economic issues, there is a high degree of continuity especially on the following.

1 Reaffirmation of the commitment to follow a fiscally prudent policy, but with a new time path for reducing the central government fiscal deficit to 3% of GDP by 2020–2021;
2 Continuation of the liberal industrial policy with efforts being made to improve the ease of doing business;
3 Continuation of the policy of openness to foreign trade, though customs duties on a number of items were raised in the 2018–2019 budget. It is not clear how the current global concern about trade wars will evolve but that could disrupt continuity in this area.
4 Continued openness to FDI with an expansion of the areas where it is allowed, including most notably defense, and also raising the equity cap in insurance from 26 to 49%.
5 Reiterating the commitment to improve infrastructure through a combination of public investment and PPPs.
6 Creating a digital IT infrastructure, based on Aadhar, the biometric identity system introduced by the UPA government, and using it to achieve financial inclusion and direct benefit transfers.

The most important new step taken by the Modi government is the introduction of a Goods and Services Tax (GST). This major reform of the system of domestic indirect taxes was initiated by the UPA government and was opposed at the time by the BJP-ruled states. However, the government can legitimately claim the credit for having got the Constitutional amendment done and introducing the system from mid-2017 onward. There are criticisms of the implementation of the GST. There are too many rates, too large a set of commodities has been excluded, and the system is more complex than it needs to be especially in the matter of crediting taxes paid on inputs and providing refunds to exporters. The government has acknowledged many of these problems and hopefully, they will be addressed over time. Once that is done, India will have a state-of-the-art domestic indirect tax system.

A second major reform is the Insolvency and Bankruptcy Code which is expected to speed up the process of debt recovery from companies defaulting on debt payments. The first few companies are now emerging from this process, with large haircuts for the banks and a complete loss of the company for the defaulting owners. Hopefully, as more successful resolutions emerge, it will create the right incentives for bankers to accept haircuts that are transparently determined and for borrowers to repay debts or face the consequences.

A new initiative in labor market reforms is the introduction of a system of fixed-term contracts for employees which allows the automatic termination of a service at the end of the contract period. It remains to be seen whether this will introduce the much needed flexibility in hiring labor, with a possibility of downsizing when market conditions require.

3. Impact of the Reforms on Growth

We now present an assessment of the impact of the reforms on different aspects of performance. For this purpose, the reform agenda is not just what was announced in 1991, but the whole agenda as it has evolved over time with some additions under successive governments.

3.1. Impact on growth

The immediate impact on growth was clearly positive, with the rate of growth of GDP averaging 6.5% in the 8 years 1992–1993 to 1999–2000. However, De Long (2003) presents a more negative assessment, based on comparing the growth performance in the 1980s with the 1990s.

De Long points out that the incremental reforms in the 1980s had produced an average growth rate of 5.6% in the period 1980–1981 to 1989–1990, which was a full 2 percentage points higher than the long-term growth achieved before 1980. Since the growth rate in the 1990s, at 5.8%, was only marginally higher than in the previous decade, De Long suggests that perhaps the reforms of the 1980s, which consisted mainly of operating the existing control system with a more pro-business approach, had a much greater impact on growth than the so-called deeper reforms of 1991. Rodrik and Subramanian (2004), build on the De Long critique to argue that the emphasis on external liberalization in trade and foreign investment in the reforms of the 1990s may have been much applauded by international organizations, but was actually much less important than operating the domestic controls in a more result-oriented manner.

I have argued against the De Long and Rodrik-Subramanian thesis in Ahluwalia (2016) on several grounds. First, the high growth of the 1980s was fueled in part by an excessively expansionary fiscal policy. The combined fiscal deficit of the center and states averaged 6.9% of GDP in the first half of the 1980s and increased to 8.6% in the second half. This was bound to have a negative effect on GDP growth, and it did surface in the form of the crisis of 1991–1992. The measured growth rate in the 1980s is, therefore, not an appropriate basis because it was not sustainable. Furthermore, the crisis it created lowered growth in the early years of the 1990s. The growth rate for the 1990s as a whole includes the crisis year of 1991–1992, and, therefore, understates the effect of the reforms. If we consider only the post reform years, the growth rate in the eight post reforms years 1992–1993 to 1999–2000 was 6.5%, which is fairly respectable.

It can be argued that a growth of 6.5% is an "underwhelming" response for a major reform effort. The reason is that the reforms, though bold in scope, were implemented only gradually, and, therefore, took time to have their full impact. For example, the reduction in customs duties was stretched over several years as was the dereservation of production for the small-scale sector. Reforms in state indirect taxes took place only in 2005, and the integrated GST for the center and states combined, a major bipartisan reform, happened only in July 2017.

The 15-year period 2003–2004 to 2017–2018 therefore provides a better measure of the impact of the reforms. The average growth rate of GDP in this period comes to 7.6%, which is a full 2.0 percentage points higher than the growth rate of 5.6% in the period 1980–1981 to 1991–1992. This growth performance is not as good as that displayed by the original Gang of Four (Hong Kong, Singapore, South Korea, and Taiwan), or more recently by China which grew at a phenomenal 10% per year over a 30-year period! However, growing at 7.6% over 15 years is a remarkable achievement.

Table 1 presents a comparison of India's growth performance with that of China, the ASEAN group, and all other Emerging Markets and Developing Economies (EMDEs). It shows that in the prereforms period 1980–1991, India grew much more slowly than China and even slower than the ASEAN 10, though it grew faster than the group of other EMDEs excluding India and China. In the first post-reforms period 1992–2002, India's growth was still much slower than China's, but it edged above the

Table 1 India's GDP growth compared to other countries/groups of countries

	1980–1991	1992–2002	2003–2017	2018–2023
Advanced economies	3.0	2.7	1.7	1.9
All EMDEs	3.4	3.8	6.0	5.0
India	5.2	5.8	7.6	7.9
China	9.2	10.2	9.4	6.1
ASEAN-10	6.1	4.6	5.4	5.0
All EMDEs excl. India and China	2.6	2.6	4.3	3.7

Source: IMF (2017).
ASEAN-10 stands for the ten members of the Association of South East Asian Nations; EMDE stands for emerging markets and developing economies.

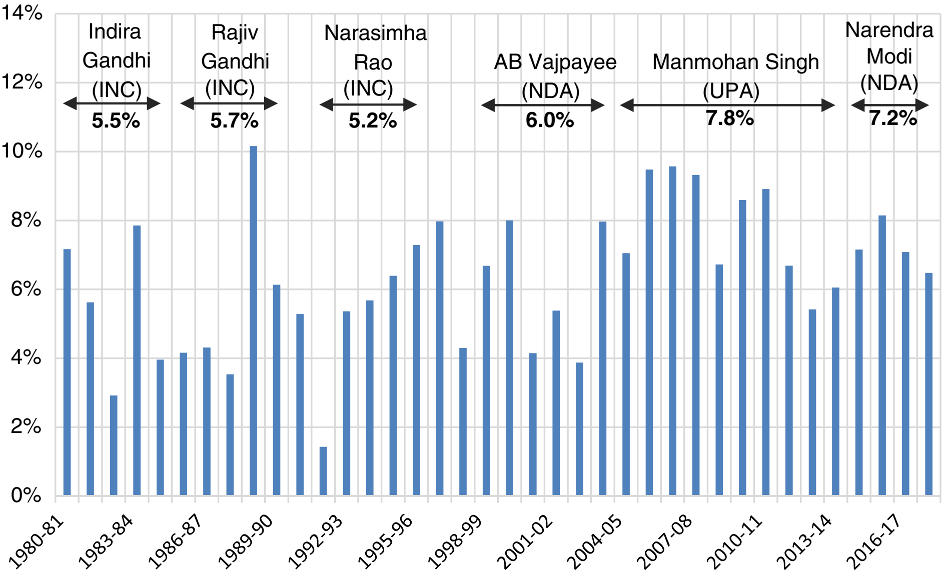

Figure 1 Growth rates of GDP.

Source: CSO (various years).

Notes: (i) Growth rates up to 2011–12 are from the old series of GDP at factor cost, 2004–05 prices. Growth rates from 2012–13 onwards are from the new series for GVA at 2011–12 prices. GVA corresponds broadly with GDP at factor cost. (ii) Arrows indicate the span of different governments under different Prime Ministers. The United Front government, which was there only for two years from 1996 to 1998, is not indicated. The percentages shown below the arrows are the average growth rate in the span of the government. Since the terms of governments do not coincide with fiscal years, there is an unavoidable approximation.

ASEAN 10. In the second post-reforms period 2003–2017, India grew significantly faster than the ASEAN 10, but still slower than China, though the gap narrowed. The IMF's projection for the period 2018–2023 shows that China is expected to slow down to 6.1% per year, while India's growth rate will average 7.9% per year overtaking China's. It is reasonable to conclude that the cumulative effect of India's reforms has been to unleash a fairly robust growth process, even if they have taken a little too long to do so.

Figure 1 provides a graphical picture of India's growth from 1980 onward indicating the growth rates under different governments. It presents a picture of gradually increasing growth in successive governments.

3.2. Were the reforms inclusive?

Traditionally, inclusiveness in India has been viewed in terms of the impact on poverty reduction. Viewed from this lens, there is no doubt that the reforms reduced poverty once the high growth kicked in. Table 2 summarizes the picture using the official estimates of poverty based on a poverty line, which is actually very close to the

Table 2 Growth and poverty in India

	Annual growth of GDP (%)		Population in poverty	
	Economy	Agriculture	% in poverty	Millions
1993–1994	—	—	45.3	403.7
2004–2005	6.2	2.9	37.2	407.1
2011–2012	8.5	3.5	21.9	269.8

Note: The annual averages are for the period preceding the year indicated. Thus, 6.2% is the annual average growth of GSP from 1993–1994 to 2004–2005.
Source: Central Statistics Office (2014) and Rangarajan (2014).

international poverty line used by the World Bank. The first 11 years of the reforms saw a decline in the percentage of the population in poverty from 45.3% to 37.2%. However, this decline was not sharp enough to offset the increase in total population, so the absolute number of people living below poverty line actually increased marginally. In the latest period 2004–2005 to 2011–2012, the situation changed dramatically. The percentage in poverty declined much more sharply, and the numbers in poverty fell by 137 million.

The sharper reduction in poverty in the most recent period can be attributed to three distinct factors. First, as shown in Table 2, the growth rate of GDP averaged 8.5% per year (about 7% per capita), in the most recent period compared with only 6.2% (4.2% per capita) in the earlier period. The faster growth rate in per-capita income would be expected to reduce the extent of poverty provided there is no significant change in the share of income going to the lower income groups. This is the "pure trickle down" effect from faster growth. Second, the composition of growth in the latter period was different as agricultural growth accelerated to 3.5% per year compared with only 2.9% in the earlier period. This demonstrates the importance of the composition of growth which makes some growth processes more likely to ensure trickling. Third, the expansion of targeted anti-poverty programs in the second period, including especially the rural employment guarantee, the program for supply of subsidized food to lower income groups, and various rural livelihood support programs, may also have contributed to a faster reduction in poverty (e.g. Himanshu & Sen, 2013).

Advocates of poverty reduction strategies tend to focus almost exclusively on programs directed at poverty alleviation, but the other two factors are also important. More research is needed to quantify the relative importance of these three components in different periods of time and perhaps also in different states.

3.3. Employment generation

A somewhat different test of inclusiveness is whether the growth generated sufficient employment. Paucity of data on the extent of employment makes it difficult to assess the nature and extent of the problem. The only official data on employment come from the Employment and Unemployment Surveys conducted every 5 years by the National Sample Survey Office (NSSO) and the latest data available are for 2011–2012.[2] These data show unemployment at 3.14% in 2011–2012. However, the low levels of open unemployment do not mean that employment is not a problem. In India's economic circumstances, a lack of employment opportunities will not show up as open unemployment for the simple reason that people cannot afford to remain unemployed for long. In the absence of social security payments, they take up whatever jobs they can find to eke out a living.

The real problem is that too many people are engaged in forms of employment that do not come up to their expectations. This is especially so for the more educated younger members of the labor force. This problem was probably moderated in recent years as children stayed longer in schools. However, as these cohorts reach school leaving age, we will have young people joining the labor force who have gained an education, and are hoping to get good-quality nonagricultural jobs in urban areas. They are unlikely to be satisfied with low productivity self-employment, and will look for more secure employment in the organized sector.

The NSSO data show that organized sector employment expanded by 58 million between 2004–2005 and 2011–2012, but 84% of the increase was in what is called "informal employment," that is, employment of temporary workers on contracts without the full benefits of social security. The better educated youth entering the labor force will not be satisfied by these jobs. They are looking for jobs in line with what they believe are their superior qualifications.

One of the reasons put forward for the slow growth of employment is that the manufacturing sector has not grown as rapidly as was hoped. The fact is that manufacturing did accelerate from an average of 5% growth per year in the pre-reforms period 1980–1981 to 1991–1992 to 8.3% in the period 2003–2004 to 2017–2018. However, this is much slower than the double-digit growth rate in manufacturing often mentioned in government documents as the target.

A possible reason for the slow growth in manufacturing is that units engaged in manufacturing are increasingly outsourcing activities such as cleaning, catering for factory canteens, gardening, transport activities, and the provision of security to third parties. This reduces measured value added in manufacturing, shifting it to the services sector. The National accounts data do show that service sector GDP growth accelerated sharply through these years from an average 6.3% in the period 1980–1981 to 1991–1992 to 9% in the period 2003–2004 to 2017–2018. The growth in employment in the services sector would have offset any decline in employment in the manufacturing sector, but the quality of service sector employment would have been poorer, with less social security and lower wages.

It is sometimes said that India need not pursue high growth in manufacturing if it can leap frog to being a services economy. There is no doubt that India has a comparative advantage in certain high end services in the information technology (IT) sector, but that is not a reason for accepting low growth in manufacturing. The high growth in IT-related services is slowing down as the base expands, but more importantly manufacturing jobs need less-skilled persons than high end services. Advanced countries are seeing a decline in the share of the manufacturing sector because it is more cost effective for them to import manufactured goods from developing countries. India should try to improve its competitiveness in manufacturing, not only to meet a large part of its own demand, but also to seek a reasonable share in the global market for exports of manufactures.

There are many reasons why India's reforms have failed to generate the kind of growth in labor-intensive manufacturing that was achieved by East Asian countries. One reason, mentioned earlier, is that many of the goods which could have formed the basis for such an export strategy, remained reserved for small-scale production in the first 10 years of the reforms! This particular policy constraint is now behind us, but there are others in play. India has yet to develop infrastructure of the quality which is essential to support export-oriented industrialization. India's labor laws also have to share the blame. They make it extremely difficult to close down a unit or retrench labor, and they are also unduly complex. Achieving a better employment outcome in manufacturing depends upon finding solutions to these problems.

3.4. Education, health services, clean drinking water, and sanitation

An inclusive strategy must ensure the delivery of critical services such as education, health, clean drinking water, and sanitation to the mass of the population. This would not only directly improve welfare, it would also improve human capabilities, and have a positive impact on growth. The following is a highly encapsulated assessment of the performance in these dimensions.

1. Access to schools has improved considerably, with the enrolment of children in primary school now being virtually universal. Gender gaps in enrollment have narrowed and pupil teacher ratios have also improved. However, learning outcomes remain poor. ASER Centre (2017) reported that about 57% of Standard VIII students in rural India could not do simple division, and 25% could not read a Standard II text. With such weak foundations, a large proportion of the children in school are bound to fall behind in learning as they progress to higher stages leading to very low learning.
2. Health outcome indicators such as life expectancy, infant mortality, maternal mortality, measures of stunting, and weight for age of children have all shown improvement, but the rate of improvement is too slow. This is an area where performance needs to be greatly improved.
3. Sanitation is directly linked to health status, especially for children, and this has long been a problem area. However, the situation is improving. In 1993, only 12% of the rural households had access to a toilet. This has increased to 50% in 2016 (NSSO, 2017). The government's Swatch Bharat program has emphasized the provision of toilets for every rural household, and there is evidence that it is making a difference.

3.5. Inequality of income and wealth

The degree of inequality in income and wealth is attracting attention globally and India is no exception. There are no official data on the distribution of income. The only information available is from the two India Human Development Surveys conducted jointly by the National Council of Applied Economic Research (NCAER) and the University of Maryland. They show a Gini coefficient of income distribution of 0.54 in 2005 and 0.55 in 2012. This puts India among the countries with relatively high levels of inequality.

An aspect of inequality that has received growing attention is the concentration of wealth. The 2018 Forbes list of billionaires reports 119 billionaires in India, the largest number after the USA, China, and Germany. While some of them have created their own fortunes, and added a great deal to the GDP in the process, a very large proportion have inherited their wealth.

Inequalities in income and wealth can create a perception of unfairness which can greatly weaken the social fabric. What is perceived to be unfair is ultimately a subjective judgement, but in a democracy it is also amenable to political manipulation. Policy makers have to be alert to deal credibly with growing dissatisfaction on this count.

3.6. Environmental sustainability

An exhaustive treatment of the environmental issues is beyond the scope of this paper, but it is necessary to acknowledge that this is the area where progress is least evident. There are several metrics associated with environmental sustainability such as maintaining the cleanliness of natural water bodies such as lakes and rivers, controlling air pollution in our cities, preventing excessive withdrawal of ground water, containing the growth of carbon emissions, and expanding the size as well as the quality of forest cover. Unlike the case with health and education, where there are shortfalls from targets but at least all indicators show progress, in the case of the environment, all relevant indicators show continuing deterioration!

The good news is that this aspect is now recognized in policy-making circles, and there is also much greater public awareness. The bad news is that this awareness has not yet reached the stage where it puts strong political pressure on governments at different levels to take strong action. As a result, we have yet to evolve credible plans for turning around the continuing deterioration.

4. Prospects for the Future

The present government has not set any official targets for growth in the medium term, but government spokespersons have talked of returning to a growth trajectory of "8% plus" in the near future. This is not an unreasonable target since the economy did achieve 8.35% growth over the 9-year period 2003–2004 to 2011–2012. However, one should keep in mind that nothing is preordained and there are many examples of countries that have grown rapidly for a while and then hit a ceiling when other constraints become binding. This is the basic idea behind the so-called middle income trap which builds on the notion that countries can get from low to middle income status by dealing with some basic problems, but they then face more complex challenges which call for new policy responses and perhaps even the development of new institutions.

What are the key policy reforms that India needs to work on? It is easy to compile a long list by skimming recent Plan documents prepared by the erstwhile Planning Commission, or the reports of its successor the NITI Aayog. What is important is to identify the critical reforms that will address the most important constraints holding back the economy at present. The following six items stand out from the discussion in this paper.

1 Macroeconomic stability is a precondition for successful growth in an open economy and the key elements are a credible monetary policy, fiscal sustainability, and sensible exchange rate management. The recent establishment of a monetary policy committee, independent of the government, takes care of one leg of this tripod. However, fiscal sustainability is a weak point. The combined fiscal deficit of the centre and the states is 6.7% of GDP which is twice that in other emerging market countries. The central government has announced a trajectory for reducing its fiscal deficit over the next three years. A similar trajectory is expected to be put in place for the states based on the recommendations of the Finance Commission expected in 2019. Performance against these trajectories will be carefully watched especially since similar trajectories announced earlier have not been adhered to. Credible progress in fiscal consolidation is particularly important at a time when India faces an expanded current account deficit. India should be able to finance a current account deficit of around 2% of GDP by long term capital inflows, but nothing scares foreign capital as much as fiscal irresponsibility and a sudden outflow can be seriously destabilizing.) Exchange rate management, the third leg of the tripod, will also be a challenge in a world which is highly interconnected and also volatile. This issue is discussed in Mohan and Ray (2019) and it is mentioned here mainly to emphasize its importance.

2 Infrastructure deficiencies pose an immediate challenge for India. If India is to aim at 8 plus percent growth, we need to ensure that the rate of investment in infrastructure as a percent of GDP goes up to 9% as was envisaged in the Twelfth Plan. Since the availability of public resources is limited, and there are heavy demands for these resources from other sectors, much of the infrastructure investment will have to come from PPP and this requires urgent resolution of the many constraints which interrupted the growth of PPP in infrastructure. Possible responses include: (a) early resolution of the problems faced by ongoing infrastructure projects which are "stuck" for one reason or another; (b) the passing of an Act of Parliament which would establish the legal framework within which PPPs in infrastructure would be attempted; and (c) the establishment of an overarching dispute resolution process to deal with disputes arising from PPPs in all sectors.

3 India will need to invest more in health and education, and this burden must be borne by both the central government and the state governments. More importantly, resources are only part of the problem. There is also a problem of state capacity. The administrative structures that deliver these essential services are all at the state and local government levels. Strong notions of state sovereignty will ensure that states will resist micro-management by the centre, and in any case such micro-management is unlikely to work. Strengthening state level systems is critical and this can only be done by the relevant political processes at the state and local levels

4 Top priority needs to be given to resolve the problems afflicting the GST. Amending the Constitution to make a GST possible was a major advance, but the GST that has emerged is structurally flawed. Far too many commodities have been excluded and there are also too many rates. It is unlikely that this can be changed before the general election of 2019, but a major effort should be made to clean up the GST immediately afterward, so that the economy can get the full benefit that was expected from the GST.

5 The Insolvency and Bankruptcy Code has become operational and, assuming it is not derailed through court interventions, it will put in place the right incentives for debtors in future. It will also speed up the problem of resolution of nonperforming assets, but the public sector banks will have to take large haircuts which will erode their capital. This presents the government with some strategic choices. If the government insists on retaining a 51% share in the equity of these banks, it will have to make large capital contributions from the budget, but this will either seriously disrupt the trajectory of reducing the fiscal deficit, or force a highly disruptive cut in other expenditures. Alternatively, the government could agree to reduce the government's stake in at least some of the public sector banks below 51% and try to attract private capital including by strategic investors. This would be a desirable step but is not likely to be attempted in the year of a general election. It will not be politically easy afterwards either, but the issue needs to be thoroughly debated so that an informed view can be taken.

6 More generally, the economy needs to be run in a manner which places domestic producers under competitive pressure to modernize their production and remain competitive internationally. This can only be done if the economy remains open to both foreign trade and FDI. This has been the consistent thrust of the gradualist reforms pursued by successive governments, but the rise of protectionism in developed countries poses a danger. It could give a fillip to those who favor greater protection for domestic industry. It will require wisdom and statesmanship to stay the course and remain open, while responding to the legitimate concerns of domestic producers where changes in government policy could increase their competitiveness.

These are only some of the priority areas emerging from this paper. There are many others related to reforms in agriculture, energy pricing, management of scarce water resources, and managing the challenge of urbanization. Constraints of space have ruled out exploring these issues.

Notes

1 Chidambaram had left the Congress Party when the Tamil Nadu wing of the party, led by G. Moopanar, broke with Narasimha Rao on the issue of aligning with the AIADMK for the 1996 general election. Moopanar formed the Tamil Maanila Congress (TMC) and Chidambaram was elected on a TMC ticket and was the Finance Minister of the UF government.

2 The NSSO have decided to conduct surveys annually, but no new data are available as yet.

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