The Post-1991 Growth Story*

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July 1991 is widely seen as a watershed month in Indian economic policy making. That was when the Indian government openly declared that it was unwinding the interventionist regime which had been in place since Independence, involving controls on economic agents, regulation of markets, a large public sector and an a priori plan as to how economic resources should be allocated. In the period to follow, policy, it was then argued, would dismantle this excessively interventionist framework, and establish and support a system driven by private initiative and relatively unfettered markets, with minimal regulation and control. The State was to transform itself from being a regulator of the market economy to being a facilitator of the functioning of the market mechanism.

Stated thus this transition appears to be void of any social or political substance. However, there was a reason why post-Independence India, steeped in poverty, made the choice of pursuing development within a highly regulated mixed economy. According to the framers of post-Independence policy, experience and the understanding distilled from it showed that reliance on market signals to allocate resources would neither help then-backward, post-colonial India diversify its economic activity to close the gap between itself and the developed countries, nor make much difference to the extreme poverty and deprivation that afflicted a majority of the population. Regulation and disciplining of industrialists and landlords, to prevent them from pursuing private profit at the expense of social benefit, and the redistribution of assets and income (through land reforms and curbs on monopoly, for example), were necessary to launch a growth strategy that made sense of freedom and preserved the unity of the country. Seen from that perspective, the decision in 1991 (and even earlier) to dismantle that interventionist regime was a major turning point. In the name of growth, the government was declaring its willingness to favour private capital at the expense of the rest of society. The latter were to be compensated with 'social expenditures' that would in the long-run reintegrate those marginalized by the strategy, while supporting them with transfers that ensured minimal benefits in the short-run.

Twenty five years down the line, there seems to be a sense of complacence about the experience with the pursuit of this strategy. The Congress, which under Rajiv Gandhi and subsequently under Narasimha Rao, launched India on the trajectory of liberalization and neoliberal reform, seems proud of that achievement and is pushing to take credit for it. Regrets, if any, relate to the fact that more was not done faster. The BJP seems comfortable taking over the legacy of reform handed over to it by the Congress, and claims that it is moving faster with more far reaching policy changes. With much of the media convinced that there is no alternative to the neoliberal path, the elite consensus in India is that the task ahead is to prevent the reversal of reform and keep messy politicians, who after all are accountable and subject to pressure from 'special' interests, from meddling too much with economic policy.

An elite consensus of this kind does not necessarily represent the truth. Till the 2008 crisis, establishment figures and intellectuals close to power across the world believed that the unfettered expansion of finance and financial markets was good for growth. A crisis that lasted eight years and is still ongoing has made that sound like nonsense. Finally, it is not the market that saved finance and is working to revive growth, but government. Similarly, few within the European establishment believed that the people of Britain, which had the best deal possible as a member of the European Union, would see the arrangement as manufactured to suit the elite, and vote to leave the club. So, an elite consensus is neither a proof of truth nor a guarantee of irreversibility.

Twenty-five years is a long period in history. Dating the adoption of a regime of development planning to 1951, when India's First Five Year Plan was launched, and treating the 1980s as an interregnum with creeping liberalization under Rajiv Gandhi as Prime Minister, we have 30 years of experience with the earlier interventionist strategy and 25 years with neoliberalism. So if definitive statements about the success of import substitution could be made by the end of the 1970s, so can such statements presumably be made about the neoliberal path traversed over the last 25 years. This, however, is not accepted by the advocates of liberalization, who still see liberalization as an unfinished agenda, the full benefits of which are yet to come. But that need not hold us back here.

So, let us turn to the yardsticks most used by the advocates of liberalization to proclaim its success. The first is economic growth. India, it is argued, has not merely managed to escape from the low-growth trap it was caught in till the 1980s, but has managed to sustain and improve on that growth rate. The numbers do seem to support that argument. From annual rates of 4.8 per cent during 1950-51 to 1964-65, 3.4 per cent during 1964-65 to 1974-75 and 4.2 per cent during 1974-75 to 1984-85, the rate of growth of GDP rose to 5.9 per cent over 1984-85 to 1994-95, 7.1 per cent over 1994-95to 2004-05 and 8.3 per cent over 2004-05 and 2013-14. Though the rate of growth seems to have stabilized at a slightly lower level subsequently, that issue is mired in controversy because of the many voices that have expressed disbelief at the rates of growth thrown up by the drastically revised new series of National Accounts Statistics with 2011-12 as base. But even leaving that aside, the figures do show a definite improvement during the last 25 years compared to the post-Independence period prior to that.

Based substantially on that, it is held, that the policy changes that began in the 1980s and were pursued more intensively after 1991, helped India escape the low, "Hindu rate of growth" in which it had been trapped till then. Discounting this achievement by referring to persisting poverty and deprivation is, in this view, unwarranted, because only with growth delivering surpluses can the resources be found to adequately address these problems. While welfare measure and safety nets might have a role in the interim, in the final analysis it is growth that would offer a sustainable solution to those problems. Needless to say, it is not just welfare that the GDP-based argument ignores, but other factors such as the appallingly poor state of physical and social infrastructure in the country.

The second, oft-quoted indicator of success is India's large foreign exchange reserves currently placed at $360 billion or the equivalent of imports over more than 11 months by current standards. That a country which had seen its reserves fall to the equivalent of the value of its imports over two weeks in 1991 and had to pledge its gold reserves to obtain temporary balance of payments financing from the IMF has recorded this turnaround is seen as remarkable.

Both these claims have to be read with caution. There are a couple of features of the GDP growth record that need noting. To start with, agriculture, now steeped in a crisis by all accounts, has been languishing in terms of growth and even manufacturing shows some buoyancy only in the years after 2004-05. So much of the growth was on account of construction and services. Given this pattern of growth it was not exports that supported the buoyancy experienced under the new regime, as was claimed would be the case by the advocates of liberalization. Moreover, much of the expansion of output was unevenly distributed over time. Growth in the 1990s was concentrated over 1994-95 to 1996-97 and it was only during 2004-05 to 2013-14 that the economy witnessed a relatively long boom (with the exception of post-crisis year 2008-09). If liberalization is regarded a success based on the growth that it has delivered, then the argument is crucially dependent on how growth during the post-2004 period is assessed, to which we return later.

The use of foreign reserves as an indicator of success is even more knotty. In the 25 years since 1991, India has recorded a current account deficit on its balance of payments in all but three years. In other words, as a country it has been spending more foreign exchange on imports of goods and services than it has earned through the export of goods and services. So there was no foreign exchange surplus that was being earned. If yet India has accumulated a large volume of foreign reserves, it is only because foreign investors and lenders have pumped into the country much more foreign exchange than was needed to finance annual current account deficits. It hardly bears stating that the inflows are liabilities and have associated with them payments commitments in future in the form of interest or earnings, and in the form of the value of the asset held by the investor if she decides to sell and exit. In sum, India’s reserves are borrowed and not earned, and the more the stock of such liabilities it accumulates the more externally vulnerable the country becomes.

When assessing these claims,it may also be appropriate to ask, how was liberalization expected to accelerate growth? A reading of the case for liberalization made by its advocates sees its primary purpose as that of unleashing the competition (domestic and foreign) that had been suppressed by the interventionist regime. The result of the absence of competition, it was argued, was the emergence of a high cost economy, with plants of uneconomic scales employing dated technologies incapable of competing in international markets. That deprived India of the possible benefits of an export stimulus to growth, and prevented it from earning the foreign exchange needed to pay for the imports of even essentials of various kinds. Liberalizing imports, freeing entry for domestic and foreign players, and removing restrictions on capacity creation and expansion was expected to redress these weaknesses. It was expected to result in a restructuring of domestic industry, which would be forced by the cutting edge of competition to establish internationally competitive capacities. Liberalization was also expected to attract foreign direct investors who, whether in collaboration with domestic partners or through investment in subsidiaries, would establish similar internationally competitive capacities, giving India an edge in international markets.

There are two features of this argument that need noting. First, it implicitly assumes that industry would be the leading sector in the growth process. Liberalization it was being argued would help fulfill the promise India showed as a potential industrial power. Second, it presumes that there would be a shift away from the inward-oriented nature of economic activity during the interventionist years, to a more outward oriented regime. The resulting foothold in international markets would not only spur growth, but ensure that India does not remain externally vulnerable and suffer the debilitating balance of payments difficulties it faced in 1991.

Neither of these features is true of India's record over the last three decades. Despite brief periods of buoyancy, manufacturing has not been the driver of growth in the country. In fact, the relative share of manufacturing in India's GDP falls far short of what it is in similarly placed countries. In 2010 industry's contribution to GDP stood at 47 per cent in China, 47 per cent inIndonesia, 39 per cent in South Korea, 44 per cent in Malaysia, and 45 per cent in Thailand. In India that contribution was only 27 per cent. India has also failed to raise its market share even in the case of traditional exports, let alone manage a diversification of commodity composition of its exports. More recently, exports have been falling in absolute dollar values, for reasons going beyond just the slowdown of the world economy. The benefits that liberalization was supposed to deliver have not been garnered, forcing the government to shrink and rebrand the manufacturing-first strategy to a "Make in India" push, where the attempt is to link as a subordinate supplier to global value chains with the help of foreign investment. That is what small, even island, economies normally attempt.

How then do we explain the performance of the economy during the high growth era starting 2004, which by all accounts (excepting the new series of National Accounts) is losing steam? Central to this story is the discovery of India as a favoured destination for foreign investors looking for quick returns in the form of capital gains (not long run profits). Foreign investment inflows that averaged $8-15 billion before 2004-05, rose to more than $60 billion in 2007-08, and, despite the crisis of 2008-09 recovered to more than $70 billion in 2014-15.

It does appear that the combination of financial liberalization and the large financial inflows that accompanied it did create a new regime of accumulation in India. Over these years India was receiving far more capital inflows than it needed. The inflow of foreign exchange had as its counterpart an increase in the overhang of liquidity in the domestic economy. Based on that overhang, a liberalized banking system has been creating new credit assets at a rapid rate. The ratio of bank credit outstanding to GDP, which had remained at around 22 per cent for a decade starting 1989-90, began to rise after 1999-2000, doubled by 2005-06 and is currently well above 50 per cent. India's has been witnessing a credit boom during its high growth years.

There were also significant changes in the sectoral distribution of credit. Overall there were two sets of sectors that gained in share. The first comprised of retail advances, covering housing loans, loans for automobile and consumer durable purchases, educational loans, and the like. The share of personal loans increased from slightly more than 9 per cent of total outstanding commercial bank credit at the end of March 1996 to close to a quarter of the total more recently. The second area of change was the distribution of credit going to industry, which at around 40 per cent of total bank credit outstanding was still substantial. The share of infrastructural lending in the total advances of scheduled commercial banks to the industrial sector rose sharply, from less than 2 per cent at the end of March 1998 to 16.4 per cent at the end of March

2004 and as much as 35 per cent at the end of March 2015. That is, even as the volume (though not share) of lending to industry in the total advances of the banking system has risen, the importance of lending to infrastructure within industry has increased hugely. Sectors like power, roads and ports, and telecommunications have been the most important beneficiaries. For commercial banks, which are known to prefer lending for short term purposes, this turn to lending to infrastructure was a high risk strategy.

The transition here needs to be understood. Till the 1990s, debt financed public expenditure played an important role in sustaining growth in India. Even the 1980s were years when large fiscal and revenue deficits on the government's budget shored up demand and drove growth. That came to an end as the government had, in return for support from the IMF in 1991, agreed to launch on a trajectory of fiscal consolidation, by limiting the fiscal deficit or the extent of debt financed spending. This would have proved a major constraint on growth. The liquidity accumulation that financial liberalization ensured, provided a solution to this problem, by taking the stimulus to growth off-budget. Now debt financed private expenditure and bank credit to private (or PPP) infrastructure projects proved to be the principal stimulus to growth. Since just offering credit to private players is inadequate to stimulate investment in areas like infrastructure with long gestation lags and higher risks, the government had to find innumerable ways of incentivizing such investment. The corporate sector was implicitly being subsidized to undertake what a government limited by its own fiscal deficit targets could not carry out. But, as it soon became clear, sudden spurts in credit to private agents, inevitably increases lending to less creditworthy borrowers. Such borrowers can default on their payments, and that could bring the whole process to a halt, besides threatening the viability of the banking system itself.

In sum, growth during the 2000s was riding on a credit bubble, which had to give. That process seems to have begun. The exposure of the banking system to stressed assets (including both NPAs and restructured assets) had increased from 5.9 per cent of gross advances at end March 2011 to 11.5 per cent by end March 2016. The engine driving growth has begun to sputter.

Thus, even the kind of growth that liberalization actually delivered is proving unsustainable. So the belief that growth would remain high for years to come, delivering benefits even to those at the bottom of the income pyramid and those steeped in poverty and deprivation, has revealed itself as myth. Even setting aside issues like the agrarian crisis, the persisting and appalling poverty and deprivation in the country, and increasing loss of economic sovereignty in the face of a literal invasion by foreign capital neoliberal reform has not delivered. Meanwhile, the government waits for another fortuitous bubble to drive another episode of growth. But as of now there are no signs of those air-filled monsters.

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