Indian Economic Policy

Suman Gera

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Published by:

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(Publishers of Educational Books)

Sales Office : 1507, 1st Floor,
Nai Sarak, Delhi-110 006
E-mail: info@neerajbooks.com
Website: www.neerajbooks.com

Typesetting by: Competent Computers

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CONTENTS

S.No. *Page*

Sample Preview of The Chapter

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INDIAN ECONOMICS POLICY

INDIAN ECONOMIC DEVELOPMENT: AN OVERVIEW

1 Growth and Structure of Indian Economy

INTRODUCTION

In six decades India's savings have increased beyond dreams and India has become world's fastest growing economies. India's position in international market has got strengthened. There has been a revival in investment and private consumption demand. The favourable capital market conditions with improvement in capital flows and business sentiments are also boosting. The manufacturing sector is also showing a growth rate better than ever before. India has proved that it can face economic cycles without disturbances. But we can learn following things from our sixty years of experience.

(a) If we wish to achieve growth with economic stability, we need to maintain price stability and macroeconomic stability in the economy.

(b) Equity goal has to be taken care of indirectly as trickle down does not work.

(c) Single policy can't trigger development; we need to follow a comprehensive approach.

CHAPTER AT A GLANCE

MEANING AND MEASUREMENT OF ECONOMIC DEVELOPMENT

'Development' Distinguished from 'Growth'

Traditional View: Traditionally, economic growth was defined as sustained increase in real value of goods and services in terms of value added over a long period of time and economic development was taken as synonyms with it.

Modern View: Modern economists distinguish between economic growth and economic development.

Economic Growth Narrow	Economic Development Comprehensive
It refers to increase in the productive capacity of the economy over years.	It refers to progressive change in the socio-economic structure of the country. It includes gender equality, change in composition of output, shift of labour force from agriculture to other sectors.
Easy to realize.	Difficult to realize.
Easy to estimate through per capita indicators etc.	Difficult to estimate as it includes many aspects.

Hence, Economic growth is quantitative measure and indicates increase in country's real per capita income over years but development is qualitative change in the economy in terms of reduction in inequalities of income, positive change in occupational structure, more security and much more of which some indicators might not be calculated quantitatively.

Prof. Dudley poses the same questions when he writes:

"The questions to ask about a country's development are therefore: what has been happening to poverty? What has been happening to unemployment? What has been happening to inequality? If all these three have declined then beyond any doubt this has been a period of development for the country."

Concept of Economic Development

Economic development can be defined as the process of increasing the extent to which resources are being utilized and productivity of the available resources is increasing which brings about an increase in economic welfare of the community by stimulating the growth of national income.

Economic Growth = Size of Real Per Capita Income (Quantitative)

Economic Development = Size of Real Per Capita Income + Economic Welfare via decrease in poverty, unemployment and inequality (Qualitative)

Therefore, to be called development following should be avoided:

- *(a)* **Jobless Growth:** Growth which does not create employment opportunities.
- *(b)* **Ruthless Growth:** Growth which increases inequalities in the economy.
- *(c)* **Futureless Growth:** Growth which degrades environment and nonrenewable resources.
- *(d)* **Voiceless Growth:** Growth which does not increase the income of deprived sections of the society.
- *(e)* **Rootless Growth:** Growth that destroys the traditional life-style and culture of the society.

Therefore, we take quality of life as a reliable indicator of development which includes education and literacy rates, IMR, MMR and life expectancy, consumption of energy per head, gender equality, freedom etc. we may get a synthetic index very soon to measure economic growth and development.

Economic Development and Structural Change

Economists have made an effort to measure structural changes that take place as an economy develops. Much work in this regard as been done by Prof. Simon Kuznets. Following important changes can be seen in an economy with development.

Constituents of GDP Change: As a percentage of GDP, savings increase, food consumption decrease, non food consumption increase, relative output of industry and tertiary sector increase and that of agriculture decrease with development.

Employment Changes: Share of workers employed in primary sector decrease and that of industry and tertiary sector increase.

Shift in the Composition of Exports: Exports account for larger proportion of incomes and composition of exports shifts from raw material to finished goods, primary products to industrial products and services. BOT will come in balance.

Rate of Increase in Population: As income increase, we can expect population to fall but gradually. First, death rate will fall and then birth rate will also fall.

Distribution of Income: At initial stages of development inequality will increase in incomes but this trend will be reversed.

STRUCTURAL CHANGES IN INDIAN ECONOMY

Indian economy took its path towards development with first Five Year Plan (FYP) on April1, 1951. It mainly aimed at bringing stability in the economy caused by partition. Second FYP aimed mainly to provide large scale and strategic industry so that productive capacity of the economy can be enhanced. New policies came after 1990 with the introduction of NEP which brought about privatization, liberalization and globalization. Growth rate increased from 3.5% in 1975 to 5.5% during 1975-1990 to 6.5% in 1990s to further 7% during 2005-12. It brought changes in structural composition of the economy.

Composition of Gross Domestic Product

Structural composition refers to relative share of three sectors in GDP of an economy. In underdeveloped economy, primary sector dominates in GDP, as economy grows share of first secondary and then tertiary sector increases. Question arises why is it so?

It is so because income elasticity of primary products is less than one while income elasticity of industrial goods and services is more than one. On the supply side, agriculture is mainly dependent on a fixed factor, land; on which law of diminishing returns applies. Therefore, industry in which all factors can be varied goes on expanding and same applies to service sector.

In Indian economy, over the period, the share of primary sector has fallen by 40%. Share of secondary and tertiary sector have increased. During 1980's, when all the three sectors were growing, secondary sector was growing at the highest rate thereafter tertiary sector was growing at the highest rate. We cannot deny the growth momentum generated by tertiary sector after 1990's. Service sector has become the growth driver of Indian economy. It is contributing almost 2/3 of GDP. In India, secondary sector has not grown fast enough to enable to transfer growing labour force. Uneducated, unskilled, landless masses of rural sector have continued to struggle in primary sector and those shifted to urban areas have joined urban sector's slum area. It shows the connection between low growth rate of secondary sector and increasing levels of poverty and unemployment.

Causes of Rapid Increase in Tertiary Sector

The following factors are responsible for rapid increase in tertiary sector.

(a) Advent of IT and knowledge economy has enhanced the growth of high productivity in this sector.

(b) Development demand better infrastructure and it is provided by service sector. Therefore, with development, it has expanded.

(c) Public services have also grown as the state has emerged as welfare state. They are paying attention on improving social and economic infrastructure.

(d) Operation of demonstration effect due to growing mobility which is caused by expanding foreign trade, tourism, cultural and educational tours is also responsible.

(e) Urbanization has also led to rise in demand for infrastructure services. Many new goods and services have added to consumption basket due to urbanization.

(f) Tourism has increased in India. It has, in turn, promoted all other types of services.

(g) In manufacturing many services like accounting, legal, advertisement, marketing and finance are required. It has also increased importance of tertiary sector.

(h) International favourable environment also opened up many possibilities for service sector.

Prospects and Opportunities

There are domestic as well as international factors behind growth of service sector in Indian economy.

Domestic Factors

Some of the important domestic factors responsible for growth of service sector are as follows:

(a) With increase in real per capita GDP, demand for goods increases faster than other sectors which in turn reinforce GDP growth itself.

(b) Intermediate consumption in service sector has multiplier effects.

(c) All other sectors use service sector and therefore, expansion in these sectors automatically increase service sector.

(d) With economic growth many new services have emerged like communication, IT, advertising, public relations etc.

(e) Efficient delivery of services increases the productivity of both labour and capital in the economy as a whole. Service sector is a catalyst for growth.

International Factors

Some of the important international factors responsible for growth of service sector are as follows:

(a) Rapid expansion of knowledge based services;

(b) Progress in IT leading to increase in R & D, inventory management, accounting, personnel management etc.

(c) Cost of communication is falling and hence, is no more affecting cost structure of the product.

(d) It is possible for a country like India to provide value added services without waiting to 'catch up' in technology of production of sophisticated equipment of products.

(e) The aging of population in the developed country has an implication that service in developing countries will grow in future as well.

Implications

(a) It calls for a need to introduce policy initiatives in this sector to ensure competition and efficiency for sustainable growth.

(b) With increase in productivity in other two sectors, employment will shift from these sectors to service sector.

(c) It will mean that service sector can constitute a vast tax-base potential which needs to be realized.

Limitations

Many challenges are there for service sector. It is lacking in clear cut policies. Liberalization has not occurred in many services. Economic and social position of workers in service sector is going down steadily. It would imply economic stagnation and consequent social tension. The workers in this sector will make use of their numerical strength to get proper wages and working conditions.

Need for an Integrated Policy

We need to introduce a coherent integrated service policy for service sector. Consequently, the depth and pace of reforms lack uniformity in all service sectors. We need to follow liberalization in this sector in phases. Social policies are needed to avoid unemployment and social unrest. It will go a long way in sustaining the dynamist of service-led growth.

DISTRIBUTION OF GDP BETWEEN AGRICULTURAL AND NON-AGRICULTURAL INCOME

The per capita GDP has increased merely by 37.5% in six decades while in other two sectors, it has increased 580%. As a result, the ratio of per capita GDP in non-agriculture sector to per capita income in agriculture sector has increased from 0.68% in 1950-51 to 3.66% in 2010-11.

Reasons:

(a) Lower growth rate in agriculture sector;

(b) No movement of population from agriculture sector to non agriculture sector.

Implications:

(a) Less than optimum utilization of resources in agriculture sector;

(b) Need to shift extra rural labour to other sectors;

(c) Need to increase rural incomes more than urban;

(d) Disguised unemployed labour force need to employed in non-agriculture sector;

(e) Natural process of urbanization must be facilitated.

SHARE OF THE RURAL AND URBAN SECTORS

Classification of population between rural and urban is useful to understand organizational structure of the economy. In last two decades the rural economy has grown much faster than urban. Consequently, in 1980's rural areas accounted for 41% of GDP but in 2010-11 it is 51%. Another change is that Indian economy is no more an agrarian economy. The share of this sector has declined from 73.8% in 1970-71 to 41.6% in 2010-11. This has increase income levels of rural Indians.

India's rural areas have far more resilience in the face fo abrupt turnaround in the economy. Following reasons are responsible for it:

(a) The government is giving benefits in rural areas not in the form of subsidies but in the form of cash transfer which increases the freedom of the beneficiaries.

(b) MSPs for paddy increased by 40% and of wheat by 80% between 2004-5 to 2010-11.

(c) The global commodities boon has brought markets for new agricultural products.

(d) There is hardly any increase in cost of farm production except labour wages.

(e) Loan waiver of 65,318 crore benefitted thousands of farmers across country.

SHARE OF THE ORGANIZED AND UNORGANIZED SECTORS

Another way to look at structural change is share of organized and unorganized sector. The NAS divides economy into organized and unorganized sectors. The unorganized sector refers to all unincorporated enterprises and household industries other than organized ones which do not maintain financial statements.

In last decades, organized sector has grown faster than unorganized sector due to fall in excise duties and tariffs. It is an indicator of modernization but unorganized sector is still dominating in the economy. It is found everywhere except public administration and defence.

SHARE OF THE PUBLIC AND PRIVATE SECTORS IN THE GDP

In the recent past, emphasis has been placed on public sector in India looking at changes in relative share of two sectors in GDP. In 1960-61, share of public sector was 11% in GDP and it has come to 25% in 2010-11. Private sector is still dominating because of agriculture sector which is fully owned by private sector.

Factor Shares

The relative shares of factors of production in GDP are called factor services. Land labour capital and entrepreneur get rent, wages, and interest and profit respectively. Self-employed people's income is a combination of these four and hence it is called "Mixed Income". India's GDP has following features:

(a) In India, Mixed Income constitutes 40% of the GDP. In India, many of the people are self-employed. It indicates that:

(i) Indian agriculture becoming more capitalist and less labour intensive;

(ii) Transport, communication and trade are making more self-employed.

(b) Another 40% gets generated in compensation of employees and has been rising. In India, the share of primary sector in total employee compensation is decreasing due to increasing mechanization, share of secondary sector is stationary and that of tertiary sector is rising as it is most employment-oriented.

(c) Share of operating surplus of public as well as private companies has been rising. It is due to increase in profitability of companies.

(d) Remittances constitute 3% of GDP at present. They help in increasing overall income levels in a poor household and these can help in eradicating poverty. These can also help in smooth consumption and can act as automatic stabilizers in a period of economic shock. Share of remittances has increased due to increase in migration, increase in MNCs and easing exchange rates.

GROWTH AND OCCUPATIONAL STRUCTURE

Occupational structure refers to distribution of workforce in different occupations. In an industrialized economy, as per the works of Simon Kuznets, we can expect the percentage of population depending on agriculture to fall and that of population dependent on industry or manufacturing to rise. Manufacturing sector will absorb extra labour from agriculture sector. Within