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INDIA'S GROWTH STORY: CHALLENGES AND PROSPECTS[*][†]

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I am grateful to the Japanese Economic Policy Association for the invitation to deliver a plenary address at this international gathering. Under the broad theme of "Economic Policies for the New World Economy", earmarked for this plenary session, I have chosen to speak on India's economic policies, which transformed a sluggish economy to an economic powerhouse. Since 2003–04, the Indian Economy has been growing at an average rate of 8.7% and in 2006–07 the GDP grew at a phenomenal rate of 9.6%. In the last fiscal year, when most developed economies were shrinking, it grew at a rate of 6.7%. In the current year, it is estimated to grow at 7%. The GDP at nominal exchange rate was 1.16 trillion US$ in 2007–2008 and at PPP it was US$ 3.11 trillion making it the 5th largest economy behind the US, China, Japan and Germany. I take pride in saying that the trigger for this turnaround was the economic reforms initiated by a former professor of Delhi School of Economics, Dr. Manmohan Singh, when he was the Finance Minister in 1991; he is now the Prime Minister of India.

First, we briefly look at the policies and the performance of the Indian economy in the first thirty years of its independence. Then we look at the reforms initiated in 1991, making a significant departure from past economic policies. Carrying out reforms to globalize the economy in a democratic setup where governments have been formed by multiparty coalitions with varying ideologies hasn't been easy. However, successive governments after 1991 have more or less stuck to the economic reform process and the present performance is probably the result of pursuing these policies. Next, we analyze the various challenges the economy faces today and whether the growth experience is likely to continue or not.

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India – A Fact Sheet

India has an area of 3.28 million square kilometers, slightly more than one-third the size of the US and area-wise the 7th largest country in the world. It has 28 states and 7 union territories, many states being formed on a linguistic basis. India has 15 recognized languages with different scripts and its 1.1 billion people speak hundreds of dialects. Hindi is the national language spoken by 41% of the population and English enjoys associate status. However, English is the most important language for national, political and commercial communication. In terms of religion, India has 80% Hindus, 14% Muslims, 2.4% Christian, 2% Sikhs, 0.7% Buddhists and 0.5% Jains. However, the state is a secular state. The purpose of stating all this is to highlight the diversity India has, the danger of facing inter-regional, inter-linguistic, inter-religious conflicts which can sometimes annul the economic gains made.

It may be worthwhile looking at the age structure of the 1.1 billion population which shows the demographic advantage India has. As per 2008 estimates, there are 31.5% people between 0–14 years, 63.3% between 15–64 years and 5.2% above 65 years. The median age of the Indian population is 25.1 years, so we may call it a young nation. The population growth rate is 1.57% and the life expectancy at birth is 69.25 years.

At independence in 1947, India adopted a representative parliamentary multiparty democracy with a federal structure. There are elected governments in states and in the centre. Over time, several regional parties, specific to certain states, have cropped up and today most governments are formed through coalition. In the last 20 years, all the governments at the centre have been coalition governments and major economic policy changes are made only at the centre through dialogue and voting in the Indian Parliament. It can be understood that such a mechanism for decision-making can delay changes and can sometimes postpone desirable policy changes indefinitely.

With this background let us now turn to Economic Policies. While analyzing the economic policies that India pursued since independence, one can identify three clear phases:

Phase I: 1950–51 to 1980–81: The Era of Licensing and Control.
Phase II: 1980–81 to 1991: Winds of Change
Phase III: 1991 onwards: Liberalization and Reforms

Phase I: The Era of Licensing and Control (1950–51 to 1980–81)

After independence in 1947, under the leadership of Jawaharlal Nehru, its first prime minister, India chose a "socialist model" where the state was in the driver's seat. The state was supposed

to plan, direct and execute economic activities so that gains in economic growth benefitted the masses. The architects of economic policy believed that private capitalism guided by profit tends to exploit and will not deliver social good. Hence, private enterprise was kept to the minimum and was highly regulated while public sector saw considerable expansion. The economic agenda of the state was well documented by the Planning Commission in the five year plan documents starting 1950–51 and private enterprise was regulated to stick to the economic agenda of the plans. Careful analysis of economic policies during this period brings out three important facets:

First, self-reliance was the avowed goal, narrowly interpreted as self-sufficiency, which led to import substitution across the board and emphasizing heavy industrialization. Second, the state appropriated a large share of savings for public investments and created a large number of public enterprises to provide not only public utilities but many private goods which could have been efficiently produced in the private sector. Third, the state regulated the private sector to conform to the priorities and targets set in the plans through various instruments of control. Many of those controls were in the form of industrial licensing, exchange rate control, import licensing, capital issue controls and price controls. Moreover, most of the instruments of control were exercised on a discretionary, case by case basis rather than through a set of transparent rules.

All these led to the emergence of a huge bureaucracy riddled with red-tapism which stifled the growth of the private sector and made most public enterprises inefficient. Added to this was also the fact that the agricultural sector was completely insulated from world markets. So, three decades of state planning controls and insulation delivered an average rate of growth of 3.5 percent per year during 1950–80 and for all its poverty alleviation programmes, 51% of the population lived in abject poverty.

When we look back now to assess the performance of that period, something good was also happening simultaneously in the education sector. Along with the goal of heavy industrialization, the state invested heavily in higher education, creating world class engineering institutes such as the IITs and management institutes, such as the IIMs. So, India also produced a large pool of English-educated skilled professionals who would play a significant role in the post-reform period ushering in what is known as the IT revolution.

Phase II: Winds of Change (1980–81 to 1990–91)

Winds of change started blowing in the eighties, particularly when Mr. Rajiv Gandhi became Prime Minister in 1984. He wanted to break away from the past and was eager to usher in a

modernized India. That the public sector had become inefficient and needed corrective action and that higher productivity was needed for optimal utilization of already-installed capacity was already noted in the Industrial Policy Statement of 1980. On the recommendation of some committees, some reform measures were initiated. These included delicensing certain industries, permission to expand capacity up to 25% of maximum production without seeking a fresh license, relaxing restrictions on large industrial houses falling under the Monopolies and Restrictive Trade Practices Act. In external trade, rules for importation of technology were liberalized and quantitative controls on imports were replaced by tariffs which brought additional revenue for the Government. All these measures indicated a constructive role for the markets and private enterprise in economic development. However, full scale reform was throttled by various pressure groups within the party and the "Bofors scandal" that Rajiv Gandhi faced. Rajiv Gandhi lost the election in 1998, which was followed by some political instability.

During this period, India also witnessed the rise of farmers and small scale industrialists as potential pressure groups demanding various types of subsidies and concessions which the central government acceded to. Lack of fiscal prudence with large scale subsidies was reflected in the gross fiscal deficits of the central government which rose to 8.47% in 1986–87 and stayed above 7% until 1990–91. Added to this was the external payment crisis that India faced because of higher oil prices due to the Gulf War and heavy withdrawal by non-resident Indian deposits fearing devaluation. The foreign exchange reserve dwindled to a precarious situation which could sustain only 2 months of import bills and India was facing the danger of defaulting on foreign loans.

It was an unprecedented situation coupled with political instability. Elections were held again in 1991 and congress formed a minority government. The first task of the new government was to take measures to avoid the crisis and bring back fiscal stability. This is the context in which reforms were undertaken that we turn to next.

Phase III: Liberalization and Reforms (1991 onwards)

In order to tackle the balance of payments crisis, India approached the World Bank and IMF for assistance. The conditions for their assistance were devaluation and liberalization and a promise to carry out a package of reforms. The government had hardly any choice. Two major international events also contributed to convince the critics that undertaking reforms and the opening of markets was the right policy to foster growth. These were: the collapse of the Soviet Union and its planned economy, resulting in a switch to a market economy, and the spectacular success China had after it opened up its market to foreign capital and trade in 1978. So the

Government set out to undertake a series of reforms in different sectors. Given the complexity of democratic decision-making and the interplay of various pressure groups, the approach has been rather gradual and cautious. We list below some of the important reform measures the government undertook.

1. Industrial Policy Liberalization

The first important task of the Government was to unshackle private investment from a plethora of controls and open up the economy. In 1991, 18 industries were reserved for the public sector. The new industrial policy dismantled almost all controls opening all sectors of the economy to private investment except three: defence, atomic energy and railways. In particular, telecommunications, iron and steel, oil, mining, air transport, heavy plant and equipment were opened up to the private sector. Industrial licensing has been almost abolished except for a few hazardous and environmentally sensitive industries.

The main area where action has been inadequate is the small-scale sector. Since the 1970s, about 800 items have been reserved for the small-scale sector, including garments, shoes and toys. Small scale means investment in plant and machinery in any individual unit cannot exceed $250,000. Gradually, about 64 items have been taken off this list which includes items such as garments, shoes, toys, and auto components, which have high export potential. The investment ceiling for certain other items has been increased to $1 million.

2. Trade Policy Liberalization:

Before the reforms, trade policy was characterized by high tariffs and widespread import restrictions. Imports of manufactured consumer goods were completely banned. Import of capital goods was subject to import licenses. There was a time when the peak tariff rate was 400 percent and having 110–115 percent tariff duty was common.

Post reforms, import licensing has been abolished. Tariffs have been considerably lowered with a duty of nil to 5 percent on many items and about 655 import lines being exempted from customs duty. The peak import tariff stands at 30%.

3. Foreign Direct Investment

Liberalizing foreign direct investment was another important part of India's reforms. The policy now allows 100 percent foreign ownership in a large number of industries and majority ownership in all except banks, insurance companies, and airlines. Procedures for obtaining permission were greatly simplified by listing industries that are eligible for automatic approval

up to specified levels of foreign equity (100%, 74% and 51%). Potential foreign investors investing within these limits only need to register with the Reserve Bank of India. For investment in other industries, or for a higher share of equity than is automatically permitted in listed industries, applications are promptly considered by a Foreign Investment Promotion Board.

Foreign Institutional Investors were also allowed to invest in the Indian stock market, opening a window for portfolio investment. India has seen a great surge in inflow of foreign capital through both FDI and FII. According to ministry estimates, the cumulative amount of FDI inflows up to May 2008 stood at $70 billion. In 2007 alone India attracted $23 billion as foreign capital inflow. According to the World Investment Report of 2008 prepared by UNCTAD, India is the second most attractive FDI destination in the world after China.

4. Financial Sector Reforms

India initiated a number of reforms in the banking and insurance sectors. Banking sector reforms included the following.

(a) Government undertook liberalization measures to dismantle interest rate controls and reduce statutory requirements to invest in government securities.
(b) It also took measures to increase financial soundness such as capital adequacy norms and strengthen banking supervision.
(c) Measures were initiated for increasing competition like more liberal licensing of private banks and freer expansion of foreign banks.

The public sector banks still dominate the banking system but the government has gradually reduced its equity share to one third. Effective control of these banks has been left to the boards of directors, although the government has some element of control. All banks are required to keep a percentage of their deposits in government securities, which is known as the Statutory Liquidity Ratio. Since 1997, it has been 25%. In addition to 25% SLR, there is the requirement of a Cash Reserve Ratio of 7% so that 32% of all bank deposits were parked in government securities and the Reserve Bank of India, which made the Indian banks safe for depositors in the period of recent crisis. Only last month, the SLR has been reduced to 24% and CRR has been reduced to 5.5% to ease liquidity for banks.

The insurance sector was earlier a public sector monopoly. It was opened up to private sector companies with foreign equity allowed up to 26%. Recently, the foreign equity component has been raised to 49%. As a result, all major global insurance companies have

entered the Indian market with collaboration from some Indian firms, particularly Indian Banks. The development of an active insurance and pension industry offering attractive products should stimulate long term savings and add depth to capital markets.

5. Disinvestment in Public Sector Enterprises

Public sector enterprises (PSEs), which were given a special role in India's planned economy, grew both in terms of numbers and investment for over four decades from the early 1950s. At the commencement of the First Five Year Plan there were five PSEs with a total investment of Rs.290m. At the end of the Seventh Plan in 1990, there were 244 PSEs and investment in them had gone up to Rs.993.29m. Many of them had become inefficient, incurring losses and the state had invested in areas which could best be done by private enterprise. So a policy of "disinvestment" was followed rather than "privatization" whereby the government would offload minority stakes to private enterprise but would still retain control. In some cases, 100 percent stakes were sold off to private enterprise. The rationale was to release public funds from sectors better left to private enterprise and invest in the social sector where the government should be concentrating. There has been only limited success in this because of huge resistance from various pressure groups; nevertheless, it has proceeded in a desirable direction. The funds generated from sale of PSE equities can fill critical gaps in social sector projects.

6. Fiscal discipline

Fiscal extravagance was seen to have caused the balance of payments crisis in 1991 and a reduction in the fiscal deficit was therefore an urgent priority at the start of the reforms. The combined fiscal deficit of the central and state governments was successfully reduced from 9.4 percent of GDP in 1990–91 to 7 percent in 1992–93 and the balance of payments crisis was over by 1993. An essential part of pursuing reforms was to improve public savings so that essential public investment could be financed with a smaller fiscal deficit. There has been only partial success on this front and the performance is a mixed bag. Since 2005–06, the gross fiscal deficit has been less than 7 percent. It was 6.4 percent in the last fiscal year and is estimated to be 5.5 percent during this year. Gross Domestic Savings from the public sector have been improving from −2% in 2001–02 to 3.2% in 2006–07.

All these reform measures kick-started the economy and the performance has been impressive, particularly during the last five years. The summary of key indicators is as follows:

Table 1: Growth rate of GDP (FC) and Gross Domestic Savings and Gross Capital Formation (as % of GDP)

	GDP	GDS	GCF
1950–51 to 1980–81 (average)	3.5	16.5	20.85
1980–81 to 1989–90 (average)	5.8	19.39	22.62
1990–91	5.7	23.10	23.22
1991–92	1.3	22.03	21.44
1992–93 to 2001–02 (average)	6.08	23.35	23.91
2002–03	3.8	26.4	25.2
2003–04	8.5	29.8	28.2
2004–05	7.5	31.7	32.1
2005–06	9.5	34.2	35.5
2006–07	9.7	35.7	36.9
2007–08	9.0	37.7	39.9
2008–09	6.7	34.9	–

Source: National Accounts Survey and Economic Survey, 2008-09.

Table 2: Sectoral Composition of Gross Domestic Product (2007–08)

Agriculture	18%
Industry	27%
Services	55%

Interlinkages Between Various Phases Of Development

When we look back at the strategy followed by India in the last sixty years of its independent existence, some natural questions come to mind. Could someone, drafting the first five year plan, have predicted the development trajectory of the country? Even in 1991, when the reform measures were initiated, could someone say with confidence what results it could deliver? The answer to both questions is an emphatic "no". For any reform measure one initiates in this country, there have been ten oppositions. This is inherent in the nature of democratic polity ruled by coalitions guided by various pressure groups. So the changes have always been gradual. Any marked policy shifts, as in 1980–81 or in 1991 have banked on "triggers" that initiated the change. In 1980, the entry of Rajiv Gandhi to Indian politics provided the trigger whereas in 1991, it was the balance of payments crisis when the honour of the country was at stake. So evolution of policy has been circumstantial rather than totally planned. The next question I would like to examine is how important were phases I and II for the continuance of phase III? One can view the first two phases as the preparatory phase for reforms to occur. During the first

thirty years, the standard argument against globalization was the infant industry argument. That the Indian industries were in a nascent stage and were not ready for global competition would be the standard text book argument. The critics would observe that one should not protect them forever and that this over-protection has bred inefficiency and backwardness. The detractors of globalization won the battle for nearly forty years but that also gave enough time for Indian industries to mature and stand their ground in the face of global competition. The role of the state to promote engineering and management education in particular and higher education in English in general during phase I, which was also bolstered in phase II, had a significant role to play in Phase III. In the eighties, Rajiv Gandhi brought in the telecom revolution and foresaw the role of computers in modern economies. When the country opened up in Phase III, it had one of the largest pools of English-speaking trained technical personnel in the world and India became an IT-hub. It also benefited from business process outsourcing. Many multinationals found India a cheaper alternative to operate from. So the growth of services sector has been phenomenal and has contributed nearly 55% to the GDP. Growth of the services sector this way wouldn't have been possible without the preparatory phase of I and II described above.

Some Major Challenges India Faces Today

As we have said above, the reform process in India did not come with a big bang. It has been gradual, slow and cautions. However, over the last seventeen years those gradual changes have piled up to spur an appreciable economic growth. In spite of rapid growth in the last five years, a lot still needs to be done. We discuss some of these issues here.

1. Poverty

According to recent estimates of poverty by the World Bank, nearly 420 million (42%) people in India lived on less than $1.25 a day in 2005 and 250 million (24%) lived on less than $1.00 a day. The latter figure corresponds to the number of poor using the Indian poverty line. There has been a marked decline in poverty when we compare this with the poverty level in 1980: the corresponding figures being 60% (less than $1.25 a day) and 42% (less than $1.00 a day). This indicates two things. First, there has been a reduction in poverty due to higher economic growth, pointing to the fact that growth is the best antidote to poverty, provided it is broad-based and inclusive. Second, no matter how we measure poverty, there are a large number of poor who need an uplift to have a reasonable living. Eradicating poverty is a major challenge that the Government faces today.

As a short term measure, the Government has introduced several social welfare measures to provide employment, dwelling units, midday meals to school children etc. The performance of some of these schemes is far from satisfactory because of leakages and poor implementation.

Instead, one should look at the policy options we have which will provide gainful employment to the masses and pull them out of poverty. If we look at sectoral employment figures, we find that 60% of the population depends on agriculture even though that sector contributes 18% to GDP. Most of the poor live in rural areas depending on agriculture which has been unable to provide a decent living to so many people. So the real task lies in pulling those people out of agriculture and providing them with gainful employment in industry. The recent growth process has been deficient in achieving that. Also, the recent growth and reform process has practically not touched agriculture. Availability of irrigation and power to the farmer is much less than desired, which results in low productivity. These two key areas are of utmost importance in order to reduce poverty.

2. Education

In 1951, 18% of the Indian population was literate. According to the 2001 census, the adult literacy rate is 65%. Though there has been progress on this front, it is much less than we observe among the peer group.

Early on, India invested heavily in higher education, favouring development of internationally competitive colleges, universities and technical institutes. Primary and secondary education were accorded relatively less importance than they should. As a result, the literacy rate, after 60 years of independence, is still a poor 65%. 35% of the population is still not adequately prepared to reap the opportunities offered by liberalization. In the current plan, the Government is trying to redress this, spending heavily on primary and secondary education.

Because of heavy investment in higher education and English being the medium, India developed a large pool of educated, highly skilled, English-speaking managerial, professional and technical workers who have been instrumental in the expansion of the service sector, particularly the IT sector. However, except for a few institutes and universities, the quality of education has been rather wanting. In recent years, there has been a shortage of good quality skilled workers. Higher education is still state funded and the entry of the private sector is restricted. In order to fill the supply demand gap for skilled and quality manpower, there is a need to bring in reforms in this sector also.

3. Infrastructure

There is an urgent need to improve power and transportation, which includes airports, ports, railways and roads.

Shortage of electricity has grown from 11.2% in 2003–04 to 14.8% in 2007–08. Without enough power, both industry and agriculture are plagued. Electricity generation is almost entirely in the public sector. Efforts to bring in the private sector with foreign capital has formed road blocks. Pricing of electricity has been one major bone of contention. Populist measures such as giving free electricity to farmers have resulted in additional thefts and huge losses for electricity boards. The silver lining is that now India can go for civilian nuclear power in a big way. However, the distribution and pricing bottlenecks have to be removed urgently.

On the transportation side, the aviation sector has been opened to private players and renovation of airports is being undertaken. However, progress is slower than expected. Indian railways, which are entirely government owned, usually charge firms an above-market freight rate in order to subsidize passenger fares. Road transportation also requires substantial improvement. Of late, there has been public-private partnership to construct and operate highways with partial success. In order to maintain growth at 8% at least, the role of infrastructure is paramount and requires speedy improvement.

4. Organized Labour Sector Reforms

During the last 17 years of reform process, the labour law has remained completely untouched because of the sensitive nature of the problem. India’s labour laws apply to employers with ten or more workers, becoming more stringent as the number of employees increase, encourage unionization and generally favour workers over employers. Any seven workers can form a union and enter into collective bargaining with an employer. Any firm having 100 or more employees needs government permission to lay off permanent staff. This is usually hard to obtain.

All these have been a major impediment to labor-intensive manufacturing. Firms hesitate to enter a world that has no exit doors. As a result, many firms try to avoid labour legislation by employing less than 10 people or by operating only with temporary hands or by escaping registration. This breeds inefficiency and corruption and the size of the economy tends to be smaller than it can be. Bringing in reforms in the labour sector is a major challenge for any government but without which the full potential of growth cannot be exploited.

5. Corruption

India ranked 70th of 163 countries in the 2006 corruption perception index compiled by Transparency International. In a World Bank survey, 38 percent of Indian firms cited corruption as a major obstacle to economic growth. Corruption in public life has become a cause for concern. Starting from the political boss down to the lowest civil servant, corruption has been all pervasive, the worst reputation being that of the police.

Corruption has vitiated the entire delivery system of any policy. In admitting this, ex-Finance Minister Mr. P. Chidambaram, states: "Outlays do not mean outcomes and this is our prime concern. There is not yet in place a mechanism that will ensure that the deliverables are indeed delivered or that the public goods and services are of acceptable quality and have reached the intended beneficiaries. Some of the problems are due to poor design of the program. There is also, regrettably, a considerable degree of waste and pilferage." Nothing can be more honest than this.

More often than not, the benefits of an economic policy are not fully realized. Infrastructure projects often turn out to be sub-standard and delayed beyond the time target. All efforts to create world class infrastructure have belied expectations and this is of serious concern.

All past attempts by the government to reform bureaucracy and to downsize the government have practically failed. However, the need for this has been emphasized over and over again and it has to be taken up by some government in order to make the delivery system more efficient.

6. Inequality

Even though poverty declined with growth, all major studies indicate that inequality increased between 1993–94 and 2004–05. The Gini ratios based on per capita consumption expenditure for All India Rural increased from 0.286 to 0.305 and for All India Urban, it increased from 0.344 to 0.376. Noting the fact that the Gini Coefficient changes only mildly over short periods, this increase in Gini values is not insignificant. More interestingly, the study by Debroy and Bhandari (2008) reveals that inequality has increased during this period in almost all states and states having higher growth have experienced a higher increase in Gini value. Also, inequality in rural areas hasn't increased as much as the urban areas. Most studies more or less confirm this general trend. And this is not surprising.

We know that when markets open up and new opportunities come by, all economic agents cannot exploit this opportunity equally. This is applicable to individuals, groups and even states. So, a rise in inequality is an obvious fall-out of this process. This has happened in China and also in other countries. Therefore, the real question one should ask is whether the rise in

inequality has been so alarming in disrupting social harmony and increasing social tension in the society as to warrant a reversal in policy. My judgment is that the present situation is far from this. This is not to profess complacency on this front. Accentuation of economic inequality can in fact hinder growth – so, policies should be in place to arrest it and ensure a better distribution of wealth. The intention of the present government is only along this line.

Somewhat related to this is the problem of the significant increase in farmer suicides in rural areas. This has been specific to particular states and is intimately linked to perennial crop failures resulting in failure to pay back loans taken from money lenders or banks. One possible solution is to have an insurance mechanism in place. The government has given loan waivers to farmers which is purely a short-term phenomenon and bad economics. The real solution lies in improving infrastructure for agriculture to prevent such continuous crop failures.

Looking Ahead

Earlier, I asked whether India can sustain an 8–9% rate of growth. In the face of the recent financial crisis, when several American investment banks have gone bankrupt and most developed economies have gone into recession, we ask two questions: 1. Can India survive the international economic meltdown? 2. Can India still attain a high growth trajectory in spite of the recession in the developed economies? The answer to the first question is yes and to the second, a conditional yes. The prospect of returning to the high growth trajectory is still alive provided we pursue the right policies. The reasons for such optimism are as follows:

1. Indian banks are well regulated and well capitalized

It is now realized by all countries, as is clear from the recent G-20 summit, that the financial sector requires some regulation. The recent ills are ascribed to too much freedom enjoyed by financial companies to pursue their greed. As against this, all Indian banks, both private and public, are governed by regulations of RBI and are supervised by RBI to ensure that they stick to those regulations. The RBI has been monitoring the current situation to provide extra liquidity through various monetary measures. So there has been no bank failure in India.

While undertaking financial sector reforms, the government was cautious. Whether India should go for full capital account convertibility or not is an issue which has been debated quite long and what we have today is a regulated one. At times of distress such as this, this proved to be a boon. The danger of the financial sector meltdown is now averted.

Then the question is how the real sector recession affects India and whether growth can be sustained. Some of the positive factors are as follows:

2. Indian growth is driven by robust domestic demand and domestic savings and investment

Domestic consumer demand is close to 65% of GDP. Exports contribute about 14% to GDP. IT-related services constitute a major part of these exports. Among manufactured goods exported, garments and gems and jewellery constitute a major component. As a result of the demand slowdown, these exports are going to be affected. By how much is still unclear. However, note that the bulk of growth is due to domestic demand and with the right kind of fiscal stimulus, domestic demand can be sustained.

Coming to savings and investment, it is expected that FII will reduce. FDI in August and September has gone up though FII has declined. Note that India's Gross Domestic Savings amounts to nearly $350 billion annually, which is far higher than the $70 billion received as foreign capital to date. However, the challenge lies in mobilizing these savings to productive investment. In spite of the foreign capital exodus, capital requirements can still be met.

3. Demographic dividend

As we noted earlier, India has one third of its population below the age of 15 years, and a median age of 25.1 years. The proportion of population in the working age group of 15–64 years will grow steadily from 63% to 69% in 2026. This also means a decline in the dependency ratio. The dependency ratio declined from 0.8 to 0.73 between 1991 and 2001 and is expected to decline sharply to 0.59 by 2011. This decline sharply contrasts with the demographic trend in the developed countries and also in China, where the dependency ratio is rising. This gives an opportunity for skill development of this young workforce. If properly tapped, this will mean growth in workforce, growth in incomes, growth in savings and investment. The challenge is to seize the opportunity.

4. India has a burgeoning middle class

There are an estimated 60 million Indians earning between Rs.200,000 and Rs.1 million and by income categorization, they constitute the middle class. However, if we take a consumer-based criterion, people who own a telephone, a two/four wheeler, a colour TV, a refrigerator etc., this number swells to 200 million and is projected to grow to 360 million by 2010. This class will sustain the demand required to spur the economy at times of decline.

5. India has a vibrant democracy, free press and an active electronic media

India is the largest democracy in the world with full freedom given to the press. Of late there has been prolific growth in electronic media working 24/7. Debates, discussions on many important economic issues help mould public opinion, which is so important for democratic decision making. The media also works as a watchdog to prevent corruption in public life by exposing people, reporting on nondelivery. In an earlier section, we noted that preventing corruption is a major challenge. Towards this, the role of press and media has been commendable. With an increase in education and literacy, coupled with a free and active press one hopes that corruption will be curtailed significantly.

Conclusion

In a globalized world, when some major economies sink and world demand shrinks, it is bound to affect all economies including India. However, the impact on India will be subdued since it is driven mostly by domestic demand and several of its sectors do not get affected by reduced world demand. Primarily for this, all growth estimates predict that India will grow at a rate not less than 7% during 2008–2010. The growth figures of 7.9% in the third quarter of 2009–10 indicate that bottom has already been reached and upturn started. In order to spur demand and growth, India should pursue the unfinished task of reforms that it started with in 1991. Only through higher growth, can India expect to reduce the number of poor and to attain this desirable rate of growth; the right policy is to globalize and bring in more reforms where required rather than less.

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