India’s economy: What the numbers reveal  
Demand-driven growth shows no signs of slowing

Paramita Dasgupta

An overview of the Indian economy was presented to the Global Executive Forum by Paramita Dasgupta Ph.D., Professor and Director Centre for Economics & Finance, Administrative Staff College of India, Hyderabad. Forum members Earl L. Wright and Steve Halstedt provided the information for this report. Wright is president/ chief executive officer of AMG National Trust Bank, a nationally chartered, non-depository trust bank headquartered in Denver with regional banks in Chicago, New York and Philadelphia. Halstedt is a cofounder and managing director of Centennial Ventures, a private venture firm formed in 1991. He is a board member of the National Venture Capital Association.

Since 1991, when the Indian government embarked on economic reforms, the country’s development has been on a steady upward course. While the road ahead continues to look promising, the government is challenged to address a number of problems if it is to sustain the current momentum.

“The goal of the Indian government is to maintain a growth rate of 7-8 percent per year,” says Earl Wright. “To do this, it needs to generate a higher rate of investments as a percentage of the GDP. Currently, it is 24-26 percent; it needs to be 30-35 percent. China does better, with an investment-to-GDP ratio of 50 percent.”

Steve Halstedt notes that “Professor Dasgupta, like many of the later speakers, contrasted India with China, which has an annual GDP growth rate of 9-11 percent. There is a pervasive defensiveness about how well China is doing and the need for India to ‘catch up.’”

Prior to 1991, India was mired in government rules and regulations that stifled economic development. The turning point came when “the need for an emergency $2.2 billion IMF (International Monetary Fund) loan, secured by India’s gold reserves, dictated economic reform, which has progressed more or less steadily through six government administrations over 14 years,” says Halstedt.

“Professor Dasgupta commented that the whole IT industry grew into a powerhouse ‘under the noses of government bureaucrats without them even noticing.’ That was a lesson on the benefits of government ‘just getting out of the way.’”

Diversified economy

India’s diversified economy is comprised of services, 52 percent; manufacturing, 26 percent; agriculture, 22 percent. Although the services sector accounts for more than half of India’s output, it employs less than one quarter of its labor force. At the other end of the spectrum, agriculture employs about two-thirds of the labor force.

“Agriculture creates the stability for the economy, but the services sector is the major economic driver,” says Wright. “It has been growing at an average annual rate of 20.2 percent and represents 31 percent of exports. Most of these exports are software and software-related services.” Here, too, there is a marked difference between India and China. “India’s growth is demand driven with an emphasis on services,” says Halstedt. “China’s growth is investment driven with an emphasis on manufacturing.”

“Demand supports growth,” says Wright, pointing to India’s growing middle class and the resultant consumer boom in telephones, cars and motorcycles as well as in various consumer support items in the durable/nondurable area.
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Challenges

- Public debt. Running at 82 percent of the GDP, public debt cannot be held by foreigners. "Therefore, annual deficits of 5-6 percent of GDP eat up savings and curtail growth," says Halstedt. This also leads to "a squeezing out of private debt that would otherwise be available for investment in the country and for reducing the government deficit," says Wright.

- Infrastructure. Highways, rail, ports, airports, power generation is all in need of major improvements and repair. Although external capital would fund the work, the government places limits on foreign direct investment. "Outside (noncitizen) investors are limited to 49 percent ownership of government projects, with the state maintaining 51 percent ownership," says Wright. Restrictions also exist in the private sector.

That may be changing. "The government has created a series of public/private partnerships to develop India's infrastructure," says Halstedt. Among the projects under way is "a private 10-mile toll road connecting Bangalore to Electronic City, the site of many IT companies." Also, he reports, the national government has awarded contracts to private companies to take over and modernize two of the country's largest airports."

- Unemployment. While unemployment is 9.9 percent, underemployment, estimated to be 70 percent, is a bigger problem. Not all of the population is educated. "The literacy rate for males is 68 percent, for women 45 percent. "Roughly 500 million people live in 600,000 rural villages; most do not have adequate educational facilities or teachers," says Halstedt. "Over time technology will transform agriculture and these villages." In the meantime, the country's poverty rate is 25 percent.

- Savings. Depending on which country India is compared to, its savings rate of 26-28 percent is either great or could be better. It's great when viewed against the US, which has a savings rate in the negative numbers. But "China's savings rate is 40 percent and other Asian countries are in the 30-35 percent range," says Wright.

"The government knows that the current savings rate is not adequate to support the kind of investment that is needed to sustain growth," says Wright. In addition, "the legal structure of the country and the political system need to catch up with the growth of what is occurring in the world economic environment into which they are moving."