

## INDIA: COUNTRY CONTEXT

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### A. Main Features of the Economy

1. India is the world's second most populous country with a population of 1.27 billion in 2015 and the world's third largest economy in purchasing power parity (PPP) terms.<sup>1</sup> More than 50% of India's population is currently below the age of 25, and more than 12 million people enter the labor market every year. By 2030, India is expected to have the largest labor force in the world. At more than 1 billion people of working age, India's labor force will be larger than the combined labor forces of the United States, the eurozone, and Indonesia. India's share of the world gross domestic product (GDP) has increased substantially from an average of 4.8% during 2001–2007 to an average of 7.0% during 2014–2015 in current PPP terms.<sup>2</sup> Its GDP per capita using market prices and exchange rates rose to \$1,584 in 2015 or \$6,261 on PPP basis.<sup>3</sup>

2. India remains predominantly rural, with two-thirds of the population living in the countryside and more than half the labor force working in the agriculture sector. However, agriculture's share of real GDP has fallen significantly, from 25% in financial year (FY)<sup>4</sup> 2000 to 18% in FY2015.<sup>5</sup> A host of factors have inhibited productivity growth in the sector, including stressed natural resources, poor rural infrastructure, inadequate irrigation facilities and technology, limited access to credit, underdeveloped extension and marketing services, lack of storage facilities, inability to adapt output to the changing consumer preferences for agricultural products, and insufficient agricultural planning at the local level.

3. The industrial sector remains underdeveloped. Its share of GDP remained unchanged at 16% from 1986 to 1992 and it grew only slowly thereafter. It accounted for about 28% of GDP in FY2015, a small share compared with the percentages in the other BRIICS.<sup>6</sup> Outdated labor laws, inadequate access to land and capital, the plethora of mandatory forms, licenses, inspections, and clearances, and crucially, the dearth of skilled workers have all contributed to the slow growth of manufacturing output, in particular. There is some evidence that the broad specialization of Indian manufacturing toward skill-intensive activities may have contributed to India's sluggish industrial expansion, as sustained growth is constrained by an inelastic skilled labor supply, leading to rising wages and declining profits.<sup>7</sup> Arguably, the skill-intensive production trend has also prevented India from benefiting fully from its comparative advantage in labor-intensive industrial activities to increase exports.

4. The services sector—particularly distribution, transport, communication, and finance—have grown rapidly and accounted for a combined 54% of GDP in FY2015. The information technology (IT) sector is a major contributor to exports. India is an important player in the global IT industry, and is a leader in the use of IT for e-government and the delivery of services. It is home to companies that have become global industry leaders in pharmaceuticals, steel, and space technologies.

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<sup>1</sup> India's land mass is the seventh largest in the world, spanning 3.28 million square kilometers, or 2.3% of the globe's land area.

<sup>2</sup> Government of India, Ministry of Finance. 2015. *Government of India Economic Survey 2015–16*. Delhi.

<sup>3</sup> International Monetary Fund. 2015. *World Economic Outlook*. Washington, DC. In comparison, in 2015, the People's Republic of China's per capita GDP was \$8,154 in nominal terms and \$13,801 in purchasing power parity terms.

<sup>4</sup> Financial years in India are indicated by the year in which they start, e.g., FY2000 covers the period 1 April 2000–31 March 2001.

<sup>5</sup> Footnote 2. A revised national income series was introduced in 2011.

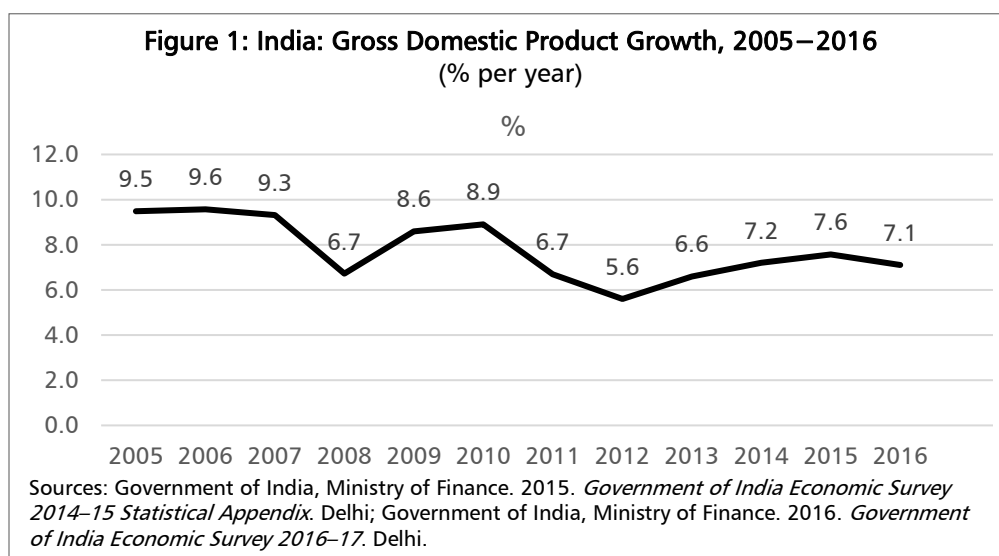
<sup>6</sup> Brazil, Russia, India, Indonesia, People's Republic of China, and South Africa.

<sup>7</sup> The Indian manufacturing sector is more skilled-labor-intensive than those of comparable countries. A. Amirapu and A. Subramanian. 2015. Manufacturing or Services? An Indian Illustration of a Development Dilemma. *Working Paper No. 409*. Washington, DC: Center for Global Development.

## B. Recent Economic and Social Developments

### 1. Macroeconomic Developments

5. The macroeconomic, financial, and structural policies and reforms implemented since the early 1990s have strengthened India's macroeconomic fundamentals, allowing it to weather periods of crisis. India has pursued a cautious approach to liberalizing its financial and capital sector, managing the capital account, maintaining a flexible but managed exchange rate, improving monetary and fiscal coordination, carrying out fiscal consolidation, reducing inflation and inflation expectations, and continuing structural reforms. The most recent reforms have focused on enhancing the implementation of monetary policy, improving efficiency of fiscal policy, encouraging financial inclusion and a sound financial system, creating a better environment for private sector activities, and facilitating infrastructure investment. These reforms have led to a period of strong economic expansion, with growth averaging 8% during FY2004–FY2009, despite a sharp decline in FY2008 owing to the global financial crisis (Figure 1).<sup>8</sup> After declining to 5.6% in FY2012, growth picked up gradually to 7.6% in FY2015, making India the fastest growing large economy in the world (Table 1).<sup>9</sup> Growth is estimated to have dipped to 7.1% in FY2016, as exports declined and both public and private investment slowed, and the demonetization of large rupee notes adversely impacted economic activity. GDP growth is expected to pick up again to reach 7.6% in FY2017 as domestic spending revives.<sup>10</sup>



<sup>8</sup> For many decades following independence, India was beset by a low rate of growth, referred to as the “Hindu rate of growth”. The economy barely grew during 1967–1973. D. Rodrik and A. Subramanian. 2005. From “Hindu Growth” to Productivity Surge: The Mystery of the Indian Growth Transition. *IMF Staff Papers*. Vol. 52, No. 2. Washington, DC: IMF.

<sup>9</sup> A new GDP series was released in January 2015 and the base year was changed to 2011–2012 from 2004–2005.

<sup>10</sup> ADB. 2016. *Asian Development Outlook 2016 Supplement: Asia’s Potential Growth*. Manila. According to GIES 2017, demonetization may raise potential growth by generating long-term benefits through reduced corruption, greater digitalization of the economy, increased flows of financial savings, and greater formalization of the economy.