APPENDIX 22

GROWTH AND CRISES IN THE INDIAN ECONOMY

As we have seen in the appendix to Chapter 20, the Indian economy has been subjected to business cycles with the output fluctuating from year to year. Here, we focus on the growth in some periods emphasizing the role of aggregate demand.

Growth till the Late 1970s

The period from the early 1950s to the mid-1960s covering the first three Five Year Plan periods was a period of relatively high rates of growth particularly in the industrial sector. The impetus of demand came primarily from import substitution and rising government expenditure particularly capital expenditure. Import controls enlarged the domestic demand for the domestic producers. In accordance with the planning strategy, government began to play a significant role. As Figure 22A-1 shows, public sector gross fixed capital formation (GFCF) at constant prices, i.e., real public fixed investment went up steadily and sharply. As a percentage of the total fixed investment, public investment went up from about 30% in 1950-51 to about 55% in 1964-65 (see Figure 21A-1 in the appendix to Chapter 21).

But this stimulus could not be sustained. Public investment fell sharply in the late 1960s and remained stagnant in the early 1970s (Figure 22A-1). Considering the importance of the public sector, this was a serious setback for the whole industrial sector and the economy. The growth rate decelerated both for the industrial sector and the output as a whole (GDP). The compound annual rate of growth (CARG) of

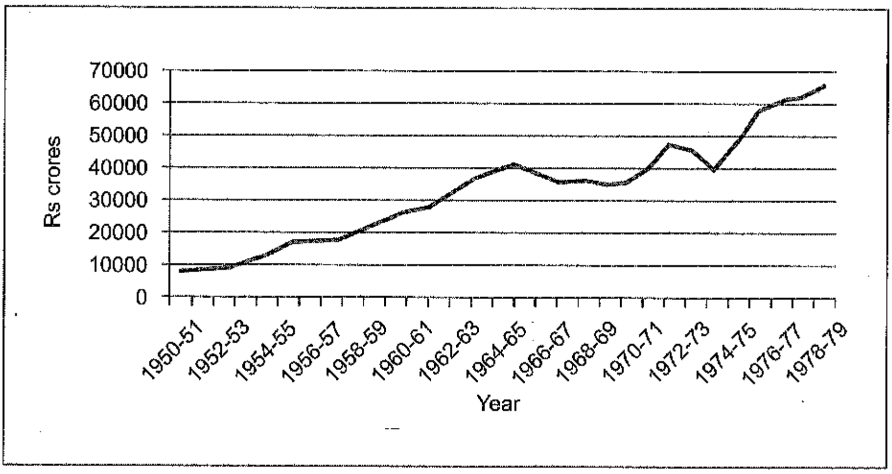

FIGURE 22A-1. Public Sector Real Fixed Investment

Source: *National Accounts Statistics*, available at the website of the Ministry of Statistics and Programme Implementation, Government of India, www.mospi.gov.in. The constant price series has been obtained by multiplying the PS share in the aggregate GFCF at current prices with the aggregate GFCF at 1999-2000 prices.

real GDP fell from 4.1% during 1950-51 to 1964-65 to 2.7% during 1964-65 to 1979-80. Similarly during the same period, the CARG for industry decelerated from 6.6% to 3.7%.[1] The decline of public investment had both supply side and demand side implications. The slowdown in public investment was dis-proportionately borne by the infrastructural sectors, for example, railways and electricity. Under-investment in these areas resulted in severe infrastructural bottlenecks, which adversely affected growth.

The primary reason for such sluggish public investments was the inability to raise resources for expenditure. As we have noted in the appendix to Chapter 16, despite the low direct tax ratio in India, government failed to use the instrument of direct taxation for the purpose of resource mobilization.

Growth in the 1980s[2]

Growth rates again accelerated in the 1980s. Real GDP growth rate (CARG) was 5.5% during 1979-80 to 1990-91 and industrial growth rate was 6.1%. This time too the primary demand stimulus came from government spending. But the way the government spent and the way revenue was obtained underwent a radical transformation. The government increased its spending despite the inability to raise tax resources. The result was that fiscal deficit went up from around 5% of the GDP in the early 1980s to about 7-8% during the mid and late 1980s (Figure 22A-2). Fiscal deficit is the gap between the total expenditure and the revenue receipts of the government comprising tax revenue and other non-tax current revenues such as dividend earnings of the

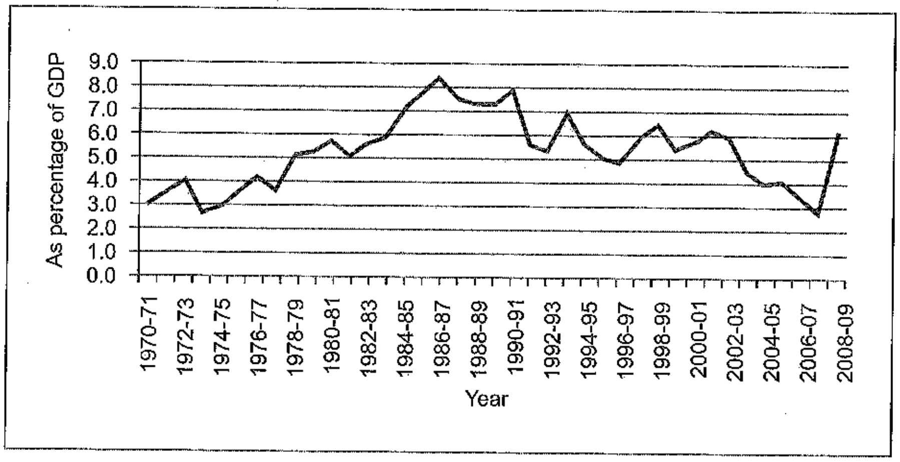

FIGURE 22A-2. Central Government Fiscal Deficit

Source: Reserve Bank of India, *Handbook of Statistics on Indian Economy*, available at the website of RBI, www.rbi.org.in.

[1] These rates of growth have been calculated from Figures 19A-1 and 19A-4.

[2] This account of the growth and crisis during the 1980s relies on Amit Bhaduri and Deepak Nayyar, *The Intelligent Person's Guide to Liberalization*, New Delhi: Penguin Books, 1996; and C P Chandrasekhar and Jayati Ghosh, *The Market that Failed: Neoliberal Economic Reforms in India*, New Delhi, LeftWorld Books, second edition, 2004.

government. In India, non-debt capital receipts such as receipts from disinvestment of shares in public enterprises are also deducted from total expenditure to calculate the fiscal deficit. Thus, fiscal deficit represents the total new loans taken by the government to finance its expenditure.

In the early days of planning, the emphasis of government expenditure was on capital expenditure rather than on current expenditure. But the priority changed later as Figure 22A-3 shows. Current expenditure as a percentage of total expenditure increased sharply particularly during the 1980s. Revenue receipts failed to keep pace not only with the total expenditure but also with the current expenditure resulting in a revenue deficit. This was a new phenomenon. Till the 1980s, except for one or two years, the central government had a surplus in the revenue account, i.e., government spent less than its income from tax and other sources. The savings thus generated could be used for financing capital expenditure. In contrast since the 1980s, the government has been borrowing not only for capital expenditure but also for current expenditure such as subsidies and defence expenditure. As Figure 22A-4 shows, the revenue deficit as a percentage of GDP went up sharply during the 1980s. Borrowings to finance current expenditure which do not generate any financial return for repayments is not sustainable in the long run. Economic Reforms have tried to control revenue deficit with some degree of success. But it may be pointed out that the initial planning strategy neither as a policy nor in practice relied on revenue deficit.

Rising demand in the economy, coupled with liberalization of imports that took place particularly since the mid-1980s, resulted in rising imports. With exports lagging behind, current account deficit started deteriorating. This was financed through external commercial borrowings particularly short-term loans and NRI deposits. The Iraq-Kuwait war (August 1990) and consequent oil shock made matters worse in the balance of payments front. While India coped up with much more severe oil shocks in 1973 and 1979, India could not manage the situation this time. The political situation became very uncertain with two governments falling between November 1990 (V P Singh) and March 1991 (Chandra Sekhar). Credit rating for India in the international capital market plummeted and it became exceedingly difficult to borrow internationally. It became very

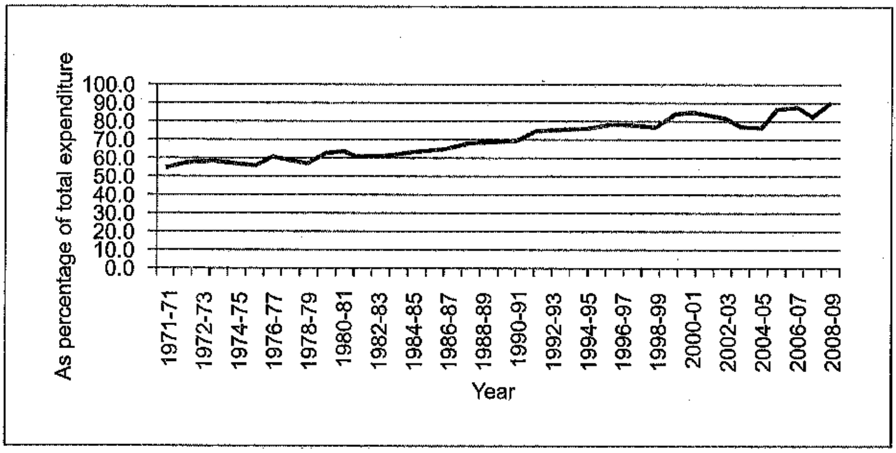

FIGURE 22A-3. Central Government Current Expenditure Share

Source: Same as in Figure 22A-2

difficult to roll over the short-term loans. NRIs started pulling out their deposits. India was on the verge of defaults in international payments with foreign exchange reserves dropping to about fortnight's of imports in January 1991 and again in June 1991. In July 1991, 47 tons of gold was shipped to vaults of the Bank of England to raise $405 million. The new government which came into power in late June 1991 (P V Narasimha Rao as the Prime Minister and Manmohan Singh as the Finance Minister) approached the IMF and the World Bank for assistance leading to not only stabilization policies but also structural reforms. Performance under Economic Reforms has been discussed in other appendices.

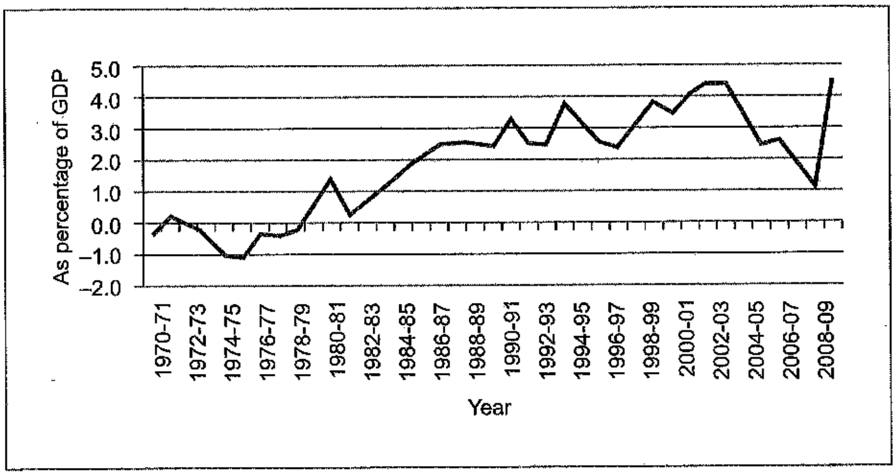

FIGURE 22A-4. Central Government Revenue Deficit

Source: Same as in Figure 22A-2