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Indian Economy: An Introduction to its Strengths and Weakness

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Abstract

This paper brief the factors of Indian Economy, why it is so strong. After several decades of sluggish growth, the Indian economy is now amongst the fastest growing economy in the world. Economic growth is currently 8-9%, second only to China.

1. Introduction

The India economy, the third largest economy in the world in terms of purchasing power, is going to touch new heights in coming years. As predicted by Goldman Sachs, the Global Investment Bank, by 2035 India would be the third largest economy of the world just after US and China. It will grow to 60% of size of the US economy. This booming economy of today has to pass through many phases before it can achieve the current milestone of 9% GDP. The history of Indian economy can be broadly divided into three phases: Pre- Colonial, Colonial and Post-Colonial.

The economic history of India since Indus Valley Civilization to 1700 AD can be categorized under this phase. During Indus Valley Civilization Indian economy was very well developed. It had very good trade relations with other parts of world, which is evident from the coins of various civilizations found at the site of Indus valley.

Before the advent of the East India Company, each village in India was a self-sufficient entity and was economically independent as all the economic needs were fulfilled within the village

2. Historical Analysis Of Indian Economy

The arrival of the East India Company in India caused a huge strain to the Indian economy and there was a two-way depletion of resources. The British would buy raw materials from India at cheaper rates and the finished goods were sold at higher than normal price in Indian markets. During this phase India's share of world income declined from 22.3% in 1700 AD to 3.8% in 1952.

After India got independence from colonial rule in 1947, the process of rebuilding the economy started. For this various policies and schemes were formulated. First five year plan for the development of Indian economy came into implementation in 1952. These Five Year Plans, started by Indian government, focused on the needs of the Indian economy.

If on one hand agriculture received the immediate attention on the other hand the industrial sector was developed at a fast pace to provide employment opportunities to the growing population and to keep pace with the developments in the world. Since then the Indian economy has come a long way. The Gross Domestic Product (GDP) at factor cost, which was 2.3 % in 1951-52 reached 6.5 in the financial year 2011-2012

Table: 1. INDIA's GDP Rate Since 1999

S. NO	Financial Year	GDP of India at factor cost (%)
1	1999-2000	6.1
2	2000-01	4.4
3	2001-02	5.8
4	2002-03	3.8
5	2003-04	8.5
6	2005-06	7.2
7	2004-05	7.5
8	2005-06	9
9	2006-07	9.2
10	2007-08	9.8

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11	2008-09	3.9
12	2009-10	8.2
13	2010-11	9.6
14	2011-12	6.9

Trade liberalization, financial liberalization, tax reforms and opening up to foreign investments were some of the important steps, which helped Indian economy to gain momentum. The Economic Liberalization introduced by Man Mohan Singh in 1991, then Finance Minister in the government of P V Narsimha Rao, proved to be the stepping-stone for Indian economic reform movements.

To maintain its current status and to achieve the target GDP of 10% for financial year 2006-07, the Indian economy has to overcome many challenges.

3. Challenges Before Indian Economy

1. **Poverty:**As per records of National Planning Commission, 36 crore people are living below the poverty line in India in 2012.
2. **Unemployment:**The increasing population is pressing hard on economic resources as well as job opportunities. Indian government has started various schemes such as JawaharRozgar Yojna, and Self Employment Scheme for Educated Unemployed Youth (SEEUY). But these are proving to be a drop in an ocean.
3. **Population explosion:** The rising population is eating into the success of India. According to 2011 census of India, the population of India has crossed one billion and isgrowing at a rate of 2.11% approx. Such a vast population puts lots of stress on economic infrastructure of the nation. Thus India has to control its burgeoning population.
4. **Rural Urban Divide:**It is said that India lies in villages, even today when there is lots of talk going about migration to cities, 70% of the Indian population still lives in villages. There is a very stark difference in pace of rural and urban growth. Unless there isn't a balanced development Indian economy cannot grow.

These challenges can be overcome by the sustained and planned economic reforms.
These include:

- Maintaining fiscal discipline
- Orientation of public expenditure towards sectors in which India is faring badly such as health and education.
- Introduction of reforms in labour laws to generate more employment opportunities for the growing population of India.
- Reorganization of agricultural sector, introduction of new technology, reducing agriculture's dependence on monsoon by developing means of irrigation.

4. Problem Facing Indian Economy

Since 1999, the Indian economy has pursued free market liberalisation, greater openness in trade and increase investment in infrastructure. This helped the Indian economy to achieve a rapid rate of economic growth and economic development. However, the economy still faces various problems and challenges.

4.1 Inflation

Fuelled by rising wages, property prices and food prices inflation in India is an increasing problem. Inflation is currently between 8-10%. This inflation has been a problem despite periods of economic slowdown. For example in late 2013, Indian inflation reached 11%, despite growth falling to 4.8%. This suggests that inflation is not just due to excess demand, but is also related to cost push inflationary factors. For example, supply constraints in agriculture have caused rising food prices. This causes inflation and is also a major factor reducing living standards of the poor who are sensitive to food prices. The Central Bank of India have made reducing inflation a top priority and have been willing to raise interest rates, but cost puhs inflation is more difficult to solve and it may cause a fall in growth as they try to reduce inflation.

4.2 Slowdown in growth

2013/14 has seen a slowdown in the rate of economic growth to 4-5%. Real GDP per capita growth is even lower. This is a cause for concern as India needs a high growth rate to see rising living standards, lower unemployment and encouraging investment. India has fallen behind China, which is a comparable developing economy

4.3 Poor educational standards

Although India has benefited from a high % of English speakers. (Important for call centre industry) there is a still high level of illiteracy amongst the population. It is worse in rural areas and amongst women. Over 48% of Indian women are illiterate. This limits economic development and a more skilled workforce.

4.4 Poor Infrastructure

Many Indians lack basic amenities lack access to running water. Indian public services are creaking under the strain of bureaucracy and inefficiency. Over 40% of Indian fruit rots before it reach the market; this is one example of the supply constraints and inefficiency's facing the Indian economy.

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4.5 Balance of Payments deterioration.

Although India has built up large amounts of foreign currency reserves the high rates of economic growth have been at the cost of a persistent current account deficit. In late 2012, the current account reached a peak of 6% of GDP. Since then there has been an improvement in the current account. But, the Indian economy has seen imports growth faster than exports. This means India needs to attract capital flows to finance the deficit. Also, the large deficit caused the depreciation in the Rupee between 2012 and 2014. Whilst the deficit remains, there is always the fear of a further devaluation in the Rupee. There is a need to rebalance the economy and improve competitiveness of exports.

4.6 High levels of private debt

Buoyed by a property boom the amount of lending in India has grown by 30% in the past year. However there are concerns about the risk of such loans. If they are dependent on rising property prices it could be problematic. Furthermore if inflation increases further it may force the RBI to increase interest rates. If interest rates rise substantially it will leave those indebted facing rising interest payments and potentially reducing consumer spending in the future

4.7 Inequality has risen rather than decreased.

It is hoped that economic growth would help drag the Indian poor above the poverty line. However so far economic growth has been highly uneven benefiting the skilled and wealthy disproportionately. Many of India’s rural poor are yet to receive any tangible benefit from the India’s economic growth. More than 78 million homes do not have electricity. 33% (268million) of the population live on less than $1 per day. Furthermore with the spread of television in Indian villages the poor are increasingly aware of the disparity between rich and poor. (3)

4.8 Large Budget Deficit

India has one of the largest budget deficits in the developing world. Excluding subsidies it amounts to nearly 8% of GDP. Although it is fallen a little in the past year It still allows little scope for increasing investment in public services like health and education.

4.9 Rigid labour Laws

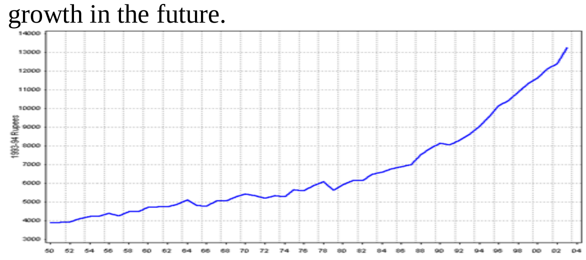
As an example Firms employing more than 100 people cannot fire workers without government permission. The effect of this is to discourage firms from expanding to over 100 people. It also discourages foreign investment. Trades Unions have an important political power base and governments often shy away from tackling potentially politically sensitive labour laws.

4.10 Inefficient agriculture

Agriculture produces 17.4% of economic output but, over 51% of the work force are employed in agriculture. This is the most inefficient sector of the economy and reform has proved slow.

5. Strength of Indian Economy

Despite several problems facing the Indian economy many economists point to potential strengths of the Indian economy which could enable it to continue to benefit from high levels of economic growth in the future.



5.1 Demographics of India are favourable

India still has a positive birth rate meaning that the size of the workforce will continue to grow for the foreseeable future. (Unlike India) A rising workforce helps to increase saving and investment. It also enables increased productivity.

5.2 There is much scope for increases in efficiency

The infrastructure of India is so bad in places that even moderate improvements could lead to significant improvements in the productive capacity of the economy.

5.3 India is well placed to benefit from globalisation and outsourcing

A legacy of the British Empire is that India has one of the largest English speaking populations in the world. For labour intensive industries like call centres India is an obvious target for outsourcing. This is an economic development likely to continue in the future.

5.4 Positive Growth Forecasts

A recent study from Goldman Sachs, forecast that India could growth at a sustainable rate of 8% growth until 2020.However it is worth noting that this assumed Indian would make several supply side policies such as labour market deregulation and improvements in education and training.

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6. Factors Affects Indian Economy

The not so obvious is that growth could actually improve going forward on the back of the following six factors.

6.1 The country has had above normal monsoons this year and this could heighten economic activity in the second half of the year as good crops lead to higher consumption amongst half of India's population.

6.2 The run up to 2014 general elections leads to higher spending from official and non-official sources and this leads to increased economic activity.

6.3 Eurozone economy is showing signs of coming out of a recession with manufacturing showing uptick over the last two months and GDP growth coming in positive for the second quarter of 2013. Eurozone coming out of recession is good for global trade and its effects will be felt on India's exports going forward.

6.4 US economy is showing strength with unemployment rate down to multi year lows and equity indices at close to record highs. Strength in the world's largest economy will filter down to India.

6.5 China's economy is showing signs of bottoming out with growth stabilizing at around 7.5% levels, exports picking up for the last couple of months and domestic consumption showing strength. Stability is the second largest economy in the world leads to improved economic activity across the globe.

6.6 Despite the Fed indicating withdrawal of additional stimulus through bond purchases, interest rates in the US, Eurozone and many other parts of the world will stay at record low levels for a while to come. Risk aversion by global investors based on prospects of higher rates will die down and flows will resume into countries like India that faced the brunt of FII selling in the May- August 2013 period.

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