History as a Lighthouse - Learning from the Past: Few Perspectives & Thoughts from India's Experience

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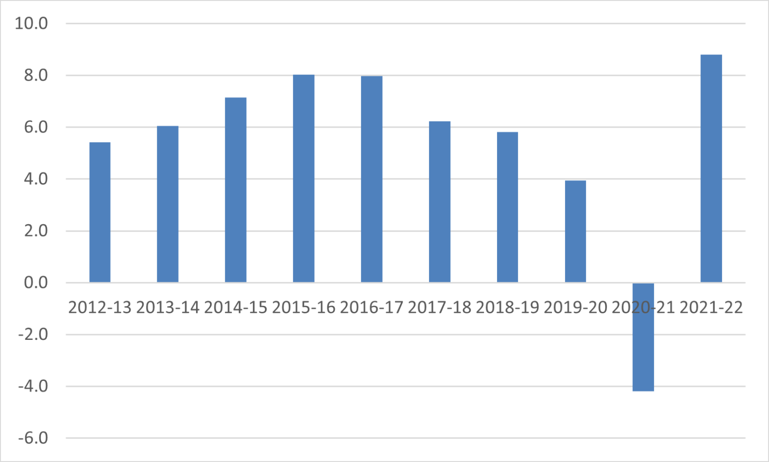
Overview of long term trends

Table 1: Indian Rates of Economic Growth

Period	**1950-1980**	**1980-1990**	**1990-2000**
Annual Real GDP Growth	3.7%	5.9%	6.2%
Annual Real GDP per Capita Growth	1.5%	3.8%	4.4%

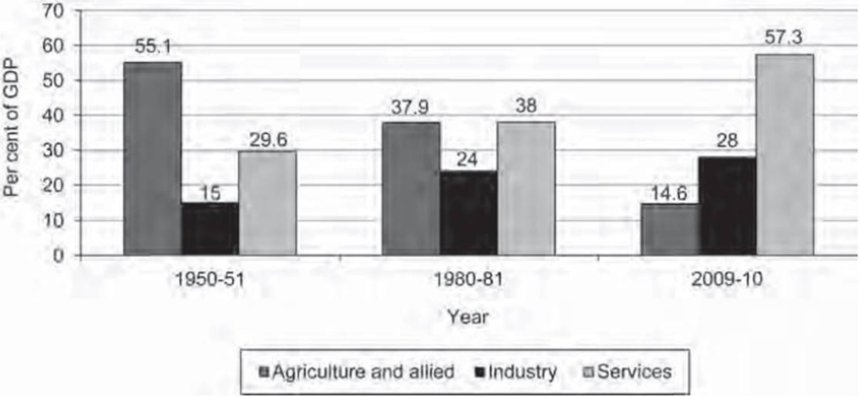
Source: De Long (2003)

Recent GDP growth rates (at current prices)



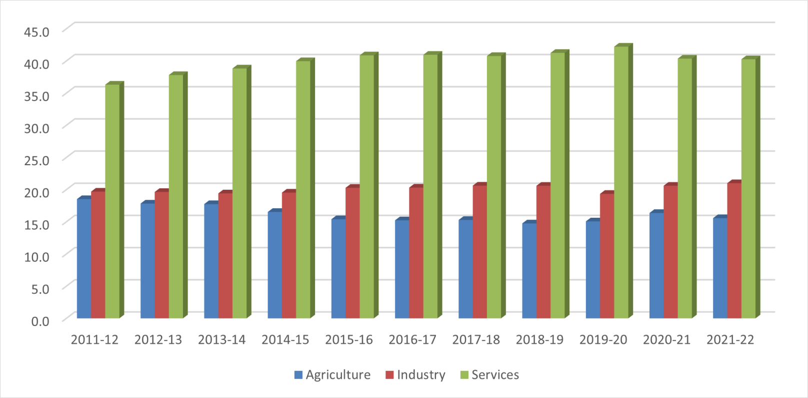
Source: National Accounts Statistics (2023)

Historical sectoral share in GDP



Source: Nagaraj (2013)

Recent sectoral share in GDP



Source: National Accounts Statistics (2023)

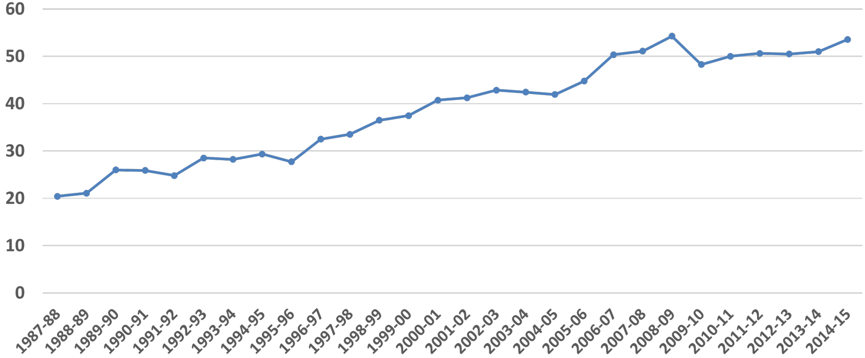
Some puzzles

- As a process of structural transformation share of agriculture in GDP has decreased whereas share of industry has increased
  - What is puzzling is that despite structural transformation, share of employment in agriculture has not fallen in India
  - Historically, as an economy grows agriculture employment share falls, but this is not visible in India
  - Industrial (manufacturing) employment is around 20-21% (8-9%) of total labour force
- Despite maintaining a high GDP growth momentum, manufacturing growth has somewhat stagnated in India
  - Historically, manufacturing has been an engine of growth
  - Skipping the usual process of agriculture to manufacturing, India has landed straight as a service led growth economy
- The above shows that India does not resemble a typical Lewis Model of economic transformation

Some puzzles (*contd.*)

- Migration in a Lewisian framework happens with people migrating from low productive primary (agriculture / rural) sector to a higher productive secondary (manufacturing / urban) sector
    - However, about $2/3^{rd}$ of rural income is now generated in non-agri. activities
    - More than half of Value Added (VA) in manufacturing is contributed by rural areas
    - There is *in-situ* occupational diversification; seasonal or cyclical migration unlike Lewis Model
- The share of manufacturing has declined in urban areas
- As per standard experiences of structural transformation, industrialization & urbanization goes hand in hand
- Then with respect to India, what explains this counter-intuitive observation?

Share of Rural GVA in manufacturing (in percentage)



Source: Annual Survey of Industries (various years)
Note: ASI only indicates formal manufacturing

Towards an explanation

- Ghani et al. (2012) looks into 1989-2005 period:
  - Organized mfg. increased in rural areas
  - However, at the same time unorganized mfg. increased in the urban sector
- They establish that this phenomenon benefited those districts that had: better infrastructure & better human capital
  - Thus, better rural infrastructure could be an explanation
- In a follow-up study, Ghani et al. (2014) contend that a major road connectivity project led to a spurt in new manufacturing units along the highway network
- Because of stricter environmental regulations in urban spaces
- Whatever may be the reason, manufacturing has not grown in India, even though rural contribution has increased

Need for industrial growth

- Pre-mature deindustrialization in India
  - Signs of direct shift from agriculture to services sector
- For India, this seeming bypassing of manufacturing sector is not preferable
  - India is a labour abundant economy
- We need industrialization
- Services sector cannot absorb labour as much as industry can
- In India's case, most of the service sector employment is informal employment (unregistered enterprises)

India's industrial policy and economic growth

- India have had an initial state led industrial growth
  - There was general skepticism about the market
  - During 19^{th} century export was the engine of growth, but 20^{th} century was filled by export pessimism
- Hence, it fell upon the state to look for generating domestic demand by intervening in the market
- That is why India initially adopted a heavy industrialization model for economic development
- General belief was specialization in primary commodities is undesirable because it holds back the country's growth
  - Instability in export earnings (large fluctuations in world prices)
  - Primary commodities are income and price inelastic
  - Prebisch-Singer: ToT between primary and manufactured products deteriorate over time

India's industrial policy and economic growth (*contd.*)

- Industrialization process in India took the form of import substituting policies of South Korea, Japan
  - There was lack of capital goods in the economy
  - Also, domestic savings were limited
  - So, make large investments into capital goods sector
  - And, create tariff walls to secure the market for domestic producers
- Argument was: In the short run growth may be low, but in the long run growth would rise
- Did it happen?
- Yes, industrial growth rose by 7-8% but overall growth of the economy stood at meager 3.5%

India's industrial policy and economic growth (*contd.*)

- Why couldn't the economy grow more than 3.5%?
- Because the agriculture sector grew at 1-2%
- The reliance in heavy industrialization model was based on the expectation that the rural (agrarian) sector would automatically respond to the industrial sector
  - That is, it was expected that demand for capital goods produced in by the urban sector would come from the rural sector
  - But, that was not to be the case
- Since the agrarian sector did not grow, it could not the generate the expected demand required to meet the supply of the capital goods sector

Recent changes and reforms

- After economic reforms of 1991, there has been a thrust for higher economic growth
- Encouraging the role of private sector
- Capital investment for trade & foreign investment
- Public investment in social goods like health & education, infrastructure, etc.
- Also regulate markets wherever necessary to ensure competition
- Maintain the macroeconomic parameters (inflation targeting, etc.)

New challenges

- India's rural economy (Rural industrialization & Non-farm sector)
  - Binswanger-Mkhize (2013) & Chand et al (2017) suggests that mfg. shift towards rural areas can have important implications towards the non-farm sector
  - As the govt. has been trying to shift employment to non-farm sector, it is important to highlight whether organized manufacturing could be that possible shift
- With policies like *Make in India*, *Atma Nirbhar Bharat*, we need to figure out what type of manufacturing would be beneficial
- The emerging idea of New Economic Geography highlights the spatial aspects of economic development, at the level of regions & cities
  - Though India has witnessed tremendous growth in the recent times, growth has been highly unequal
  - Certain States or regions have experienced more development than others
  - How do we address inter-regional inequality?