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Editorial Note

This issue of SAJMR is dedicated to the fond memory of Late Prof. Dr. A. D. Shinde a renowned Chartered Accountant and Founder of SIBER Trust. It was his vision and untiring efforts that has led to the creation of the educational empire in Southern Maharashtra. Number of students from all over the country and especially students of rural areas have been immensely benefited from the educational programs initiated by Dr. A. D. Shinde. In his memory on the first anniversary, Dr. C. Rangarajan, Chairman, Economic Advisory Council to the Prime Minister of India delivered the first memorial lecture. We are happy to publish this memorial lecture as a lead article in the current issue.

Keeping in view the interdisciplinary approach of the journal the articles ranging from the fields of economics, finance, marketing and health care services have been selected for the present issue. All these articles are comprehensive in their coverage and use latest statistical tools for analyzing both the primary and the secondary data collected. These statistical techniques include factor analysis, reliability test and techniques of hypothesis testing and others. We are sure this issue of SAJMR would provide an excellent reference material both for the researchers and students from different disciplines.

As a continuing feature of the journal we have incorporated a Case Study for the benefit of the readers. This is followed by a book review on Future of HRM. In all the present issue covers wide range of issues from management area along with a case study. It is expected that these articles will provide new insights to readers and thereby encourage them for taking up further research on these lines.

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Editor

The Indian Economy : Some Current Concerns*

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(Speech Delivered for the First Dr. A. D. Shinde Memorial Lecture at Chh. Shahu Institute of Business Education and Research, Kolhapur on 26th August 2011)*

It gives me great pleasure to be in your midst this morning and to deliver the First Dr. A.D. Shinde Memorial Lecture. The late Prof. A.D. Shinde was a Chartered Accountant who, among other things, was responsible for building up this Institute of Business Education and Research. I understand that SIBER is doing well as an academic institution and has been recognized by the UGC as a college with potential for excellence. It is a fitting tribute to the memory of Dr. A.D. Shinde.

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1. Economic Reforms and Their Rationale

India has traveled through a remarkable journey in the last two decades. Seen purely from the angle of growth, the performance has been very impressive. In the Ninth Plan the annual growth rate was 5.5 per cent. It rose to 7.5 per cent in the Tenth Plan and to an 8.2 per cent in the first four years of the Eleventh Plan.

The year 1991 is a landmark in the post-independent economic history of India. The country faced a severe economic crisis, triggered in part by a serious balance of payments situation. The crisis was converted into an opportunity to effect some fundamental changes in the content and approach to economic policy.

There is a common thread running through all the measures introduced since July 1991. The objective is simple and that is to improve the efficiency of the system. The regulatory mechanism involving multitudes of controls had fragmented capacity and reduced competition even in the private sector. The thrust of the new economic policy is towards creating a more competitive environment in the economy as a means to improving the productivity and efficiency of the system. This is to be achieved by removing the barriers to entry and the restrictions on growth of firms. While the industrial policy seeks to bring about a greater competitive environment domestically, the trade policy seeks to improve international competitiveness subject to the protection offered by tariffs which are coming down. The private sector is being given a larger space to operate in as some of the areas earlier reserved exclusively for the public sector are also now allowed to the private sector. In these areas, the public sector will have to compete with the private sector, even though the public sector may continue to play a dominant role. What is sought to be achieved is an improvement in the functioning of the various entities whether they are in the private or public sector by injecting an element of competition. There is, however, nothing in the new economic policy which takes away the role of the State or the public sector in the system. The New Economic Policy of India has not necessarily diminished the role of state; it has only redefined it, expanding it in some areas and reducing in some others. As it has been said, somewhat paradoxically 'more market' does not mean 'less Government', but only 'different Government'.

That the content and process of our economic reforms are in the right track is vindicated by the performance of the economy since the launch of the reforms. Between 1981-82 and 1990-91, that is the decade before the reforms, the economy grew at 5.6 per cent on a compound average basis. Between 1992-93 and 2010-11, the economy grew at an average rate of 6.8 per cent per annum, a significant improvement over the pre-reform period.

Coming to the more recent period, economic growth in the six year period from 2005-06 to 2010-11, despite the crisis-affected year of 2008-09, was at an average of 8.6 per cent. This clearly represented an acceleration in the pace of growth and marks a distinct break from any previous five year period. Per capita GDP grew by an average of 7.0 per cent in these six years.

Under the severe impact of the global crisis, the Indian economy registered a growth of 6.7 per cent in 2008-09 after having registered over 9 per cent rate of growth for three successive years. By any standards, the Indian economy was able to protect itself reasonably well in the turbulent conditions of the financial crisis.

The growth rate picked up subsequently and the economy achieved a growth rate of 8.0 per cent in 2009-10 despite a severe drought. Disaggregating this growth rate, it is seen that the growth rate of agriculture was 0.4 per cent, that of industry was 8.0 per cent and that of services 10.1 per cent.

The growth rate of the Indian economy was 8.5 per cent in 2010-11. There was a substantial jump in agricultural production. The monsoon had been good and, therefore, the agriculture GDP grew at 6.6 per cent during that year. Industrial production was strong in the first half and started slowing down in the second half. From April 2010 to March 2011, the growth in manufacturing sector was 8.1 per cent. With the jump in agricultural production and with industrial and service sectors growing at 7.9 per cent and 9.4 per cent, respectively, the growth rate in 2010-11 comes to 8.5 per cent.

India's growth rate in 2011-12 will be 8.2 per cent. Agriculture is expected to grow at 3 per cent while industry and services will grow at 7.1 per cent and 10 per cent, respectively. Monsoon has been good so far and we should expect to see agriculture grow reasonably well. The expected growth rate of 3 per cent in agriculture will be on top of a strong growth of 6.6 per cent in the previous year. As far as industry is concerned, while the first quarter may not show strong growth, there can be a good pick up from August 2011 onwards. Services sector may grow at 10 per cent which will be a slight improvement over the growth rate of the previous year. In this context, we need to take into account the world economic situation which is by no means encouraging. If the world situation further deteriorates, it will have an impact on the growth of our economy.

In this context, a frequently asked question is whether India has the potential to grow at 9 per cent in a sustained way. India's savings rate has crossed 34 per cent of GDP. The investment rate has exceeded 36 per cent of GDP. Even with an incremental capital-output ratio of 4, this should enable the Indian economy to grow at 9 per cent. Thus the broad macro economic parameters relating to savings and investment are conducive for achieving a high growth rate. However, for this to happen, we also need to remove the constraints that may come in the way.

2. Distribution of Income

Before going into the issue of constraints let me turn to the issue of distribution of income. While growth is important, it is necessary to remember that it is not the only dimension for measuring performance or achievement. It is equally important to know who benefits from growth. There has been considerable dispute in this country in estimating the people below the poverty line. There is no consensus yet on what constitutes the poverty line. According to the methodology adopted by the Planning Commission until recently, the number of people below poverty line in 1993-94 was 36.0 per cent. According to the same methodology, it came down to 27.5 per cent in 2004-05. However, the Tendulkar Committee by adopting a slightly different methodology came to the conclusion that the overall poverty ratio was 45.3 per cent in 1993-94 and 37.2 per cent in 2004-05. While the Tendulkar Committee estimates are higher than the earlier estimates, both methodologies show that the reduction in the poverty ratio was in the range of 8 to 8.5 per cent. While growth has contributed to reducing the poverty ratio, it has to be acknowledged that the absolute level of poverty is still high. Truly we have miles to go before eliminating poverty. We need to ensure that the growth process is such as to include every section of the economy. We must maintain, nevertheless, a high growth rate which will alone enable the government to raise the resources to meet the various socioeconomic obligations. In short, growth and equity must be weaved together to provide a coherent pattern of development.

One aspect of the growth process is balanced regional development. It is normally expected that with economic development, the per capita income of the States will show a tendency to converge. Comparing the two periods of 1993-94 to 1999-00 and 1999-00 to 2008-09, data do not show a convergence. However, there is a strong evidence of "catching up" by the lower income States. The median growth rate increased one-and-a-half times between the two periods, increasing from 3.9 per cent in the earlier period to 5.7 per cent in the latter period. States with lower per capita GSDP like Assam, Orissa, UP and Bihar have made significant gains in growth rates in the latter period. Notwithstanding these gains, convergence was subdued because some of the higher income States like Gujarat, Kerala, and Haryana also posted high growth rates. In other words, what the recent data indicate is that while most of the lower income States have shown stronger growth rates, several of the higher income States have also shown an increase in the recent period.

3. Short Term Concerns

There are a few areas where immediate engagement of the policy makers is needed. In the short run, managing inflationary pressures is the biggest challenge. I shall talk about it in some detail later.

A second concern relates to the balance of payments. India's current account deficit remained low till 2008-09. Since then it has started climbing and the current account deficit was 2.8 per cent of GDP in 2009-10. In the first half of 2010-11 the current account deficit remained very high at 3.7 per cent of the GDP. However, in the second half, exports picked up strongly while import growth was weaker. It is now estimated that the current account deficit for this year may be around 2.5 per cent of the GDP. We have had no problems so far in financing the current account deficit. Even in 2010-11, capital flows were adequate to cover the current account deficit and add to the reserves $12 billion. Efforts must be made to keep the current account deficit around the manageable level of 2.5 per cent of GDP. This is desirable to impart much needed stability on the external payment front and to reduce the risk the domestic economy runs from volatility in international financial markets.

Another critical challenge on the way forward is fiscal consolidation which is a necessary pre-requisite for sustained growth. In the wake of the international financial crisis, India like many other countries adopted an expansionary fiscal policy in order to stimulate demand. As a consequence, the fiscal deficit of the Government of India which was coming down started rising. In 2008-09, the fiscal deficit was 6 per cent of GDP. It rose to 6.4 per cent in the next year. Unlike other countries in the advanced world, where there is a continuing debate regarding when to terminate the expansionary fiscal policies, we in India have taken a decision to initiate the process of fiscal consolidation. In 2010-11, the fiscal deficit came down to 4.7 per cent of GDP and it is projected to fall to 4.6 per cent in the current year. We should maintain this course and reach soon the FRBM target of 3 per cent of GDP.

4. Medium Term Constraints

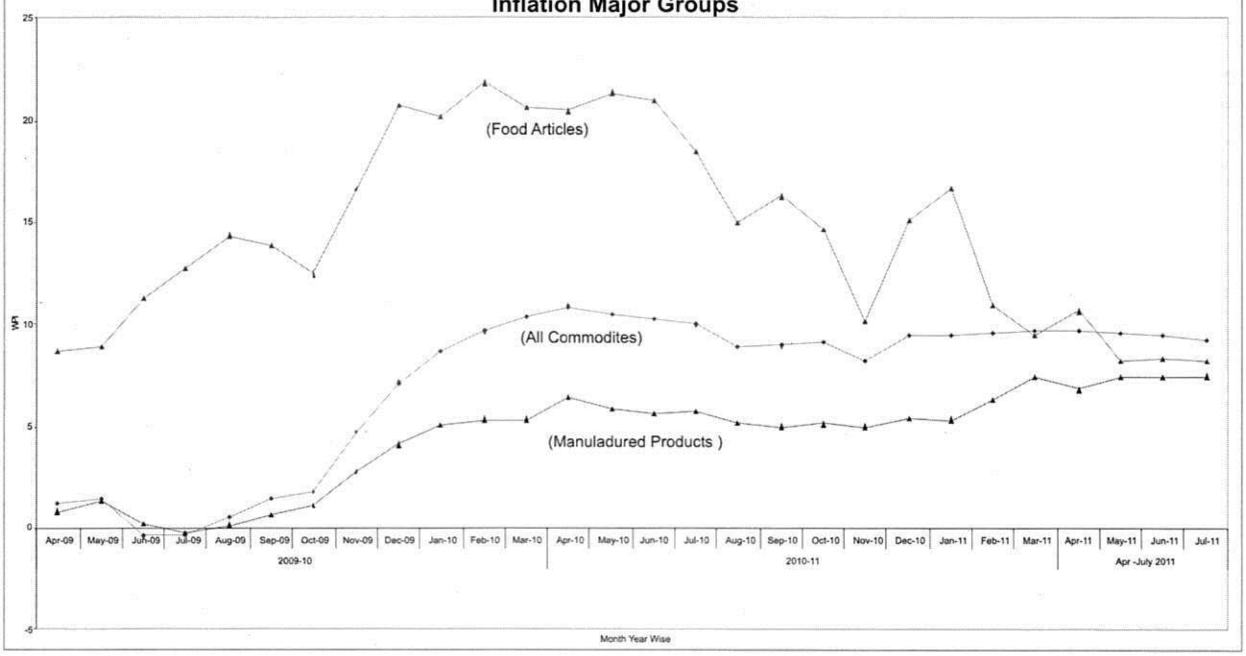
In the medium term, the two sectors which pose a major challenge are the farm economy and the power sector. The first of these, farm economy is primarily constrained by the relatively low levels of yield in major cereal crops and pulses as compared to other Asian economies especially China. We have large science and technology establishments for agricultural research. But the results in terms of productivity gains leave much to be desired. Necessary steps must be taken to revitalize the traditional crop agriculture which is vital to food security and farm income. Equally, as shifts in demand occur reflecting changes in income and taste, agricultural production must also respond to them.

The second challenge for the country is the shortage of physical infrastructure of which the single most important item is electricity. Shortage of electric power leads not only to direct production losses but also results in inefficiency in a broad range of areas impacting profitability and competitiveness. Recent data clearly indicate a short fall in achieving the targets for capacity creation. This is despite the fact that the achievement in capacity creation in the first four years of the 11[th] Plan is higher than that in the first four years of the 10[th] Plan. Government is the largest player in production, transmission and distribution of power and a high order of Government intervention in capacity creation and other supportive components of electricity business is crucial to sustaining a high growth rate of 9 per cent. A more aggressive path of capacity creation must start immediately.

5. Current Inflation

We have had two years of high inflation (Chart 1). 2009-10 was badly affected because of the deficient monsoon. Foodgrain production declined by 17 million tonnes. The decline in the production of rice alone was 11 million tones. As a consequence, inflation was triggered by the increase in foodgrain prices. Food inflation stood at as high as 21 per cent in February 2010. Overall inflation as measured by the wholesale price index touched the peak of 10.9 per cent in April 2010. It was expected that inflation would moderate through 2010-11. It in fact started happening till November 2010. However, prices started rising after that. As of March 2011, year on year inflation had touched 10.0 per cent. While the food price inflation of 2009-10 was triggered by the rise in foodgrain prices, in 2010-11 it was triggered by the rise in the prices of vegetables, fruits and eggs, meat and fish. The increase in vegetable prices has been significant. The late rains had a severe impact on the supply of some vegetables including onion. Inflation in vegetables rose to 34 per cent in December 2010 and 67 per cent in January 2011. Normally, vegetable prices show a seasonal decline during winter months. During 2010-11, prices of raw cotton rose on an average by 43 per cent. The persistence of food inflation led to the spread of inflation to other sectors.

CHART 1
Inflation Major Groups



In 2010-11, the weighted contribution of the manufacturing sector to total inflation was 41.8 per cent.

Inflation continues to remain an area of concern in the current year. As of July 2011, the headline inflation in wholesale price index stood at 9.2 per cent. While inflation in food articles has eased from 10.6 per cent in April 2011 to 8.2 per cent in July 2011, inflation in manufactured products has risen from 5.3 per cent in January 2011 to 7.5 per cent in July 2011. Weekly data show a further easing in food inflation since the second half of July 2011. However, primary food inflation still remains at a fairly high level. The rationalization process in the pricing of petroleum products is still to be completed and this may have an impact on price levels in the coming months. Factoring all these, the headline WPI inflation would remain high till October 2011. One could expect significant easing in the last quarter of the year and inflation may come down to 6.5 per cent in March 2012.

Supply side constraints have to be necessarily eased in order to continue with growth along with price stability. However, interventions in the area of supply constraints take some time to mature, which only means that the problem has to be identified rapidly and the process of intervention rolled out with some haste. In our case, at least as far as foodgrains is concerned, use of the official stocks in an imaginative manner can be used to keep prices under control.

Thus the extraordinarily high level of inflation seen in the last two years is due to certain severe supply constraints, particularly of agricultural products. An analysis of the inflation rate and growth rate for the last six years clearly indicates that in the three years when the growth rate was around 9 per cent, inflation rate was not necessarily higher.

The fact that inflation is triggered primarily by supply side shocks does not mean that monetary policy has no role to play in such conditions. As mentioned earlier, food price inflation, if it persists long enough, gets generalized. Thus, monetary policy and at one step removed, fiscal policy have to play their part in containing the overall demand pressures. It is only in this context one can understand the series of actions taken by RBI to control inflation.

6. Impact of Inflation

There are, however, situations in which growth can contribute to push up inflation. High growth rate may result in higher inflation, when the growth rate exceeds the potential capacity of the economy. That will be the situation of "over-heating". We have had examples of such situations even in the recent period. In early 2007, inflation picked up because the economy was operating at full capacity. However, it did not last long because investment rate was high and output caught up with increased demand. Thus the crucial factor lies in determining "potential" growth of the economy. As mentioned earlier, the investment rate in the Indian economy now exceeds 36 per cent and can realistically be expected to rise to 38 per cent under favourable investment conditions. Even with an incremental capital-output ratio of 4:1 we should be able to grow at 9 per cent comfortably. This rate of growth of 9 per cent may be regarded as the 'potential' of the economy. We have not touched this level of growth in the last two years when the inflation rate had remained at double digit level for several months. Supply constraints have been the main trigger of inflation. In fact, what we need to watch out is the impact of high inflation on growth. Persistent high inflation can distort the motives for investment and thereby undermine growth.

There has been a considerable debate on what is an acceptable level of inflation. I had in a different context used the term "threshold level of inflation", defining it as the level beyond which costs of inflation begin to rise sharply. The Chakravarty Committee (of which I was a Member) regarded the acceptable rise in prices as 4 per cent. This, according to the Committee, will reflect changes in relative prices necessary to attract resources to growth sectors. When growth takes place, it does not happen uniformly in all the sectors. Thus maintenance of absolute price stability meaning thereby zero rate of increase in prices may not be possible. Nor is it desirable. Obviously, there is a certain amount of judgement involved in determining the acceptable or threshold level of inflation. One has to take into account not only the impact on output but also the distributional implications.

In the early decades after Independence, the argument that inflation was endemic in economic growth led to very steep increases in prices. We should not let that happen in the years of high growth. We must remain committed to maintain inflation at a low level. High growth does not warrant a higher level of inflation. We must use all of our policy instruments to bring down the current inflation and re-anchor the inflationary expectations to the 5 per cent comfort zone.

7. Need for High Growth

As mentioned earlier, with the investment rate touching 38 per cent of the GDP, the economy should be able to grow at 9.0 per cent. Pushing the economy beyond that will run into problems. First of all, it will be difficult to achieve the required investment rate, second, pushing the economy beyond its capacity would result in strong inflationary pressures re-emerging. The deficit in the current account of the balance of payments will also widen. It is, therefore, prudent to aim at a growth rate of 9 per cent.

Some people raise a question whether it is necessary at all to grow at this rate. Growth is an important factor in generating employment and reducing poverty. Obviously, the composition of growth is equally important. As I mentioned earlier, particular focus on agriculture is extremely important. Growth in agriculture is necessary not only from the point of view of ensuring food security but also in making a dent on poverty. Nevertheless, overall growth is an important factor while examining the progress in terms of living standards. With population growth rate coming down, a strong growth will mean a substantial growth in the per capita income. If we grow at 9 per cent per annum, India's per capita GDP will increase from the current level of $1,600 to $8,000-10,000 by 2025. Then we will become part of the middle income group of countries. Without a strong growth, we will not be able to provide employment to the growing number of young people who will join the labour force. Analysis of the preliminary NSSO data for 2009-10 suggests that, compared to 2004-05, there has been a reduction of about 3-4 percentage points in the poverty ratio. Continued strong growth will help to accelerate the declining trend in poverty ratio. In the recent period, we have launched a number of schemes aimed at broadening the base of growth. These include employment guarantee scheme, universalisation of education, expansion of rural health and food security. All these programmes have made a substantial demand on public expenditure. This has been made possible only because of the strong growth that we have seen in recent years. Growth has facilitated raising more resources by the Government.

Development has many dimensions. It has to be inclusive; it must be poverty reducing and it must be environment-friendly. We need to incorporate all these elements in the growth process. However, at our present stage of development, we cannot afford to sacrifice growth. It is key to improving the living standards of our people. A strong and balanced growth will enable the economy to achieve multiple goals including lowering inflation. Over the medium and long terms, increasing the availability of goods and services pari pasu with the increase in demand will keep inflation low. However, if in the short term because of temporary aberrations inflation raises its head, the dominant concern of the policy makers must be to contain and tame inflation.