

## **INDIAN ECONOMIC DEVELOPMENT – DETERMINANTS**

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### **ABSTRACT**

The Growth and Development of a country largely depends on strong Agriculture, Industrial growth, sustained and considerable balance in the foreign exchange and a reasonable amount of gold reserve. As India happens to be basically an agrarian economy, necessary efforts should be placed in safeguarding the productive land for growing the agricultural production to feed our people and also to earn by way of exporting it to other parts of the world. A strong and vibrant industrial base will provide employment opportunities to people to earn a decent income to increase their standard of living to a greater extent. This paper takes into account some prominent points that support the economic growth and development of the country such as Human Development Index and various factors affecting the growth and development of India in a detailed manner. Importance of capital formation as well as the natural resources is detailed in the paper to have a clear understanding about the growth of the country and also the future prospect of India.

**Key Word - Economic growth, Economic Development, Capital Formation, Natural Resources, Human Development Index, Agriculture**

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\* O/O DCA, ZAO, CBDT, CHENNAI

## Introduction –

The Growth and Development of a country largely depends on strong Agriculture growth, development of Industrial growth, sustained improvement and considerable balance in the foreign exchange and a reasonable amount of gold reserve. As India happens to be basically an agrarian economy, necessary efforts should be placed in safeguarding the fertile land for increasing the agricultural production to feed our people and also to earn by way of exporting it to other parts of the world. A strong industrial base will provide employment opportunities to people to earn a decent income to increase their standard of living as well as creating a good at the international level about our strong industrial growth. To have a stable and steady growth of the economy, a good amount of foreign exchange reserve is need to meet our international obligations compulsorily and that too within the stipulated time. This will create a friendly and congenial atmosphere for growth of the economy to a greater extent. And above all, a strong financial base is a must to withstand financial problems taking place within the country as well as outside the country. So a strong currency base is a must to meet the financial transactions taking place in the country. This paper takes into account some prominent points that support the economic growth and development of the country in a very brief manner

## 1. Economic Growth

Economic Growth is defined as the rise in the money value of goods and services produced by all the sectors of the economy per head during a particular period of time. It is a quantitative measure that shows the increase in the number of commercial transactions in an economy. Economic growth can be expressed in terms of gross domestic product and gross national product that helps in measuring the size of the economy. It is an outcome of the increase in the quality and quantity of resources and advancement of technology. Economic growth is caused by two main factors i.e., **a) an increase in aggregate demand and b) an increase in aggregate supply**. This can be stated in the following way: -.

$$AD= C + I + G + X- M$$

- C= Consumer spending
- I = Investment
- G = Government spending

- X = Exports
- M = Imports

### **Reasons for Aggregate Demand -**

- Lower interest rates – Lower interest rates reduce the cost of borrowing and so encourage spending and investment.
- Increased wages. Higher real wages increase disposable income and encourages consumer spending.
- Increased government spending (G).
- Fall in value of sterling which makes exports cheaper and increases quantity of exports(X).
- Increased consumer confidence, which encourages spending (C).
- Lower income tax which increases disposable income of consumers and increases consumer spending (C).

### **Long Term Economic Growth –**

It depends on the long run aggregate supply which may be the result of the following well known reasons, such as – *‘Increased capital, Increase in working population, Increase in Labour productivity, Discovering new raw materials and technological improvements to improve the productivity of capital and labour’*.

## **2. Economic Development**

Economic Development is defined as *‘the process of increase volume of production along with the improvement in technology, rise in the level of living, institutional changes’*, etc. In short, it is the progress in the socioeconomic structure of the economy. Human Development Index is the appropriate tool to gauge the development in the economy. It considers the overall development in an economy regarding the standard of living, GDP, living conditions, technological advancement, improvement in self esteem needs, creation of opportunities, per capita income, infrastructural and industrial development and much more.

### 3. Human development index –

The **Human Development Index** is a tool **developed** by the United Nations to measure and rank countries' levels of social and economic **development** based on four criteria: Life expectancy at birth, mean years of schooling, expected years of schooling and gross national income per capita. The Human Development Index is **“a statistical tool used to measure a country's overall achievement in its social and economic dimensions. The social and economic dimensions of a country are based on the health of people, their level of education attainment and their standard of living”**. It is one of the best tools to keep track of the level of development of a country, as it combines all major social and economic indicators that are responsible for economic development.

#### Recent Trend –

India continued to rank low in the Human Development Index (HDI), climbing just one notch to the 130th rank in the latest UNDP report on account of rise in life expectancy and per capita income. India ranked 130 among 188 countries in Human Development Report 2015 released on Monday by the United Nations Development Programme.



#### Representational image Reuters

As per the latest report, India's rank has moved from 131 to 130. India's HDI value for 2014 is 0.609, which puts the country in the medium human development category, positioning it at 130 out of 188 countries and territories."Between 1980 and 2014, India's HDI value increased from 0.362 to 0.609, an increase of 68.1 percent or an average annual increase of about 1.54 percent. Norway topped followed by Australia and Switzerland. Among the BRICS nations, India was ranked lowest. Other countries in the group are Brazil, Russia, China and South Africa.

The HDI is an average measure of basic human development achievements in a country. It is a summary measure for assessing long-term progress in three basic dimensions of human development — a long and healthy life, access to knowledge and a decent standard of living. Life expectancy at birth increased to 68 years in 2014 from 67.6 in the previous year and 53.9 in 1980. Gross National Income (GNI) per capita was USD 5,497 in 2014 up from USD 5,180 in 2013 and USD 1,255 in 1980. India's GNI per capita increased by about 338 per cent between 1980 and 2014. However, as per the report, the expected years of schooling is stagnant at 11.7 since 2011. Also, mean years of schooling at 5.4 has not changed since 2010. Between 1980 and 2014, India's life expectancy at birth increased by 14.1 years, while mean years of schooling increased by 3.5 years and expected years of schooling increased by 5.3 years.

#### **4. Factors affecting economic growth in India –**

Factors like *Levels of infrastructure, Levels of corruption, Educational standards, Labour productivity and mobility Flow of foreign aid and investment, and Level of savings and investment*. Of all the economic factors that affect the economic development in the country, *Capital Formation*, the life blood of all economic activities which increases the image of the country at the international level by way of starting Industries and thereby providing employment to the people, plays an important role.

#### **5. Capital Formation -**

Gross Fixed Capital Formation in India decreased to 8672.29 INR Billion in the fourth quarter of 2015 from 8916.06 INR Billion in the third quarter of 2015. Gross Fixed Capital Formation in India averaged 4742.57 INR Billion from 2001 until 2015, reaching an all time high of 8916.06 INR Billion in the third quarter of 2015 and a record low of 2021.90 INR Billion in the first quarter of 2002. Gross Fixed Capital Formation in India is reported by the Ministry of Statistics and Programme Implementation (MOSPI). In the modern free-market economy, the process of capital formation consists of three stages i.e., **an increase in the rate of real savings, existence of a good financial system and the act of investment nature.**

## **I. Household Savings:**

Household savings comprise **savings of all households and individuals, both rural and urban, and non-corporate business undertakings, partnerships and non-profitable institutions like charitable trusts**. Households save when they do not spend all their incomes on consumer goods. When individuals or households save, they release resources from the production of consumer goods and capital goods. The level of savings in a country depends upon the power to save and the will to save. The savings of the households are either in the form of financial assets like bank deposits, shares, bonds, provident fund, life insurance policies, national saving certificates etc., or in the form of physical assets such as various capital goods, houses, etc.

**i. Inflation** - In the economy when there is high inflation rate or prices are continuously rising, value of money declines. The rise in prices or the fall in the value of money has an adverse effect on the savings in the economy because most of the money has to be spent on essential goods to meet their day to day needs. People will normally think that savings will not be of much use when prices are increasing.

**ii. Interest rate** - To inculcate savings habits in the minds of the people, several economists suggested positive real interest which is the nominal rate of interest rate minus rate of inflation. A negative real interest rate will divert savings to information financial markets, unproductive investment category nature, such as investment in gold, jewels, and housing sector. Positive real rate of interest ensures efficient and better utilization of scarce capital for productive purposes and thereby providing employment to people and ultimately increasing the standard of living of the people.

## **II. Government Savings:**

Public Savings are another source of savings. In Government, savings are included the surplus of revenue obtained through taxes and surpluses from public undertakings over and above the current expenditure of the Government. It is worth noting that all revenue earned from taxes, etc. does not constitute the public savings because a good part of the tax revenue is spent on current consumption expenditure of the Government such as civil administration, defence and other unproductive services. The huge combined fiscal deficit of the centre and the states is adversely affecting saving and investment in the economy and therefore the rate of economic growth of the Indian economy. A former economic advisor to the Ministry of Finance, Shri Shankar Acharya said Revenue Deficit during the periods from 1995-96 to 1998-99 resulted in the worsening of

aggregate savings and investment ratios over the period. To increase the rate of savings and investments in the Indian economy it is of paramount importance to take steps in reducing the fiscal deficit. It will be highly possible by way of increasing the base of taxation and reducing the subsidies.

**Taxation and Subsidies** - In the tax structure it is better to withdraw several exemptions thereby augmenting the revenue to the Government and in the subsidies side; it must be well targeted to the needy people and to see that it reaches them in all possible ways. Moreover, non-plan non-essential government expenditure must be reduced along with the reforms in the taxation system. Due care should be given on education and health which promote accumulation of human capital and have far reaching implications on the economic growth of the country.

### **III. Corporate Sector Savings –**

Corporate business enterprises save when they do not distribute whole of their profits but retain a part of them in the form of undistributed profits. They then use these undistributed profits for investment in real capital. It has been widely practiced in USA and UK which constitute about 50 percent to 60 percent of the total annual domestic savings. **The lower corporate saving** was attributed to - High rental cost of capital, high corporate tax rate, high rates of excise duties, tax on dividend distribution, inefficiency in use of investment funds and under-utilization of production capacity. **The high Corporate Savings** was attributed to - Liberalization followed in India since 1991, gave room for reduction in tariff rates on imported raw materials, corporate tax, and excise duties resulted in higher corporate saving in 1995-96 and 1997-98. Corporate Savings showed a positive figure since 2002-00 on account of lowering of lending interest rate which resulted in increasing the profits of the corporate sector. Corporate sector saving rose from 4.4% of GDP in 2003-04 to 6.6% in 2004-05, to 7.5% in 2005-06 and 7.9% in 2006-07 and further rose to 9.4% in 2007-08. The global financial crisis in 2008-09 affected the saving of the corporate sector which declined to 7.4 per cent in 2008-09 and 8.2% per cent in 2009-10 and 7.9% in 2010-11.

**B. Financial System:**

Mobilization of savings of the people are under taken by various institutions like Banks, investment trusts, life insurance companies, finance corporations, and other financial institutions in the country. One reason responsible for the low rate of capital formation in India has been the absence of well-developed capital market. Indian capital is said to be very shy. If the rate of capital formation in the private sector is to be stepped up, the development of financial system is very necessary. Well-developed financial market will ensure that the savings of the society will be mobilised and transferred to the entrepreneurs or businessmen who require them for investment.

**C. Investment:**

For savings to result in capital formation and economic growth they must be invested. It depends on a good number of honest and dynamic entrepreneurs in a country who are willing to take risks and bear uncertainty of production. For this purpose, a good inducement to invest is needed which ultimately depends on marginal efficiency of capital, i.e., rate of return or profit on the one hand, and real rate of interest on the other. It is generally believed that at a lower real rate of interest, investment is more and at a higher real rate of interest, investment is less. In other words, it means that when credit is cheaper, businessmen will borrow more funds for investment purposes.

**Marginal efficiency of capital** depends upon the cost or supply price of capital as well as the expectations of profits. Fluctuations in investment are mainly due to the changes in expectations regarding profits. The primary factor which determines the level of investment or capital formation in an economy is the size of market for goods. Demand for capital equipment like machinery depends upon the demand for goods it helps to produce. The inducement to invest is limited by the size of the market.

**i. Public Investment in Infrastructure** - Private investment is also affected by the availability of infrastructure such as power, good roads and means of transport, good means of communication, good ports, etc. Slowdown in the Indian economy since 1996-97 is also partly due to lack of good infrastructure. It has therefore been suggested that public investment in infrastructure not

only generates demand for the industrial products but also leads to the expansion of infrastructural facilities such as power, ports, roads etc. Thus, in the Indian context public investment helps to solve both the supply-side and demand side problems of private sector investment. Therefore, in India the greater public investment crowds in private investment rather than crowding it out.

**ii. Taxation Policies** - Taxation policies of the Government also affect investment behavior of the corporate sector. High corporate taxes discourage private investment. For example, high corporation income tax, tax on dividend distribution, high excise duties and tariffs adversely affect corporate sector investment by lowering the profitability of investment. Therefore, to increase corporate investment, investment-friendly taxation policies need to be adopted.

**iii. Availability of Credit** - Apart from internal savings, the corporate sector gets investment funds from the capital market and banks. To meet their needs for working capital they rely on bank credit. Therefore, to ensure greater private investment adequate credit facilities must be made available. After 2003 when both public investment and private investment had picked up, growth rate of GDP rose to over to 9 per cent per annum during the three years 2005-08. Apart from that Gross Domestic Saving rate had gone up to 36.9 per cent per annum in 2007-08, but started declining due to the impact of global financial crisis in 2008-09 which resulted in the growth rate of GDP to 6.7% in 2008-09 and to 8.4% in both 2009-10 and 2010-11 and poor show of 6.5 percent in 2011-12.

## **6. Natural Resources:**

The principal factor affecting the development of an economy is the natural resources. Among the natural resources, the land area and the quality of the soil, forest wealth, good river system, minerals and oil-resources, good and bracing climate, etc., are included. For economic growth, the existence of natural resources in abundance is essential. A country deficient in natural resources may not be in a position to develop rapidly. In fact, natural resources are a necessary condition for economic growth but not a sufficient one.

According to Lewis, *“Other things being equal man can make better use of rich resources than they can of poor”*. In less developed countries, natural resources are unutilized, under-utilized or mis- utilized. This is one of the reasons of their backwardness. This is due to economic backwardness and lack of technological factors.

**i. Use of natural resources in India -** The natural resource sector has been passing through a testing phase in India. Though we got rich mineral reserves and resources, we are not able to capitalize on it for our economic strength due to blanket bans and clearance delays. Countries like Brazil, Canada, Australia and those in Latin America were on par with India when it came to the utilization of natural resources. Today, these countries have moved far ahead and we have remained stagnant. In India, the fall of GDP growth can be attributed largely to the sluggish growth of the natural resource sector. The attitude of not using the available resources coupled with legal battle as well as illegitimate mining has resulted in the crippling of industrial activities in the country .This has affected the economies of various states and the livelihood of millions of people.

## **ii. Rare Resource**

India is blessed with the fourth largest bauxite deposits in the world about 3000 million tones and we are not able to make any concrete opening of any large bauxite mine in more than 35 years. There is no remarkable exploration of gold and copper mines in spite of a go judgment by the Supreme Court. The State of Goa is in deep economic crisis. In Goa, it is a matter of survival for over one-third of the state's population. The iron ore mining ban has paralyzed almost 20,000 trucks. But the biggest loss is to the economy running over Rs 25,000 crore. It is not just a loss to the miners even thousands of ancillary industries associated with iron ore mining are on the verge of closure.

Until mining bans came into force, India produced about 200 million tonnes of iron ore and about 50 per cent was exported, making India the world's third-largest exporter of iron ore. The ban has declined the export from 117 million tonnes in 2008-09 to 18 million tonnes in 2012-13. The condition of exports is further deteriorating, to 14- 15 million tonnes, in the current financial year.

India enjoys the richness of iron ore reserves like that of Australia and Brazil but the difference in production and outlook is un-measurable. Where Australia has doubled its production to 500 million tonnes and Brazil has doubled its production to 400 million tonnes, India's production has gone down to less than 50 per cent to 100 million tonnes, and is even struggling to sustain this level, though our country has immense potential to produce much more.

For a developing nation like India, it is only pertinent to capitalize on the available natural resources, in the most sustainable manner, by bringing in large investments and through simplification of policies and procedures. **This is the only sector that has the true potential to make India an economic powerhouse.**

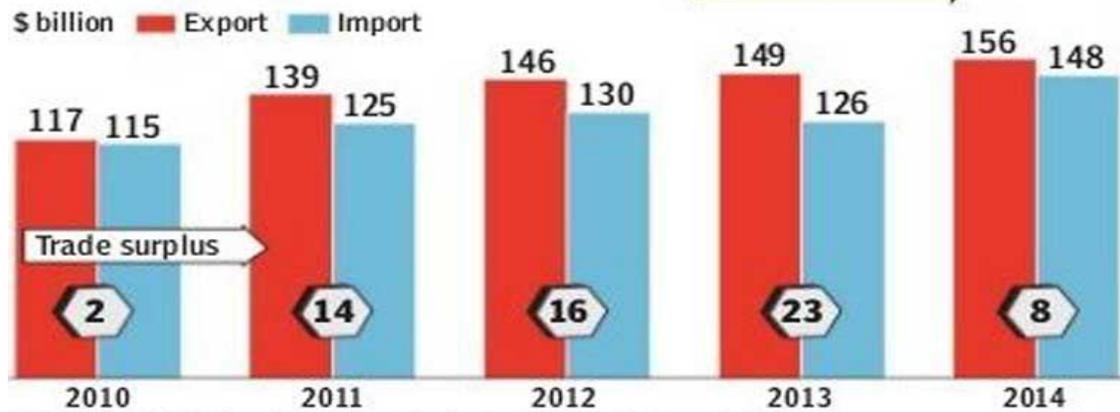
### **7. Marketable Surplus of Agriculture:**

Increase in agricultural production accompanied by a rise in productivity is important from the point of view of the development of a country. But what is more important is that the marketable surplus of agriculture increases. The term 'marketable surplus' refers to the excess of output in the agricultural sector over and above what is required to allow the rural population to subsist. The importance of the marketable surplus in a developing economy emanates from the fact that the urban industrial population subsists on it. With the development of an economy, the ratio of the urban population increases and increasing demands are made on agriculture for food grains. These demands must be met adequately; otherwise the consequent scarcity of food in urban areas will arrest growth.

### **India's trade - it is advantage agriculture**

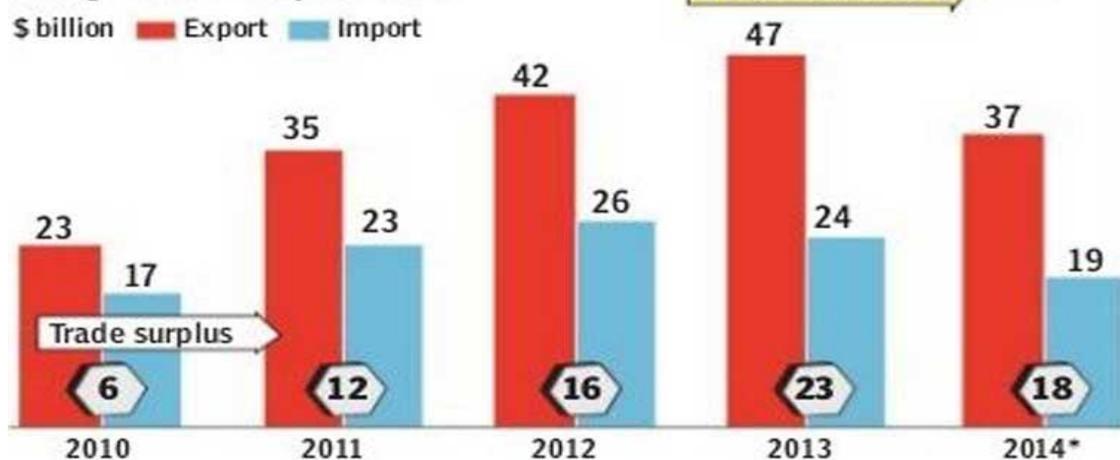
**A. Services** According to Reuters, Dollar earnings for India from international agricultural trade are higher than from trade in services. While the services sector has a lion's share of close to 60% in India's GDP, when it comes to net foreign exchange earnings, it is the agricultural sector that wins hands down. In India Services export receives excessive adulation in every available forum within the country. No one in the country is highlighting the impact of heavy import of services. It remains out of public knowledge and scrutiny. It is disturbing to note that the data on services export is available easily in the country but the services import is very difficult to get in details. But is it easily available from UCTAD, WTCO ITC ITC etc.

## India's international trade in services



Source: UNCTAD, WTO, ITC joint data set based on IMF statistics accessed from <http://www.intracen.org/itc/market-info-tools/statistics-import-country-service/>

## India's international trade in agricultural products



\*Estimates from FTPA, Ministry of Commerce, India accessed from <http://commerce.nic.in/ftpa/comgrpq.asp>  
Source: WTO International Trade Statistics

The data empirically establishes that the services industry is import-intensive. In fact, on a five-year average basis, for every \$1.09 billion services exported, India imported \$1 billion. The export-import ratio is a highly fragile 1.09. India was the sixth-largest exporter of services globally in 2013. It slipped to eighth position in 2014. Its net foreign exchange earnings also sharply declined. In value terms, earnings in 2014 from services exports are similar to what the country earned in 2007. As of 2014, India ranks 21st globally in the net income from services trade. Small countries such as Croatia, Cuba, Hong Kong, Israel, etc, earn higher net income from services trade. Surely, the UN data knocks down the self-perceived and self-promoted

superiority of the Indian services sector. At \$148 billion, India's services import for 2014 was larger than the oil import bill of \$113 billion (FY15). The trade surplus was a mere \$8 billion. This demolishes the popular perception that India's services export help counterbalance oil import bill.

**i. Woolly data and Exim Bank** - The woolly data about services import is of serious concern. "Exports to touch \$100 billion in FY15," proudly proclaims the website of Nasscom, the industry body created by the software services exporting companies. The imports of services by Nasscom members are not readily available and that too not easily accessible. "Software product imports are now growing faster than software services exports," cautions Sharad Sharma, former head of Yahoo India in a recent online article.

On July 1, 2015, the Exim Bank released a report titled Catalyzing India's Trade and Investment, giving the latest snapshots of the economy. Regrettably, the report carries incorrect data on the country's services import as it erroneously claims that services import declined from \$81 billion to \$80 billion between 2013 and 2015, even as services export increased from \$146 billion to \$155 billion. It is interesting to observe that the data released by UN agencies do not at all support the Exim Bank data. Minor variation between the government of India data and that from UN agencies is acceptable as the latter follow the calendar year while India follows the financial year, but major variations can be neither be justified nor accepted. Even the Reserve Bank of India's master circular no 13/2014-15 of July 1, 2014, mandates that in case of non-physical imports (i.e. software or data through internet etc), the importers should keep customs authorities informed.

## **B. Agriculture**

Agriculture sector is widely considered as an underdog and is actually outperforming the services sector in foreign exchange earnings – an incredible one in today's context. Unfortunately, Indian agriculture is unrecognized, unutilized and uncelebrated. The objective revelation that India's 0.19 billion hectares of gross cultivated land added \$75 billion net income to the national exchequer from exports in the last five years should delight the present government keen on ushering equitable growth and rural prosperity.

Agriculture is the largest private sector enterprise. Millions of rural families earn their livelihoods from agriculture. **As per WTO – International trade Statistics 2014** Global exports in agricultural products were \$1,745 billion in 2013. India ranks the fifth largest exporter of agricultural products after the US, Brazil, China and Canada. While the US earned only \$30 billion from agricultural trade in 2013, India earned as high as \$23 billion, drastically reduced the level of imports. The statistics send out a clear message. The dollar earnings to India from the international agricultural trade are higher than the one from trade in services. The services sector has a lion's share of close to 60% in India's GDP, but when it comes to net foreign exchange earnings, it is the agricultural sector that wins hands down.

Until 2000, Indian agricultural production was driven predominantly by food security. Subsequent diversification into high-value crops has changed the complexion of our agricultural production and exports as well. India is currently the second-largest player in agricultural production in the world. Between 2000 and 2013, agricultural products exports sharply increased from \$6 billion to \$47 billion. The added advantage of giving an export thrust to our farm products is that the import component is insignificant in Indian agriculture, unlike services sector. The basic resources for agriculture such as sunlight, land, water and labour are all available locally.

### **Conclusion –**

From the above it is clear that the economic growth and development of India largely lies on Capital Formation which supports the growth of industrial activities in the country for providing employment with reasonable income to increase the standard of living of the people, Use of natural resources to augment the foreign exchange reserves to have better say at the international arena, and give reasonable thrust on agricultural growth in the country as it supports nearly 70 percent of the population in the country and also to place a significant status to services sector which is the recently developed one but has a strong hold in the Gross Domestic Product of the country.

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