

Indian context of fragmenting political institutions and a largely private enterprise economy – was a recipe for failure.

II. POLICIES AND ECONOMIC GROWTH

As noted in the previous chapter, after returning to power in 1980, Indira Gandhi slowly but surely distanced herself from her earlier commitment to socialism and instead initiated a shift that has turned into a growing alliance with business groups.¹⁶ In what follows, I analyze the pro-business economic policies that emerged from this political shift and trace the impact of these policies on the acceleration of economic growth in India. Of course, any full analysis of India's economic growth during the post-1980 period, which is not provided here, would also need to take account of the cumulative changes in the nature of the Indian economy since independence and of shifts in the global context. The emphasis here is on the state's pro-business interventions in the economy and on how these interventions have released economic dynamism in India.

One respectable interpretation of the recent Indian economic experience – let us call it the pro-market interpretation – emphasizes the process of economic liberalization in India that began in 1991.¹⁷ India's earlier sluggish growth, according to this well-known line of thinking, was largely a product of a highly interventionist state and of a misguided import-substitution trading regime. In 1991, the argument might continue, India adopted a pro-market strategy that liberalized its internal regulatory framework, reduced tariffs, adopted appropriate exchange rate policies, and allowed foreign investors to play a significant role in the economy. As a result, rates of capital accumulation and the efficiency of the economy improved, propelling India into the ranks of the world's fastest-growing economies.

While widely embraced, this pro-market interpretation is unable to explain some important empirical anomalies in the Indian record and is plagued by some logical inconsistencies. First, economic growth in India started accelerating a full decade prior to liberalization of 1991.¹⁸ Second, industrial production in India – a key object of reforms – did

not accelerate in the decade following the liberalizing reforms,¹⁹ though it has in recent years. And third, if a set of policies is supposed to work anywhere and at any time, why have some states within India responded well while others have not?²⁰

I provide an alternate political economy account of India's recent growth acceleration that explains these anomalies. This account emphasizes the state's changing role since 1980, especially the abandonment of left-leaning anticapitalist rhetoric and policies, the prioritizing of economic growth, and a slow but steady embrace of Indian capital as the main ruling ally. Let us call such a strategy of development a pro-business strategy. In providing such an interpretation – let us call it the pro-business interpretation – I adopt a more general view that rapid industrialization in the developing world was promoted, not by minimal states that embraced the market, but by highly interventionist states that prioritized economic growth as a state goal, ruthlessly supported capitalists, repressed labor, mobilized economic nationalism in order to provide social glue, and channeled activities of firms to produce both for protected domestic markets and for export.²¹ In light of such an analysis of "success," one can suggest, as I have earlier, that India's sluggish economic growth from 1950 to 1980 was a product, not mainly of the state's market distortions, but of a mismatch between the limited capacities of the Indian state and the highly ambitious statist model of development. Following 1980, I will now move on to argue, the acceleration of growth in India has mainly been a product of the state's embrace of economic growth as a priority goal and of business groups as the main political ally. Before developing this argument in some detail, however, it is important to lay out some abstract issues that set the framework for developing the more empirical argument. Those uninterested in theoretical concerns can readily skip the following brief detour and move straight to the Indian materials that follow.

Pro-market versus Pro-business State Intervention

Rare though the cases are, the experience of rapid and sustained economic growth in a developing country has repeatedly provoked scholarly debate. The underlying questions are familiar: how did country A or B

¹⁶ In this section I am drawing on my two earlier essays. See Kohli (2006a) and Kohli (2006b).

¹⁷ For example, see Srinivasan and Tendulkar (2003) and Panagariya (2008).

¹⁸ For example, see Nagarat (2000), De Long (2003), Rodrik and Subramaniam (2004), and Virmani (2004).

¹⁹ See Chaudhri (2002) and Nagarat (2003).

²⁰ See Ahluwalia (2000).

²¹ I have developed this argument in detail in Kohli (2004).

(say, South Korea or China) get on the high-growth path, and does the experience of A or B provide a model, or at least lessons, for others? The main lines of the debate are also familiar: a high rate of growth resulted from the state's embrace of a pro-market strategy, namely, a move toward limited state intervention and an open economy; or, on the contrary, the country's success was a product of an interventionist state, especially of a close collaboration between the state and business groups aimed at growth promotion. Of course, in popular discourse on development, there is a tendency to treat all pro-business governments as pro-market governments. Even some scholars collapse this distinction, either obfuscating important analytical issues or, worse, providing an ideological cloak for what are clearly class issues.²² Before interpreting the recent growth experience of India, therefore, it may be useful to sharpen the distinction between pro-market and pro-business strategies of state intervention; these development strategies vary in terms of the choice of typical policies, the logic and pattern of expected outcomes, and the underlying politics.

Whereas a pro-market strategy supports new entrants and consumers, a pro-business strategy mainly supports established producers.²³ A pro-market strategy rests on the idea that the free play of markets will lead to efficient allocation of resources, as well as promote competitiveness, hence boosting production and growth. This simple but venerable idea inspired the so-called Washington consensus on development during the 1980s and 1990s.²⁴ Shorn of numerous complexities, this development orthodoxy consisted of a few key arguments. First, the proponents of the orthodoxy were quite critical of the earlier state-interventionist, import-substitution model of development that was pursued by many countries in the 1950s and 1960s. Second, the suggestion was instead that economic growth in the developing world would improve if developing countries shrank their economic role and opened their economies to the external world. A failure to do so, the argument went, would produce fiscal and trade imbalances. Pressing policy issues thus involved bringing governmental expenditure more in line with revenues, on the one hand, and opening the economy with the hope of promoting exports, on the other. And finally, more specific policy suggestions that emerged included

privatizing public sector enterprises, cutting public subsidies, reducing the public role in setting prices, currency devaluation, reduction of tariffs, and opening the economy to foreign investors.

All this is relatively well known and has by now been roundly criticized.²⁵ What needs to be reiterated is that advocates of a pro-market strategy logically expected a competitive, open, and efficient economy to lead to a number of additional benign outcomes: for the same amount of investment, a more efficient economy would lead to higher rates of economic growth; pursuing comparative advantage would create labor-intensive industrialization and thus rapid employment growth; competition would facilitate new entrants; terms of trade would shift toward the countryside, benefiting the rural poor; and since capital moves to capital-scarce areas in search of higher returns, regional inequality would diminish over time. The major anticipated problems in the pursuit of such a benign strategy would occur mainly in the short run, when the transition away from a statist, closed economy was likely to create disruption and recession. This also suggested that the pursuit of a pro-market strategy might be politically problematic. Since a pro-market strategy bets mainly on future winners, weak states of the developing world were likely to find few domestic allies in the short run. This is why external support for "reformist" developing country governments was deemed crucial by the proponents of pro-market strategies.

If the pro-market development strategy derived its inspiration mainly from some strands of neoclassical economics, the ideas behind a pro-business interpretation of economic success have developed more from real-world experience, especially from the rapid-growth successes of some East Asian economies. The key idea here is that success or failure is a function not so much of the degree but of the quality of state intervention. More specifically, identifying variation in how states are organized and in the institutionalized relationship between the state and the private sector is the key to understanding the relative effectiveness of state intervention in the economy. This relationship varies along a continuum stretching from considerable convergence in goals to mutual hostility between the state and the private sector. Other things being equal, the setting that has proved to be most conducive to (that is, that serves as a necessary but not sufficient condition for) rapid industrial growth in the developing world is one in which the state's near-exclusive commitment to high growth has coincided with the profit-maximizing needs of private entrepreneurs.

²² Panagariya, for example, holds that the distinction between pro-business and pro-market strategies is a "spurious distinction." See Panagariya (2008), p. 18.

²³ See Rodrik and Subramaniam (2004).

²⁴ See Williamson (1990).

²⁵ See, for example, Serra and Singlitz (2008).

The narrow ruling coalition in these cases has been a marriage of repression and profits, aimed at economic growth in the name of the nation. The developmental states of East Asia have generally created such political economies. Turning their countries into state-guided corporations of sorts, they have tended to be the fastest-growing economies in the developing world (e.g., South Korea and Taiwan, and in an earlier era, Japan).

Growth-oriented developmental states have pursued their commitment to high growth by developing trade and industry using well-designed, consistent, and thoroughly implemented state intervention. Specific policy measures have varied but have generally aimed at easing the supply-and-demand constraints faced by private entrepreneurs. Some of these interventions have been direct, and others indirect. On the supply side, for example, developmental states have helped facilitate the availability of capital, labor, technology, and even entrepreneurship. Thus the supply of capital was boosted at times by superior tax collection and public investment, at other times by using publicly controlled banks to direct credit to preferred private firms and sectors, and at yet other times by allowing inflation to shift resources toward private industrialists and away from agriculture and urban labor. Repression was also a key component in enabling private investors to have a ready supply of cheap, "flexible," and disciplined labor. Examples of less-direct interventions on the supply side have included the promotion of technology by investing in education and research and development, and/or by bargaining with foreign firms to facilitate technology transfer.

On the demand side, too, developmental states have pursued a variety of policies to promote their growth commitment. These have included expansionist monetary and fiscal policies, and tariff and exchange-rate policies aimed at boosting domestic demand. And when domestic demand was not sufficient, these states have just as readily adopted newer policies that shifted incentives in favor of export promotion or, more often, that helped promote production for both domestic and foreign consumption.

There has thus been significant variation in the specific policy measures undertaken by developmental states. Only some policies, such as labor discipline, have necessitated a repressive state. But what most policies adopted by developmental states reflected instead was a single-minded and unyielding political commitment to growth, combined with a political realization that maximizing production requires assuring the profitability of efficient producers but not of inefficient ones. Sometimes this has required getting prices right, but just as often it has required

exports, and holding wages back behind productivity gains. The central issue has concerned the state's goals and capacities, expressed in the institutionalized relationship between the state and the private sector. Developmental states in successful late-late-industrializers have thus been pragmatically – and often ruthlessly – pro-business, more than they have been purely and ideologically pro-market.

The discussion of the contemporary Indian growth experience that follows, then, is framed by these general considerations: has India's recent economic growth resulted more from the embrace of the pro-market or the pro-business development strategy? To anticipate, the argument presented here is that, since 1980 or so, the pro-business political shift in India that I analyzed in the last chapter has led in the realm of the economy to the adoption of a pro-business development strategy. Of course, India is no East Asia: as a democracy, with considerable political fragmentation, India can't replicate the cohesion, effectiveness, or brutality of a Korean state; India's indigenous capitalism was also a lot more advanced by the 1980s as compared to, say, that in Korea around the mid-1960s, when a developmental state came into being there and needed to "pick winners" in order to create new capitalists; and labor in India remains well organized and protected. The new developmental state that India is thus in the process of crafting resembles the developmental states of yore mainly in terms of prioritizing growth and realigning closely with capital. The Indian state also remains activist insofar as it continuously seeks to create a growth-oriented framework, supports capital as needed, and helps tame labor as far as possible within the constraints of a democracy. Many aspects of India's recent economic performance, in areas of both growth and distribution, are best explicable if one keeps in mind this pro-business standpoint adopted by the Indian state.

The Politics of Economic Growth in the 1980s

A glance at both Table 2.1 (p. 86) and Figure 2.1 clarifies the fact that economic growth in India accelerated noticeably around 1980. It is the case that the rate of growth of industrial production from 1980 onward (Table 2.1 and Figure 2.2) was not all that impressive, both by international standards and in comparison to India's own record in the 1950s.²⁶ Nevertheless, the growth of the 1950s began from a very low starting point, and the performance since 1980 has been a significant improvement over the 1970s, a decade dubbed the "decade of stagnation." Moreover,

²⁶ See Wallack (1992).

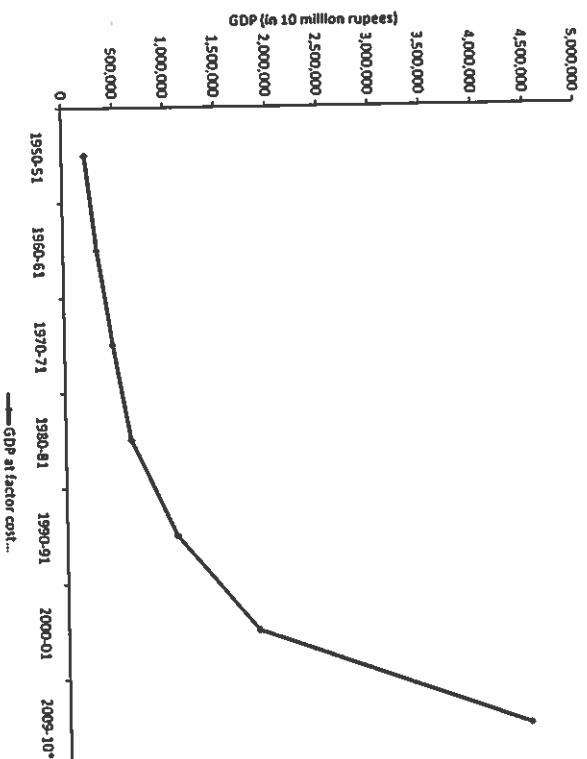


FIGURE 2.1. Gross Domestic Product in India, 1950–2010. *Source:* Government of India, *Economic Survey 2010–11*. *Quick Estimate

a number of economists have established, using a variety of more formal tests, that 1980 (or thereabouts) indeed represents a break from India's "Hindu growth rate."²⁷ So the first empirical puzzle is: what underlying changes might help us explain this break from the past?²⁸

²⁷ See, for example, Rodrik and Subramaniam (2004) and Virmani (2004).

²⁸ It should be noted that some of those sympathetic to India's liberalizing reforms in 1991 tend not to find the growth pickup of the 1980s all that puzzling, maintaining instead that this growth was not sustainable, e.g., Srinivasan and Tendulkar (2003) and Panagariya (2008). This view is not fully persuasive because the underlying fiscal problems toward the end of the 1980s were not of crisis proportions, and the pressure on the balance of payments was generated at least in part by unforeseen external circumstances. As to fiscal issues, note that interest payments on government debt constituted about 17 percent of government expenditures at the end of the 1980s, and 31 percent at the end of the "liberalizing" 1990s (Mohan 2000, Table 5b, p. 2029). The external debt service ratio in 1988 of 29.2 percent was high but was much lower than the 36.4 percent average of "all moderately indebted low income countries." India's short-term debt was also relatively low (Mookherjee 1992, Table 1). The pressure of maintaining payments on foreign debt was, in turn, exacerbated around 1991 by a sharp drop in remittances by nonresident Indians that at the time constituted nearly a third of India's export earnings (Kapur 2010, Figure 4.2). This drop (and the threat of a drop) was fueled by such unpredictable external circumstances as the disintegration of India's major trading

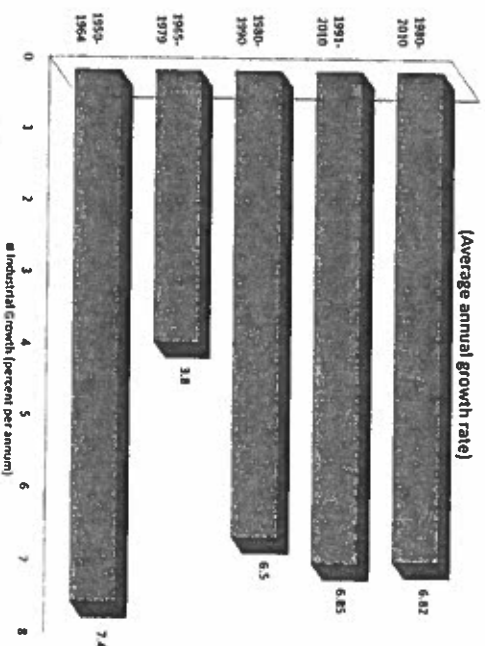


FIGURE 2.2. Industrial Growth in India, 1950–2010. *Source:* Author's estimates based on government of India, *Economic Survey 2008–09, 2010–11*.

A brief look at the more proximate economic determinants of the rapid increase in production sets the stage for a deeper analysis of the more distant causal variables in the broader political economy. In a rough-and-ready manner, economic growth accelerated because of improvements in the rate of both investment and productivity. As is evident from Table 2.1 (p. 86) and Figure 1.2 (p. 44), the overall rate of investment in the economy improved from 1980 onward (the trend actually began in the second half of the 1970s) and has shot up quite dramatically since 2005. The growth in investment in the 1980s was fueled by both growing public investment and private corporate investment, and in the 1990s, as public investment declined, by growing private investment (Figure 1.2); the role of foreign investment has also increased during the most recent period. As to productivity, especially total factor productivity in manufacturing, the literature generated by economists seems to suggest that there was a surge in the 1980s and then, though the economy still improved, some deceleration in the growth rate during the 1990s and beyond.²⁹ For

partnet, the Soviet Union, and the first Iraq war and the related increase in oil prices, both creating a sense that devaluation might be imminent. So, while the macroeconomic problems were real, the government also used the occasion to do what it already wanted to do.

²⁹ See, for example, Virmani (2004a).

the purposes of a broad political economy analysis, then, leaving aside numerous related measurement and other problems that economists rightly debate, the first empirical puzzle translates into this: what political and policy changes during the 1980s help explain improvements in the rate of investment in and the efficiency of the Indian economy?

Before answering that question, however, two caveats are in order. First, it is important to reiterate that the higher rate of economic growth from 1980 on is at least in part a result of the changing composition of the national economic product. Over the last few decades, the contribution of the slow-growing agricultural sector to the national product has declined steadily, while the contributions of the more rapidly growing industrial and the service sectors, especially that of the latter, have grown; the fact that the overall economy now grows at a faster rate than it did when the agricultural sector dominated is to an extent simply a statistical artifact of the changing structure of the economy.³⁰ The outcome one is trying to explain, then – namely, improvement in the rate of investment and in the efficiency of the economy, especially of the industrial economy – is mainly of an order that brought to an end the earlier “decade of stagnation.” And second, some component of the improvement in the growth rate from 1980 on was clearly a function of building on a good foundation a factor that is not readily quantified: accumulating technology, entrepreneurship, and management; trained workers; a sufficient tax base; dense supplier networks; and adequate demand in the economy.

What eventually triggered the upward shift in the growth rate of the Indian economy around 1980 was a slow but sure adoption of a new model of development. Instead of the statist and nationalist model of development of the Nehru era, which was then accentuated in a populist direction by Indira Gandhi during the 1970s, Indira Gandhi herself shifted India's political economy around 1980 in the direction of a state and business alliance for economic growth. This change was not heralded loudly and has often been missed by scholars, especially because Indira Gandhi remains deeply associated with the politics of *garibi hatao*. Nevertheless, as analyzed in the last chapter, evidence shows that the post-Emergency Indira Gandhi was a different Indira Gandhi: she downplayed redistributive concerns and prioritized economic growth; sought an alliance with big business; adopted an anti-labor stance; put the brakes on the growth of public sector industries; and downgraded the significance

of economic planning and of the planning commission. As suits a complex democracy, these changes emerged in fits and starts, and they were often camouflaged, helping maintain some of Indira Gandhi's credentials as the leader of the masses. The changes were nevertheless profound; they involved a shift from left-leaning state intervention that flirted with socialism, to right-leaning state intervention in which the ruling elites recommitted themselves to a more distinctly capitalist path of development. And important economic actors within India, especially big capital, understood these changes pretty clearly, expressing their satisfaction by increasing investment and helping India's economy grow rapidly.

The three components of the new model of development that Indira Gandhi adopted from 1980 on – and that for the most part has also been pursued by subsequent governments – were prioritizing economic growth as a state goal, supporting big business in order to achieve this goal, and taming labor as a necessary aspect of this strategy. The shape of the new model emerged slowly but quite, quite surely. First, let us take the issue of prioritizing growth. Within six months of coming to power, Indira Gandhi's government put out a new industrial policy statement that declared “maximizing production” to be its top priority.³¹ Between then and 1982, a year she dubbed the “year of productivity,” India's development strategy underwent a dramatic change: jettisoning redistributive socialism, a move hailed by the Indian press at the time, development was now to be pursued by a policy of “growth first,” focusing on improvements in production and productivity.³²

Indira Gandhi established powerful committees to study how this major transformation was to be implemented: among them were the L. K. Jha committee to study the overhaul of economic administration; the Abid Hussain committee to review trade; and the M. Narasimhan committee to consider financial reforms. These three senior bureaucrats were well regarded by the Indian business community. In addition to this long-term process, with its important signaling effect, numerous policy measures were also adopted to give concrete meaning to the “growth first” policy. As already noted, these all indicated considerable convergence of views between the government and Indian big business concerning the factors impeding growth: constraints on and lack of governmental support for business; labor activism; the inefficiency of the public sector; and the

³¹ See Paranjape (1980).

³² See Nayyar (1989), p. 349.

decline in public investment, especially in infrastructure.³³ Notice also how the diagnosis within India of the factors impeding growth diverged from that offered by the emerging "Washington consensus" on development of the time. While there was some shared emphasis on deregulation and the inefficiency of the public sector, Indian business and government, for the most part, advocated a much more activist state, one that would spend more, control labor more, and support capital more actively. The shared elite policy preferences within India were thus clearly more pro-business than pro-market.

Starting in the early 1980s, then, Indira Gandhi's government initiated a series of pro-business policy reforms. First, the government withdrew some important constraints on big business and, going further, encouraged private firms to enter some areas hitherto reserved for the public sector. The Monopoly and Trade Restrictions Act (the MRTA act), which had effectively limited the growth of big business, was thus diluted, removing licensing restrictions and allowing big business to expand in such core industries as chemicals, drugs, ceramics, and cement. The government also encouraged the private sector to get into such areas as power generation. While small business was not always happy with such changes, big business welcomed them effusively.

Second, if expansion was to be encouraged, there was the question of financing the expansion. The government initially liberalized credit for big borrowers, but there was much back-and-forth on the policy.³⁴ Additional policies for the provision of finance were twofold. The government provided some tax relief to big business to encourage investment. More

³³ See, for example, the lead editorial, "All for Production," in *Economic and Political Weekly*, *Review of Management*, August 30, 1980. Reporting on Indira Gandhi's "two well-publicized meetings with selected group of industrialists and businessmen," the editorial noted that "it was... made quite clear to the industrialists... what the government was most concerned about just now was higher production. Of course, this precisely has been the industrialists position always... [they] have been haranguing the government about the urgent need to remove alleged fetters on larger production... the Prime Minister herself and her senior cabinet colleagues told the industrialists quite explicitly that the government accepted the position... the government further accepted that industrialists needed to be given incentives to raise production." Also see B.N.I., "FICCI's Blueprint," *Economic and Political Weekly*, Jan. 26, 1980, p. 133, where the FICCI's policy preferences at the time are outlined.

³⁴ A few banks were nationalized during this phase. It would be a mistake to take this as a sign of continuing "socialism." The nationalized banks were losing money and were nationalized – bailed out, really – after mutual agreement. Bank nationalization and credit, however, did become a visible political issue; the government eventually tilted some of the credit towards the countryside, where the majority of the electorate lives.

important, the government altered the legal framework, as well as providing incentives, to encourage the private sector to finance new investment by raising resources directly from the public. As Pranab Mukherjee, the finance minister from 1982 on, commented:

An area of strength for the industrial sector today is the highly favorable investment climate, which has prevailed since 1980. This is a result of a series of policy measures implemented with the conscious objective of creating an environment conducive to industrial dynamism. Many of these measures have responded to the felt needs of the corporate sector... the annual budgets for the years 1980-85 have a distinct philosophy. Incentives were provided to encourage savings and channel them into productive investment... The Government has actively encouraged the corporate sector to mobilize the financial resources it needs for investment and modernization directly from the public. This policy has been highly successful. The total amount of capital issued by the private corporate sector increased from a little over Rs. 300 crores in 1980-81 to Rs. 529 crores in 1981-82, and further to Rs. 809 crores in 1983-84. This is an expansion of 170 percent in three years.³⁵

Clearly, the government was consciously paving a pro-business path to higher growth and wanted to take credit for it.

Third, if private industry was to expand rapidly, both the national government and the business community felt that labor activism had to be tamed. This was difficult for Indira Gandhi in light of the fact that she was widely regarded as a leader on the left. Nevertheless, she put the "national situation" ahead of labor's interests and put labor on notice. Strikes, *gheraos*, "go-slow," and "work-to-rule" movements were increasingly characterized by Indira Gandhi as "anti-social demonstrations of irresponsibility by a few" (*Times of India*, July 10, 1980). Special legislation was passed to discourage strikes, and labor and business were increasingly supposed to cooperate. While labor activism continued – India is after all a democracy – the die was cast for a new government attitude toward labor.

In addition to creating a new pro-business and antilabor context, one consistent with its growth-first policy, the Indian government also sought to restructure its own economic role. Of course, it is important to reiterate that what we are discussing here is India and not some well-constructed, cohesive, and brutal developmental state of the East Asian variety; Indian politics is not a world in which governments pick winners, corporatize interest groups, and balance budgets. Within the limits of India's

³⁵ See Mukherjee (1984), pp. 58-9.

fragmented state power, the scope of political reordering was nevertheless impressive. Unlike those following the "Washington consensus," the Indian state in the 1980s never considered cutbacks in public expenditures that could have been recessionary; there was instead widespread agreement that public investment in infrastructure "crowds in" rather than "crowds out" private investment. Accordingly, Indira Gandhi sought new revenue. Given the perceived political limitations (e.g., the inability to tax more widely or effectively) and tax concessions to both investors and well-off consumers – to keep up demand – the main source of new revenue was indirect: excise and customs duties. With this new revenue, and some borrowing at home and abroad, the government kept up the pace of public spending (see Figure 1.2, p. 44), contributing to growth.

With revenues from direct taxes declining (because of tax concessions to big business), on the one hand, and growing expenditures, including the cost of modernizing defense and sustaining investment in infrastructure, on the other, the fiscal pressure on budgets was significant. In line with its new priorities – enhancing production mainly via the private sector – the government sought to cut back some of its traditional expenditures. Most significantly, it sought to limit new investments in public sector enterprises; the new mantra instead was to improve their efficiency, in part by better capacity utilization (read fewer labor strikes), and in part by allowing them to revise upward the prices they charged for their output. The latter was also consistent with socialism taking a back seat. Other changes of the same kind included cuts in subsidies to the public distribution system and the abandonment of the Food for Work program in 1982. While budget deficits and the size of the public debt grew during the Indira Gandhi years, that growth was downright modest in comparison to what followed during the Rajiv period.

Finally, one should take note of some of the changes in India's economic relations with the outside world.³⁶ As an oil importer, the second

petroleum price hike in 1981 increased India's import costs significantly. A commitment to increasing industrial growth was also going to require importation of machinery and other technology. Anticipating a foreign exchange squeeze, India entered a loan agreement with the IMF in 1981 for nearly \$5 billion over a few years. India's pro-business policies had already been moving in a direction that the IMF found "encouraging," though not quite the "structural adjustment" package more commonly demanded. It is notable that the IMF did not insist that India cut back its public expenditures; in light of the fact that India did not owe any huge sums of money to foreign creditors, and given India's size and the leverage that that provides, Indian policy makers convinced the IMF of the need to keep up public investment in order to accelerate economic growth via the private sector.³⁷

What India did do was to open up the economy somewhat, both to foreign investors and to foreign goods. Import liberalization in 1981, especially, was far from trivial, but also proved to be short-lived. The import bill rose sharply, without a commensurate increase in exports. Indian businessmen reacted sharply to the threat of cheaper imports and demanded protection.³⁸ The Indian government obliged; import restrictions were imposed again in the budget of 1983–4, around the same time that India terminated its IMF agreement, even before taking advantage of the full loan. If one ever needed evidence to support the claim that the primary commitment of the Indian state at this time was to establish Indian businesses rather than to any general principle of creating free markets and a global opening, here it is. This was a pattern that would repeat itself during the Rajiv Gandhi years – more on this later – and that was not fully abandoned even during the more sharply liberal 1990s.

³⁶ is tempted to label ideological. While the focus on the opening of the economy to the outside world is thus understandable (or at least comprehensible), it can also be myopic, especially if one wants to understand some of the key economic dynamics of such a large country.

³⁷ See Sengupta (2001), Chapter 2.

³⁸ By mid-1982, for example, FICCI was arguing against trade liberalization. The demands to restrict imports, however, were not universal. The Birlas were arguing against rayon imports and the Tatas against the dirt-cheap Bulgarian soda ash. Select public sector industries were also arguing against cheap imports of computer components. Those benefiting from cheap imports, however, also made some noise but did not prevail; these included some in the textile industry who wanted to import shuttle-less looms and glass manufacturers who wanted cheap soda ash. See "Clamors against Liberalization," *Economic and Political Weekly*, July 10–17, 1982, pp. 1133–6.

To sum up the discussion so far, Indira Gandhi during the first half of the 1980s abandoned a commitment to redistribution and committed herself to a "growth first" model of development. The political underpinnings of these shifting priorities were analyzed in the last chapter. These priorities, in turn, led Indira Gandhi to tilt the policy process in favor of big business and against labor, and to restructure the state's own role in the economy toward growth promotion. There were some halting efforts to open up the economy as well. While this model adopted some of the policies recommended by the "Washington consensus" on development, it was considerably more statist and more explicitly growth-oriented; it was also more pro-business than pro-market. Beginning in 1980, then, India's nationalist-capitalist model of development began to share some important traits with the East Asian model, in which highly interventionist states commonly ally with business and against labor and only selectively link their economies to the world, often more via trade than via capital.³⁹ Of course, state power in India is considerably more fragmented and checked by democratic forces than is the case in, say, a South Korea under Park Chung Hee. These differences were also consequential: budget deficits remained an issue as direct taxes were hard to collect and expenditures hard to limit; mercifully, labor could never be fully tamed; and the state itself remained "soft," creating numerous problems of inefficiency in the bureaucracy and public management. The shift in development strategy also created significant political problems, especially that of winning the support of a majority where the majority is poor, or near-poor, and the rhetoric of socialism and *garibi hatao* is being put on the back burner; these have already been discussed.

The growth-first, pro-business, antilabor shift initiated by Indira Gandhi basically continued under her successor, Rajiv Gandhi. Leaving aside a lot of rhetorical flourishes, as well as a fair amount of back-and-forth on specific policies, Rajiv Gandhi continued the policy changes initiated by Indira Gandhi, moving a little faster in some areas, a little slower in others. By the end of his rule some significant changes in the domestic political economy and a few changes that altered India's links with the world had been put in place. Most significantly, state controls on such activities of private Indian firms as entry into production, production decisions, and expansion in size were eased even further. Indian

³⁹ See Kohli (2009) for a discussion of the nationalist-capitalist model of development pursued in Asia in general.

business groups were also provided significant concessions on corporate and personal taxes, as well as assurances about future patterns of taxation. On the external front, some import barriers came down, though not dramatically; some import quotas were removed; and there was some currency devaluation. For the most part, however, the internal changes were more significant than the external ones.

Three important political economy observations concerning the Rajiv period need to be made.⁴⁰ First, irrespective of what actual reforms were implemented during this period, Rajiv Gandhi and his advisors decided from the outset to emphasize a break with the past. Whereas Indira Gandhi's growing embrace of big business was increasingly straining her commitment to socialism, as noted earlier, Rajiv Gandhi dropped the pretense of socialism altogether and openly committed his government to a new "liberal" beginning. Among Rajiv's important economic advisors at this time were individuals like L. K. Jha, Manmohan Singh, Montek Singh Ahluwalia, and Abid Hussain. These individuals had also been critical players during the post-1980 Indira Gandhi period, and some of them, especially Manmohan Singh and Montek Singh Ahluwalia, played a decisive role in the policy shift of 1991. Two conclusions thus seem warranted: stressing continuity or change was as much a political decision as one having to do with the substance of policy reforms; and more important, the decision to undertake major reform of the economy was already very much on the mind of key policy makers during the 1980s, who were then waiting for an appropriate political moment, which finally emerged with the "crisis" of 1991.

Second, it is clear from the policy changes adopted during this phase that the government's commitment was first and foremost to economic growth, and only secondarily to some abstract notion of "openness" or "laissez-faire." In spite of growing budget deficits, for example, the government kept up the pace of public investment, including investment in infrastructure. Public spending thus helped growth not only by boosting demand, but also by easing supply constraints. The government self-consciously lowered taxes on the middle class so as to boost demand, especially for consumer durables. Much of the new private investment flew into these areas, also improving the productivity of the hitherto heavy industry economy. And finally, the state got actively involved in promoting the growth of industries such as computers and electronics, providing them supply-side support and also maintaining pressure on

⁴⁰ For details, see Kohli (1989).

them to stay competitive by minimizing protection. For example, Rajiv Gandhi took a personal interest in the development of the computer industry. He encouraged collaboration among Indian computer specialists at home and abroad. Rules for entry were simplified; a variety of supports – such as technical parks – were provided; and collaboration with foreign companies was encouraged. Major Indian IT companies, such as Infosys and WIPRO, matured during these years, and such foreign companies as Texas Instruments and Microsoft established bases in India.⁴¹ While problems of fiscal and balance-of-payment imbalances were building up, the government was also self-consciously promoting growth and succeeding.

Finally, it is important to note that the policy pattern was more pro-business, especially pro-big Indian business, than anything else. Much of internal policy reform – such as eliminating many licensing requirements, removing restrictions on the size of businesses, and opening up areas reserved for the public sector to the private sector – helped big rather than small or medium-sized private businesses. Moreover, whenever conflicts arose over external opening, especially on issues of foreign investment, but also on trade, the government accommodated the demands of Indian business groups. Spokesmen for FICCI, as well as government representatives such as L. K. Jha, often reiterated that the “pace of domestic liberalization” would continue but that “external liberalization was not really an objective of the policy.”⁴²

Indira and Rajiv Gandhi dominated the Indian political economy during the 1980s. This was also the decade in which India's economy made a breakthrough, moving beyond the “Hindu growth rate” to a more rapidly growing economy. One central suggestion here is that this shift in economic performance was triggered by the pro-business policy shift engineered by the two Gandhis. The new growth strategy produced both higher rates of investment and improvements in the efficiency of investment, contributing to higher growth rates, especially in the industrial and services sectors. The government's commitment to growth was evident, first, in sustaining relatively high levels of public investment during the 1980s (see Figure 1.2, p. 44). This investment helped ease a variety of infrastructural bottlenecks, such as those in coal, power, and railways; it might also have contributed to a higher growth rate by providing a

⁴¹ See Ye (2007), Chapter 8. Also see Evans (1991).

⁴² These quotes are from my interview with L. K. Jha. See Kohli (1989), p. 315.

TABLE 2.2. *Patterns of Capital Formation by Sector, 1970–2008*
(averages as percentage of GDP)

	Total Gross Capital Formation	Private Corporate Sector	Public Sector	Household Sector
1970–75	18.2	2.8	7.7	7.7
1975–80	22.5	2.3	11.0	10.0
1980–85	21.9	4.5	10.2	7.2
1985–90	23.7	4.5	10.5	8.7
1990–95	23.7	6.0	9.1	8.6
1995–2000	24.8	8.0	7.0	9.8
2000–08	30.5	10.6	7.1	12.8

Source: Author's estimates based on government of India, *Economic Survey*, various issues (<http://indiabudget.nic.in>).

boost to overall demand.⁴³ More important than the recovery of public investment was the changing behavior of the private sector.

Assuming that businessmen react to favorable opportunities for profit making, it is reasonable to suggest that the government's new pro-business policy regime in the 1980s was responsible for the rising share of corporate investment in GDP evident in Table 2.2 and Figure 1.2 (p. 44). Other evidence also supports the claim that private sector companies grew at a relatively rapid pace during the 1980s: whereas the paid-up capital of private companies grew at an average annual rate of 7.3 percent during the 1970s, the growth rate during the 1980s was nearly twice that, 14.3 percent; also, the number of private companies during the 1980s grew at an annual average rate of 13.5 percent, compared to a growth rate of 3.3 percent for public sector companies.⁴⁴ We also know that private investment in India tends to be more efficient than public sector investment. It follows that the state's pro-business tilt contributed to a higher rate of growth via the enhanced role of the private sector in the Indian economy. While the major beneficiaries were established big

⁴³ Rodrik and Subramanian (2004) find that public investment in the 1980s did not impact growth, though they do allow that the relationship holds with some time lag. Most economic analysis of India instead find a strong association between public investment and higher growth rates; see, for example, Nagaraj (2003). Even analysts considered pro-liberalization, but committed to growth, worry about declining public investment in India; see, for example, Mohan (2002).

⁴⁴ See Pedersen (2000), p. 268; and Virmani (2004a), p. 35.

business firms, the relative ease of entry also enabled new players to emerge as giants.

If the partial impact of the changing governmental commitment to growth can be traced via changing policies and enhanced investment, both public and private, our understanding of why and how the productivity and efficiency of the economy also improved remains rather diffuse.⁴⁵ Some of the underlying factors were probably unrelated to short-term policy changes; as noted earlier, these might include the building stock of technology and management in the economy, the establishment of a variety of producer networks, sufficient demand in the economy, an adequate tax base, and the presence of a sizable working class. Among the policy-related changes, firms might have become more productive by the 1980s because many of them were producing more consumer than capital goods; technology imports were facilitated, and so was the availability of foreign exchange, enabling ready availability of a variety of scarce inputs and thus helping utilize industrial capacity at a relatively high level. Domestic competition also must have put pressure on some firms to economize, though for others a near-monopoly type of growth, and thus achievement of economies of scale, may have helped produce a similar outcome. The precise causal impact on productivity of such factors is hard to establish; what does seem clear is that the shift in governmental policies and the enhanced role of the private sector helped improve not only the rate of investment, but also the efficiency of the economy.

While the new pro-business strategy of the two Gandhis was indeed responsible for accelerating India's economic growth, it also created numerous other problems. The political problem of how to accommodate the excluded has already been analyzed. What is worth reiterating is a political economy problem. Given the nature of power in the Indian state, the embrace of a state-capital-alliance-for-rapid-growth model of development could never fully replicate the East Asian model; India's authority structure was and remains too fragmented, and given Indian democracy, the underlying class basis of state power could never be too exclusively pro-business. The clearest economic manifestation of these political traits

was the slow but steady building up of fiscal pressure: the inability to collect more revenue, on the one hand, and the inability to limit a variety of public expenditures, on the other. Even some of the external borrowing mainly fed internal fiscal imbalances. The growing fiscal and balance-of-payment difficulties, in turn, helped create the "crisis" of 1991.

The Politics of Economic Growth, 1990–2010

During the post-reform period, the service sector of the Indian economy has grown most rapidly. By contrast, agricultural growth has decelerated, and the growth rate in the industrial sector has been about the same as it was during the 1980s (Table 2.1, p. 86). In what follows I will analyze the political and policy underpinnings of these growth patterns, focusing especially on industrial growth because reforms have been aimed mainly at Indian industry. The stunning fact about recent industrial growth in India is this: in spite of all the noise about reform, the growth rate of India's industry has not been influenced all that greatly by the reforms (see Figure 2.2, p. 99). The real break in growth occurred around 1980. Since then nothing dramatic has changed, at least in terms of the aggregate outcomes. What have changed instead are the distributive outcomes associated with this growth, an issue to which I will return later. It is also notable that employment in manufacturing remained constant at around 12 percent of the workforce during the 1980s and then during the post-reform period.⁴⁶ How does one interpret this pattern as well as this rate of growth?

Once again, observing the more proximate economic determinants of these trends helps set the stage for a deeper political economy analysis. It is clear from Table 2.2 and Figure 1.2 (p. 44) that the overall rate of capital formation in the Indian economy did not alter significantly between the 1980s and the 1990s, though it did shoot up sharply during the post-2005 period. The composition of this investment has shifted throughout this period (Figure 1.3, p. 45): public investment has declined since the 1990s, and the resulting gap has been filled – nay, more than filled – by a variety of private investors. The growth rate of total factor productivity of the economy has not altered much, though labor productivity has improved. So the puzzle for analysis concerns the impact of the reforms on investment – especially on its changing composition – and on the rate of industrial growth, where the gains are not dramatic.

⁴⁵ Writing eloquently, and with an authority that he well deserves, I. G. Patel (1992) thus noted: "Efficiency, of course, is a dynamic concept and its best promoters, apart from entrepreneurship, skills and capital, are good information, competition with a level-playing field, transparency, relative stability of policies and improvements in technology. Once again, efficiency transcends the domain of micro-economics as narrowly and traditionally conceived, and requires something more than competitive market" (p. 43).

⁴⁶ See Nagarni (2003), p. 3708.

That India in 1991 adopted a fairly significant set of economic policy reforms is well known. The economic reforms undertaken since 1991 have influenced both India's industrial policy and its external economic relations. The various industrial policy reforms – further loosening of licensing requirements, removal of MRTP constraints, tax concessions, further opening to private enterprise of areas hitherto reserved for the public sector, and taming labor – are best viewed as continuation of the “internal liberalization” well under way during the 1980s. These reforms also ought to be judged mainly as pro-indigenous business, enabling well-established businesses to grow and allowing some new ones to emerge and flourish. In light of the earlier discussion, none of these reforms should be all that surprising. Where there was a significant element of discontinuity was in the area of India's external economic relations, including trade, foreign investment, and financial relations. As is also well known, starting in 1991 import quotas were removed (fully only in 2001), tariffs came down slowly but surely, the currency was devalued, the foreign investment regime was liberalized, and various restrictions on external financial transactions were eased. Some of these reforms helped Indian business; others put enormous competitive pressure on them. In adopting these external economic reforms, the Indian state was responding to a sharply changed world, as already discussed, and in the process attempting to establish a new social contract with Indian business: we will continue to put our full weight behind you, but you, in turn, must become more competitive. The underlying politics of these reforms was analyzed in the previous chapter.

While I move to trace the impact of India's economic reforms, the scope of external economic reforms must be kept in perspective. By India's own past standards, the changes were quite dramatic. In a comparative and global perspective, however, India's opening to the world remains relatively modest.⁴⁷ On the trade front, for example, tariffs did come down significantly, but the decline began in 1987, during the Rajiv Gandhi years, and toward the end of the millennium Indian tariffs still averaged some 30 percent, among the highest in the world. India's share of foreign trade, at some 2.5 percent of the GDP, was also among the lowest in the world in the early twenty-first century. The story on foreign investment is not all that different. While the inflows in the 1990s were huge compared to the past – averaging nearly \$4 billion, including both direct and

portfolio investment – on a per capita basis India remained one of the least exposed countries to foreign investment in the world; of course, FDI and portfolio investment shot up in India during the post-2005 period, but again declined during 2009 and 2010. And finally, it is well known that capital movement in India remains relatively restricted.

Of the major policy reforms initiated in 1991, then, internal deregulation has proceeded the furthest, and global opening has been real but slow and modest. By contrast, the attempts to trim current public expenditures, privatization of public enterprises, and labor reform face political obstacles and for the most part have not been pursued. As noted earlier, this pattern of reform underlines the pattern of power distribution in India: reforms that favor big business have been relatively easy to push through, but a variety of other interest groups are able to moderate any rigid ideological plan to turn Indian economy into a paradigmatic example of “neoliberalism.”

A brief discussion of a specific case, the case of the automobile industry – a case that is far from atypical – will help explicate the pattern of these macro changes at a micro level.⁴⁸ Up until 1980 or so, India's auto industry was highly protectionist, dominated by two or three private business houses, including the Birlas and the Tatas. When Indira Gandhi introduced her important pro-growth policies in the early 1980s, a variety of controls on the entry of new firms and on expansion were loosened, leading to her son's effort to develop a new automobile manufacturing company, the Maruti Udyog. When these efforts faltered, collaboration with the Japanese auto manufacturer Suzuki Motors was the first major joint venture with a foreign company in the auto sector. The success of this venture put pressure on established automobile companies, many of whom entered into similar arrangements, leading to the entry into India of a number of Japanese automobile companies. While new products were introduced and supply bottlenecks eased, none of these changes threatened established, indigenous businesses in any fundamental way: tariffs and quotas on automobile imports remained, as did limits on the conditions under which foreign companies could enter India, generally as junior partners in joint ventures with established Indian companies.

As the Indian economy opened during the 1990s, the automobile industry came under further pressure. Industry associations lobbied

⁴⁷ In listing the “modesty” of these reforms, I am drawing on Nayar (2001).

⁴⁸ In this discussion of the auto industry, I am drawing on the important research of Ye (2007), Chapter 8. Also see D'Costa (2005).

successfully to moderate the opening. Quantitative restrictions on imports remained in place during the 1990s, and foreign investors had to meet a variety of requirements such as minimum initial investment, export obligations, and obligations to use local inputs. In order to comply with WTO rules, India had to end quantitative restrictions on auto imports in the new millennium. The fear of imports again mobilized Indian automobile manufacturers. In line with the broader political economy analysis already developed, the Indian state again obliged, limiting the damage that unimpeded imports and foreign investment might cause to indigenous manufacturers. As quantitative restrictions were lifted, a variety of new customs duties on imports of new and old automobiles were introduced. Restrictions on foreign investors, including the need to use local inputs and export obligations, were institutionalized. By the mid-2000s, the Indian auto industry was a lot more open than it had been during the pre-1980 period, but the opening had been calibrated so as to preserve the interests of indigenous manufacturers. In the words of one analyst, global opening of the Indian auto industry "was allowed in areas that strengthened the competitiveness of Indian automakers and rejected when it threatened industrial interests."⁴⁹

To return to the more macro issue of the rate of growth and the impact of reform, in the words of Montek Ahluwalia, a key policy maker in India, the reforms "were expected to generate faster industrial growth and greater penetration of world markets in industrial products, but performance in this respect has been disappointing."⁵⁰ With reform advocates themselves expressing disappointment, the real debate in the literature is about explaining the disappointing performance. The "disappointment," of course, has to be kept in perspective: at some 6 percent annual growth, India's is still among the world's fastest-growing economies; exports have grown steadily, and the balance-of-payment situation has improved considerably since the reforms. And yet industrial growth in the two decades following the reforms did not exceed the rate achieved during the 1980s; growth in total factor productivity during the post-reform period also did not improve dramatically as compared to the 1980s; export growth continued to be surpassed by growing imports; and the share of public investment declined, while the share of public debt continued to grow. Contending explanations, as one might expect,

tend to suggest either that the reforms have not gone far enough or that they have already gone too far, too fast.⁵¹

Focusing mainly on the political economy of growth, what requires discussion is why India's reforms did not lead to an acceleration of industrial growth – though, unlike cases of real neoliberalism in Latin America, they also did not hurt economic growth. As before, one needs to focus on issues both of rates of investment and of productivity. It is well known to observers of India that private investment, including corporate investment, has for the most part remained buoyant during the post-reform period but that public investment has declined (see Table 2.2 and Figure 1.2). Private corporate investment shot up rapidly after the reforms but peaked in the mid-1990s and has now again shot up during the post-2005 period. Capital formation in the household sector has also grown rapidly since the mid-1990s.

One must attribute the continued buoyancy of private sector investment to the various pro-business industrial policy changes introduced during the post-1991 period. The fact that the investment boom originated mainly in the "registered sector," especially in the first half of the 1990s, further suggests two observations: reform policies initially helped big business more than small business; and big business felt relatively comfortable with the slow pace of the external opening of the economy, at least until later in the 1990s, when continued imports and foreign-investor-produced goods brought forward protests and discouraged further investments. Since around 2005, supported by a business-friendly Congress government, the private sector has again accelerated its investment. The relatively high rate of private investment is also one of the main forces that has propelled the steady growth of industry during the post-reform period. The pro-growth and pro-business drift of the Indian state – which began in the 1980s and continued into the 1990s and beyond – is thus mainly responsible for the respectable performance of the industrial

⁴⁹ See, for example, Ahluwalia (2002) and Parmak (1999) for these respective views. Advocates of more "liberalization" do not always clarify why they think what they think. Ahluwalia, for example, seems to suggest that further lowering of tariff barriers, further opening of the economy to direct foreign investment, and enhancing labor "flexibility" are the steps necessary to improve India's economic performance. Why he believes that these policies will do the trick is never made explicit; it is as if all sensible people must of course agree. An occasional reference is made to East Asia, with a suggestion that this is how East Asia did it. While my analysis too is influenced by East Asian successes, East Asia is a diverse place, and the fastest-growing states within that region, such as South Korea and Taiwan, during their peak-performing period were hardly models of open economies with "flexible" labor regimes. See Kohli (2004).

⁴⁹ See Ye (2007), p. 241.

⁵⁰ See Ahluwalia (2002), p. 75.

economy; I will return later to the issues of both why this growth has not been more impressive and the growth of the service sector.

Several related observations further support the point that the main dynamic underlying India's sustained industrial growth is not so much liberalization as it is the state's continuing pro-business orientation. First, contrary to what one might expect from further liberalization, the labor intensity of Indian industry decreased steadily during the 1990s.⁵² Second, the unregistered sector of Indian industry – which one presumes to be more export-oriented and less capital-intensive – did not attract much new investment during the post-reform period.⁵³ Related to this, there is no clear evidence that exports of labor intensive goods grew sharply. Fourth, the level of concentration in private industry has increased since 1991: for example, the market capitalization of the top ten private companies increased from 2.2 percent of GDP in 1990 to 12.9 percent in 2004, and sales of the top ten companies during the same period grew from 2.3 to 9.3 percent of GDP.⁵⁴ And finally, the share of employment generated by the manufacturing sector has not kept pace with the rate of growth during the post-reform period.⁵⁵

Leaving aside the issue of private industry, public investment in India as a proportion of total economic activity declined noticeably during the 1990s and beyond (Table 2.2, p. 109; Figure 1.2, p. 44). The underlying dynamics are not hard to understand. Given the fragmented nature of state power in India, public authorities find it hard to raise direct taxes – though some of this is now changing – in order to generate revenue. While direct taxes have gone up somewhat, a variety of tax concessions to the rich and the middle class have cut into the revenue pie, as has the decline of import duties. The service and agricultural sectors remain largely untaxed. The pressure on the expenditure side is merciless, especially the cost of

⁵² See Chaudhuri (2002), p. 160.

⁵³ See Nagaraj (2003), p. 3711.

⁵⁴ These are my own calculations. Company data was taken from *Businessworld*, 22 August–6 September 1998 and 27 December 2004. The sales data for 2004 were collected from www.valuenotes.com. For one study that documents that further consolidation has been the main corporate response (along with growing use of foreign technology) to economic reforms, see Basant (2000). Another more recent paper that documents a similar trend is Mazumdar (2008). Yet another recent study, however, using a different data set, finds that the Herfindahl index of concentration has in recent years become more dispersed, especially if one includes the new entrants in the service sector. This study also finds that older business leaders continue to be leaders in the “post-liberalization” era; see Altaro and Chari (2009).

⁵⁵ For an argument that this is a result of the skill-intensive nature of India's manufacturing growth, see Kochhar et al. (2006).

interest on the growing public debt and of providing for national defense. Faced with severe fiscal pressures in 1991, along with an IMF loan and the associated conditions, the Indian government sought to trim the deficit. While the successive governments have made some headway, they have been unable to control current expenditures. The budget deficit has thus been reduced mainly by cutting public investment, including investment in infrastructure. Among the various consequences, such vital inputs to industrial growth as the supply of electricity suffered during the period under discussion. Can anyone doubt that such state shrinkage is hurting India's economic growth? It is no wonder that various analysts, of a variety of persuasions, seem to agree that public investment in India needs to be stepped up.

The continued buoyancy of private investment and the decline of public investments constitute key elements of India's industrial growth “story” in the 1990s. An additional issue that deserves further attention is that the rate of productivity growth of the industrial economy during the post-reform did not improve over the 1980s. While the international opening of the economy has led to a fair amount of restructuring and consolidation of Indian industry, as well as to an increase in technology imports, somehow none of this is adding up to any sharp improvement in efficiency. Why? The answer of reform advocates seems to be that tariffs are still too high and that the labor regime remains rigid. While this may be the case, it is also possible that one should not expect too much from mere international opening, especially in a large economy with a relatively small role for international trade and investment. Moreover, the claim that trade opening will enhance economic efficiency may also have the causal sequence backward, at least for late-late-industrializers. If East Asian countries like South Korea are to be a model, note that state-supported improvements in industrial efficiency came first, and export success only later.⁵⁶

In sum, while the Indian state indeed recommitted itself to private sector-led growth around 1980, India is no South Korea or Taiwan. The fact is that the Indian state has not done enough either to help improve the efficiency of the private industrial economy or to improve the life chances of its poor. First, India's dismal infrastructure continues to add to the cost of private industry. Second, while there is much talk of improving the labor situation, not only is the action limited, but the underlying model of change is poorly understood. Once again, if East Asia is to be the

⁵⁶ See Amsden (1989).

model, labor regimes in such rapidly growing countries as South Korea have combined job security, training on the job, continuing skill improvements, and strict discipline, involving repression; such a "model" is thus neither fully desirable nor likely to be replicated in India. Third, the state has not done nearly enough to help improve the technological efficiency of the Indian economy. Imports of foreign technology have helped somewhat. However, with declining R&D investment in the private sector, and with the continuing cuts in the role of the public sector, the trend is in almost the opposite direction. Fourth, the efforts to improve India's human capital have been minimal. And lastly, both the incentives and pressures on the private sector to boost exports have remained insufficient. This continuing inaction – some of it a result of political incapacity and some due to a lack of imagination – may cumulatively help us understand why the productivity growth of India's industrial economy has not improved during the post-reform period.

If industrial growth during the post-reform period has been less than spectacular, the main driver of overall growth has been the service sector. By now the service sector accounts for nearly half of India's GDP. The category of "services" is something of a motley category insofar as it includes such disparate economic activities as banking, public administration, hotels and restaurants, spending on education and health, trade, communications, and business services. Data on services also tends to be unreliable, posing problems for analysts.⁵⁷ Still, there is a broad consensus in the scholarly literature, and official data supports the claim, that India's service sector has led India's post-reform economic growth (see Table 2.1, p. 86).⁵⁸ Unfortunately, there is also a consensus in the literature that much of this growth has not generated significant new employment opportunities. While scholars continue to debate the causes of this jobless growth in services (as well as in manufacturing, as noted earlier), it is likely that employment growth in some subsectors is being neutralized by declining employment in other subsectors.⁵⁹

While most services have grown at handsome rates, the truly impressive growth – double-digit per annum growth – has been concentrated in only a few subsectors, especially business services, communications, and banking. The most significant services – that is, significant in terms

of their contribution to GDP – are trade (including wholesale and retail, nearly 14 percent of GDP), public services (including public administration, defense, education, and health; nearly 11 percent of GDP), banking (nearly 6 percent of GDP), and real estate (some 5 percent of GDP). Of these, only banking has grown at double-digit rates during the post-reform period. This is a result both of the growth of public banks in India, which have grown in tandem with the broader economy, and of relaxed new rules that have encouraged new private entrants, including foreign banks. The rapid expansion in services that has attracted most attention, of course, is the expansion in business services – mainly in the IT sector, including call centers, software design, and business process outsourcing – and in communications, mainly telecommunications, including cell phones. As I discuss these further, it is important to note that the much-publicized IT sector of India contributes less than 2 percent of India's GDP. While the growth of this sector is of great importance to India because of its balance-of-payment contribution via export earnings, the contribution it makes to the overall growth of GDP is limited. Nevertheless, the explosive growth rate of nearly 20 percent deserve some attention.

As India has emerged as a global leader in business services, many have wondered how India did it. The IT sector is relatively new in India, with its roots mainly in government-initiated programs begun in the 1970s. Unlike other major industries of India, there were no import-substitution-protected Indian giants in this area that would require a "calibrated" opening of the sector. The IT sector was thus never really regulated, and it globalized fairly rapidly. The links between Indians abroad with computer-related skills and similarly trained Indians in India helped the process of IT sector growth.⁶⁰ Unlike manufacturing, then, the case that economic growth in India is a product of liberalization and of new global links is stronger for some service sectors such as the IT sector. Even this claim, however, requires important qualifications.⁶¹ First, the technically trained manpower that has fueled India's IT industry is a product of heavily state-subsidized technical institutions; these were established in an earlier era, when the ideology of statism and self-sufficiency prevailed. Second, the state has actively promoted the IT sector by providing a variety of supports, especially software technology parks, such as those outside Delhi (NOIDA) and in Bangalore. And third, the public funding

⁵⁷ See, for example, Nagari (2009).

⁵⁸ See Gordon and Gupta (2004), Dasgupta and Singh (2005), and Banga (2008).

⁵⁹ See Banga (2008).

⁶⁰ See Ye (2007).

⁶¹ I borrow these qualifications from D'Costa (2009). Also see Evans (1995).

of research, especially via defense industries, has fed the development of the private sector IT industry.

Finally, a brief discussion of India's poorly performing agricultural sector is in order. As was evident in Table 2.1, agricultural growth in India since 1991 has been relatively sluggish, production and income in the urban areas have grown some two to three times faster on a per annum basis than income in the agricultural sector. Sluggishness in agriculture not only is a drag on overall growth but also has serious distributional implications; the majority of India's working population continue to live in the countryside, but their incomes are growing at a much slower rate than those in the cities. While I will return to distributional issues later, it is important here to focus on the underlying causes of low rates of growth in the agricultural sector.⁶²

Critics of India's "liberal" model of development have suggested that slow agricultural growth in India is part and parcel of India's global opening. The evidence to support this criticism is limited insofar as import penetration in agriculture has not been significant.⁶³ Much stronger evidence suggests instead that sluggishness in agriculture is associated with a decline in public investment in agriculture. It can be argued that this decline reflects the overall bias toward the private sector at the expense of the public sector that is part of post-1991 liberalization. While this argument is somewhat more persuasive, it is the case that public investment in agriculture started declining around 1980 and did not climb back to the 1980 level even toward the mid-2000s.⁶⁴ This decline in public investment is consistent with the suggestion that India adopted a pro-big business model of development around 1980. Relative neglect of agriculture, in turn, hurt agricultural growth via numerous links.

The most significant impact of low levels of public investment on agricultural production was probably mediated by the relatively slow expansion of agricultural areas under irrigation; important studies have documented the importance of irrigation for agricultural growth in India.⁶⁵ In addition, higher rates of public investment might have improved the quality of agricultural research and rural infrastructure. One analyst of Indian agriculture thus concludes: "deficiency in agricultural and rural infrastructure is the biggest problem for agricultural development. There

is a need for massive increase in outlays (or public investments) for agricultural and rural infrastructure by simultaneously improving the delivery system."⁶⁶ It is the case, then, that the attention of Indian leaders has been focused on higher rates of growth, especially via promoting the industrial and service sectors. The neglect of agriculture has contributed not only to low rates of agricultural growth but also to negative distributional outcomes, a set of issues to which I now turn.

III. THE STATE AND DISTRIBUTION

Pro-business growth in India has been accompanied by growing economic inequality. This inequality is manifest on several dimensions: across regions; city versus the countryside; and across class lines, especially within cities. I will now document this growing inequality and suggest how government policies contribute to it. Among the important consequences of growing inequality is the fact that economic growth does not alleviate poverty as rapidly as it might if inequality remained stable. Still, it is the case that rapid economic growth in India over the last three decades has helped reduce poverty. I document these trends, too, but qualify them in two ways. First, assessing levels of poverty in India is a controversial terrain, and much depends on how poverty is defined: depending on the definition adopted, the number of poor in India can vary anywhere from some 300 million to 500 million people. And second, beyond income poverty, other indicators of well-being such as calories consumed, undernourishment among children, levels of illiteracy, and women's health paint a depressing picture. While the size of the problem is truly daunting, the repeated failure of public policy formation and implementation has also contributed to these outcomes.

Growing Inequality

Any discussion of the growing inequality in India must begin with the caveat that some of these trends are par for the course. After all, even with a relatively level field at the onset of rapid growth, inequality has grown significantly in "communist" China. Capital and skills tend to be scarce in economies like those of India and China, especially compared to labor, and are likely to command higher rates of return in the process of rapid economic growth. Moreover, some of the growth in inequality in

⁶² For two good analyses on which I am drawing here, see Balakrishnan et al. (2008) and Dev (2009).

⁶³ See Balakrishnan et al. (2008), p. 17.

⁶⁴ Ibid., Table 6a, p. 22.

⁶⁵ See, for example, Vaidyanathan (2010).

⁶⁶ See Dev (2009), p. 44.