The Economy: 70 years after Independence*

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The defining feature of the economic programme of independent India's first government was to accelerate the transition to a modern economy dominated by industry. Agriculture and related activities at that time accounted for around half of GDP and modern industry in the form of factory establishments for just above 6 per cent. Thus, colonial rule had made India the victim of the barriers to productivity increase typical of predominantly agrarian economies.

These circumstances influenced the Nehruvian vision that made rapid diversification in favour of manufacturing the principal economic objective. The 'big planners' of that time did recognize that this will not deliver the jobs needed to absorb the country's large underemployed and unemployed labour force and address the extreme poverty and deprivation that colonialism had left behind. But those challenges it was argued could be addressed separately, so long as growth got going.

At first it appeared that success was at hand. The years after 1951, and especially after 1956, did see large and rapidly rising investments in industry and infrastructure. But, it is clear, with hindsight, that the process lost momentum rather early. The share of manufacturing in GDP did rise from around 9 per cent in 1950-51 to 16 per cent in 1961. But it did not cross the 18 per cent mark for a little more than a decade after that, and touched 20 per cent at its peak in 1996. This was well short of what had been achieved in many other comparable economies. In 1971, manufacturing's share in GDP stood at 29 per cent in Brazil and 35 per cent in China. In 1996, the figure was 27 per cent in Korea, 28 per cent in Malaysia and 26 per cent in Thailand. The contribution of manufacturing to employment in India was, as expected, was even more dismal.

There were two principal and proximate factors responsible for this shortfall relative to targets in a country that showed much promise as a candidate for successful industrialisation. One was the failure to grow the mass market for manufactures, through appropriate measures, and especially through the implementation of land reforms that helped raise the incomes of the majority among the agriculture-dependent population. The other was the inability of the state to mobilise the resources to finance the expenditures needed to drive and facilitate the process of industrialization.

Agrarian reform was needed to break down land monopoly, which by facilitating rack-renting by absentee landlords, who also earned surpluses from usury and control over poorly-paid, bonded labour, dis-incentivised productive investment in land on the part of semi-feudal and feudal land owners. It also, on the other hand, deprived the tenants who cultivated the land of the means and the incentive to invest. Productivity enhancing investments were thus limited. Further, land concentration meant that whatever increases in agricultural income did accrue, were not distributed in a manner that encouraged the expansion of demand for manufactured mass consumption goods.

In the event, the expansion of domestic demand for the still nascent factory sector came to depend on government expenditures, which by financing direct purchases by the state, increasing demand mediated through employment in the state sector, and the multiplier effects of these, drove manufacturing growth. But the inability of the state to raise through taxation the resources needed to finance these expenditures, and the limits to other forms of potentially inflationary financing like indirect taxation and borrowing, meant that growth remained at the disappointing pace at which it occurred.

Both these features of the development path—the failure of land reform and the fiscal crunch affecting the State—were in turn the result of an uneasy compromise between the landlords in the rural areas and the business elite in the urban areas that had as its counterpart a compromise between the conservatives in the Congress, on the one hand, and Nehru and his supporters in Congress governments at the Centre and the states, on the other. Land reforms, though flagged in many policy documents and in government statements of intent remained largely unimplemented, and direct tax revenues were woefully inadequate to support the programme of State-led economic modernisation. Structurally the economy remained the same, not merely in terms of the degree of diversification, but also in terms of the structures of economic dominance, with traditional landlords and business groups concentrating economic power in their hands.

The dominance of a small industrial elite also meant that the government could not push them to produce for export to international markets, that would have helped earn scarce and precious foreign exchange, as well as find an alternative source of demand to supplement that deriving from the domestic market. Indian capital preferred the comfort of the protected home market, which though trapped in slow growth, was quite lucrative for those at the top of the wealth pyramid. In the event the picture was one characterised by slow growth, a neglect of agriculture and balance of payments vulnerability reflected in periodic crises.

One reason why this vulnerability did not result in multiple crises that were not as intense as the inflation-cum-balance of payments crisis that affected India in the mid-1960s, which lead to the devaluation of the rupee and forced reliance on the Bretton Woods institutions for recovery, was the ability to use temporary measures of crisis prevention and even growth management. The most striking example of the latter was the adoption of the Green Revolution strategy in the late 1960s, riding on the productivity improvements that new high-yielding varieties promised if appropriately exploited. Combining delivery of HYV seeds, the fertilisers and pesticides that needed to accompany them, and credit (including for investments that helped ensure more stable access to water), the government did manage to raise yields in foodgrain production. This partly made up for the absence of land reforms, since it encouraged resumption of land by large landholders for direct cultivation given the promise of higher profits from investment. It also reached the benefits of the technology to farmers with medium-sized holdings. The gradual spread of Green Revolution "practices" across the country did help stave off the worst food crises. Combined with a public procurement and distribution system that was partly aimed at stabilising prices received by farmers, this also kept at bay the kind of famines that historically plagued the country.

What went unnoticed was that the Green Revolution helped shift land reform and the embarrassment of having left it unimplemented out of day to day policy discourse. The "success" also helped conceal the damaging effects of the way the Green revolution strategy was implemented on the soil, on the water table and on the quality of water. Those effects of the misuse of the Green Revolution are now being felt in the form of various threats to the sustainability and viability of farming.

A second temporary reprieve came in the 1980s in the form of access to borrowing from abroad. By the 1970s the international financial system had changed hugely. Surpluses from oil exporters benefiting from the oil shocks and capital accumulated from the pension funds servicing the post-war baby-boom generation were finding their way into financial markets in search of returns. Developing countries like India, which earlier did not have access to private financial capital, were now discovered as emerging markets and favoured with capital flows. To exploit this opportunity, India opened its doors to inflows of credit from the international commercial banking system and non-resident Indian financial investors. Access to this capital allowed the government to increase its own debt financed expenditures, since the foreign capital could be used to finance imports that kept domestic inflation in control. Public debt rose, foreign debt increased, but public expenditure helped accelerate growth, and imports helped dampen inflation. This was the decade when India was seen to have escaped from the "Hindu rate of growth" in which it had ostensibly been trapped. But the cost to be paid was a rising import bill and current account deficit, which soon generated fears among foreign lenders that India may not have the foreign exchange to meet its debt service commitments. Soon the credit flow from abroad dried up, reserves collapsed, and in July 1991 a balance of payments crisis forced India to turn to the IMF for a loan. To assuage foreign financiers and win the support of the IMF, the government used the crisis to launch a deep-seated programme of neoliberal reform involving drastic liberalisation of trade and foreign investment and wide-ranging deregulation in the domestic sphere.

Since the reform was supposed to enforce fiscal discipline as well, which would have necessitated curtailing government expenditure, the expectation was it would slow growth. But that was not to be the case. In fact, growth stayed at the 1980s level through the 1990s and then accelerated after 2003, taking India to an even higher growth trajectory. Though growth is off the peaks it touched before the global financial crisis, official figures suggest that India is keeping pace with and often overtaking China as the world's fastest growing nation.

But this too seems to have been because of rather unusual circumstances. When the balance of payments crisis struck in 1991, the fact that India had paved the way for removal of most controls on the inflow of foreign capital, especially financial capital into India's equity and debt markets, provided the basis for a third reprieve. The effects of this reliance on foreign capital proved even stronger after 2003 because of a capital inflow surge and its domestic collateral effects.

The 1991 crisis did in the first instance freeze up flows from the international banking system to India. But flows from foreign institutional investors, who were now permitted entry into India's equity and subsequently debt markets, made up for the loss. This allowed continuation of the 1980s style growth strategy where the government pump-primed the system with deficit spending and kept inflation at bay with the help of foreign exchange. But reliance on foreign finance finally forced the state to implement fiscal reform, by tying its hands with legislation in the form of Fiscal Responsibility and Budget Management Acts. The FRBM Act at the central level was passed in 2003, setting off a process that has brought the fiscal deficit to

GDP ratio down to close to 3 per cent. This forecloses growth based on debt-financed government spending.

If despite this cutback in government spending growth in India shifted onto a higher trajectory, it was because of a spike in debt financed private spending. The large liquidity infused into the system because of the post-2003 capital inflow surge triggered a boom in bank credit, focussed largely on retail lending (loans for housing, automobile and durable purchases, and sundry personal expenditures) and on lending to investments in capital intensive industry and infrastructure. While this spurred growth in the first instance, it also increased the exposure of banks to areas and projects that where vulnerable and were soon defaulting. The net result is that a decade after the boom began non-performing assets in the banking system have risen sharply and bank profitability and even solvency are under threat. As a result credit growth is shrinking as bank turns cautious, shaving off a few percentage points from the growth rate.

However, for India's majority, the problem is not just sustained growth. It is that the reliance on fortuitous, unsustainable and volatile stimuli to drive growth has had as its counterpart a pattern of growth least suited to employment generation, deeply in equalising and largely incapable of addressing even the worst forms of social deprivation. Much has indeed changed as India floated across trajectories driven by one fortuitous factor to another. Yet little has changed when seen from the point of view of those whom development is supposed to ultimately serve.

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