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THE HISTORY OF ECONOMIC DEVELOPMENT IN INDIA SINCE INDEPENDENCE

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Abstract

The task that the democratically elected leaders of newly independent India embarked on in the early 1950s was not for the faint of heart. It was to lift living standards of a people accounting for one-seventh of the world's population who earned an average income that was one-fifteenth of the average American income of the time.1 Three-fourths of the Indian people were engaged in agriculture working with primitive tools and techniques, as either destitute landless laborers, highly insecure tenants-at-will, or small-plot holders eking out subsistence living from their meager plots. The literacy rate stood at 14 percent, and the average life expectancy was thirty-two years. How successful has the country been in fulfilling the task over sixty years later? The charts in this article, using World Bank data, show how some of the country's development indicators have changed in the last half-century. The country has experienced an increase in per capita income especially since the 1980s—as well as reductions in poverty and infant mortality rates. These improvements are not insignificant and mark a sharp break from the near stagnation that the country experienced during British rule. But a comparison with the later superior performance of China and South Korea, countries with a comparable level of development in the 1950s, reveals that India's performance remains below its potential. How did that come about? This essay provides an account of India's strategy of economic development, its achievements, shortfalls, and future challenges.

Keywords: Economic development, Indian economy, Inflation, GDP.

Introduction

The government in the 1950s adopted a very particular strategy of economic development: rapid industrialization by implementing centrally prepared five-year plans that involved raising a massive amount of resources and investing them in the creation of large industrial state-owned enterprises (SOEs). The industries chosen were those producing basic and heavy industrial goods such as steel, chemicals, machines and tools, locomotives, and power. Industrialization was pursued because leaders believed, based in part on the beliefs of some economists, that the industrial sector offers the greatest scope of growth in production. It was not that the Indian agricultural sector offered no scope for growth. Crop yields in India were quite low compared

to other countries, and the recent famine in 1943 had underscored the need to increase food production. Still, Indian leaders did not want to make agriculture the mainstay of their strategy. The pre-eminence of agriculture they believed was characteristic of a backward economy, and growth in agriculture eventually runs up against the problem of insufficient demand.

There is only so much, after all, that people are willing to eat. Investments in the creation of public enterprises were chosen because one goal of the government was to establish a "socialistic pattern of society," i.e., using democratic methods to bring large swathes of the country's productive resources under public ownership. Industries producing basic and heavy goods were chosen for investment over consumer goods because the government wanted to reduce the country's reliance on imports of basic and heavy industrial goods in line with their belief in the goodness of national self-reliance. "To import from abroad is to be slaves of foreign countries," the first Prime Minister, Jawaharlal Nehru, once declared. The production of consumer goods such as clothing, furniture, personal care products, and similar goods was left to small privately run cottage industry firms that had the added advantage of being labor-intensive and therefore a potential generator of mass employment.

The particular nature of the chosen strategy of development can be understood by comparing it to the alternative strategies that could have been adopted. One such strategy would have been to prioritize public investments in not industry but agriculture, which was the source of livelihood for more than three-fourths of its people. Investments in agriculture take the form of irrigation projects, education of farmers in scientific methods of farming, construction of rural roads and storage facilities, and agricultural research and development. Once the agricultural sector was relatively healthy and the poverty of its participants somewhat reduced, rising incomes could have been used to finance industrial development. The planners rejected such a strategy because putting off industrialization meant that the country would have to continue to rely on imports for needed industrial goods, while the leaders were impatient for the industrialization they identified with progress. People who argued for the priority of agriculture over industry were dismissed as being reactionaries and possibly stooges of the Central Intelligence Agency (CIA).

Another strategy could have been to rely on private enterprise for industrial development while the government focused its resources on investments in infrastructure, public health, and education sectors that are not served well by the private sector. Though leaders were cognizant of the dynamism of the private sector and the existence of India's vibrant entrepreneurial class, they rejected the strategy that involved a prominent role for the private sector out of a commitment to establishing the socialistic pattern of society that they believed was morally superior. As things eventually turned out, the country came around in the 1990s to adopting this previously rejected strategy.

In order to assure the success of the government's chosen strategy in the 1950s, complementary measures were put in place. Most industries were given significant trade protection so that their growth was not hampered by competition from more efficient foreign producers. An industrial licensing system was set up to ensure that private enterprises would not expand beyond the bounds that national planners had set for them. The system required all private firms beyond a certain small size to obtain a license whenever they wanted to expand capacity, produce new products, change their input mix, import inputs, or relocate plants. The system put the activities of the private sector under significant control of the government. Pundits and students of political economy who were not socialists derisively nicknamed this stifling system "the license Raj," comparing this economic format of oppression to the political control of the imperialist British Raj.

Their strategy of increasing agricultural production was based on plans to reform agrarian institutions. According to the thinking of the planners, the poor performance of Indian agriculture was due to the fact that

tillers did not own the land they worked, so they had little incentive to make land improvements that would increase long-term productivity. The government planned to implement legislation to redistribute land from large landlords to actual tillers and improve the terms under which tenant cultivators leased land from the landowners. The government also planned to organize small farmers into cooperative societies so that their resources could be pooled in order to buy modern tools and implements and the strength of their numbers could be used to obtain higher crop prices. In addition to increasing agricultural production, such reforms were also expected to alleviate the poverty of the huge class of peasants.

The Initial Results

Industrialization was a moderate success. The newly created public enterprises, albeit after major cost overruns and several delays, turned out steel, chemicals, and other products that were generally associated with developed countries. A British colonial official in the early twentieth century once scoffed that he would be willing to eat all the steel than the Indians would produce. If alive in 1960, he would have eaten 6,300 tons of steel.

Still, by the late 1950s several problems resulting from the planners' chosen strategy of economic development were coming to the fore, and such problems intensified in the 1960s and the 1970s. Many SOEs were run on political rather than economic considerations, so they produced losses that drained government resources rather than as the planners had hoped augmenting them. The SOEs could also not be counted on to generate mass employment due to their capital and skill rather than labor-intensive character. Several enterprises were overstaffed and faced insufficient demand for what they produced, forcing them to render idle some of their capacity. The case of the Haldia fertilizer plant is an extreme but illustrative example. The plant was set up in the 1970s and employed 1,500 people. The workers and managers showed up regularly, kept the machine facilities clean and in working condition, and often received annual bonuses and overtime. They lived in a nearby spanking- new township built specially for them, one that had excellent roads, schools, and homes. There was only one thing missing. Because of numerous problems, the plant never produced even an ounce of fertilizer. Yet the government kept Haldia's lights on for twenty-one years.

The expenditures necessitated by the massive investments in SOEs generated new problems. One government method for financing expenditures was the creation of new money, which resulted in significant inflation. The government feared the political backlash that the rising prices could generate. Consequently, it resorted to price controls of essential commodities, which caused black markets to flourish, and the government found itself resorting to increasingly intrusive regulations and engaging in cat-and-mouse games with traders. At one point, the government even attempted to nationalize wholesale trade in grains without much success. The efforts at price controls generally failed while consuming much public and private attention.

The plans for the reform of agrarian institutions did not pan out. The push for land redistribution ran into political opposition and clashed with the requirements of due process, so as little as 5 percent of the land was actually redistributed. The creation of agricultural cooperatives also did One government method for financing expenditures was the creation of new money, which resulted in significant inflation not materialize due to difficulties of organization and lack of enthusiasm on the ground. Agricultural production barely kept pace with population growth, and the country's food security remained precarious. The drawback of prioritizing industry over agriculture for public investments became glaringly apparent when the country experienced a food crisis in the mid-1960s, necessitating urgent large-scale imports of subsidized grain from the United States. The crisis undermined the government's claim that its strategy of prioritizing industry over agriculture for public investment would increase national self-reliance.

Under the fixed exchange rate regime that existed in the country, high inflation in the

1960s reduced the country's exports while increasing its imports, resulting in a shortage of foreign exchange. The shortage was exacerbated by the food imports made necessary by a drought and a war with Pakistan. Foreign exchange became one of the items the government had to resort to rationing. The reverberations were felt throughout the economy. Several new factories lay idle for want of foreign exchange to import some necessary inputs, while others hoarded foreign exchange to starve their competitors or earn a premium in the black market. Holding foreign exchange without a license became an offense punishable by jail time. Ultimately, the rupee had to be devalued, which generated further disruptions in the economic lives of most people.

Meanwhile, the industrial licensing system, designed to ensure that the private sector operated according to the five-year plans, became a source of much inefficiency and corruption. The micromanagement of the private sector called for much more knowledge and technical ability than government bureaucrats possessed. The system descended into a mechanism for rewarding political supporters of the rulers, which undermined the confidence of the people in the integrity of their governmental institutions. Perhaps the most unfortunate legacy of prioritizing industry at the expense of other alternatives for investment was that scarce public resources were diverted away from health and education. The meager resources expended on these in India stand in marked contrast to the plentiful attention paid to them in China and other Asian countries. Seventy years after independence, India has still to catch up on these fronts; one-half of its children are malnourished, one-half of women are illiterate, and twothirds of its people lack basic sanitation. As a result, a large fraction of Indians today are unable to directly take advantage of the opportunities pened up by the country's recent tilt toward a market economy and globalization.

The Change in Strategies

In response to the food crisis of the mid-1960s, the government changed its agricultural strategy. Rather than holding out for the reform of agrarian institutions, it began to guarantee higher crop prices to farmers and utilize subsidies to promote use of modern inputs such as chemical fertilizers and high-yielding varieties of grain developed in other parts of the world. The resulting surge of production the so-called "green revolution" of the late 1960s made the country self-sufficient in food grains. The strategy was controversial because it increased economic disparities among the farmers. For the greatest chance of success, the government had to focus its strategy on the irrigated sections the very parts of the country that were already doing relatively well. The uptake of subsidized inputs was also the highest among large landowners, owing to their greater education, creditworthiness, and the ability to bear the risk posed by adopting new methods. The strategy did not do much to alleviate the economic condition of the agrarian poor, other than providing the indirect benefit of living in a country with better overall food security that has not since experienced famine.

Micronutrient deficiencies (not caloric) such as anemia are today a bigger problem among the poor, and the country's health indicators lag behind those of other countries with comparable levels of income. The strategy toward industry, however, turned more interventionist after 1965. Elaboration of all the reasons for this need not detain us here; there is a strong case that the interventionist turn was a cynical ploy by new Prime Minister Indira Gandhi for consolidating her power in response to certain political developments. The new policy stance displayed a suspicion of large firms and a preference for the small. The licensing system imposed additional restrictions on the activities of large firms, curtailing their growth. Under a policy that was one of a kind, consumer goods such as apparel, footwear, furniture, sporting goods, office supplies, leather goods, and kitchen appliances were reserved by law for production by small firms. Foreign firms were asked to dilute their ownership stake in their Indian subsidiaries and in response, multinationals such as IBM and Coca-Cola closed their operations and left the country.

To the extent that the success of the large firms was due to their superior technical or organizational capacity, the curtailment of their growth meant that such capacity remained underutilized. Delays and arbitrariness in the issuing of industrial licenses resulted in supply bottlenecks and shortages of many consumer goods. For example, in the 1970s, there was an eight-year waiting list for people wanting to buy a scooter, the preferred vehicle for middle-class Indians.

The reservation of consumer goods for small enterprises meant that the benefits of economies of scale were forgone, resulting in the production of poor-quality and high-priced goods that foreigners shunned and domestic consumers had no choice but to accept. Meanwhile, countries such as South Korea and Taiwan were growing rich by exporting this very category of goods. It was during this time that Indians developed a craze for foreign products, the imports of which were restricted, and the term “imported” became synonymous with “high-quality.” The result of such policies was economic stagnation. The country’s per capita income grew by an average of less than 1 percent a year between 1966 and 1980, a rate that was too low to make a dent in the country’s massive poverty. Thirty-five years after independence, India’s leadership had yet to achieve, to any significant degree, its pledge of lifting living standards.

The About Turn

When a foreign exchange shortage threatened a crisis again in 1991, the government made a clear break with past policies. By then, the intellectual consensus in favor of state-led, import-substituting development strategies had greatly weakened. The breakup of the Soviet Union had substantially discredited central planning, and the export-led success of East Asian countries had thrown into light the drawbacks of an inward-looking model of development. Also, cultural changes in India, consisting of a deemphasis of asceticism and a greater acceptance of the pursuit of material gain, had made extensive economic controls untenable.7 At the behest of the International Monetary Fund (IMF), which provided rescue during the foreign exchange crisis, but also of its own accord, the government announced major economic reforms. It dismantled the license Raj almost overnight, slashed tax rates and import duties, removed controls on prices and entry of new firms, put up several SOEs for sale, and rolled out the welcome mat for foreign investors. Rather than socialism, the guiding principles of policy now were liberalization, privatization, and globalization.

The economy responded with a surge in growth, which averaged 6.3 percent annually in the 1990s and the early 2000s, a rate double that of earlier time frames. Shortages disappeared. On the eve of the reforms, the public telecom monopoly had installed five million landlines in the entire country and there was a seven-year waiting list to get a new line. In 2004, private cellular companies were signing up new customers at the rate of five million per month. The number of people who lived below the poverty line decreased between 1993 and 2009 from 50 percent of total population to 34 percent. The exact estimates vary depending on the poverty line used, but even alternative estimates indicate a post-1991 decline of poverty that is more rapid than at any other time since independence. The country’s share in world trade increased from 0.4 percent on the eve of the reforms to 1.5 percent in 2006, and foreign exchange shortages, once a chronic headache for policymakers, have now been replaced by reserves upward of US $350 billion prompting debates about what to do with the “excess reserves.”

Several significant economic challenges remain for India. The economy has polarized into a highly productive, modern, and globally integrated formal sector, employing about 10 percent of the labor force, and a low-productivity sector consisting of agriculture and urban informal activities, engaging 90 percent of the labor force. The sectors that have experienced the most growth are services and capital-intensive manufacturing. It is illustrative that IT and pharmaceuticals are the two sectors of the economy with international renown. Such industries tend to be urban and employ mainly skilled workers. Yet to come India’s way are millions of low-skill

manufacturing jobs that have allowed the poor in East Asian countries to climb into the middle class. Companies are loath to set up labor-intensive manufacturing because Indian labor laws are some of the most restrictive in the world. For example, a manufacturing unit hiring more than 100 workers cannot lay off any of them without seeking government permission, which is rarely granted. Liberalization of labor laws tends to run into fierce political opposition. The second reason for the dearth of manufacturing jobs is that the country's infrastructure is relatively deficient, and so companies increasingly practicing just-in-time inventory management do not find it cost-effective to include India in their global supply chains.

The provision of public services in India is appallingly poor. Government schools and clinics are underfunded and inadequately supervised, and their workers display low morale and high absenteeism. Yet such public institutions are rarely held accountable for their performance. The middle class has largely opted out of the system in favor of private health care, schools, and transportation so there is little political pressure from them to improve the system. Most middle-class Indians now even own a power generator to cope with everyday power cuts. The poor take the brunt of the derelict public services. Two million children die in India every year from easily preventable diseases, according to the United Nations Children's Fund (UNICEF), and immunization rates in India are amongst the lowest in the world. Air pollution levels in urban areas pose a severe public health crisis. According to a survey by the World Health Organization (WHO), thirteen out of the twenty most polluted cities in the world are Indian.12

The country still relies heavily on inexpensive coal to generate power and has shown very little willingness to move toward alternative energy sources. Given the current policies and state of governance in India, it is hard to see an obvious path into the middle class for the multitudes still remaining in poverty. Global demand for low-wage, low-skill labor to sew T-shirts or assemble TVs is not what it used to be, because production is now becoming increasingly mechanized and some of it is being "reshored" back to the rich countries. For several hundred million poor people in delicate health and with little education, the country will have to find a way to overcome the technical, institutional, and economic barriers to developing the capabilities necessary for functioning in a twenty-first-century economy. It is not a task for the faint-hearted.

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