ECONOMY OF INDIA

IndianEconomy on the Eve of Independence

Introduction

The primary objective of this part is to familiarise you with the basic features of the Indian economy, and its development, post Independence. However, it is equally important to know something about the country's economic past even as you learn about its present state and future prospects. So, let us first look at India's economy prior to the country's Independence and form an idea of the various considerations that shaped India's post-Independence development strategy.

The structure of India's present day economy has its roots steeped in history, particularly, in the period when India was under British rule which lasted for almost two centuries before India finally won its independence on 15 August 1947. The sole purpose of the British colonial rule in India was to reduce the country to being a raw material supplier for Great Britain's own rapidly expanding modern industrial base. An understanding of the exploitative nature of this relationship is essential for any assessment of the kind and level of development which the Indian economy has been able to attain over the last six and half decades.

Textile Industry in Bengal

Muslin is a type of cotton textile which had its origin in Bengal, particularly, places in and around Dhaka (spelled during the pre-Independence period as Dacca), now the capital city of Bangladesh. 'Daccai Muslin' had gained worldwide fame as an exquisite type of cotton textile. The finest variety of muslin was called *malmal*. Sometimes, foreign travellers also used to refer to it as *malmal shahi* or *malmal kha s*implying that it was worn by, or fit for, the royalty.

Low Level of Economic Development under the Colonial Rule

India had an independent economy before the advent of British rule. Though agriculture was the main source of livelihood for most people, the country's economy was characterised by various kinds of manufacturing activities. India was particularly well known for its handicraft industries in the fields of cotton and silk textiles, metal and precious stoneworks etc. These products enjoyed a worldwide market based on the reputation of the fine quality of material used and the high standards of craftsmanship seen in all imports from India.

The economic policies pursued by the colonial government in India were concerned more with the protection and promotion of the economic interests of their home country than with the development of the Indian economy. Such policies brought about a fundamental change in the structure of the Indian economy — transforming the country into supplier of raw materials and consumer of finished industrial products from Britain.

Obviously, the colonial government never made any sincere attempt to estimate India's national and per capita income. Some individual attempts which were made to measure such incomes yielded conflicting and inconsistent results. Among the notable estimators — Dadabhai Naoroji, William Digby, Findlay Shirras, V.K.R.V. Rao and R.C. Desai — it was Rao whose estimates during the colonial period were considered very significant. However, most studies did find that the country's growth of aggregate real output during the first half of the twentieth century was less than two per cent coupled with a meagre half per cent growth in per capita output per year.

Agriculture During Pre-British India

The French traveller, Bernier, described seventeenth century Bengal in the following way: "The knowledge I have acquired of Bengal in two visits inclines me to believe that it is richer than Egypt. It exports, in abundance, cottons and silks, rice, sugar and butter. It produces amply — for its own consumption — wheat, vegetables, grains, fowls, ducks and geese. It has immense herds of pigs and flocks of sheep and goats. Fish of every kind it has in profusion. From *rajmahal* to the sea is an endless number of canals, cut in bygone ages from the Ganges by immense labour for navigation and irrigation."

Agricultural Sector

India's economy under British colonial rule remained fundamentally agrarian — about 85 per cent of the country's population lived mostly in villages and derived livelihood directly or indirectly from agriculture. Yet, the agricultural sector continued to experience stagnation and, not infrequently, unusual deterioration. Agricultural productivity became low though, in absolute terms, the sector experienced some growth due to the expansion of the aggregate area under cultivation. This stagnation in the agricultural sector was caused mainly because of the various systems of land settlement that were introduced by the colonial government. Particularly, under the *zamindari* system which was implemented in the then Bengal Presidency comprising parts of India's present-day eastern states, the profit accruing out of the agriculture sector went to the *zamindars* instead of the cultivators.

However, a considerable number of *zamindars,* and not just the colonial government, did nothing to improve the condition of agriculture. The main interest of the *zamindars* was only to collect rent regardless of the economic condition of the cultivators; this caused immense misery and social tension among the latter. To a very great extent, the terms of the revenue settlement were also responsible for the *zamindars* adopting such an attitude; dates for depositing specified sums of revenue were fixed, failing which the *zamindars* were to lose their rights. Besides this, low levels of technology, lack of irrigation facilities and negligible use of fertilizer, all added up to aggravate the plight of the farmers and contributed to the dismal level of agricultural productivity. There was, of course, some evidence of a relatively higher yield of cash crops in certain areas of the country due to commercialisation of agriculture. But this could hardly help farmers in improving their economic condition as, instead of producing food crops, now they were producing cash crops which were to be ultimately used by British industries back home. Despite some progress made in irrigation, India's agriculture was starved of investment in terracing, flood-control, drainage and desalinisation of soil. While a small section of farmers changed their cropping pattern from food crops to commercial crops, a large section of tenants, small farmers and sharecroppers neither had resources and technology nor incentive to invest in agriculture.

Industrial Sector

As in the case of agriculture, so also in manufacturing, India could not develop a sound industrial base under colonial rule. Even as the country's world famous handicraft industries declined, no corresponding modern industrial base was allowed to come up to take pride of place so long enjoyed by the former. The primary motive of the colonial government behind this policy of systematically de-industrialising India was two-fold. The intention was, first, to reduce India to the status of a mere exporter of important raw materials for the upcoming modern industries in Britain and, second, to turn India into a sprawling market for the finished products of those industries so that their continued expansion could be ensured to the maximum advantage of their home country — Britain. In the unfolding economic scenario, the decline of the indigenous handicraft industries created not only massive unemployment in India but also a new demand in the Indian consumer market, which was now deprived of the supply of locally made goods. This demand was profitably met by the increasing imports of cheap manufactured goods from Britain.

During the second half of the nineteenth century, modern industry began to take root in India but its progress remained very slow. Initially, this development was confined to the setting up of cotton and jute textile mills. The cotton textile mills, mainly dominated by Indians, were located in the western parts of the country, namely, Maharashtra and Gujarat, while the jute mills dominated by the foreigners were mainly concentrated in Bengal. Subsequently, iron and steel industries began coming up in the beginning of the twentieth century. The Tata Iron and Steel Company (TISCO) was incorporated in 1907. A few other industries in the fields of sugar, cement, paper came up after the Second World War.

However, there was hardly any capital goods industry to help promote further industrialisation in India. Capital goods industry means industries which can produce machine tools which are, in turn, used for producing articles for current consumption. The establishment of a few manufacturing units here and there was no substitute to the near wholesale displacement of the country's traditional handicraft industries. Furthermore, the growth rate of the new industrial sector and its contribution to the Gross Domestic Product (GDP) remained very small. This sector remained confined only to the railways, power generation, communications, ports and some other departmentalundertakings.

Foreign Trade

India has been an important trading nation since ancient times. But the restrictive policies of commodity production, trade and tariff pursued by the colonial government adversely affected the structure, composition and volume of India's foreign trade. Consequently, India became an exporter of primary products such as raw silk, cotton, wool, sugar, indigo, jute etc. and an importer of finished consumer goods like cotton, silk and woolen clothes and capital goods like light machinery produced in the factories of Britain. For all practical purposes, Britain maintained a monopolistic control over India's exports and imports. As a result, more than half of India's foreign trade was restricted to Britain while the rest was allowed with a few other countries like China, Ceylon (Sri Lanka) and Persia (Iran). The opening of the Suez Canal further intensified British control over India's foreign trade (see Box 1.3).

The most important characteristic of India's foreign trade throughout the colonial period was the generation of a large export surplus. But this surplus came at a huge cost to the country's economy. Several essential commodities—food grains, clothes, kerosene etc. — were scarcely available in the domestic market. Furthermore, this export surplus did not result in any flow of gold or silver into India. Rather, this was used to make payments for the expenses incurred by an office set up by the colonial government in Britain, expenses on war, again fought by the British government, and the import of invisible items, all of which led to the drain of Indian wealth.

Trade through the Suez Canal

Suez Canal is an artificial waterway running from north to south across the Isthmus of Suez in north-eastern Egypt. It connects Port Said on the Mediterranean Sea with the Gulf of Suez, an arm of the Red Sea. The canal provides a direct trade route for ships operating between European or American ports and ports located in South Asia, East Africa and Oceania by doing away with the need to sail around Africa. Strategically and economically, it is one of the most important waterways in the world. Its opening in 1869 reduced the cost of transportation and made access to the Indian market easier.

Demographic Condition

Various details about the population of British India were first collected through a census in 1881. Though suffering from certain limitations, it revealed the unevenness in India's population growth. Subsequently, every ten years such census operations were carried out. Before 1921, India was in the first stage of demographic transition.

The second stage of transition began after 1921. However, neither the total population of India nor the rate of population growth at this stage was very high.

The various social development indicators were also not encouraging. The overall literacy level was less than 16 per cent. Of this, female literacy level was at a negligible low of about seven per cent. Public health facilities were either unavailable to large chunks of population or, when available, were highly inadequate. Consequently, water and air-borne diseases were rampant and took a huge toll on life. No wonder, the overall mortality rate was very high and in that, particularly, the infant mortality rate was quite alarming—about 218 per thousand in contrast to the present infant mortality rate of 63 per thousand. Life expectancy was also very low—44 years in contrast to the present 66 years. In the absence of reliable data, it is difficult to specify the extent of poverty at that time but there is no doubt that extensive poverty prevailed in India during the colonial period which contributed to the worsening profile of India's population of the time.

Occupational Structure

During the colonial period, the occupational structure of India, i.e., distribution of working persons across different industries and sectors, showed little sign of change. The agricultural sector accounted for the largest share of workforce, which usually remained at a high of 70-75 per cent while the manufacturing and the services sectors accounted for only 10 and 15-20 per cent respectively. Another striking aspect was the growing regional variation. Parts of the then Madras Presidency (comprising areas of the present-day states of Tamil Nadu, Andhra Pradesh, Kerala and Karnataka), Bombay and Bengal witnessed a decline in the dependence of the workforce on the agricultural sector with a commensurate increase in the manufacturing and the services sectors. However, there had been an increase in the share of workforce in agriculture during the same time in states such as Orissa, Rajasthan and Punjab.

Infrastructure

Under the colonial regime, basic infrastructure such as railways, ports, water transport, posts and telegraphs did develop. However, the real motive behind this development was not to provide basic amenities to the people but to subserve various colonial interests. Roads constructed in India prior to the advent of the British rule were not fit for modern transport. The roads that were built primarily served the purposes of mobilising the army within India and drawing out raw materials from the countryside to the nearest railway station or the port to send these to far away England or other lucrative foreign destinations. There always remained an acute shortage of all-weather roads to reach out to the rural areas during the rainy season. Naturally, therefore, people mostly living in these areas suffered grievously during natural calamities and famines.

The British introduced the railways in India in 1850 and it is considered as one of their most important contributions. The railways affected the structure of the Indian economy in two important ways. On the one hand it enabled people to undertake long distance travel and thereby break geographical and cultural barriers while, on the other hand, it fostered commercialisation of Indian agriculture which adversely affected the self-sufficiency of the village economies in India. The volume of India's exports undoubtedly expanded but its benefits rarely accrued to the Indian people. The social benefits, which the Indian people gained owing to the introduction of the railways, were thus outweighed by the country's huge economic loss.

Along with the development of roads and railways, the colonial dispensation also took measures for developing the inland trade and sea lanes. However, these measures were far from satisfactory. The inland waterways, at times, also proved uneconomical as in the case of the Coast Canal on the Orissa coast. Though the canal was built at a huge cost to the government exchequer, yet, it failed to compete with the railways, which soon traversed the region running parallel to the canal, and had to be ultimately abandoned. The introduction of the expensive system of electric telegraph in India, similarly, served the purpose of maintaining law and order. The postal services, on the other hand, despite serving a useful public purpose, remained all through inadequate.

To sum up, by the time India won its Independence, the impact of the two-century long British colonial rule was already showing on all aspects of the Indian economy. The agricultural sector was already saddled with surplus labour and extremely low productivity. The industrial sector was crying for modernisation, diversification, capacity building and increased public investment. Foreign trade was oriented to feed the Industrial Revolution in Britain. Infrastructure facilities, including the famed railway network, needed upgradation, expansion and public orientation. Prevalence of rampant poverty and unemployment required welfare orientation of public economic policy. In a nutshell, the social and economic challenges before the country were enormous.

India's Development Experience Phase I – 1950-1990

Introduction

On 15 August 1947, India woke to a new dawn of freedom after some two hundred years of British rule; the job of nation building was now in our own hands. The leaders of independent India had to decide, among other things, the type of economic system most suitable for our nation, a system which would promote the welfare of all rather than a few. There are different types of economic systems – market or capitalist economy, socialist economy and mixed economy. Socialist economy appealed to Jawaharlal Nehru, India's first Prime Minister, the most. However, he was not in favour of the kind of socialism established in the former

Soviet Union where all the means of production, i.e. all the factories and farms in the country were owned by the government. There was no private property. It is not possible in a democracy like India for the government to change the ownership pattern of land and other properties of its citizens in the way that it was done in the former Soviet Union.

Nehru, and many other leaders and thinkers of the newly independent India, sought an alternative to the extreme versions of capitalism and socialism. Basically sympathising with the socialist outlook, they found the answer in an economic system which, in their view, combined the best features of socialism without its drawbacks. In this view, India would be a socialist society with a strong public sector but also with private property and democracy; the government would plan for the economy with the private sector being encouraged to be part of the plan effort. The 'Industrial Policy Resolution' of 1948 and the Directive Principles of the Indian Constitution reflected this outlook. In 1950, the Planning Commission was set up with the Prime Minister as its Chairperson. The era of five-year plans (Box 1) had begun.

The Goals of Five Year Plans

A Plan should have some clearly specified goals. The goals of the five-year plans are: growth, modernisation, self-reliance and equity. This does not mean that all the plans have given equal importance to all these goals. Due to limited resources, a choice has to be made in each Plan about which of the goals is to be given primary importance. Nevertheless, the planners have to ensure that, as far as possible, the policies to implement the Plans do not contradict these four goals. Let us now learn about the goals of planning in some detail.

Growth: It refers to increase in the country's capacity to produce the output of goods and services within the country. It implies either a larger stock of productive capital, or a larger size of supporting services like transport and banking, or an increase in the efficiency of productive capital and services. A good indicator of economic growth, in the language of economics, is steady increase in the Gross Domestic Product (GDP). The GDP is the market value of all the goods and services produced in the country during a year. You can think of the GDP as a cake and growth is increase in the size of the cake. If the cake is larger, more people can enjoy it. It is necessary to produce more goods and services if the people of India are to enjoy (in the words of the First Five Year Plan) a more rich and varied life.

The GDP of a country is derived from the different sectors of the economy, namely the agricultural sector, the industrial sector and the service sector. The contribution made by each of these sectors makes up the structural composition of the economy. In some countries, growth in agriculture contributes more to the GDP growth, while in some countries the growth in the service sector contributes more to GDP growth (see Box 2.4).

Mahalanobis: The Architect of Indian Planning

Many distinguished thinkers contributed to the formulation of our five-year plans. Among them, the name of the statistician, Prasanta Chandra Mahalanobis, stands out.

Planning, in the real sense of the term, began with the Second Five Year Plan. The Second Plan, a landmark contribution to development planning in general, laid down the basic ideas regarding goals of Indian planning; this plan was based on the ideas of Mahalanobis. In that sense, he can be regarded as the architect of Indian planning.

Mahalanobis was born in 1893 in Calcutta. He was educated at the Presidency College in Calcutta and at Cambridge University in England. His contributions to the subject of statistics brought him international fame. In 1946 he was made a Fellow (member) of Britain's Royal Society, one of the most prestigious organisations of scientists; only the most outstanding scientists are made members of this Society.

Mahalanobis established the Indian Statistical Institute (ISI) in Calcutta and started a journal, *Sankhya,* which still serves as a respected forum for statisticians to discuss their ideas. Both, the ISI and *Sankhya,* are highly regarded by statisticians and economists all over the world to this day.

During the Second Plan period, Mahalanobis invited many distinguished economists from India and abroad to advise him on India's economic development. Some of these economists became Nobel Prize winners later, which shows that he could identify individuals with talent. Among the economists invited by Mahalanobis were those who were very critical of the socialist principles of the Second Plan. In other words, he was willing to listen to what his critics had to say, the mark of a great scholar.

Many economists today reject the approach to planning formulated by Mahalanobis but he will always be remembered for playing a vital role in putting India on the road to economic progress, and statisticians continue to profit from his contribution to statistical theory.

Source: *Sukhamoy Chakravarty, 'Mahalanobis, Prasanta Chandra' in John Eatwell et.al, (Eds.) The New Palgrave Dictionary: Economic Development, W.W. Norton, New York and London.*

Modernisation: To increase the production of goods and services the producers have to adopt new technology. For example, a farmer can increase the output on the farm by using new seed varieties instead of using the old ones. Similarly, a factory can increase output by using a new type of machine. Adoption of new technology is called modernisation.

However, modernisation does not refer only to the use of new technology but also to changes in social outlook such as the recognition that women should have the same rights as men. In a traditional society, women are supposed to remain at home while men work. A modern society makes use of the talents of women in the work place — in banks, factories, schools etc. — and such a society in most occassions is also prosperous.

Self-reliance: A nation can promote economic growth and modernisation by using its own resources or by using resources imported from other nations. The first seven five-year plans gave importance to self-reliance which means avoiding imports of those goods which could be produced in India itself. This policy was considered a necessity in order to reduce our dependence on foreign countries, especially for food. Further, it was feared that dependence on imported food supplies, foreign technology and foreign capital may make India's sovereignty vulnerable to foreign interference in our policies.

Equity: Now growth, modernisation and self-reliance, by themselves, may not improve the kind of life which people are living. A country can have high growth, the most modern technology developed in the country itself, and also have most of its people living in poverty. It is important to ensure that the benefits of economic prosperity reach the poor sections as well instead of being enjoyed only by the rich. So, in addition to growth, modernisation and self-reliance, equity is also important. Every Indian should be able to meet his or her basic needs such as food, a decent house, education and health care and inequality in the distribution of wealth should be reduced.

Let us now see how the first seven five year plans, covering the period 1950-1990, attempted to attain these four goals and the extent to which they succeeded in doing so, with reference to agriculture, industry and trade. You will study the policies and developmental issues taken up after 1991 in the next part.

Agriculture

You have learnt in the previous section that during the colonial rule there was neither growth nor equity in the agricultural sector. The policy makers of independent India had to address these issues which they did through land reforms and promoting the use of 'High Yielding Variety' (HYV) seeds which ushered in a revolution in Indian agriculture.

Land Reforms: At the time of independence, the land tenure system was characterised by intermediaries (variously called *zamindars*, *jagirdars*etc.) who merely collected rent from the actual tillers of the soil without contributing towards improvements on the farm. The low productivity of the agricultural sector forced India to import food from the United States of America (USA). Equity in agriculture called for land reforms which primarily refer to change in the ownership of landholdings. Just a year after Independence, steps were taken to abolish intermediaries and to make the tillers the owners of land. The idea behind this move was that ownership of land would give incentives to the tillers to invest in making improvements provided sufficient capital was made available to them.

Land ceiling was another policy to promote equity in the agricultural sector. This means fixing the maximum size of land which could be owned by an individual. The purpose of land ceiling was to reduce the concentration of land ownership in a few hands.

The abolition of intermediaries meant that some 200 lakh tenants came into direct contact with the government — they were thus freed from being exploited by the *zamindars*. The ownership conferred on tenants gave them the incentive to increase output and this contributed to growth in agriculture. However, the goal of equity was not fully served by abolition of intermediaries. In some areas the former *zamindars* continued to own large areas of land by making use of some loopholes in the legislation; there were cases where tenants were evicted and the landowners claimed to be self cultivators (the actual tillers), claiming ownership of the land; and even when the tillers got ownership of land, the poorest of the agricultural labourers (such as sharecroppers and landless labourers) did not benefit from land reforms. The land ceiling legislation also faced hurdles. The big landlords challenged the legislation in the courts, delaying its implementation.

The Green Revolution: At Independence, about 75 per cent of the country's population was dependent on agriculture. Productivity in the agricultural sector was very low because of the use of old technology and the absence of required infrastructure for the vast majority of farmers. India's agriculture vitally depends on the monsoon and if the monsoon fell short the farmers were in trouble unless they had access to irrigation facilities which very few had. The stagnation in agriculture during the colonial rule was permanently broken by the Green Revolution. This refers to the large increase in production of food grains resulting from the use of high yielding variety (HYV) seeds especially for wheat and rice. The use of these seeds required the use of fertilizer and pesticide in the correct quantities as well as regular supply of water; the application of these inputs in correct proportions is vital. The farmers who could benefit from HYV seeds required reliable irrigation facilities as well as the financial resources to purchase fertilizer and pesticide. As a result, in the first phase of the Green Revolution (approximately mid 1960s up to mid 1970s), the use of HYV seeds was restricted to the more affluent states such as Punjab, Andhra Pradesh and Tamil Nadu. Further, the use of HYV seeds primarily benefited the wheat growing regions only. In the second phase of the green revolution (mid-1970s to mid-1980s), the HYV technology spread to a larger number of states and benefitted more variety of crops. The spread of the Green Revolution technology enabled India to achieve self-sufficiency in food grains; we no longer had to be at the mercy of America, or any other nation, for meeting our nation's food requirements.

Growth in agricultural output is important but it is not enough. If a large proportion of this increase is consumed by the farmers themselves instead of being sold in the market, the higher output will not make much of a difference to the economy as a whole. If, on the other hand, a substantial amount of agricultural produce is sold in the market by the farmers, the higher output can make a difference to the economy. The portion of agricultural produce which is sold in the market by the farmers is called marketed surplus. A good proportion of the rice and wheat produced during the Green Revolution period (available as marketed surplus) was sold by the farmers in the market. As a result, the price of food grains declined relative to other items of consumption. The low-income groups, who spend a large percentage of their income on food, benefitted from this decline in relative prices. The Green Revolution enabled the government to procure sufficient amount of food grains to build a stock which could be used in times of food shortage.

While the nation had immensely benefited from the Green Revolution, the technology involved was not free from risks. One such risk was the possibility that it would increase the disparities between small and big farmers—since only the big farmers could afford the required inputs, thereby reaping most of the benefits of the Green Revolution. Moreover, the HYV crops were also more prone to attack by pests and the small farmers who adopted this technology could lose everything in a pest attack. Fortunately, these fears did not come true because of the steps taken by the government. The government provided loans at a low interest rate to small farmers and subsidized fertilisers so that small farmers could also have access to the needed inputs. Since the small farmers could obtain the required inputs, the output on small farms equalled the output on large farms in the course of time. As a result, the Green Revolution benefitted the small as well as rich farmers. The risk of the small farmers being ruined when pests attack their crops was considerably reduced by the services rendered by research institutes established by the government.

Industry and Trade

Economists have found that poor nations can progress only if they have a strong industrial sector. Industry provides employment which is more stable than the employment in agriculture; it promotes modernisation and overall prosperity. It is for this reason that the five-year plans place a lot of emphasis on industrial development. You might have studied in the previous chapter that, at the time of Independence, the variety of industries was very narrow largely confined to cotton textiles and jute. There were two well managed iron and steel firms — one in Jamshedpur and the other in Kolkata — but, obviously, we needed to expand the industrial base with a variety of industries if the economy was to grow.

Public and Private Sectors in Indian Industrial Development: The big question facing policymakers was — what should be the role of the government and the private sector in industrial development? At the time of independence, Indian industrialists did not have the capital to undertake investment in industrial ventures required for the development of our economy; nor was the market big enough to encourage industrialists to undertake major projects even if they had the capital to do so. It is principally for these reasons that the state had to play an extensive role in promoting the industrial sector. In addition, the decision to develop the Indian economy on socialist lines led to the policy of the state controlling the commanding heights of the economy, as the Second Five Year plan put it. This meant that the state would have complete control of those industries that were vital for the economy. The policies of the private sector would have to be complimentary to those of the public sector, with the public sector leading the way.

Industrial Policy Resolution 1956 (IPR 1956): In accordance with the goal of the state controlling the commanding heights of the economy, the Industrial Policy Resolution of 1956 was adopted. This resolution formed the basis of the Second Five Year Plan, the Plan which tried to build the basis for a socialist pattern of society. This resolution classified industries into three categories. The first category comprised industries which would be exclusively owned by the state; the second category consisted of industries in which the private sector could supplement the efforts of the state sector, with the state taking the sole responsibility for starting new units; the third category consisted of the remaining industries which were to be in the private sector. Although there was a category of industries left to the private sector, the sector was kept under state control through a system of licenses. No new industry was allowed unless a license was obtained from the government. This policy was used for promoting industry in backward regions; it was easier to obtain a license if the industrial unit was established in an economically backward area. In addition, such units were given certain concessions such as tax benefits and electricity at a lower tariff. The purpose of this policy was to promote regional equality.

Even an existing industry had to obtain a license for expanding output or for diversifying production (producing a new variety of goods). This was meant to ensure that the quantity of goods produced was not more than what the economy required. License to expand production was given only if the government was convinced that the economy required a larger quantity of goods.

Small-Scale Industry: In 1955, the Village and Small-Scale Industries Committee, also called the Karve Committee, noted the possibility of using small-scale industries for promoting rural development. A 'small-scale industry' is defined with reference to the maximum investment allowed on the assets of a unit. This limit has changed over a period of time. In 1950 a small-scale industrial unit was one which invested a maximum of rupees five lakh; at present the maximum investment allowed is rupees one crore. It is believed that small-scale industries are more 'labour intensive' i.e., they use more labour than the large-scale industries and, therefore, generate more employment. But these industries cannot compete with the big industrial firms; it is obvious that development of small-scale industry requires them to be shielded from the large firms. For this purpose, the production of a number of products was reserved for the small-scale industry; the criterion of reservation being the ability of these units to manufacture the goods. They were also given concessions such as lower excise duty and bank loans at lower interest rates.

Trade Policy: Import Substitution

The industrial policy that we adopted was closely related to the trade policy. In the first seven plans, trade was characterised by what is commonly called an inward looking trade strategy. Technically, this strategy is called import substitution. This policy aimed at replacing or substituting imports with domestic production. For example, instead of importing vehicles made in a foreign country, industries would be encouraged to produce them in India itself. In this policy the government protected the domestic industries from foreign competition. Protection from imports took two forms: tariffs and quotas. Tariffs are a tax on imported goods; they make imported goods more expensive and discourage their use. Quotas specify the quantity of goods which can be imported. The effect of tariffs and quotas is that they restrict imports and, therefore, protect the domestic firms from foreign competition.

The policy of protection is based on the notion that industries of developing countries are not in a position to compete against the goods produced by more developed economies. It is assumed that if the domestic industries are protected they will learn to compete in the course of time. Our planners also feared the possibility of foreign exchange being spent on import of luxury goods if no restrictions were placed on imports. Nor was any serious thought given to promote exports until the mid-1980s.

Effect of Policies on Industrial Development: The achievements of India's industrial sector during the first seven plans are impressive indeed. The proportion of GDP contributed by the industrial sector increased in the period from 11.8 per cent in 1950-51 to 24.6 per cent in 1990-91. The rise in the industry's share of GDP is an important indicator of development. The six per cent annual growth rate of the industrial sector during the period is commendable. No longer was Indian industry restricted largely to cotton textiles and jute; in fact, the industrial sector became well diversified by 1990, largely due to the public sector. The promotion of small-scale industries gave opportunities to those people who did not have the capital to start large firms to get into business. Protection from foreign competition enabled the development of indigenous industries in the areas of electronics and automobile sectors which otherwise could not have developed.

Despite the contribution made by the public sector to the growth of the Indian economy, some economists are critical of the performance of many public sector enterprises. It was proposed at the beginning of this chapter that initially public sector was required in a big way. It is now widely held that state enterprises continued to produce certain goods and services (often monopolising them) although this was no longer required. An example is the provision of telecommunication service. This industry continued to be reserved for the Public Sector even after it was realised that private sector firms could also provide it. Due to the absence of competition, even till the late 1990s, one had to wait for a long time to get a telephone connection. Another instance could be the establishment of Modern Bread, a bread-manufacturing firm, as if the private sector could not manufacture bread! In 2001 this firm was sold to the private sector. The point is that after four decades of planned development of the Indian economy, no distinction was made between what the public sector alone could do and what the private sector could also do. For example, even now only the public sector supplies national defence. And even though the private sector can manage hotels well, yet, the government also runs hotels. This has led some scholars to argue that the state should get out of areas which the private sector can manage and the government may concentrate its resources on important services which the private sector cannot provide.

Many public sector firms incurred huge losses but continued to function because it is difficult to close a government undertaking even if it is a drain on the nation's limited resources. This does not mean that private firms are always profitable (indeed, quite a few of the public sector firms were originally private firms which were on the verge of closure due to losses; they were then nationalised to protect the jobs of the workers). However, a loss-making private firm will not waste resources by being kept running despite the losses.

The need to obtain a license to start an industry was misused by industrial houses; a big industrialist would get a license not for starting a new firm but to prevent competitors from starting new firms. The excessive regulation of what came to be called the permit license raj prevented certain firms from becoming more efficient. More time was spent by industrialists in trying to obtain a license or lobby with the concerned ministries rather than on thinking about how to improve their products.

The protection from foreign competition is also being criticised on the ground that it continued even after it proved to do more harm than good. Due to restrictions on imports, the Indian consumers had to purchase whatever the Indian producers produced. The producers were aware that they had a captive market; so they had no incentive to improve the quality of their goods. Why should they think of improving quality when they could sell low quality items at a high price? Competition from imports forces our producers to be more efficient.

A few economists also pointed out that the public sector was not meant for earning profits but to promote the welfare of the nation. The public sector firms, on this view, should be evaluated on the basis of the extent to which they contribute to the welfare of people and not on the profits they earn. Regarding protection, some economists held that we should protect our producers from foreign competition as long as the rich nations continue to do so. Owing to all these conflicts, economists called for a change in our policy and this, along with other problems, led the government to introduce a new economic policy in 1991.

Though the progress of the Indian economy during the first seven plans was impressive, many economists became dissatisfied with the performance of many public sector enterprises. Excessive government regulation prevented growth of entrepreneurship. In the name of self reliance, our producers were protected against foreign competition and this did not give them the incentive to improve the quality of goods that they produced. Our policies were 'inward oriented' and so we failed to develop a strong export sector. The need for reform of economic policy was widely felt in the context of changing global economic scenario, and the new economic policy was initiated in 1991 to make our economy more efficient. This is the subject of the next chapter.

India's Development Experience: Phase II

Introduction

Since Independence, India followed the mixed economy framework by combining the advantages of the capitalist economic system with those of the socialist economic system. Some scholars argue that, over the years, this policy resulted in the establishment of a variety of rules and laws, which were aimed at controlling and regulating the economy, ended up instead in hampering the process of growth and development. Others state that India, which started its developmental path from near stagnation, has since been able to achieve growth in savings, developed a diversified industrial sector which produces a variety of goods and has experienced sustained expansion of agricultural output which has ensured food security.

In 1991, India met with an economic crisis relating to its external debt — the government was not able to make repayments on its borrowings from abroad; foreign exchange reserves, which we generally maintain to import petrol and other important items, dropped to levels that were not sufficient for even a fortnight. The crisis was further compounded by rising prices of essential goods. All these led the government to introduce a new set of policy measures which changed the direction of our developmental strategy.

Background

The origin of the financial crisis can be traced from the inefficient management of the Indian economy in the 1980s. We know that for implementing various policies and its general administration, the government generates funds from various sources such as taxation, running of public sector enterprises etc. When expenditure is more than income, the government borrows to finance the deficit from banks and also from people within the country and from international financial institutions. When we import goods like petroleum, we pay in dollars which we earn from our exports.

Development policies required that even though the revenues were very low, the government had to overshoot its revenue to meet problems like unemployment, poverty and population explosion. The continued spending on development programmes of the government did not generate additional revenue. Moreover, the government was not able to generate sufficiently from internal sources such as taxation. When the government was spending a large share of its income on areas which do not provide immediate returns such as the social sector and defence, there was a need to utilise the rest of its revenue in a highly efficient manner. The income from public sector undertakings was also not very high to meet the growing expenditure. At times, our foreign exchange, borrowed from other countries and international financial institutions, was spent on meeting consumption needs. Neither was an attempt made to reduce such profligate spending nor sufficient attention was given to boost exports to pay for the growing imports.

In the late 1980s, government expenditure began to exceed its revenue by such large margins that meeting the expenditure through borrowings became unsustainable. Prices of many essential goods rose sharply. Imports grew at a very high rate without matching growth of exports. Foreign exchange reserves declined to a level that was not adequate to finance imports for more than two weeks. There was also not sufficient foreign exchange to pay the interest that needs to be paid to international lenders. Also no country or international funder was willing to lend to India.

India approached the International Bank for Reconstruction and Development (IBRD), popularly known as World Bank and the International Monetary Fund (IMF), and received $7 billion as loan to manage the crisis. For availing the loan, these international agencies expected India to liberalise and open up the economy by removing restrictions on the private sector, reduce the role of the government in many areas and remove trade restrictions between India and other countries.

India agreed to the conditionalities of World Bank and IMF and announced the New Economic Policy (NEP). The NEP consisted of wide ranging economic reforms. The thrust of the policies was towards creating a more competitive environment in the economy and removing the barriers to entry and growth of firms. This set of policies can broadly be classified into two groups: the stabilisation measures and the structural reform measures. Stabilisation measures are short-term measures, intended to correct some of the weaknesses that have developed in the balance of payments and to bring inflation under control. In simple words, this means that there was a need to maintain sufficient foreign exchange reserves and keep the rising prices under control. On the other hand, structural reform policies are long-term measures, aimed at improving the efficiency of the economy and increasing its international competitiveness by removing the rigidities in various segments of the Indian economy. The government initiated a variety of policies which fall under three heads viz., liberalisation, privatisation and globalisation.

Liberalisation

As pointed out in the beginning, rules and laws which were aimed at regulating the economic activities became major hindrances in growth and development. Liberalisation was introduced to put an end to these restrictions and open up various sectors of the economy. Though a few liberalisation measures were introduced in the 1980s in areas of industrial licensing, export-import policy, technology upgradation, fiscal policy and foreign investment, reform policies initiated in 1991 were more comprehensive. Some important areas such as the industrial sector, financial sector, tax reforms, foreign exchange markets and trade and investment sectors received greater attention in and after 1991.

Deregulation of Industrial Sector: In India, regulatory mechanisms were enforced in various ways (i) industrial licensing under which every entrepreneur had to get permission from government officials to start a firm, close a firm or to decide the amount of goods that could be produced (ii) private sector was not allowed in many industries (iii) some goods could be produced only in small scale industries and (iv) controls on price fixation and distribution of selected industrial products.

The reform policies introduced in and after 1991 removed many of these restrictions. Industrial licensing was abolished for almost all but product categories — alcohol, cigarettes, hazardous chemicals, industrial explosives, electronics, aerospace and drugs and pharmaceuticals. The only industries which were reserved for the public sector were defenceequipments, atomic energy generation and railway transport. Many goods produced by small scale industries were dereserved. In many industries, the market was allowed to determine the prices.

Financial Sector Reforms: Financial sector includes financial institutions such as commercial banks, investment banks, stock exchange operations and foreign exchange market. The financial sector in India is regulated by the Reserve Bank of India (RBI). All the banks and other financial institutions in India are regulated through various norms and regulations of the RBI. The RBI decides the amount of money that the banks can keep with themselves, fixes interest rates, nature of lending to various sectors etc. One of the major aims of financial sector reforms is to reduce the role of RBI from regulator to facilitator of the financial sector. This means that the financial sector may be allowed to take decisions on many matters without consulting the RBI.

The reform policies led to the establishment of private sector banks, Indian as well as foreign. Foreign investment limit in banks was raised to around 50 per cent.

Those banks which fulfil certain conditions have been given freedom to set up new branches without the approval of the RBI and rationalise their existing branch networks. Though banks have been given permission to generate resources from India and abroad, certain managerial aspects have been retained with the RBI to safeguard the interests of the accountholders and the nation. Foreign Institutional Investors (FII) such as merchant bankers, mutual funds and pension funds are now allowed to invest in Indian financial markets.

Tax Reforms: Tax reforms are concerned with the reforms in government's taxation and public expenditure policies which are collectively known as its fiscal policy. There are two types of taxes: direct and indirect. Direct taxes consist of taxes on incomes of individuals as well as profits of business enterprises. Since 1991, there has been a continuous reduction in the taxes on individual incomes as it was felt that high rates of income tax were an important reason for tax evasion. It is now widely accepted that moderate rates of income tax encourage savings and voluntary disclosure of income. The rate of corporation tax, which was very high earlier, has been gradually reduced. Efforts have also been made to reform the indirect taxes, taxes levied on commodities, in order to facilitate the establishment of a common national market for goods and commodities. Another component of reforms in this area is simplification. In order to encourage better compliance on the part of taxpayers many procedures have been simplified and the rates also substantially lowered.

Foreign Exchange Reforms: The first important reform in the external sector was made in the foreign exchange market. In 1991, as an immediate measure to resolve the balance of payments crisis, the rupee was devalued against foreign currencies. This led to an increase in the inflow of foreign exchange. It also set the tone to free the determination of rupee value in the foreign exchange market from government control. Now, more often than not, markets determine exchange rates based on the demand and supply of foreign exchange.

Trade and Investment Policy Reforms: Liberalisation of trade and investment regime was initiated to increase international competitiveness of industrial production and also foreign investments and technology into the economy. The aim was also to promote the efficiency of the local industries and the adoption of modern technologies.

In order to protect domestic industries, India was following a regime of quantitative restrictions on imports. This was encouraged through tight control over imports and by keeping the tariffs very high. These policies reduced efficiency and competitiveness which led to slow growth of the manufacturing sector. The trade policy reforms aimed at (i) dismantling of quantitative restrictions on imports and exports (ii) reduction of tariff rates and (iii) removal of licensing procedures for imports. Import licensing was abolished except in case of hazardous and environmentally sensitive industries. Quantitative restrictions on imports of manufactured consumer goods and agricultural products were also fully removed from April 2001. Export duties have been removed to increase the competitive position of Indian goods in the international markets.

Privatisation

It implies shedding of the ownership or management of a government owned enterprise. Government companies are converted into private companies in two ways (i) by withdrawal of the government from ownership and management of public sector companies and or (ii) by outright sale of public sector companies.

Privatisation of the public sector enterprises by selling off part of the equity of PSEs to the public is known as disinvestment. The purpose of the sale, according to the government, was mainly to improve financial discipline and facilitate modernisation. It was also envisaged that private capital and managerial capabilities could be effectively utilised to improve the performance of the PSUs.

The government envisaged that privatisation could provide strong impetus to the inflow of FDI. The government has also made attempts to improve the efficiency of PSUs by giving them autonomy in taking managerial decisions. For instance, some PSUs have been granted special status as *maharatnas, navratnas* and *miniratnas*.

Globalisation

Although globalisation is generally understood to mean integration of the economy of the country with the world economy, it is a complex phenomenon. It is an outcome of the set of various policies that are aimed at transforming the world towards greater interdependence and integration. It involves creation of networks and activities transcending economic, social and geographical boundaries. Globalisation attempts to establish links in such a way that the happenings in India can be influenced by events happening miles away. It is turning the world into one whole or creating a borderless world.

Outsourcing: This is one of the important outcomes of the globalisation process. In outsourcing, a company hires regular service from external sources, mostly from other countries, which was previously provided internally or from within the country (like legal advice, computer service, advertisement, security — each provided by respective departments of the company). As a form of economic activity, outsourcing has intensified, in recent times, because of the growth of fast modes of communication, particularly the growth of Information Technology (IT). Many of the services such as voice-based business processes (popularly known as BPO or call centers), record keeping, accountancy, banking services, music recording, film editing, book transcription, clinical advice or even teaching are being outsourced by companies in developed countries to India. With the help of modern telecommunication links including the Internet, the text, voice and visual data in respect of these services is digitised and transmitted in real time over continents and national boundaries. Most multinational corporations, and even small companies, are outsourcing their services to India. The low wage rates and availability of skilled manpower in India have made it a destination for global outsourcing in the post-reform period.

World Trade Organisation (WTO): The WTO was founded in 1995 as the successor organisation to the General Agreement on Trade and Tariff (GATT). GATT was established in 1948 with 23 countries as the global trade organisation to administer all multilateral trade agreements by providing equal opportunities to all countries in the international market for trading purposes. The WTO is expected to establish a rule-based trading regime in which nations cannot place arbitrary restrictions on trade. In addition, its purpose is also to enlarge production and trade of services, to ensure optimum utilisation of world resources and to protect the environment. The WTO agreements cover trade in goods as well as services to facilitate international trade (bilateral and multilateral) through removal of tariff as well as non-tariff barriers and providing greater market access to all member countries.

As an important member of WTO, India has been in the forefront of framing fair global rules, regulations and safeguards and advocating the interests of the developing world. India has kept its commitments towards liberalisation of trade, made in the WTO, by removing quantitative restrictions on imports and reducing tariff rates.

Some scholars question the usefulness of India being a member of the WTO as a major volume of international trade occurs among the developed nations. They also say that while developed countries file complaints over agricultural subsidies given in their countries, developing countries feel cheated as they are forced to open up their markets for developed countries but are not allowed access to the markets of developed countries.

Indian Economy during Reforms: An Assessment

The reform process has completed two and a half decades since its introduction. Let us now look at the performance of the Indian economy during this period. In economics, growth of an economy is measured by the Gross Domestic Product. Look at Table 1. The growth of GDP increased from 5.6 per cent during 1980-91 to 8.2 per cent during 2007-2012. During the reform period, the growth of agriculture has declined. While the industrial sectors reported fluctuation, the growth of service sector has gone up. This indicates that the growth is mainly driven by the growth in the service sector. The Twelfth Plan (2012-2017) envisages the GDP growth rate at 9 or 9.5 per cent. In order to achieve such a high growth rate, the agriculture, industrial and service sectors have to grow at the rates of 4 to 4.2, 9.6 to 10.9 and 10 percentage points, respectively. However, some scholars raise apprehensions over the projection of such high rates of growth as unsustainable.

TABLE 1

Growth of GDP and Major Sectors (in %)

Sector	*1980-1991*	*1992-2001*	*2002-2007*	*2007-2012*	*2012-2017 XII Plan*	
					Target I	*Target II*
Agriculture	3.6	3.3	2.3	3.2	4.0	4.2
Industry	7.1	6.5	9.4	7.4	9.6	10.9
Services	6.7	8.2	7.8	10.0	10.0	10.0
Total	**5.6**	**6.4**	**7.8**	**8.2**	**9.0**	**9.5**

Sources: *Tenth Five Year Plan; Faster, sustainable and more inclusive growth & An Approach to the 12th Five Year Plan, Planning Commission, Government of India, 2011.*

The opening up of the economy has led to rapid increase in foreign direct investment and foreign exchange reserves. The foreign investment which includes foreign direct investment (FDI) and foreign institutional investment (FII), has increased from about US $ 100 million in 1990-91 to US $ 467 billion in 2012-13. There has been an increase in the foreign exchange reserves from about US $ 6 billion in 1990-91 to about US $ 304 billion in 2013-14. India is one of the largest foreign exchange reserve holders in the world.

India is seen as a successful exporter of auto parts, engineering goods, IT software and textiles in the reform period. Rising prices have also been kept under control.

On the other hand, the reform process has been widely criticised for not being able to address some of the basic problems facing our economy especially in the areas of employment, agriculture, industry, infrastructure development and fiscal management.

Growth and Employment: Though the GDP growth rate has increased in the reform period, scholars point out that the reform-led growth has not generated sufficient employment opportunities in the country. You will study the link between different aspects of employment and growth in the next section.

Reforms in Agriculture: Reforms have not been able to benefit agriculture, where the growth rate has been decelerating. Public investment in agriculture sector especially in infrastructure, which includes irrigation, power, roads, market linkages and research and extension (which played a crucial role in the Green Revolution), has fallen in the reform period.

Reforms in Industry: Industrial growth has also recorded a slowdown. This is because of decreasing demand of industrial products due to various reasons such as cheaper imports, inadequate investment in infrastructure etc. In a globalised world, developing countries are compelled to open up their economies to greater flow of goods and capital from developed countries and rendering their industries vulnerable to imported goods. Cheaper imports have, thus, replaced the demand for domestic goods. Domestic manufacturers are facing competition from imports. The infrastructure facilities, including power supply, have remained inadequate due to lack of investment. Globalisation is, thus, often seen as creating conditions for the free movement of goods and services from foreign countries that adversely affect the local industries and employment opportunities in developing countries.

Moreover, a developing country like India still does not have the access to developed countries' markets because of high non-tariff barriers. For example, although all quota restrictions on exports of textiles and clothing have been removed in India, U.S.A. has not removed their quota restriction on import of textiles from India and China.

Disinvestment: Every year, the government fixes a target for disinvestment of PSEs. For instance, in 1991-92, it was targeted to mobiliseRs 2,500 crore through disinvestment. The government was able to mobilize Rs 3,040 crore more than the target. In 2013-14, the target was about Rs 56,000 crore whereas the achievement was about Rs 26,000 crore. Critics point out that the assets of PSEs have been undervalued and sold to the private sector. This means that there has been a substantial loss to the government. Moreover, the proceeds from disinvestment were used to offset the shortage of government revenues rather than using it for the development of PSEs and building social infrastructure in the country.

Reforms and Fiscal Policies: Economic reforms have placed limits on the growth of public expenditure especially in social sectors. The tax reductions in the reform period, aimed at yielding larger revenue and to curb tax evasion, have not resulted in increase in tax revenue for the government. Also, the reform policies involving tariff reduction have curtailed the scope for raising revenue through customs duties. In order to attract foreign investment, tax incentives were provided to foreign investors which further reduced the scope for raising tax revenues. This has a negative impact on developmental and welfare expenditures.

To sum up, the process of globalisation through liberalisation and privatisation policies has produced positive as well as negative results both for India and other countries. Some scholars argue that globalisation should be seen as an opportunity in terms of greater access to global markets, high technology and increased possibility of large industries of developing countries to become important players in the international arena.

On the contrary, the critics argue that globalisation is a strategy of the developed countries to expand their markets in other countries. According to them, it has compromised the welfare and identity of people belonging to poor countries. It has further been pointed out that market-driven globalisation has widened the economic disparities among nations and people.

Viewed from the Indian context, some studies have stated that the crisis that erupted in the early 1990s was basically an outcome of the deep-rooted inequalities in Indian society and the economic reform policies initiated as a response to the crisis by the government, with externally advised policy package, further aggravated the inequalities. Further, it has increased the income and quality of consumption of only high-income groups and the growth has been concentrated only in some select areas in the services sector such as telecommunication, information technology, finance, entertainment, travel and hospitality services, real estate and trade, rather than vital sectors such as agriculture and industry which provide livelihoods to millions of people in the country.

Recent Developments in Planning in India

NITI Aayog

Since 1950s, through Five Year Plans, Planning Commission played crucial role in making developmental policies for India. In 2015, NITI Aayog (National Institution for Transforming India), New Delhi has been set up in place of the Planning Commission. NITI Aayog envisages: (a) an empowered role of States as equal partners in national development and operationalizing the principle of Cooperative Federalism; (b) to work as a knowledge hub of internal as well as external resources; serving as a repository of good governance best practices, and a Think Tank offering domain knowledge as well as strategic expertise to all levels of government; (c) provide a collaborative platform facilitating implementation of various government policies; by monitoring progress, plugging gaps and bringing together the various Ministries at the Centre and in States, in the joint pursuit of developmental goals.

Make in India

In 2014, India initiated this programme encouraging both domestic and multinational companies to invest in India and manufacture goods and provide services. Under this programme, the governments both centre and states attempt to facilitate investment, foster innovation and entrepreneurship, protect intellectual property, and build best-in-class manufacturing infrastructure. Many sectors which were reserved for public sector such as defence and railways have now been opened up for private domestic and global industries. Rules and regulations for setting up industrial units have now been relaxed without compromising the environmental concerns. It is expected that this will generate employment opportunities, promote self reliance and speed up growth of economy.

Skill India

One of the reasons for low employment generation in India is that a large section of young and middle aged population is less or unskilled. The post-1991 India has been witnessed with changes in technology. Most of the new jobs in different manufacturing and service sectors require skilled persons. In order to realise the objectives of *Make in India*, it is essential that skills of people in the working age group be upgraded. This led the Union Government to set up the Ministry of Skill Development and Entrepreneurship. Recently the government also released a separate national policy document on Skill Development and Entrepreneurship.

JAM Trinity

In India, both the central and state governments subsidise a wide range of products to make them affordable for the poor. Some of them are rice, wheat, pulses, sugar, kerosene, Liquefied Petroleum Gas (LPG), water, electricity, fertiliser and railways. Most of these are physically distributed to people leading to wastage, pilferage and corruption. Since 2014, Indian Governments introduced a new initiative such as **J**an Dhan Yojana, use of **A**adhar cards and **m**obile numbers (JAM) to transfer government subsidies directly to the bank accounts of low income families so that they can buy these services directly from the markets. This is expected to reduce government expenditure on distribution of subsidised goods and services but also make sure that low income households benefit from these subsidies.

Also the Union Government introduced three new schemes such as Pradhan Mantri Suraksha Bima Yojana (accident insurance), Pradhan Mantri Jeevan Jyoti Yojana (life insurance) and Atal Pension Yojana.