

The Political Economy of Development in India

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How did India make the transition from an economic laggard to one of the fastest growing economies in the world? India's sluggish economic growth has been pejoratively described as the "Hindu rate of growth".¹ Industrial modernization and the green revolution could muster a mere 3.4% average annual rate of growth between 1956 and 1974, at a time when many economies of Asia had boomed. Economic growth accelerated to a rate higher than 5% between 1975 and 1990 and furthermore to over 6%, after 1992. Growing at 8.8% between 2003 and 2007, India transformed itself to one of the fastest growing economies in the world, after China. The World Bank – IMF Annual Meeting in Singapore in 2006 was dedicated to the rise of China and India. India continued to grow more rapidly (6.1% in 2008/09) than all the major Asian economies, except China, in the aftermath of the global financial crisis.²

India gradually deregulated private sector investment after 1975.³ This phenomenon was consolidated in the 1980s. There was substantial domestic opposition to engaging with trade in the 1980s, even though the lessons from the success stories in East Asia were making an impact on policymakers. It was only after the balance of payments crisis of 1991 that

¹ The term "Hindu rate of growth" first used by the Indian economist Raj Krishna depicted a condition of slow growth in India. See Montek S Ahluwalia, "Economic Reform for the 1990s," *First Raj Krishna Memorial Lecture* (Jaipur: Department of Economics – University of Rajasthan, 1995): 1, available at <<http://planningcommission.nic.in/aboutus/speech/spemsa/msa033.pdf>>, accessed on August 20, 2009.

² The Indian economy grew more rapidly in 2008/09 than the economies of countries like South Korea, Malaysia, Taiwan, Indonesia, Philippines, Vietnam, Russia and South Africa. China was the one major country that whose economy grew more rapidly than India's. Data was accessed from two databases The World Development Indicators, The World Bank, and the database of the Economist Intelligence Unit, accessed via the National University of Singapore library web site.

³ For two important accounts that see 1975 as the year of change, see Baldev R Nayar, "When Did the 'Hindu' Rate of Growth End?" *Economic and Political Weekly* 41:19 (May 13 2006): 1885-90; Jessica S Wallach, "Structural Breaks in Indian Macroeconomic Data," *Economic and Political Weekly* 38:41 (October 11 2003): 4312-15.

substantial economic deregulation favoring the private sector became possible. This was also a time when industrial policies aggressively began to favor export promotion. India's economic deregulation has to be understood in the context of its evolution as one of the most highly regulated economies in 1975.

India's story of economic development defies the logic of development in many Asian economies that were characterized as hard authoritarian states. It has been argued that the story of promoting competitiveness and human development is one of dealing with powerful vested interests, which are prone to hide behind protectionist walls. Authoritarian states in Asia disciplined industrialists, redistributed land and promoted literacy and public health – which were the pre-requisites for competitiveness and economic growth.⁴ The landed, the industrialists and the bureaucrats, on the other hand, could use their ability to organize themselves more effectively to oppose trade liberalization and stall the empowerment of the poor and lower caste groups.⁵ How did a state, which became increasingly soft towards business groups, the poor and lower caste groups, attend to the problem of promoting competitiveness and human development? What challenges confront the sustenance of economic growth and social development in India?

This chapter is divided into three sections. The first section describes India's economic development between 1947 and 1974. It details the process by which the government came to control substantial parts of Indian industry. It tells the story of how the neglect of Indian agriculture was replaced by an emphasis on food security. India's experiments with the closed economy did neither generate substantial economic growth nor welfare for its citizenry. The second section analyzes the period from 1975 till 1990. This was a period when India promoted its private enterprises in the context of a closed economy. India's economic growth accelerated, its agricultural sector grew rapidly, and greater attention was paid to the concerns of human development. Rapidly rising government expenditures during this period could not be sustained in the context of unfavorable international financial conditions. The final section from 1991 till the present, describes the paradox of the shift to rapid economic growth and globalization, which has been accompanied with a rather slow progress in the well being of its citizens.

⁴ Robert Wade, *Governing The Market* (Princeton: Princeton University Press, 1990); Stephan Haggard, *Pathways from the Periphery* (Ithaca: Cornell University Press, 1988); Peter Evans, *Embedded Autonomy* (Princeton: Princeton University Press, 1995); Alice Amsden, *Asia's Next Giant* (Oxford: Oxford University Press, 1989).

⁵ On the political economy of interest groups favoring the status quo, see Pranab Bardhan, *The Political Economy of Development in India* (Oxford: Basil Blackwell, 1984): 40-59. On why the Indian state enjoyed less autonomy to engineer economic change in the 1980s than in the 1960s when Prime Minister Nehru was at the helm, see Sudipta Kaviraj, "A Critique of the Passive Revolution," in Partha Chatterjee, ed., *State and Politics in India* (New Delhi: Oxford University Press, 1997): 45-87.

Democratic politics may be gradually producing a welfare state, which will depend on the sustainability of the high growth path.⁶

The Legacy of Controls in a Self Reliant Economy: 1947-74

India's "mixed economy"⁷ was born in the immediate aftermath of an anti-colonial struggle. There was a widespread belief that colonialism had harmed Indian industry.⁸ The opposition to trade liberalization was legitimized by a powerful economic development paradigm of import substituting industrialization, which deployed the infant industry argument. It was believed that infant industries, especially in high technology areas required substantial state supported finance and protection from international trade till they matured into competitive industries.⁹ This section provides the context within which the liberalization measures after 1975 needed to be understood.

There contestation between the radicals and the moderates about the optimal extent of state intervention within the ruling Congress Party after independence produced a compromise that increased the state's command over the economy over time. The powerful Deputy Prime Minister Vallabhbhai Patel was a foil to Prime Minister Nehru's more radical inclination towards state intervention till Patel's untimely death in 1950.¹⁰ The Industrial Policy Resolution of April 1948 had reserved three sectors for the state, and the next one in 1956 added another 12. The Indian Development and Regulation Act (1951)¹¹ was the genesis of a system of industrial licensing, which involved seeking the government's permission for initiating commercial activities in a few select areas. Nehru was impressed with Soviet economic planning and rapid capital intensive industrialization. He promoted a powerful and technocratic Planning Commission and a greater involvement of the state in economic activity.¹²

⁶ On the relationship between economic growth and welfare expenditure in India, see Baldev R Nayar, *The Myth of the Shrinking State* (New Delhi: Oxford University Press, 2009): 70-107.

⁷ "Mixed Economy" is a term used to connote an economy where neither the government-owned sectors nor the private sector dominate economic activity. See for example, Baldev R Nayar, *India's Mixed Economy* (Bombay: Popular Prakashan, 1989).

⁸ Nandan Nilekani, *Imagining India* (New Delhi: Allen Lane, 2008), pp. 61-66.

⁹ On the impact of the import substituting industrialization paradigm on the developing world and on India see, Jagdish Bhagwati, *India in Transition* (Oxford: Clarendon Press, 1993): 5-11; Anne O Krueger, *Political Economy of Policy Reform in Developing Countries* (Cambridge, MA: The MIT Press, 1995): 37-51.

¹⁰ Medha M Kudaisya, *The Life and Times of G D Birla* (New Delhi: Oxford University Press, 2003): 278-91.

¹¹ On how the debate between the economic radicals and liberals were being resolved in favor of the latter in the early years, see Francine R Frankel, *India's Political Economy 1947-2004* (New Delhi: Oxford University Press, 2005): 70-77; Kudaisya, *The Life and Times of G D Birla*, 305-16; Vivek Chibber, *Locked in Place* (Princeton, NJ: Princeton University Press, 2003): 126-57.

¹² On the rise of the Planning Commission and industrial regulation see, Frankel, *India's Political Economy 1947-2004*, 113-30. For an account on how the Planning Commission was unsuccessfully challenged even in the best of

Rapid capital intensive industrialization posed a constraint on resources available for agricultural development during the Second Five-Year Plan. The total plan outlay on agriculture and irrigation, which was 34.6% in the First Five-Year Plan (1951-56), was reduced to 17.5% in the Second Five-Year Plan.¹³ The planners assumed that land reforms and cooperative farming premised upon small land owners voluntarily participating in the collective management of farms would generate ample food for the population. The policy of supporting industrialization at the cost of agricultural development was unsuccessfully opposed by state-level Congress Party leaders and the Ministry of Agriculture.¹⁴

India was faced with political and economic uncertainties after Prime Minister Nehru's death in 1964. India had become heavily dependent on foreign funds for financing its industrialization after the financial crisis of 1957. It had lost a war with China in 1962, which would necessitate a rise in defense expenditure. The country had become heavily dependent on subsidized wheat shipment from the US under the US Public Law 480 Program at a time when the US was becoming skeptical about the merits of India's planning.¹⁵ Lal Bahadur Shastri was the unanimous choice for the next Prime Minister in 1964. He had to confront another war with Pakistan in 1965, declining food-grain production, and rising inflation in 1964 and 1965. The World Bank had become critical of Indian planning and industrial controls at this time.¹⁶

Prime Minister Shastri (1964-66) initiated changes to the Nehruvian approach to economic development. First, priority was accorded to agriculture. India began to experiment with US seed technology working closely with the US government.¹⁷ The power of the Planning Commission, which had favored capital intensive industrialization over agricultural development, was curbed.¹⁸ The decisions to align India's economic policy with the Bell Report commissioned by the World Bank were taken in 1965. It was decided to devalue the Rupee,

times see, Medha Kudaisya, "A Mighty Adventure': Institutionalizing the Idea of Planning in Post-colonial India," *Modern Asian Studies* 43:4 (2009): 939-78. Nehru did see a role for the private sector, despite his emphasis on the government. See P N Dhar, *The Evolution of Economic Policy in India* (New Delhi: Oxford University Press, 2003): 230-33; Kudaisya, *The Life and Times of G D Birla*, 316-21; 331-36.

¹³ Frankel, *India's Political Economy 1947-2004*: 131.

¹⁴ On the declining emphasis on Indian agriculture see after the second Five-Year Plan see, Frankel, *India's Political Economy 1947-2004*, pp. 131-200. Ashutosh Varshney, *Democracy, Development and the Countryside* (Cambridge, MA: Cambridge University Press, 1998): 28-47.

¹⁵ On US's aid weariness after 1963 see, Bruce Muirhead, "Differing Perspectives: The World Bank and the 1963 Aid India Negotiations," *India Review* 4:1 (January 2005): 1-22; Medha M Kudaisya, "Reforms by Stealth," *South Asia* 25:2 (August 2002): 216-20.

¹⁶ On the critical Report of the Bell Commission see, David B H Denoon, *Devaluation under Pressure* (Cambridge, MA: The MIT Press, 1986): 72-75; John P Lewis, *India's Political Economy* (Delhi: Oxford University Press, 1997): 138; Benjamin B King, *Transcript of Interview with Robert W Oliver* (Washington DC: The World Bank Oral History Program Archives, July 24-25 1986): 16-28. Benjamin King had authored some parts of the report.

¹⁷ Varshney, *Democracy, Development and the Countryside*, 49-80; Frankel, *India's Political Economy 1947-2004*: 248-67.

¹⁸ On the rise of the Prime Minister's Office at this time see, Frankel, *India's Political Economy 1947-2004*: 251-52.

liberalize imports, free some sectors such as fertilizer production from government control, reduce the size of the public sector, and, increase foreign investment. These policy decisions were supposed to generate an additional aid amount of \$400 million, raising the annual available financial aid level to \$1.6 billion.¹⁹ This quantum of assistance was considered essential for financing the Fourth Five-Year Plan.

Indira Gandhi, known to be the shy daughter of the late Prime Minister Jawaharlal Nehru, was appointed Prime Minister in January 1966 after the sudden and unexpected death of Prime Minister Shastri. She initially followed the direction charted out by Shastri. Her decision to devalue the Rupee was met with widespread opposition in the Indian Parliament in June 1966. The majority of the economists at that time opined that devaluation and trade promotion would not serve India well. Almost all Indian industrialists, barring a few involved with export oriented production, opposed the decision to devalue the Rupee. It was widely believed that devaluation and trade liberalization had occurred as a result of foreign pressure rather than an internal generated consensus on the matter. These policy measures had been deemed important for the continuation of food and industrial aid at levels necessary to finance the Fourth Five-Year Plan.²⁰

The Government pursued a policy of promoting agriculture in the aftermath of the devaluation episode, which was consistent with World Bank advice. It did not wish to face the humiliation of begging for food-grains before the US government. The introduction of 200 metric tons of a high-yielding variety of Mexican wheat was successful under Indian conditions. The technological and financial assistance from the US, which led to the doubling of India's wheat output between 1965 and 1970, had produced India's green revolution. Even though the green revolution favored the richer and middle farmers, it made a significant impact on India's food security and poverty alleviation.²¹ When John Lewis, an advisor to the US Government at that time asked why the Government of India followed US advice in agriculture but not in other areas such as trade and industrialization, a senior Indian civil servant L K Jha opined, that this was because the former was a part of an internally generated consensus, whereas the latter was not.²²

¹⁹ David B H Denoon, "Cycles in Indian Economic Liberalization, 1966-1996," *Comparative Politics* 31:1 (October 1998): 49-50.

²⁰ On the opposition to devaluation see, Rahul Mukherji, "India's Aborted Liberalization -1966," *Pacific Affairs* 73:3 (Fall 2000): 382-84, 385-89.

²¹ On the green revolution see, Varshney, *Democracy, Development and the Countryside*: 50-78. On the impact of the green revolution on poverty see, Manoj Panda, "Agriculture and Poverty Reduction," in Shovan Ray, ed., *Oxford Handbook of Agriculture* (New Delhi: Oxford University Press, 2007): 116-17. The states that benefited the most from the green revolution also had the lowest number of people living below the poverty line.

²² Lewis, *India's Political Economy*: 135.

Two significant reasons explain the arrival of the most intensely state-driven and autarkic phase of India's industrialization between 1969 and 1974. First, there was a mismatch between Indian and American expectations. The Indian establishment was of the view that it had done its best, despite serious internal opposition, to satisfy the Aid India Consortium and the World Bank.²³ The US establishment, on the other hand, considered the Indian policy response to be rather inadequate. Aid pledges were below Indian expectations. And, given Indira Gandhi's critical views on the US's intervention in Vietnam, President Johnson placed India's food-grain shipments on a policy of short-tether. Presidential consent was required for every shipment of food-grain to India after that.²⁴

Second, Indira Gandhi turned to the left for political reasons. She felt insecure in the company of the senior right-wing political leadership within the Congress Party. Congress Party leaders like Kamraj and Morarji Desai had treated her as one who was soon to be replaced, once the leadership issue was sorted out within the senior leadership. She aligned herself with the Communist Party of India and mobilized the Congress Forum for Socialist Action to deal with the threat to her position within the Congress Party. Her preferred candidate in 1969, Varahagiri Venkata Giri, did not win the majority of the Congress votes and would have lost the election to the Congress's official candidate Neelam Sanjiva Reddy without the support of the Communist Party of India. Her liberal minded ministers and civil servants were soon replaced by ones who were in favor of a higher degree of state control.²⁵

Domestic political opposition to devaluation and liberalization, and Mrs. Gandhi's alliance with the left, ensured that the state would curb private sector activities to the greatest extent between 1969 and 1974. The Monopolies and Restrictive Trade Practices Act (1969) placed stringent regulations for any private company worth greater than Rupees 200 million. The Foreign Exchange Regulation Act (1974) restricted the maximum possible equity participation in an Indian firm to 40%. This meant that it would be difficult for foreign companies to secure 50% of the vote of shareholders necessary for substantial corporate governance powers in India. Sectors such as steel, copper, banking, insurance and wheat trade were all nationalized.²⁶

State control and autarkic industrialization were supposed to contribute to poverty alleviation and human development. These expectations were not met. The Indian economy

²³ On the compulsions of the Indian side see, Mukherji, "India's Aborted Liberalization – 1966", 381-89.

²⁴ For the US side of the story see, James Warner Bjorkman, "Public Law 480 and Policies of Self-Help and Short-Tether," in Lloyd I Rudolph and Susanne H Rudolph, eds., *The Regional Imperative* (New Jersey: Humanities Press, 1980): 232-33.

²⁵ Frankel, *India's Political Economy 1947-2004*: 388-433.

²⁶ Arvind Panagariya, *India: The Emerging Giant* (New Delhi: Oxford University Press, 2008): 59-71. Frankel, *India's Political Economy 1947-2004*: 434-90.

grew at a dismal average annual rate of 3.4% between 1956 and 1974. The poverty ratio or the total number of people below the poverty line did not register a decline between 1951 and 1974. It remained largely in the range of 45% to 50%, and exceeded the 50% figure for some years.²⁷

Slow growth and unacceptable levels of absolute poverty coincided with a period when Mrs. Gandhi's approach to dealing with politics had become quite authoritarian. The chapter on social mobilization describes how she undermined the democratic institutions within the Congress Party and the Government of India. Efforts were made to initiate welfare programs that would allow the central government to directly reach out to the poor by bypassing the governments in the various states.²⁸ Political opposition in an increasingly mobilized society where the channels of interest articulation were becoming fewer, led to social movements in states like Bihar and Gujarat led by a charismatic socialist leader - Jaya Prakash Narayan. An insecure Mrs. Gandhi imposed authoritarian rule in 1975, in the aftermath of a decision taken by a High Court where she had been accused of electoral malpractices. The highest level of state intervention in the economy was accompanied with the political and economic problems that had become a cause for concern.²⁹

The Gradual Evolution of the Liberal Momentum: 1975-1990

The Indian economy began to rely on private initiative to a greater extent than was the case in previous times after 1975. Years of sluggish economic growth accompanied with a poor record in human development had given rise to critical thinking within policy circles. Asian economies such as South Korea, Taiwan and Singapore, had demonstrated that private initiative and trade promotion could result in rapid economic growth and well being. China's rise powered by export orientation since the late 1970s was an even more convincing example of how the world economy could be beneficial for poor developing countries.³⁰ The Government of India produced a number of important reports that were critical about industrial regulations of the Government, and suggested the need to promote exports.³¹

²⁷ Panagariya, *India: The Emerging Giant*: 133-36.

²⁸ Steven I Wilkinson, "Explaining changing patterns of party-voter linkages in India," in Herbert Kitschelt and Steven I Wilkinson, ed., *Patrons, Clients, and Policies* (New York: Cambridge University Press, 2007): 113-18.

²⁹ Atul Kohli, *Democracy and Development in India* (New Delhi: Oxford University Press, 2009): 23-42; Vernon Hewitt, *Political Mobilization and Democracy in India* (London: Routledge, 2008): 62-120.

³⁰ Indira Gandhi, *Selected Speeches and Writings – Volume 4* (New Delhi: Publications Division of the Ministry of Information and Broadcasting, November 1985): 236.

³¹ For an overview of these reports, see P N Dhar, "The Indian Economy," In Robert E B Lucas, and Gustave F Papanek, eds., *The Indian Economy* (New Delhi: Oxford University, 1988): 13-14. Important reports included, P C Alexnader (chair), *Report of the Committee on Import and Export Policies* (New Delhi: Ministry of Commerce,

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Prime Ministers, Indira Gandhi (January 1966 – March 1977; January 1980 – October 1984), Rajiv Gandhi (October 1984 – December 1989), Morarji Desai (March 1977- July 1979), Charan Singh (July 1979 – January 1980), Vishwanath Pratap Singh (December 1989 – November 1990) and Chandra Shekhar (November 1990 – March 1991), continued to gradually and often stealthily deregulate economic activities of the private sector, despite the socialist rhetoric.³² Of the above-mentioned premiers, Rajiv Gandhi was most proactive about promoting the private sector. Trade promotion was less successful than industrial deregulation during this period, and the ratio of trade to gross domestic product (GDP) did not witness an appreciable rise between 1980 and 1990. The liberalization initiatives were politically contested by factions within the Congress Party and Indian industry. Powerful interest groups created over years of regulation had developed a stake in maintaining a highly protected economy ridden with government controls.

The vast majority of Indian industrialists had become accustomed to beating the system of controls, where licenses and approvals were required for production, imports and exports. Industrialists became past masters at the art of what Stanley Kochanek has aptly termed “briefcase politics”. Industrialists maintained excellent relations with the politician and the bureaucrat through their offices in Delhi. A senior minister in Indira Gandhi’s cabinet, Lalit Narayan Misra, had become famous for collecting money in return for providing commercial privileges to industrialists. The cash used to be collected in briefcases, and each bag full of Rupee bills, signified a unit of value.³³

The pressure for promoting industrial competitiveness rarely came from the business class. They desired more privileges for conducting business within India but were not promoting global competitiveness. The Federation of Indian Chambers of Commerce and Industry (FICCI’s) was the most powerful industry organization in the early 1980s. FICCI advised the government to reduce import duty on intermediate goods and sought concessions for 100% export oriented units. Yet, they seemed to be unaware of India’s export potential in information technology and

1978); Vadilal Dagli, *Report of the Committee on Controls and Subsidies* (New Delhi: Ministry of Finance, 1978); Abid Hussain (chair), *Report of the Committee on Trade Policy* (New Delhi: Ministry of Commerce, 1984); M Narasimham (chair), *Report on Industrial Licensing and Related MRTTP Aspects* (New Delhi: Ministry of Finance, 1985).

³² On liberalization by stealth during this period, see Panagariya, *India: The Emerging Giant*: 78-94. For a more general treatment of stealth and economic liberalization in India, see Rob Jenkins, *Democratic Politics and Economic Reform in India* (Cambridge: Cambridge University Press, 1999).

³³ Stanley Kochanek, “Liberalization and Business Lobbying in India,” in Rahul Mukherji, ed., *India’s Economic Transition* (New Delhi: Oxford University Press, 2007): 417-20.

pharmaceuticals, which were soon to emerge as the growth areas for India's exports and the route to its engagement with the global economy.³⁴

The need for industrial reforms was understood by the technocracy and promoted by the Prime Minister's Office (PMO). The Industrial Policy Statement of 1980 under the premiership of Indira Gandhi showed a new direction, and was more gradual than the reforms initiated by Rajiv Gandhi.³⁵ Her most visible decision was to engage with the IMF for funds in the aftermath of the second oil shock in 1979. The Government of India pre-empted macro-economic policy reforms that the IMF would have demanded and secured funds that were used largely for harnessing India's oil and natural gas reserves by developing the publicly owned Oil and Natural Gas Commission. The funds were secured in 1981, despite severe criticism from the left parties in India. The IMF was interested in building a relationship with India, even though the Reagan administration was averse to this decision.³⁶ These funds contributed to India's energy security as the ratio of oil imports to domestic production was reduced from 60:40 to 30:70 within a period of five-years.³⁷

A significant liberalization measure included gradual deregulation of production decisions made by Indian industry. The annual growth of Indian industry, which was 4.5% during the period 1961 and 1974, accelerated to 5.9% between 1975 and 1990.³⁸ Licensing or the process of obtaining government permission required to allow private companies to open industrial units in specified sectors had become a corruption racket rather than a way of directing industrialization with a purpose. The intellectual architects of the licensing regime like eminent economist and technocrat Indraprasad Gordhanbhai Patel opined in the mid-1980s that policy makers had not expected industrial licensing would become a corruption racket.³⁹

Rajiv Gandhi was an airline pilot and had a deep interest in electronics and radios before he decided to enter politics.⁴⁰ He dedicated his tenure as Prime Minister to technological development and to reducing the government's control over industrial activity. Thirty industries and 82 pharmaceutical products were de-licensed by Rajiv Gandhi. By the end of the decade, under the premiership of V P Singh, there was no need for a government license for

³⁴ FICCI, *Correspondence: 1981* (New Delhi: Federation House, 1981): 141-276.

³⁵ *Statement on Industrial Policy* (New Delhi: Department of Industrial Development – Ministry of Industry, July 1980).

³⁶ John G Ruggie, "Political Structure and Change in the International Economic Order," in John G Ruggie, ed., *Antinomies of Interdependence* (New York: Columbia University Press, 1983): 458-59; Praveen K Chaudhry, Vijay L Kelkar and Vikash Yadav, "The Evolution of 'Homegrown' Conditionality," *Journal of Development Studies* 40:6 (August 2004): 59-76.

³⁷ Catherine Gwin and Lawrence A Veit, "The Indian Miracle," *Foreign Policy* 58 (Spring 1985): 87.

³⁸ These figures were accessed from the World Development Indicators, The World Bank database online at the NUS web site.

³⁹ I G Patel, "On Taking India into the Twenty-First Century," *Modern Asian Studies* 21:2 (1987): 216-18.

⁴⁰ Dinesh C Sharma, *The Long Revolution* (New Delhi: HarperCollins, 2009): 124-73.

investments up to Rupees 250 million in developed regions, and for up to Rupees 750 million in backward underdeveloped areas. Second, broad-banding allowed firms to change the mix of products within approved production capacity. To give one example, if a company had a license to produce 50,000 high powered motor bikes and 60,000 fuel efficient bikes, they could adjust production among the two types of bikes. Third, firms needed permission to produce more than the government allocated production quota assigned for them, which was a disincentive for increasing production. This problem was addressed by allowing firms that were producing goods at the level of 80% plant efficiency to increase their production capacity to 133%. Last but not least, the Monopolies and Restrictive Trade Practices Act had stringently controlled businesses with assets worth Rupees 200 million. Rajiv Gandhi raised the Rupees 200 million limit to Rupees 1 billion, and waived MRTTP clearance for 27 industries.⁴¹

The Government engaged in a successful joint venture with the Suzuki Corporation of Japan, despite opposition from India's leading car makers. This decision was accompanied by an allowance of automatic expansion of capacity in the automobile sector. The successful production of the Maruti Suzuki car was a landmark achievement in improving the efficiency and reliability of Indian cars. The Fiat car under the brand name Premier Padmini was a version of the Fiat 1100, and was very popular in India from the 1950s till 1985. The Hindustan Ambassador was a version of the Morris Oxford III model produced by the Morris Motor Company in 1956. Suzuki's technology and reliability challenged the two existing brands, which had monopolized the Indian roads since the 1950s. The lack of foreign and domestic competition for both the cars had ensured that the Indian consumer was still using the technology of the 1950s. Deregulation in the automobile sector in the 1980s also became the basis for realizing comparative advantage in the auto components area in the years to come.⁴²

Telecommunications services and the manufacture of telephone switches were deregulated for the first time in the 1980s. A Department of Telecommunications (DOT) was created within the Ministry of Communications to focus attention on enhancing the quality telecommunications services. A government-owned corporate entity called Mahanagar Telecom Nigam Limited (MTNL) was created to serve the metropolises of Delhi and Mumbai. Political opposition from the DOT ensured that MTNL was not allowed to operate in any other Indian city. The Centre for the Development of Telematics (CDOT) was born as an autonomous agency within the Government. It produced the technology for a switch for telephone exchanges in rural areas after competing with multinationals like Alcatel. Innovation within a

⁴¹ The best account of industrial deregulation is described by Panagariya, *India: The Emerging Giant*, 98-109. See also Kohli, *Democracy and Development in India*, 147-63; Nayar, "When Did the Hindu Rate of Growth End?", 1887-90.

⁴² Subir Gokarn, Anindya Sen and Rajendra R Vaidya, *The Structure of Indian Industry* (New Delhi: Oxford University Press, 2004): 281-96.

government department was licensed for the first time to private manufacturers who were given licenses to produce telephone switches. The creation of CDOT and the MTNL were both opposed by the employees of the Department of Telecommunications located within the Ministry of Telecommunications.⁴³

The 1980s also witnessed the birth of comparative advantage in India's Information Technology (IT) sector. This was the first commercial activity that earned India's service-trade a good reputation. English education, excellent engineering colleges and institutions of higher learning in the sciences coupled with low wages, produced a natural comparative advantage in IT services. The exit of companies like International Business Machines (IBM), owing to foreign regulations in the early 1970s, freed the talent for India's first generation of middle class entrepreneurs and managers. The Department of Electronics under the Prime Minister's Office (PMO) was manned by scientists and technocrats rather than career civil servants. These technocrats supported the highly qualified engineer entrepreneurs of the IT sector and pursued a policy of deregulation. Easier imports of computers and software for facilitating exports became possible. The efforts of the Department of Electronics were often opposed by the Ministry of Finance, which worried about revenue losses owing to lowered customs duty.⁴⁴

India's agriculture boomed during the 1980s. The annual growth rate of 3.4% in the 1980s has been higher than in any other decade after India's independence. Farmers had successfully pressured the Ministry of Agriculture to take a generous view of agricultural pricing after the Janata government came to power in 1977. Charan Singh who was a senior minister within the Janata Party that dethroned Indira Gandhi's Congress government went on to become the Prime Minister during a brief period between July 1970 and January 1980. He had fought for the interests of middle farmers since the 1950s. Even though the Janata government was short-lived, pro-farmer procurement prices and subsidies initiated during this period held their sway during the decade.⁴⁵ Powerful farm lobbies led by people like Mahendra Singh Tikait,

⁴³ See J P Singh, *Leapfrogging Development* (Albany, NY: State University of New York Press, 1999): 141-63; M B Athreya, "India's Telecommunications Policy," *Telecommunications Policy* 20:1 (January 1996): 11-17; Rahul Mukherji, "Managing Competition," in Rahul Mukherji, ed., *India's Economic Transition* (New Delhi: Oxford University Press, 2007): 301-04. On the success of the CDOT, see Evans, *Embedded Autonomy*: 134-35.

⁴⁴ On how the 1980s prepared the IT sector for a boom in the 1990s, see Vibha Pingle, *Rethinking the Developmental State* (New Delhi: Oxford University Press, 1999):126-41; AnnaLee Saxenian, "Bangalore," in Rahul Mukherji, ed., *India's Economic Transition* (New Delhi: Oxford University Press, 2007): 361-69. On why the electronics industry did not take a similar route, see E Sridharan, *The Political Economy of Industrial Promotion* (Westport, Conn: Praeger, 1996): 113-156.

⁴⁵ On the difference made by the growing power of the farmer's lobby to agricultural policy, see Varshney, *Democracy, Development and the Countryside*, 81-145.

Sharad Joshi and M D Nanjundaswamy kept the pressure on the government by arguing convincingly that urban India had neglected rural India for a long time.⁴⁶

Human Development

Industrial and agricultural development during the 1980s made some impact on the well being of people. First, India's success in the area of higher education was accompanied with unacceptable levels of illiteracy and poverty. The late MIT Professor Myron Weiner had argued that there was perhaps something in India's caste system and the stratified social structure that enabled it to produce excellent institutions of higher learning but not free and compulsory education for all. The government had turned a blind eye and even argued in favor of child labor, arguing that this might be necessary for the survival of poverty stricken families.⁴⁷

A few notable policies that would work towards reversing this trend were initiated after 1975. Realizing that education had suffered partly because it was governed exclusively by the states within the Indian Union, Indira Gandhi successfully put her political weight behind amending the Indian constitution in 1976. Education was moved from the list of subjects governed by the Indian states to one that would be governed concurrently by the Centre and the states. The National Policy on Education and the National Literacy Mission initiated by Rajiv Gandhi were significant attempts to make an impact on eradicating illiteracy.⁴⁸ Second, education attracted more policy attention and resources compared with public health.⁴⁹ Third, while there had been no significant decline in the proportion of Indians living below the poverty line till 1973, a steady decline had begun to occur after 1973.⁵⁰

The Roots of a Financial Crisis

The Indian economy underwent domestic deregulation but did not engage significantly with the global economy after 1975. Its trade as a percentage of GDP, which was 16% in 1980, remained at the same level in 1990. The same figures for China were 22% and 35%, respectively.⁵¹ The import of the success of Asian economies such as Japan, South Korea, Taiwan, Singapore, and most recently the rapid economic growth in China, was not lost on

⁴⁶ On farmer's movements in India, see Gail Omvedt, "Farmer's Movements," in Raka Ray and Mary F Katzenstein, eds., *Social Movements in India* (New Delhi: Oxford University Press, 2005): 185-90; Akhil Gupta, *Postcolonial Developments* (Durham: Duke University Press, 1998): 62-101.

⁴⁷ Myron Weiner, *The Child and the State in India* (Delhi: Oxford University Press, 1991).

⁴⁸ Nilekani, *Imagining India*, 196-99; Jandhyala B G Tilak, "Universalizing Elementary Education," in *Universalizing Elementary Education in India* (New Delhi: Oxford University Press, 2009): 41-50.

⁴⁹ Baldev R Nayar, *The Myth of the Shrinking State* (New Delhi: Oxford University Press, 2009): 86-92.

⁵⁰ Panagariya, *India: The Emerging Giant*, 131-36.

⁵¹ These figures were accessed from the *World Development Indicators Online*, The World bank, from the NUS library web site on September 29 2009.

Indian policy makers. India had failed to discipline capital and change the orientation of the economy away from import substitution and towards export-led-growth.⁵²

Second, India had decided not to take advantage of debt-free foreign direct investment by multinational companies that could have freed resources for economic growth. Industrialists, farmers and the urban middle classes were all making demands on the state in the 1980s. The rising demands from an increasingly mobilized society described in a separate chapter in this book had led to a growing deficit between government expenditure and revenue.⁵³ The Government became increasingly dependent on commercial sources of borrowing to fund this deficit.

A financial crisis was looming large over India by 1990. Given the growth of spending in the Government, the fiscal deficit, which measures the difference between expenditures and revenues of the Government increased as a proportion of GDP from 8.1% between 1980/81 and 1984/5, to 10.1% between 1985/86 and 1989/90. The growth areas of government expenditure were interest payments on commercial borrowings, subsidies for targeted beneficiaries in agriculture and industry, and defense expenditure.⁵⁴ This pattern of expenditure reflected a political economy where the farmer, the industrialist and the urban middle class, all exerted pressures for concessions within a democratic polity. The Government had to acquiesce to these pressures. Moreover, the social mobilization of erstwhile backward and untouchable classes meant that the Government had to pay greater heed to a larger number of interest groups than had been the case in the past.⁵⁵

Government expenditure had increased substantially at the very time when India had become dependent on commercial borrowings. Commercial banks did not view the ever growing fiscal deficit in a positive light. They became further concerned about political uncertainty when Rajiv Gandhi was succeeded first by Prime Minister Vishwanath Pratap Singh in December 1989, soon thereafter and by Prime Minister Chandra Shekhar in November 1990.

⁵² On the impact of China, see Jalal Alamgir, *India's Open Economy Policy* (New York: Routledge, 2009): 89-120. Montek S Ahluwalia, the Deputy Chairman of India's Planning Commission since 2004 confirmed this view (Author interview, New Delhi, January 5 2005).

⁵³ On the relationship between increasing level of political and social mobilization and the fiscal deficit, see Rahul Mukherji, "Economic Transition in a Plural Polity: India," in Rahul Mukherji, ed., *India's Economic Transition* (New Delhi: Oxford University Press, 2009): 119-26.

⁵⁴ *Ibid.*, 126-28. Vijay Joshi and IMD Little, *India: Macroeconomics and Political Economy* (New Delhi: Oxford University Press, 1994): 225-35.

⁵⁵ On social and political mobilizations in the 1980s, see Francine Frankel, "Decline of a Social Order," in Sudipta Kaviraj, ed., *Politics in India* (New Delhi: Oxford University Press, 1997): 370-82; Lloyd I Rudolph and Susanne H Rudolph, *In Pursuit of Lakshmi* (Chicago: The University of Chicago Press, 1987): 228-44. Atul Kohli, *Democracy and Development in India* (New Delhi: Oxford University Press, 2009): 23-42; Ashutosh Varshney, "Is India Becoming More Democratic?" *Journal of Asian Studies* 59:1 (February 2000): 3-25; Christophe Jaffrelot, "The Rise of the Other Backward Classes in the Hindi Belt," *Journal of Asian Studies* 59:1 (February 2000): 86-108; Sumit Ganguly, *The Crisis in Kashmir* (Cambridge, UK: Cambridge University Press, 1997): 14-42.

The issue of implementing the recommendations of the Mandal Commission (1980), which had recommended reserving 27% of the seats in institutions of higher learning and in government jobs for other backward classes, in addition to the 22% reserved for the scheduled castes and tribes, was raised for the first time during the premiership of Vishwanath Pratap Singh.⁵⁶ Commercial banks worried that the politics of populism and political uncertainty was there to stay in India for some time.

The Gulf War occurred at the time when the politics of populism had generated an expanding fiscal deficit. The Gulf War (August 1990) and the consequent rise in the price of oil hurt the Indian exchequer to the tune of 1% of India's GDP. A substantial downgrade in the Moody's credit rating from A2 (good ability to pay) to Ba2 (speculative) between June 1990 and March 1991 led to a shutting down of all the credit windows.⁵⁷ The Moody's highlighted India's high debt to service payment ratio, its high dependence on commercial borrowing, and its high debt to export ratio, as reasons for downgrading India's sovereign rating.⁵⁸

Private sector orientation and higher subsidies for all groups became unsustainable in the context of a relatively closed economy with substantial industrial controls. Higher rates of growth in manufacturing and in agriculture could not be sustained in the context of the finances available for India's development. Constituencies within the Government that wished India to promote competitiveness more vigorously and engage with the global economy were validated by a fiscal crisis that was turning into a serious balance of payments crisis for the first time after 1966. India was two weeks to a default in June 1991.

The most visible sign of desperation among the pro-liberalizing technocrats was a confidential paper authored by Montek Singh Ahluwalia within the Prime Minister's Office in June 1990, which was leaked to the press. Prime Minister Vishwanath Pratap Singh had visited Malaysia with Montek Ahluwalia and was surprised to find a backward country develop to a greater extent than India within a short span of time. He had urged Ahluwalia to pen his thoughts about economic reforms at a time when the balance of payments crisis was around the corner. In a paper titled, "Towards restructuring industrial, trade and fiscal policies," Ahluwalia had drawn the blue-print for radical economic reform in India. The paper recommended tariff reduction, greater freedom for foreign capital, a 20% devaluation of the Rupee, the closure of unviable public sector units, and raising the MRTP asset limit quite

⁵⁶ Frankel, *India's Political Economy*: 688-89.

⁵⁷ Ephraim Clark and Geeta Lakshmi, "Controlling the risk: a case study of the Indian liquidity crisis 1990-92," *Journal of International Development* 15:3 (March 2003): 285-98.

⁵⁸ Joshi and Little, *India: Macroeconomics and Political Economy*, 65-67; 180-89. Amit Bhaduri and Deepak Nayyar, *An Intelligent Person's Guide to Liberalization* (New Delhi: Penguin Books, 1996): 24-30.

substantially.⁵⁹ The agenda for economic reform had arrived, even though the political conditions for change would need to wait till the balance of payments crisis of 1991.

The Consolidation and Sustenance of the Liberal Economy: The Indian Economy after 1991

We have described how Indian technocrats and statesman had attempted to improve the conditions for private business in India during the 1980s. They could make limited progress in improving the conditions for entrepreneurship, and had achieved much less in the area of promoting India's trade. The political economy of growth and development after 1975 had produced a fiscal situation and consequent dependence on foreign commercial banks that was financially unsustainable after May 1991. It was this economic condition that empowered liberal statesman and technocrats to move the Indian economy substantially in the direction private entrepreneurship and economic globalization after 1991. The 1980s had prepared the ground for this ideational shift. It is in this sense that 1991 marks a watershed in India's economic history.

This section will describe why substantial economic reforms occurred after 1991. Second, what were the significant changes in trade and industrial policies, and what was their impact on domestic and foreign firms? Third, why did infrastructure provision in areas like telecommunications, stock markets, the Indian Railways, and airlines become efficient? Fourth, what are the significant challenges to development that need to be addressed? We will discuss the problems facing the power sector and the serious nature of agrarian distress in India. India has made some progress in employment generation, literacy promotion, and poverty alleviation, even though it continues to house the largest number of absolutely poor people in the world. Malnutrition and public health are the areas of most serious policy concern in India today.⁶⁰ India presents the paradox of spectacular economic growth accompanied with low levels of human development. This condition has been described as being the result of the political economy of a "flailing" state – whose national level elite institutions have performed well in many areas but whose governance at the local level leaves much to be desired.⁶¹

⁵⁹ I am grateful to Montek S Ahluwalia for these insights (Author interview, New Delhi, January 5 2005). See also Vanita Shastri, "The politics of economic liberalization in India," *Contemporary South Asia* 6:1 (1997): 43-44.

⁶⁰ For an excellent account of gradualism and economic reform in India, see Montek S Ahluwalia, "Economic Reform in India since 1991," in Rahul Mukherji, ed., *India's Economic Transition* (New Delhi: Oxford University Press, 2007): 86-111.

⁶¹ This paradox has most recently been described as a "flailing state" by Lant Pritchett. See Lant Pritchett, "Is India a flailing state?" *Faculty Research Working Paper Series RWP01-13* (Cambridge, MA: John F Kennedy School of Government, May 2009): 1-46.

Why Did the Substantial Reforms Occur after 1991?

The foreign exchange crisis forced India to approach the IMF for conditional lending in June 1991. The Government had tried all sources of funding for meeting its import obligations. It had even shipped gold to the Union Bank of Switzerland and the Bank of England to obtain foreign exchange. Commercial banks had decided to stop lending to India. Non-resident Indians, whose deposits in India could have been used for meeting foreign exchange obligations, began withdrawing their savings. The option for India was either to default on its import payments or to seek conditional resources from the IMF. A default would have affected India's substantial oil and intermediate goods imports. It would have been difficult to manage the economy without essential imports.⁶²

The dire crisis situation created a firm resolve within a technocracy to promote India's competitiveness and its private sector. There was greater support for economic deregulation and trade promotion among economists and technocrats in 1991, than was the case in 1966. The crisis aided the reformer technocrats to deal with the opponents of reforms. Rajiv Gandhi's assassination in May 1991 increased the resolve of the Congress Party, which came to power in June, to leverage the crisis and fulfill the late Prime Minister's unfulfilled vision.

Prime Minister P V Narasimha Rao understood that he was faced with a unique situation in India's economic history. The Cold War had ended at the time when India was faced with a financial crisis. India's special economic relationship with the USSR for markets and for imports had to be restructured. It was also an opportunity for the country to chart a new course of economic engagement with Asia, the US and parts of the Western world, which had benefited from global economic interdependence during the Cold War.⁶³ Rao invited a technocrat - Dr. Manmohan Singh to serve as Finance Minister. Singh had understood the importance of global economic interdependence even at the time of writing his doctoral dissertation at Oxford, which was published by Clarendon Press in 1964. This thesis was an important argument suggesting that India needed to promote its exports at a time when import substitution rather than export promotion seemed to be the order of the day.⁶⁴

Technocrats favoring greater private sector and trade orientation such as Montek Singh Ahluwalia, C Rangarajan, Rakesh Mohan, and Raja Chelliah⁶⁵, who had gained enormous policy

⁶² On the severity of the crisis, see Bahduri and Nayyar, *The Intelligent Person's Guide to Liberalization*, 22-30.

⁶³ I am grateful to the late Prime Minister Rao for these insights. (Author interview, New Delhi, February 2001).

⁶⁴ See Manmohan Singh, *India's Export Trends* (Oxford: Clarendon Press, 1964). Amartya Sen has argued that this was quite an exceptional argument at that time, see Amartya Sen, "Theory and Practice of Development," in Isher J Ahluwalia and I M D Little, eds., *India's Economic Reforms and Development* (New Delhi: Oxford University Press, 1998): 73-84.

⁶⁵ Ahluwalia was Commerce Secretary in 1990/91 and Secretary: Ministry of Finance between 1991-98; Rangarajan was a Member of the Planning Commission in 1991, and served as Governor of the Reserve Bank from 1991-97;

experience in the 1980s, enjoyed the support of the Prime Minister. They made virtue of necessity by taking the economy in the direction of embracing global economic interdependence to an extent that would not have been possible in the absence of a crisis. This process was aided by support within parts of Indian industry, which were more professionally inclined. Rajiv Gandhi had worked closely with the Association of Indian Engineering Industry (AIEI) to increase its profile in relation to the pre-eminent Indian industry association – the Federation of Indian Chambers of Commerce and Industry (FICCI). He had upstaged the AIEI over FICCI and convinced the AIEI leadership to change its name to the Confederation of Indian Industry (CII). Secretary General Tarun Das worked with parts of Indian industry that were more favorable towards reforms after 1991. Moreover, Indian industrialists, the majority of who favored the protected Indian market, needed resources for financing imports. Acquiescing to reforms thrust upon them by the IMF and the technocracy seemed to be the only option in the short-run.⁶⁶

The IMF was quite respectful of the views of the Indian technocrats that had evolved substantially over the 1980s. There was substantial country-ownership of the IMF program. The IMF allowed the technocracy to deviate from the beaten track to a greater extent than has been the case when many IMF programs have failed to strengthen the economy of the target country. Labor laws were not restructured. India was allowed to run fiscal deficits in excess of what the IMF thought was optimal beyond the first year of the program.⁶⁷

Economic Reforms and Industrialization in India

The results of the reform program are worthy of note. Substantial tariff liberalization, especially in intermediate goods, was accompanied with a significant devaluation of the Indian Rupee. Tariff liberalization reduced the cost of inputs and pressured Indian industry to become more competitive. The devaluation of the Rupee increased the cost of imports and reduced the

Mohan served as an advisor in the Ministry of Finance between 1991-97; and Chelliah chaired the Tax Reforms Committee between 1991-93, and served as fiscal advisor in the Ministry of Finance between 1993-95.

⁶⁶ On the evolution of the relationship between AIEI, CII and the Government of India, see Kochanek, "Liberalization and Business Lobbying in India", 424-27; Jorgen D Pederson, "Explaining Economic Liberalization in India," *World Development* 28:2 (2000): 268-71; Aseema Sinha, "Understanding the rise and transformation of business collective action in India," *Business and Politics* 7:2 (2005): 1-27; Sharmila Kantha and Shubhajyoti Roy, *Building India with partnership: The Story of CII* (New Delhi: Penguin, 2006): 139-87. I am grateful to Tarun Das, Chief Mentor, CII for valuable insights and for introducing me to persons who are steering the organization. (Author interview, New Delhi, June 3 2009). For business opposition to the reforms of 1991, see Alamgir, *India's Open Economy Policy*, 31-33. I am indebted to D H Pai Panandiker, Secretary General – FICCI in 1991 for his views on the matter. (Author interview, New Delhi, June 2 2009).

⁶⁷ I am indebted to discussions with Jagdish Bhagwati, University Professor, Columbia University, a person outside the government who played an important role during the crisis episode (Author interview, New York City, November 14 1997); Montek S Ahluwalia (Author interview, New Delhi, January 5 2005); Vijay L Kelkar (Author interview, Mumbai, January 3 2005); and, Rakesh Mohan (Author interview, Mumbai, January 3 2005). Ahluwalia, Kelkar and Mohan had been influential technocrats involved with the reform process.

price of Indian exports.⁶⁸ The net effective protection enjoyed by Indian industry was thus reduced to a much lesser extent than what the magnitude of tariff reduction would suggest. Indian products immediately became more competitive due to the currency devaluation. This was a major boon for export oriented sectors like IT. India's merchandise exports doubled once between 1991 and 1999, and again between 2002/03 and 2005/06. India's IT and service exports most recently doubled between 2004/05 and 2005/06.⁶⁹

The Foreign Exchange Regulation Act (FERA), which had restricted foreign equity to a maximum limit of 40%, was replaced with a regime that allowed 51% foreign equity most sectors of the economy. India consequently attracted much greater foreign investment than in the past, but much less than was the case in China. It received \$24 billion worth foreign investment via the foreign direct investment route between 1992 and 2002 – a figure that China could surpass in a single year. Indian companies had been largely averse to the presence foreign of companies in India.⁷⁰

Some Indian industrialists have welcomed foreign investment. The IT sector, which is highly competitive, has accepted the presence of foreign capital. Second, smaller Indian companies that needed foreign capital, technology and managerial expertise to compete with the larger Indian companies, have welcomed foreign capital as joint venture partners. They have successfully opposed the aversion of the larger Indian industrialists. To give one example, increasing the foreign equity limit in Indian telecommunications was welcomed by Bharati Enterprises, whose telecom company Airtel has benefited enormously from partnership with Singtel, Warburg Pincus and other foreign companies. Airtel is India's largest telecom company. Its cash rich competitors such as Tata Telecom and Reliance Infocomm had been opposed to the entry of foreign capital in India's telecom sector.⁷¹

The availability of abundant entrepreneurial resources aided the process of promoting India's competitiveness in many areas after 1991. India's largest business group - the Tatas - valued at \$63 billion in 2008, has transformed itself into an Indian multinational company. Global sales for the year ending March 2008 represented 61% of total sales. 30% of Tata's 350,000 employees resided outside India. Ratan Tata, the Head of the Tata Group, transformed Tata companies in two significant ways after 1991. First, he decided to enhance and productivity of Tata companies. To give an example, Tata Steel successfully negotiated a

⁶⁸ On trade reforms see, Suresh D Tendulkar and T A Bhavani, *Understanding Reforms: Post 1991 India* (New Delhi: Oxford University Press, 2007): 116-25.

⁶⁹ Panagariya, *India: The Emerging Giant*, 262. For an account of the political economy of India's trade policy, see Vinod K Aggarwal and Rahul Mukherji, "India's Shifting Trade Policy," in Vinod K Aggarwal and Min Gyo Koo, eds., *Asia's New Institutional Architecture* (Heidelberg: Springer-Verlag, 2008): 215-58.

⁷⁰ Tendulkar and Bhavani, *Understanding Reforms: Post 1991 India*, 106-16.

⁷¹ Rahul Mukherji, "The Politics of Telecommunications Regulation: State-Industry Alliance Favoring Foreign Investment in India," *Journal of Development Studies* 44:10 (November 2008): 1405-23.

voluntary retirement scheme for 30,000 workers and invested \$ 2.5 billion in capital upgrades to propel the company from being a top 50 corporation to a top five steel company in the world. Second, a strategy of globalization was pursued aggressively. The purchase of the Anglo-Dutch company Corus Steel at \$ 12.1 billion in 2007 was one of the largest deals in the history of steel industry. The strategy was to link low-cost production in India with the high quality products of Corus. Other major Tata group buys that are designed to aid its foray into the international market include the purchase of the Tetley - the second largest selling tea brand (2000), and automobile brands such as Jaguar and Landrover (2008). Globalization requires significant innovation. Not only has Tata Motors produced a successful Indian car (Indica), it has also introduced a new concept in the Nano – which is the world’s cheapest car priced at \$2,500. The Nano has catapulted the Tata Group to the 6th spot among the world’s most innovative companies according to BusinessWeek – behind Microsoft, Google and Apple, and ahead of Sony, Nokia, IBM and BMW.⁷²

Another example of a successful globalizer in the area of manufacturing is Bharat Forge. It produces machine components used by the world’s top auto makers, and is the second largest forging company in the world behind ThyssenKrupp of Germany and ahead of Sumitomo Metal of Japan. The company had emerged as a leader within India under the regime of industrial controls by the late 1980s. Its chairman and managing director, Baba Kalyani, turned a company that depended on low skilled manpower using rudimentary mechanization, to one that used skilled professionals and the state of the art technology. The company has made significant foreign acquisitions that have helped it access technology and penetrate markets. Its 11 manufacturing locations in 2008 included three in India, three in Germany, two in China, and, one each in North America, Sweden and Scotland.⁷³

Middle class Indian entrepreneurs like Narayan Murthy and Nandan Nilekani of Infosys took advantage of deregulation and India’s emerging natural comparative advantage in the software and services sector in the 1980s. The company, which had been founded on the basis of a \$250 initial investment by a group of talented engineers in 1981, was a \$ 4 billion company in 2008. Their comparative advantage was based on low-cost skilled English speaking engineers who had been trained in India’s engineering colleges. Infosys was an early globalizer but was struggling with software export in the late 1980s. Sales were less than half a million dollars in 1989 and one of the founders left the company at that time.

The devaluation of the Rupee and substantial reduction in import controls after 1991 allowed companies like Infosys to become global brands. Infosys adopted the strategy of adopting sound corporate governance by submitting itself to the standards set by NASDAQ, and

⁷² Nirmalya Kumar, *India’s Global Powerhouses* (Boston: Harvard Business Press, 2009): 157-76.

⁷³ *Ibid.*, 83-94.

by accepting the US's Generally Accepted Accounting Principles (GAAP). Excellent corporate governance and commitment to clients won the company a good brand name. The talent of the entrepreneurs lay in locating the bulk of the work in India at low cost, and shifting the bare minimum of client servicing to foreign destinations. Infosys Centre was created as one of the largest human resource development facilities in the world capable of training 13,500 people in every quarter. In 2007, Infosys barely accepted 3% of the candidates out of a talented pool of 1.3 million applicants.⁷⁴

Promoting Efficient Infrastructure Provision

This section describes the manner in which structural reform promoting efficiency in various key infrastructure sectors was consolidated in India. India's stock markets, its telecommunications sector, private airlines and Indian Railways have changed beyond recognition in the post-reform period. In most cases, the political will to promote efficiency at the time of a looming financial crisis disciplined these sectors and rendered them more efficient.

India's stock market reforms were significant. These markets have attracted both foreign and Indian savings, which were critical for the growth of India's corporate sector. India received \$ 24 billion each between foreign direct and portfolio investment, respectively, between 1992 and 2002.⁷⁵ Portfolio investment, which is purchase of shares and bonds in a foreign country's stock markets, was a way of attracting foreign capital. Stock markets also began to attract the savings of Indian nationals – as they offered the promise of higher returns.

The financial crisis was necessary but not sufficient for engendering reforms in the governance of India's stock markets. The old regime had resisted computerization and electronic trading, and had continued with an opaque system of settlement of transactions that favored the established brokers of the Bombay Stock Exchange. The brokers protected their turf with all their might. The reforms attempted by the President of the Bombay Stock Exchange (BSE) Mahendra Kampani in the late 1980s – were successfully resisted by the brokers. The Ministry of Finance had hoped that the BSE would reform itself in the aftermath of the balance of payments crisis in 1991. When reforms were not forthcoming, it decided to set up the National Stock Exchange (NSE) in 1993. The NSE became the largest stock exchange in India by 1995. The NSE spurred reforms in the BSE. All stock exchanges were subsequently computerized by 1999.

Reforms in trading norms had to wait till 2003. The power of the old brokers was so significant that it was only after a major stock market scam in 2001 that trading rules were

⁷⁴ Ibid., 64-82; Tarun Khanna, *Billions of Entrepreneurs* (Boston: Harvard Business School Press, 2007): 122-26.

⁷⁵ Tendulkar and Bhavani, *Understanding Reforms: Post 1991 India*, 111-12.

made transparent owing to immense pressure from the Ministry of Finance. India's stock market reforms were aided by the substantial powers that the Ministry of Finance wielded over the setting up of new stock exchanges in India. Moreover brokers were cash rich but did not carry many votes. These strategic advantages aided the Ministry of Finance to challenge the BSE by setting up the NSE.⁷⁶

India's telecommunications sector has recorded a growth rate that surpasses all other countries in the world. Telephone connections in India have boomed from about 23 million in 1999 to about 430 million in 2009. Of the 430 million telephone lines in 2009, 340 million are mobile phones. The private sector served about 80% of India's telecom market in 2009. Even though the disparity between rural and urban mobile connections is quite substantial, mobile phones are serving the rural areas.⁷⁷ Connectivity is as much a boon for the rich as it is for the poor. Construction workers, vegetable sellers, cab drivers, have all benefited from connectivity, as much as high technology and knowledge intensive service industries. India's telecom boom was aided by developments in cellular technology, which was less capital intensive and relatively free from regulatory bottlenecks, compared with network expansion aided by land lines.

Reforms in the 1990s promoted private sector participation in Indian telecommunications. The Department of Communications (DOT) located within the Ministry of Communications resisted private sector participation in two ways in the 1990s. First, it allowed the private participation initially in areas, which it thought did not have much business potential. Exclusive private sector participation was allowed in mobile telephony based on this assumption. Second, the bidding procedures and taxation rendered the business environment quite adverse for private players. Private sector participation was promoted by the Prime Minister's Office, often with the support of the Ministry of Finance. It was these institutions that aided the process of consolidating the Telecom Regulatory Authority of India (TRAI) and Telecom Dispute Settlement Appellate Tribunal (TDSAT). The TRAI and the TDSAT were designed to create a level playing field for the public and private sector telephone operators.

Prime Minister Atal Bihari Vajpayee (1998-2004) was able to nudge the system towards independent regulation at the time of an investment crisis in 1999 and 2000. The DOT as regulator and service provider had devised rules that were financially hurting the private sector. A serious crisis of investment for private telecom companies had arrived in 1999 when the government-owned company MTNL was allowed license-fee free entry into the cellular

⁷⁶ John Echeverri-Gent, "Politics of Market Micro-Structure: Towards a New Political Economy of India's Equity Market Reform," in Rahul Mukherji, ed., *India's Economic Transition* (New Delhi: Oxford University Press, 2007): 331-50.

⁷⁷ There are more than 15 mobile connections per 100 people in rural areas. Department of Telecommunications, *Annual Report 2008/09* (New Delhi: Ministry of Communications and Information Technology, 2009): 1-3.

business in 1998. Government-owned financial organizations that had lent to the private sector would also have lost in the process. The initiatives of Prime Minister Vajpayee at this time enabled the regulatory institutions to become more independent in settling disputes between the private companies and the government-owned telecommunications providers. A privately owned company, Airtel is India's largest service provider. Government companies such as MTNL and BSNL had become efficient and served significant rural markets.⁷⁸

Private airlines were introduced in the 1990s. The Air Corporations Act (1994) was a significant departure from an earlier act governing civil aviation since 1953, which had nationalized civil aviation in India. This act of 1994 permitted the operation of private airlines for the first time since 1953. In the post liberalization era, airlines such as Jet, Kingfisher, Air Deccan, Indigo and Spice Jet are serving a variety of customer tastes along domestic and international routes. Foreign investment is allowed up to 49% in an Indian company. Airline traffic has surged from about 13 million in 2000 to 37 million in 2008. The airlines sector still lacks an independent regulator.⁷⁹ Even though the sector has become more competitive, the Government-owned carrier - Air India continues to make substantial losses.

The Indian Railways (IR) has graduated from a situation of near bankruptcy in 2001 to an entity that enjoyed a cash surplus of \$ 6 billion in 2008. IR carries about 18 million passengers and two million tons of freight daily on 63,327 kilometers of tracks. Reforming the world's largest commercial utility employer with 1.4 million employees and 1.1 million pensioners looked impossible in 2001. At that time, expenses were growing annually at the rate of 13% and the revenues were creeping along at 8%. The situation has changed substantially after 2004. Freight and passenger volumes have been growing at an annual rate of 9% between 2004 and 2008. Reforms occurred at a time when the IR's freight and passenger business were being increasingly challenged by other modes of transportation.

A financial crisis was brewing for IR at a time when the Government did not seem willing to foot the bill for losses that were mounting in 2004. Minister Lalu Yadav, renowned for the politics of populism in the backward state of Bihar was the key figure in guiding this transformation. He used his native intelligence and provided a competent team of technocrats with substantial room for maneuver. Profitability was achieved neither by retrenchment of workers nor by raising tariffs. First, the turnaround was achieved by realizing economies of scale by increasing the number of railway coaches. Additional coaches with more passenger and freight led to a reduction in unit costs. Second, the freight rate of commodities like iron ore was raised substantially. IR enjoyed competitive advantage in door to door operations in this

⁷⁸ On India's telecom transformation, see Ashok V Desai, *India's Telecommunications Industry* (New Delhi: Sage, 2006); Rahul Mukherji, "Interests, Wireless Technology and Institutional Change: From Government Monopoly to Regulated Competition in Indian Telecommunications," *The Journal of Asian Studies* 68:2 (May 2009): 491-517.

⁷⁹ Panagariya, *India: The Emerging Giant*, 397-401.

commodity whose prices were booming. Earnings from freight increased from \$209 million in 2004 to over \$1 billion in 2008.⁸⁰

Challenges for Development

India's economic reforms have not had the desired impact on substantial parts of the economy. Electricity generation, which is critical for industry, agriculture, and the general well being of the citizenry, is in a dismal shape. The agriculture sector, which feeds the majority of the people, has been growing slowly. Even though there has been some success in the area of literacy and poverty alleviation, India lags behind China to a considerable extent in these areas. India's record in the area of nutrition is cause for even greater concern. The disparity in economic growth and development between the states in India has grown after 1991. The poorest parts of India with low levels of human development are also the regions where the majority of Indians reside.

The failure of India's power sector to provide services efficiently is in sharp contrast to the success in the telecom sector. The electricity boards run by the state governments are losing money. The net subsidy burden has increased from Rupees 221.2 billion in 2005/06 to Rupees 327.2 billion in 2008/09.⁸¹ Two kinds of problems affect efficient service delivery in this sector. First, politically powerful rich and middle farmers are unwilling to pay for electricity. Chief Ministers in states like Andhra Pradesh and Tamil Nadu that lack abundant ground water resources use free electricity as way of getting re-elected. Second, there is rampant theft of electricity. One senior civil servant in the state of Haryana reported that the geography of theft shifted in his state depending on the party in power and the political constituency of the Chief Minister.⁸² States like Andhra Pradesh have registered some progress in the governance of their power sector. They had been able reduce losses by managing the state-owned power plants well and by serving industrial customers. Industrial consumers who demanded high quality power at a higher price, cross subsidized the losses owing to theft and the non-payment of tariffs by the farmers.⁸³

Indian agriculture faces a dilemma. Subsidy to the agriculture sector as a proportion of India's GDP has risen steadily from 0.43% in 1990/91 to 0.74% in 2005/06. Increased subsidy did not produce higher rates of agricultural growth between 1990 and 2000 (2.97%) compared

⁸⁰ Sudhir Kumar and Shagun Mehrotra, *Bankruptcy to Billions: How the Indian Railways was Transformed* (New Delhi: Oxford University Press, 2009): 1-29; Panagariya: *India: The Emerging Giant*, 410-13.

⁸¹ Ministry of Finance, *Economic Survey 2007/08* (New Delhi: Government of India, 2008): 214.

⁸² I am indebted to Ashok Lavasa a senior Haryana cadre Indian Administrative Service officer for this insight. (Author interview, New Delhi, December 24 2007).

⁸³ Rahul Mukherji, "Regulation and Infrastructure Development in India," *World Bank Consultation Paper* (New Delhi: The World Bank, 2008): 16-28.

with the 1980s (3.4%).⁸⁴ The growth rate was 2.9% between 2000 and 2007 with a couple years of negative or zero growth between 2000 and 2004.⁸⁵ This dip in the rates of growth created the prospect of a second agrarian crisis in India after the mid-1960s. There were reports that subsidies were growing at the expense of public investment, which was benefitting powerful farm lobbies. The Government has launched a program of substantial investment in rural development called Bharat Nirman (Building India). Resources available for Bharat Nirman were raised from Rupees 18.6 billion in 2006/07 to Rupees 26.6 billion in 2007/08. These funds were to be used for activities like irrigation, drinking water, housing, electrification and telephony in rural areas.⁸⁶

The growth of the agricultural sector at an annual average rate of less than 3% when the economy was growing at a rate considerably in excess of 6% has consequences for the employment of the vast majority of the Indian people living in rural areas. Sociological accounts suggest that agrarian distress is pushing people out of rural areas.⁸⁷ Employment statistics for the two periods 1993/94 to 1999/00 and 1999/00 to 2004/05 reveal that distress has been less than what low levels of agricultural growth would predict. Even though agricultural wage employment has become less during this period, rural non-agricultural employment has grown quite substantially.⁸⁸ Persons working in cities are repatriating money to the village, and there are those who are commuting to cities to earn a livelihood.⁸⁹

Farmer suicides in states like Andhra Pradesh, Kerala and Karnataka have been reported in the media. There is growing scholarly evidence that farmer suicide occurs largely due to a movement from subsistence to commercial agriculture. Commercial agriculture can be risky in the absence of social safety nets. Farmers are often lured by the prospect of profit and make investments without understanding the risks involved with a commercial enterprise. A good crop can be misleading. When farmers get into risky ventures and become dependent on the moneylender but cannot pay back due to a bad crop, pride rather than the experience of

⁸⁴ S Mahendra Dev, *Inclusive Growth in India* (New Delhi: Oxford University Press, 2008): 115.

⁸⁵ The 2000-2007 figures were accessed from The Economist Intelligence Unit online at the NUS library web site. For other figures of agricultural growth, see Dev *Inclusive Growth in India*, 28.

⁸⁶ Dev, *Inclusive Growth in India*, 50-53.

⁸⁷ Dipankar Gupta, *The Caged Phoenix: Can India Fly?* (New Delhi: Penguin Viking, 2009): 84-111.

⁸⁸ Dev, *Inclusive Growth in India*, 181.

⁸⁹ On city migrants enriching the villages, see Chandra Bhan Prasad, "Markets and Manu," *CASI Working Paper Series* Number 08-01 (Philadelphia: University of Pennsylvania, 2008): 24-28; Goran Djurfeldt, Venkatesh Athreya, N Jayakumar, Staffan Lindberg, A Rajagopal and R Vidyasagar, "Agrarian Change and Social Mobility in Tamil Nadu," *Economic and Political Weekly* 43:45 (November 8 2008): 52-60; Gupta, *The Caged Phoenix: Can India Fly*, 91-111.

poverty, takes a life. Farmer suicides in India have occurred among those involved with commercial farming. It is not commonplace among marginal farmers.⁹⁰

The National Rural Employment Guarantee Act (NREGA, 2005) has been hailed as a significant poverty alleviation measure in India. It is timely when the prospect of a drought looms large in 2009. The Government had assured 100 days of employment at the rate of Rupees 60 per day. The right to work has been guaranteed by law, even though it is not enforceable in a court of law. The poor are engaged with the construction of durable public goods that are supposed to lead to water conservation, draught proofing, irrigation and land development. This is a firm financial commitment, which unlike previous anti-poverty programs, is irreversible because it has been legislated into a law. The NREGA web site details information about its progress in all the districts in the country.⁹¹ This has ensured greater transparency and accountability than had been the case in the past. The Right to Information Act can also be invoked by people's organizations and non-governmental organizations (NGOs) to deal with corruption involved with the implementation of NREGA.

What are the results of this major institutional change favoring social justice in India? No state had provided 100 days of employment per household till 2007/08. The best performing states in 2007/08 were Rajasthan (81 days), Assam (72 days), Madhya Pradesh (69 days), Tripura (67 days) and Sikkim (59 days). Scheduled castes and tribes together participated in more than 60% of the employment generating activities at the All India level. Newspapers have reported that caste is breaking down in Andhra Pradesh as a result of NREGA.⁹² Women participated in more than 50% of the employment.⁹³

India enjoys a food surplus but suffers from a rather poor record in nutrition. 43% of Indian children were suffering from malnutrition in 2005/06. According to one estimate, the proportion of malnourished children may be higher in India than in Ethiopia.⁹⁴ The public distribution system in India suffers from leakages to the non-deserving population. Many poor

⁹⁰ On farmer suicides, see D Narasimha Reddy and Srijit Misra, "Agriculture in the Reforms Regime," in D Narasimha Reddy and Srijit Misra, eds., *Agrarian Crisis in India* (New Delhi: Oxford University Press, 2009): 3-43; V M Rao, "Farmers' Distress in a Modernizing Agriculture," in D Narasimha Reddy and Srijit Misra, eds., *Agrarian Crisis in India* (New Delhi: Oxford University Press, 2009): 109-25.

⁹¹ See <http://nrega.nic.in>.

⁹² P Sainath, "NREGS: not caste in stone," *The Hindu*, September 14, 2009, accessed at <http://www.thehindu.com/2009/09/14/stories/2009091454990900.htm>. See also <http://nrega.nic.in>; http://www.ndtv.com/news/videos/video_player.php?id=1147552.

⁹³ On NREGA, see Ashok K Pankaj, "The National Rural Employment Guarantee Act," in Hari M Mathur, ed., *India: Social Development Report 2008* (New Delhi: Oxford University Press and Council for Social Development, 2008): 221-50.

⁹⁴ Michael Walton, "The Political Economy of India's Malnutrition Puzzle," *IDS Bulletin* 40:4 (July 2009): 16-24.

people are not included and those that are not suffering from acute poverty are able to deny resources meant for the poor.⁹⁵ States such as Kerala, Tamil Nadu and Himachal Pradesh have successful public distribution systems, and enjoy a reasonable amount of food security, whereas Bihar, Uttar Pradesh, West Bengal and Madhya Pradesh are able to distribute much less food to the poor through the same system. Left parties in Kerala, and the DMK and AIDMK parties in Tamil Nadu, have played a significant role in assuring food for the poor.⁹⁶

India's literacy record is poor compared with China and many other developing countries. The youth literacy rate for those aged between 15 and 24 years in India was 80% in 2005/06, whereas the same figure for China was 99%. India's story of promoting primary education has been one of dismal neglect since independence. Education has received fitful policy attention over time.⁹⁷ In 1993, India's Supreme Court linked the right to literacy to the right to life. In 2001/02 the Sarva Shiksha Abhiyan (Education for All Program) was launched. Expenditure on primary education rose from 0.37% of India's GDP in 1950 to 1.04% in 1975. In 2005, the same figure 1.57% of GDP. The Right to Education Bill was passed in India in August 2009 with the promise of substantial resources dedicated towards free and compulsory education in India.⁹⁸ A significant challenge for the promotion of primary education is the prevalence of low quality of government schools with very high rates of teacher absenteeism. This phenomenon has led to the mushrooming of cheap private schools, which are serving the lower middle class and the poor. Government schools remain the only option for the children of the poorest of the poor. Their poor quality will lead to growing disparity in access to education between the children of the poor, and those who can afford private schools.⁹⁹

There is considerable variation in literacy rates in India. Kerala's adult literacy rate was over 90% in 2001. This achievement was aided by a historical process that involved considerable efforts on the part of Christian missionaries, the King of Travancore and other minority groups since the early 20th century. Non-Brahmin education was widespread in Kerala

⁹⁵ Ritika Khera, "Access to the Targeted Public Distribution System: A Case Study of Rajasthan," *Economic and Political Weekly* 44:29 (November 1 2008): 51-56; Jos Mooij, "Food and Power in Bihar and Jharkhand," *Economic and Political Weekly* 36:34 (August 25 2001): 3289-95; 3297-99.

⁹⁶ On inter-state variation in the success of distribution of food to the poor, see Dev, *Inclusive Growth in India*, 101-31; A K Venkatsubramanian, "The Political Economy of the Public Distribution System in Tamil Nadu," in Vikram K Chand, ed., *Reinventing Public Service Delivery in India* (Washington and New Delhi: World Bank and Sage): 266-93; V K Ramachandran, "On Kerala's Development Alternatives," in Jean Dreze and Amartya Sen, eds., *Indian Development* (New Delhi: Oxford University Press, 1996): 237-50.

⁹⁷ Figures accessed from the World Bank's World Development Indicators, accessed at NUS the NUS library web site.

⁹⁸ Tilak, "Universalizing Elementary Education", 60-63.

⁹⁹ *Ibid.*, 50-52; Nazmul Chaudhury, Jeffrey Hammer, Michael Kramer, Karthik Muralidharan and F Halsey Rogers, "Missing in Action: Teacher and Health Worker Absence in Developing Countries," *Journal of Economic Perspectives* 20:1 (Winter 2006): 101-07; Lant Pritchett and Rinku Murgai, "Teacher Compensation," *India Policy Forum* 2006/07 (Washington D C and New Delhi: Brookings Institution and Sage, 2007): 123-78.

even before the advent of the British.¹⁰⁰ States like Rajasthan, Madhya Pradesh and Himachal Pradesh, which had a substantial illiterate population at the time of independence in 1947, have succeeded in raising their literacy rates. Rajasthan was one of the few states that had a school in every village.¹⁰¹ Madhya Pradesh's experiment with empowering the local village government to increase accountability had successfully reduced teacher absenteeism in that state to one of the lowest levels in the country.¹⁰² There is evidence to suggest that the surge in literacy has had a positive impact on the quality of democracy in India. A literate population demands an accountable government.¹⁰³ The large, poor and populous states of Bihar and Uttar Pradesh have been less successful in promoting literacy.

The proportion of people living below the poverty line in India has come down more sharply during the post-reform period after 1991 compared to the pre-reform era. There is a debate about the extent of this decline between 1993/94 and 1999/00 because the 50th round of the National Sample Survey (NSS, 1993) had a questionnaire that was different from the one used in the 55th round (1999). Angus Deaton and Jean Dreze have sought to resolve this problem by analyzing the common basket of goods used for assessing consumption levels during both these rounds. A reasonable assessment would be to infer that the head count ratio or the number of people living below the poverty line has decreased from 36% in 1993 to 26.1% in 1999/00.¹⁰⁴

The decline in the headcount ratio notwithstanding, India continues to be home to the largest number of absolutely poor people in the world. Large, populous heartland states such as Bihar, Madhya Pradesh and Uttar Pradesh carry the bulk of the absolutely poor people in India. Punjab and Haryana, the two states that benefited the most from the green revolution, enjoy the lowest headcount ratio in India. Kerala, which is not a rich state, has reduced absolute poverty by being able to redistribute wealth to the poor.¹⁰⁵

¹⁰⁰ On the origins of Kerala's rise in literacy rates, see Ramachandran, "On Kerala's Development Achievements", 255-74; Weiner, *The Child and the State in India*, 175-77.

¹⁰¹ Prema Clarke and Jyotsna Jha, "Rajasthan's Experience in Improving Service Delivery in Education," in Vikram K Chand, ed., *Reinventing Public Service Delivery in India* (Washington DC and New Delhi: World Bank and Sage, 2006): 225-65.

¹⁰² *Reforming Public Services in India* (Washington DC: The World Bank, 2006): 46-52.

¹⁰³ Anirudh Krishna, "Poverty and Democratic Participation Reconsidered," *Comparative Politics* 38:4 (July 2006): 439-58; Anirudh Krishna, "Politics in the middle: mediating relationships between the citizen and the state in rural North India," in Herbert Kitschelt and Steven I Wilkinson, eds., *Patrons, Clients and Policies* (New York Cambridge University Press, 2007): 149-58.

¹⁰⁴ On the poverty debate, see Angus Deaton and Jean Dreze, "Poverty and Inequality in India," in Baldev R Nayar, ed., *Globalization and Politics in India* (New Delhi: Oxford University Press, 2007): 408-57; Panagariya, *India: The Emerging Giant*, 129-56.

¹⁰⁵ Panda, "Agriculture and Poverty Reduction", 111-27.

The post-reform period has witnessed a growing gap in the rates of growth between the richest and poorest states in India. States became more directly involved with the task of attracting investment after industrial licensing was abolished in 1991. Federal funds for developing poor states also became less after 1991. Well governed states that provided the best investment opportunity to investors were more likely to attract investment and grow at a faster pace in this new regime. This change in the investment regime has helped entrepreneurial states like Maharashtra and Gujarat to grow rapidly, while the poorer ones like Bihar, Uttar Pradesh and Orissa are lagging far behind. The gap between the richest and poorest states has grown quite substantially since the 1980s. Growing disparities may make the richer parts of India resemble Singapore while the poorer ones might resemble Sub Saharan Africa.¹⁰⁶

Economic Change in India

This story of the Indian economy casts light on the gradual process of economic change in a democratic polity. The Indian experience did not resemble stories of rapid economic transformation in more authoritarian Asian political settings. How did politics in a democracy produce a shift from a high degree of state control directed towards self reliant industrial development, to a policy paradigm that emphasized the private sector and trade promotion? It is this shift that has accelerated economic growth in India. Second, why did economic policies that emphasized capital intensive industrialization at the cost of agricultural development, begin to pay greater emphasis to food security and the interest of farmers? Third, what explains the growing emphasis on the right to work and education, and, a spurt in social sector expenditures after 2004? The 1980s prepared the ground for India's industrial transformation and was the time when India reaped the benefits of green revolution to the greatest extent.

A shift from state-driven economic self reliance to regulated private sector promotion and competitiveness, poses a challenge for accounts that have contended that the interests of the dominant coalition of industrialists, big farmers and the bureaucracy were locked in a manner that would make a change in the policy paradigm rather difficult in the 1980s.¹⁰⁷ We

¹⁰⁶ Lloyd I Rudolph and Susanne H Rudolph, "Iconization and Chandrababu: Sharing Sovereignty in India's Federal Market Economy," in Rahul Mukherji, ed., *India's Economic Transition* (New Delhi: Oxford University Press, 2007): 231-64; Montek S Ahluwalia, "State-Level Performance under Economic Reforms," in Anne O Krueger, ed., *Economic Policy Reforms and the Indian Economy* (New Delhi: Oxford University Press, 2002): 91-122; B B Bhattacharya and S Sakthivel, "Regional Growth and Disparity in India," in Baldev R Nayar, ed., *Globalization and Politics in India* (New Delhi: Oxford University Press, 2007): 408-57.

¹⁰⁷ Economic change would be difficult according to some accounts because the status quo reflected the balance of class forces, see Bardhan, *The Political Economy of Development in India*. Others have argued that economic reform could only occur stealthily in India, Jenkins, *Democratic Politics and Economic Reform in India*; or because the left parties acquiesced to the economic reforms of the Congress Party in 1991 that involved elite

find that gradual economic deregulation in the 1980s prepared the ground for a major shift in policy after the balance of payments crisis in 1991. In 1991, a substantial part of the technocracy and the policy elite was more convinced about the economic benefits of change arising from economic deregulation and the promotion of competitiveness, than was the case in 1966, when India was faced with a similar crisis. They were convinced that economic self reliance was not sustainable in the context of the rising demands of a highly mobilized populace. The crisis in 1991 and India's dependence on the IMF was used by the reforming technocrats as an opportunity to deal with powerful interests groups favoring the status quo. Changes in industrial and trade policy between 1991 and 1993 produced the most substantial shift towards promoting India's private sector, competitiveness and trade.

The gradual nature of economic change propelled by financial crises backed with political and technocratic will favoring reforms, pointed to the political power of vested interests in India. First, the telecom regulator could only be consolidated in 2000. These reforms favoring private participation and efficiency had to wait for a severe crisis of private sector investment due to predatory regulation of the sector by the government. The support of Prime Minister Vajpayee was vital for dealing with a Department of Telecommunications averse to private sector participation. Reforms leading to greater transparency in India's stock market transactions needed to wait till 2003. Second, the stock market scandal of 2001, which would have hurt Indian industry's capacity to mobilize financial resources, was the proximate cause for the final set of reforms that have produced high levels of governance in this sector. Third, the Government-owned Indian Railways recovered from a serious financial condition only after 2004, aided by excellent ministerial stewardship under Minister Lalu Yadav. Areas of physical infrastructure that are in serious need of reform include the power sector, roads, airports and ports. Efficient service provision in these areas will be essential for the promotion of India's competitiveness and economic growth in the future.

The agrarian crisis of the 1960s and technocratic and political conviction favoring greater financial and technological commitment to Indian agriculture, produced the green revolution in India, aided by US support. The droughts of 1965 and 1966 increased India's dependence on the US for food supplies. Food security was an essential consideration in a democracy. Famines or mounting inflation can easily bring down governments in India. The green revolution aided by US technology and finance laid the foundation for robust agricultural growth in the 1980s, which was sustained in the 1990s. India is self-sufficient in food-grains.

constituencies, in order to combat a more serious enemy – Hindu nationalism, see Ashutosh Varshney, "Mass Politics or Elite Politics?" in Rahul Mukherji, ed., *India's Economic Transition* (New Delhi: Oxford University Press, 2007): 145-69. These accounts emphasize the status quo bias, and the sheer difficulty in realizing economic change in India.

The challenge of inclusive growth described in the previous section remains quite substantial. Can public investment in agriculture that benefits the poorer farmers be increased by redirecting subsidies that benefit the richer ones? Can rich farmers be forced to pay a subsidized rate for better quality of power supply, as opposed to the current practice of free electricity that benefits only those farmers who can afford electric pump sets? How can social security benefits be devised for farmers so that risky investments do not result in suicides? How can corruption in employment guarantee and food distribution schemes be checked for accelerating the process of poverty alleviation in India? How can teachers be made to perform in government schools that are attended by the children of poor parents? A literate population, after all, affects the quality of democracy, and forces greater accountability within the government.

The poor rural voter has won greater respect from the government after the 2004 general elections. Economic reforms in a democratic polity with increasing levels of political awareness among the poor described in the chapter on social mobilization - needed to attend to the demands of the common citizen. There has been a substantial rise in the commitment of resources for the social sector after 2004. India has embarked on a path to developing a welfare state, where the right to work and the right to become literate have become enshrined in law, and legislation on the right to food is being prepared. The powerful Right to Information Act (2005), which empowers citizens to access government information on par with legislators, has been legislated to check corruption that may impede the realization of the other rights in India.¹⁰⁸ It can be conjectured that the strategy of securing welfare for the needy after the 2004 election victory of the United Progressive Alliance led by the Congress Party was rewarded by the people in a more convincing electoral verdict in favor of the Congress Party in 2009. Democratic participation in India could be playing a silent role in making the growth story more inclusive.

¹⁰⁸ Aruna Roy, Nikhil Dey and Suchi Pandey, "The Right to Information Act 2005: A Social Development Perspective," in Hari Mohan Mathur, ed., *India: Social Development Report: 2008* (New Delhi: Council for Social Development and Oxford University Press, 2008): 205-220.