Politics of Economic Growth in India, 1980-2005

Part I: The 1980s

For the last quarter of a century India's economy has grown at an average rate of nearly 6 per cent per annum. The widely embraced argument that this growth pick up is a result of the Indian state's adoption of a pro-market strategy is inadequate for three reasons: the growth pick up in India began a full decade prior to the liberalising reforms in 1991; post-1991 industrial growth has not accelerated; and uneven growth across Indian regions defies any simple market logic. Instead, India's economy has grown briskly because the Indian state has prioritised growth since about 1980, and slowly but surely embraced Indian capital as its main ruling ally. This pro-business growth strategy is likely to have adverse distributional and political consequences. The political economy argument for the growth in the 1980s is developed in Part I, and for the post-1991 period in Part II, which will be published next week.

ATUL KOHLI

For the last quarter of a century India's economy has grown at an average rate of nearly 6 per cent per annum. Considering that India's economy hardly grew in the first half of the 20th century, and then following independence, grew at a sluggish rate of some 3 to 4 per cent per annum, this recent growth acceleration is quite remarkable. It is the case that India's recent rapid economic growth has been accompanied by growing inequalities; the share of the poor in this new growth is also being vigorously debated [see, for example, Deaton and Dreze 2002; Sen and Himanshu 2004]. Nevertheless, there is no denying that the Indian economy in recent decades has been one of the world's fastest growing economies. Moreover, unlike in much of high growth east Asia, the Indian economy has grown within the framework of a democracy. The scholarly questions then abound: How has India done it? What lessons, if any, can others draw from the Indian case?

While the cumulative changes in the nature of the Indian economy since independence, as well as the shifts in the global context of India, must be part of any full explanation of "how India has done it", a central issue for interpretation also concerns the changing role of the state within India: Has India's growth acceleration resulted from the state's embrace of neoliberal policies, or from some more complex but identifiable pattern of state intervention? This paper attempts to answer this question.

One respectable interpretation of the recent Indian experience, let us call it the pro-market interpretation, emphasises the process of economic liberalisation in India that began earnestly in 1991 [Srinivasan and Tendulkar 2003]. India's earlier sluggish growth, according to this well known line of thinking, was largely a product of a highly interventionist state and of a misguided import substitution trading regime. In 1991, the argument might continue, India adopted a pro-market strategy that liberalised its internal regulatory framework, reduced tariffs, adopted appropriate exchange rate policies, and allowed foreign investors to play a significant role in the economy. As a result, to repeat the metaphor used by the *Economist* (India Survey, May 4, 1991) the animal urges of Indian entrepreneurs were "uncaged": capital accumulation in and the efficiency of the economy improved, propelling India into the ranks of the world's fastest growers.

While widely embraced, this pro-market interpretation is unable to explain some important empirical anomalies in the Indian record, and is plagued by some logical inconsistencies. First, economic growth in India started accelerating a full decade prior to liberalisation of 1991 [Nagaraj 2000; De Long 2003; Rodrik and Subramanian 2004; Virmani 2004]. Why? Second, industrial production in India – a key object of reforms – did not accelerate following the liberalising reforms; if any change is observable when the post-reform industrial growth is juxtaposed against the 1980s, it is nearly in the opposite direction [Chaudhuri 2002; Nagaraj 2003]. Again, why? And third, if a set of policies is supposed to work anywhere and at any time, why have some states within India responded well, while others have not [Ahluwalia 2000]?

India's record also has to be situated in a broader comparative context. By international standards, India's embrace of the global economy has been relatively modest [Nayar 2001]. The economic record of many other developing countries that have also liberalised, and often more deeply, is, at best, mixed [for Latin America, see Stallings and Peres 2000; and for sub-Saharan Africa, see van de Walle 2003]. India's superior economic performance in this comparative context suggests two further observations. First, any analysis of India's recent economic performance must take into account India's relatively favourable initial conditions around 1980, especially a robust indigenous industrial sector and a low foreign debt economy. And second, as the realisation grows that the "Washington Consensus" has not worked very well in many places [Easterly 2001; Stiglitz 2002; Milanovic 2003], it becomes more and more likely that the pro-market interpretation of India is also mistaken, and that what is needed is an alternate account of the state's role in growth success and failure.

In what follows I provide such an alternate political economy account of India's recent growth acceleration, emphasising the state's changing role since 1980, especially the abandonment of left-leaning, anti-capitalist rhetoric and policies, prioritising of economic growth, and a slow but steady embrace of Indian capital as the main ruling ally. Let us call such a strategy of development a pro-business strategy. In providing such an interpretation – let us call it the pro-business interpretation – I adopt the view that rapid industrialisation in the developing world – as, for example, in South Korea or in some time periods in Brazil – was promoted, not by minimal states that embraced the market, but by highly interventionist states who prioritised economic growth as a state goal, ruthlessly supported capitalists, repressed labour, mobilised economic nationalism to provide social glue, and channelled firm activities to produce both for protected domestic markets and for exports [Kohli 2004].[1] In light of such an analysis of "success", one might argue that India's sluggish economic growth from 1950 to 1980 was a product, not mainly of state's market distortions, but of a mismatch between the limited capacities of the Indian state and the highly ambitious statist model of development. Following 1980, moreover, one can argue, as I did in a recent work, but only in passing, that economic growth in India accelerated as a result of a "rightward drift" in Indian politics, via which "the embrace of state and business continues to grow warmer, leaving many others out in the cold" [Kohli 2004: 285].[2] The present paper provides an opportunity to elaborate and specify this statist argument about India, focusing especially on the pro-business political and policy changes since 1980 that are responsible for the recent growth acceleration.

The argument that growth acceleration in India is mainly a product of the state's embrace of economic growth as a priority goal and of business groups as the main political ally is built in this paper in three analytical steps. First, I juxtapose the more redistributive pre-1980 political and policy orientation in India against the more pro-growth and pro-business orientation that followed in the 1980s. Noting the strong association between this political shift on the one hand, and the improved growth performance on the other hand, I also suggest some possible causal mechanisms that might link political and economic changes. Second, the more liberal policies adopted in the early 1990s indeed ushered in a new policy regime; this regime is best characterised as part pro-business, especially pro-indigenous business, and part pro-market, especially in the sense of enhanced global opening. After analysing these policy changes, I document the limited impact of these new policies on growth rates in manufacturing and in industry in India. This evidence helps cast doubt on the widespread belief that pro-market policies are helping propel India's economic growth and, at the same time, helps underline the proposition that the pro-indigenous business policies adopted since 1980 are probably still the main dynamic force behind India's sustained but unaltered industrial growth. And finally, a similar pattern is discernable in intra-national variations within India: Indian states with more pro-growth and pro-business governments have tended to experience higher rates of economic growth. An analysis of these variations then provides a further check on the argument.

Of course, what may be a good approach for promoting growth may not always be a popular or a just ruling strategy. When a democratic state is narrowly committed to growth and business groups, not only is the quality of that democracy likely to suffer, but it is also likely to create distributional and political problems. The three most evident in India are: growing regional and class inequalities, with political ramifications; the utilisation of ethnic nationalism – instead of the less volatile, interest-oriented appeals – as a tool of political mobilisation; and a rapid turnover in ruling governments.

The paper is organised as follows. In the first brief section, I deal with some theoretical considerations, establishing the distinction between pro-market and pro-business patterns of state intervention; this discussion then frames the empirical analysis. In the second and the third sections, I document the political and policy changes that occurred in India in the 1980s and the 1990s respectively, tracing their impact on economic outcomes. I undertake a similar exercise in the fourth section with reference to a few select Indian states. I finally return to some general comments and to the implications of the argument in the conclusion.

I
Pro-Market versus Pro-Business State Intervention

Rare though the cases are, the experience of rapid and sustained economic growth in a developing country has repeatedly provoked scholarly debates. The underlying questions are familiar: how did a country A or B (say, South Korea or China) get on the high growth path; and does the experience of A or B provides model or, at least, lessons for others. The main lines of the debate are also familiar: high growth resulted from the state's embrace of a pro-market strategy, namely, a move towards limited state intervention and an open economy; or, no, the growth success was a product of an interventionist state, especially of a close collaboration between the state and business groups aimed at growth promotion. Of course, in popular discourse on development, there is a tendency to treat all pro-business governments simultaneously as pro-market governments. Even some scholars collapse this distinction, either obfuscating important analytical issues, or worse, providing an ideological cloak for what are clearly class issues. Prior to interpreting the recent growth experience of India, therefore, it may be useful to sharpen the distinction between pro-market and pro-business strategies of state intervention; these development strategies vary in terms of the choice of typical policies, the logic and pattern of expected outcomes, and the underlying politics.

Whereas a pro-market strategy supports new entrants and consumers, a pro-business strategy mainly supports established producers [Rodrik and Subramanian 2004]. A pro-market strategy rests on the idea that free play of markets will lead to efficient allocation of resources, as well as promote competitiveness, hence boosting production and growth. This simple but venerable idea inspired the so-called "Washington consensus" on development during the 1980s and the 1990s [Williamson 1990].

Shorn of numerous complexities, this development orthodoxy consisted of a few key arguments. First, the proponents of the orthodoxy were quite critical of the earlier state-interventionist, import-substitution model of development that was pursued by many countries in the 1950s and the 1960s. Second, the suggestion was instead that economic growth in the developing world would improve if developing country states shrunk their economic role and opened their economies to the external world. A failure to do so, the argument went, would repeatedly produce fiscal and trade imbalances. Pressing policy issues thus involved bringing governmental expenditures more in line with revenues on the one hand, and opening the economy with the hope of promoting exports on the other hand. And finally, numerous more specific policy suggestions that emerged included privatising public sector enterprises, cutting public subsidies, reducing public role in setting prices, devaluation, reduction of tariffs and opening the economy to foreign investors.

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

If the pro-market development strategy derived its inspiration mainly from some strands of neoclassical economics, the ideas behind a pro-business strategy have developed more via real world experience, especially from the rapid growth successes of some east Asian economies. The key idea here is that growth success or failure is not so much a function of the degree but the quality of state intervention. More specifically, identifying variations in how states are organised and in the institutionalised relationship of the state to the private sector is the key to understanding the relative effectiveness of state intervention in the economy. This relationship varies along a continuum stretching from considerable convergence in goals to mutual hostility between the state and the private sector. Other things being equal, the setting that has proved to be most conducive (that is, serves as a necessary but not a sufficient condition) to rapid industrial growth in the developing world is one in which the state's near-exclusive commitment to high growth coincided with the profit-maximising needs of private entrepreneurs. The narrow ruling coalition in these cases was a marriage of repression and profits, aimed at economic growth in the name of the nation. Developmental states of east Asia have generally created such political economies.[3] Turning their countries into state-guided corporations of sorts, they have tended to be the fastest growers in the developing world (e g, South Korea and Taiwan).

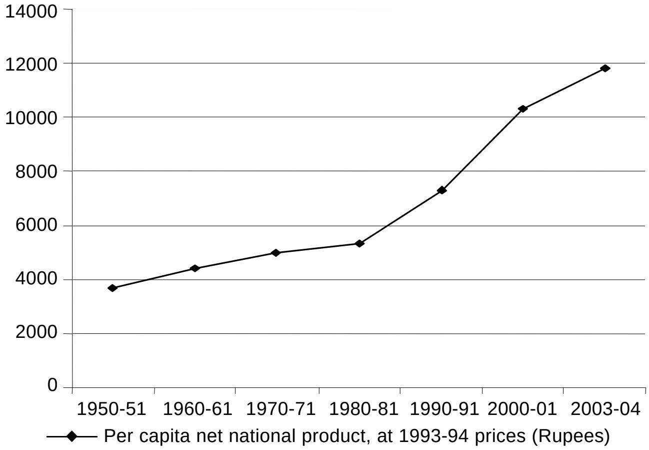
Growth-oriented developmental states pursued their commitment to high growth by developing trade and industry with well-designed, consistent, and thoroughly implemented state intervention. Specific policy measures varied but were generally aimed at easing supply-and-demand constraints faced by private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

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

There was thus significant variation in the specific policy measures undertaken by developmental states. Only some policies, such as labour discipline, necessitated a repressive state. But what most policies adopted by developmental states reflected instead was a single-minded and unyielding political commitment to growth, combined with a political realisation that maximising production requires assuring the profitability of efficient producers but not of inefficient ones. Sometimes this required getting prices right, but just as often it required "price distortions", such as undervaluing exchange rates, subsidising exports, and holding wages back behind productivity gains. The central issue concerned the state's goals and capacities, expressed in the institutionalised relationship between the state and the private sector. Developmental states in successful late late-industrialisers have thus been pragmatically – and often ruthlessly – pro-business, much more than they have been purely and ideologically pro-market.

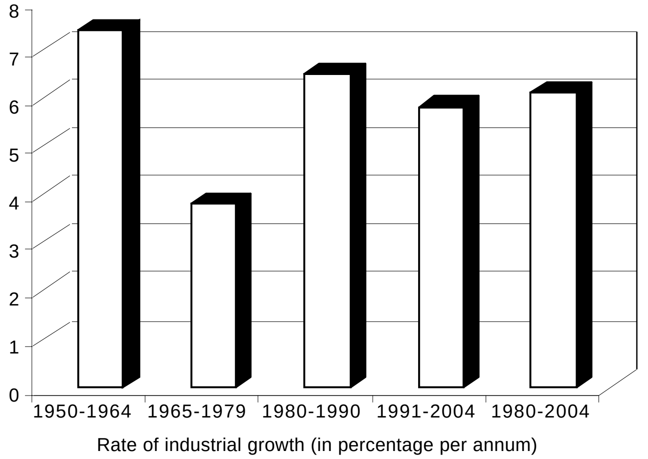
The empirical discussion of contemporary India that follows is then framed by these general considerations: has India's recent economic growth resulted more from the embrace of the pro-market or the pro-business development strategy? To anticipate, the argument below is that India from 1950 to 1980 was a fairly classic case of a statist, import-substitution model of development, with a socialist flourish. From 1980 onwards, however, the Indian state has shifted Indian political economy towards east Asian models of development. This emulation is, of course, not always self-conscious, and, even then, quite partial, because India can not readily replicate the cohesion, effectiveness, or the brutality of a Japanese or a Korean state; the Indian state is also not very good at educating or improving the life-chances of its poor. The emulation is thus mainly in terms of prioritising economic growth and realigning more closely with Indian

Figure 1: Growth of Per Capita Net National Product in India (1950-2004)



Source: Based on Government of India, *National Accounts Statistics*, various issues.

Figure 2: Industrial Growth in India (1950-2004)



Source: Author's estimates based on, Government of India, *Economic Survey*, various issues.

capitalists. An attempt is thus underway to shift "socialist India" into "India incorporated"; this attempt is, and, mercifully, is likely to remain partial. The growth successes in India, as well as the numerous limits on even higher growth rates, are explicable in terms of this partial shift in India towards a pro-business development strategy.

II
Politics of Economic Growth in the 1980s

A glance at both Table 1 and Figure 1 clarifies that economic growth in India accelerated noticeably around 1980. It is the case that the rate of growth of industrial production from 1980 onwards (Table 1 and Figure 2) was not all that impressive, both by international standards, and in comparison to India's own record in the 1950s [Wallack 2003]. Nevertheless, the growth in the 1950s was from a very low starting point and the performance since 1980 has been a significant improvement over the "decade of stagnation" that went before [Ahluwalia 1985]. Moreover, Virmani (2004A and 2004B) and Rodrik and Subramanian (2004) have established via a variety of more formal tests that 1980 (or thereabouts) indeed represents a break from India's "Hindu growth rate". So, the first empirical puzzle is: what underlying changes might help us understand this break from the past?[4]

A brief look at the more proximate economic determinants of rapid increases in production sets the stage for a deeper analysis of the more distant causal variables in the broader political economy. In a rough and ready manner, economic growth accelerated because of improvements in both the rate of investment and productivity. As is evident in Table 1, the overall rate of investment in the economy improved from 1980 onwards (the trend actually began in the second half of the 1970s) and, fluctuations notwithstanding, has remained in the range of 22-23 per cent per annum. The growth in investments was fuelled in the 1980s by both growing public investments and private corporate investments, and in the 1990s, as public investments declined, by a variety of growing private investments (Table 2 and Figure 3). As to productivity, especially total factor productivity in manufacturing, the literature seems to suggest that there was a surge in the 1980s [Virmani 2004B; Rodrik and Subramanian 2004] and then, though still improving, experienced some deceleration in the growth rate in the 1990s [Kumar 2000 and Chaudhri 2002].[5] Some support for this overall picture concerning productivity is also evident in Figure 4. Leaving aside numerous related measurement and other problems that economists rightly debate, for the purposes of a broad political economy analysis, the first empirical puzzle then translates into this: what political and policy changes during the 1980s help explain improvements in the rates of investment in and the efficiency of the Indian economy?

Before answering that question, however, two caveats. First, it is important to reiterate that higher economic growth from 1980 on, was at least in part a result of the changing composition of the GDP [Wallack 2003]; the outcome one is trying to explain then, namely, improvements in the rate of investment and in the efficiency of the economy, especially of the industrial economy, is mainly of an order that brought to an end the earlier "era of stagnation". And second, some non-quantifiable component of

Table 1: Some Basic Growth Data, 1950-2004
(All figures in percentage per annum)

	1950-1964	1965-1979	1980-1990	1991-2004	1980-2004
GDP growth	3.7	2.9	5.8	5.6	5.7
Industrial growth	7.4	3.8	6.5	5.8	6.1
Agricultural growth	3.1	2.3	3.9	3.0	3.4
Gross investment/GDP	13	18	22.8	22.3	22.5

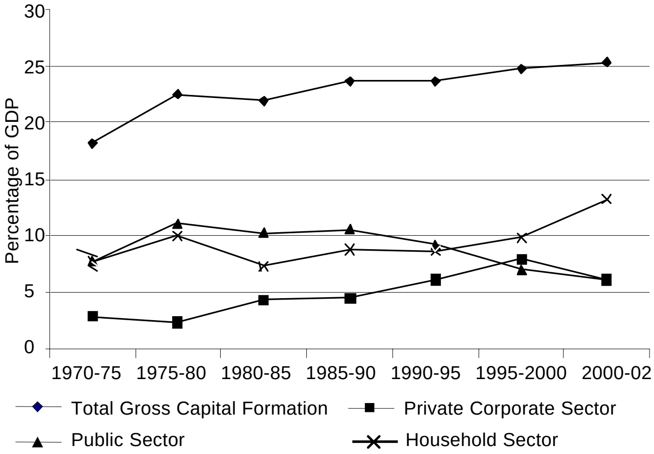
Source: Author's estimates based on, Government of India, *Economic Survey*, various issues (http://indiabudget.nic.in)

Table 2: Patterns of Capital Formation, by Sector 1970-2002
(Percentage of GDP)

Period	Total Gross Capital Formation	Private Corporate Sector	Public Sector	Household Sector
1970-1975	18.2	2.8	7.7	7.7
1975-1980	22.5	2.3	11.0	10.0
1980-1985	21.9	4.5	10.2	7.2
1985-1990	23.7	4.5	10.5	8.7
1990-1995	23.7	6.0	9.1	8.6
1995-2000	24.8	8.0	7.0	9.8
2000-2002	25.3	6.0	6.1	13.2

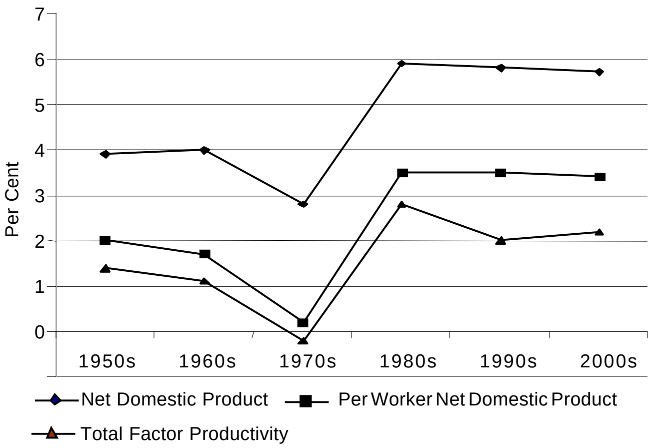
Source: Author's estimates based on, Government of India, *Economic Survey*, various issues (http://indiabudget.nic.in).

Figure 3: Patterns of Capital Formation in India, by Sector (1970-2002)



Source: Based on data in Table 2.

Figure 4: Economic Performance in India (1950-2004) (Annual Growth Rates)



Source: Based on data presented in Arvind Virmani, 'Sources of India's Economic Growth: Trends in Total Factor Productivity', Working Paper No 131, Indian Council for Research on International Economic Relations, May 2004, Table 1.

the improvement in the growth from 1980 on was clearly a function of building on a good foundation: accumulating technology, entrepreneurship and management; trained workers; a sufficient tax base; dense supplier networks; and adequate demand in the economy.

What eventually triggered the upward shift in the growth rate of the Indian economy around 1980 was a slow but sure adoption of a new model of development.[6] Instead of the statist and the nationalist model of development of the Nehru era, that was then accentuated in a populist direction by Indira Gandhi during the 1970s, Indira Gandhi herself shifted India's political economy around 1980 in the direction of a state and business alliance for economic growth. This change was not heralded loudly and has often been missed by scholars, especially because Indira Gandhi remains deeply associated with the politics of 'garibi hatao'. Nevertheless, as documented below, evidence shows that the post-Emergency Indira Gandhi was a different Indira Gandhi: she downplayed redistributive concerns and prioritised economic growth; sought an alliance with big business; adopted an anti-labour stance; put brakes on the growth of public sector industries; and demoted the significance of economic planning and of the Planning Commission. As suits a complex democracy, these changes emerged in fits and starts; they were also often camouflaged, helping maintain some of Indira Gandhi's credentials as the leader of the masses. The changes were nevertheless profound; they involved a shift from left-leaning state intervention that flirted with socialism, to right-leaning state intervention in which the ruling elites recommitted themselves to a more sharply capitalist path of development. As important, key economic actors within India, especially big capital, understood these changes pretty clearly, expressing their satisfaction by investing more and helping India's economy grow rapidly.

While Indira Gandhi had already started moving away from "socialism" during the Emergency, a more consistent shift towards prioritising economic growth and embracing the private sector began after Indira Gandhi returned to power in 1980. Right after coming to power in January 1980, Indira Gandhi let it be known that improving production was now her top priority. Numerous public statements and policy changes indicated this shift; the shift was also understood well by participants and observers. *The Times of India* thus editorialised within a year: "A change of considerable significance is taking place in India…the emphasis has shifted from distributive justice to growth" (February 22, 1981). A close advisor noted that, after returning to power in 1980, Indira Gandhi "was clearly determined to get back to the firm foundations of economic reform" [Sengupta 2001: 55]. And the *Economic and Political Weekly* also reported (in an editorial entitled 'All for Production', Review of Management, August 1980) that the prime minister in her various meetings with industrialists had clarified that "what the government was most concerned about just now was higher production".

The underlying changes that triggered the policy shift were both of the slow moving type – changes that accumulate slowly but surely, but are not always noticed in daily newspaper reports – and of the more noticeable variety. Among the slow changes was the accumulating evidence that India's economic growth throughout the 1970s had been fairly dismal; accelerating production was thus very much on the policy agenda. The context within which higher rates of growth were to be achieved included the important fact that the significance of capitalism in the Indian economy, both in the countryside and in the cities, had grown steadily [Nayar 1989: 330-50]. The more this happened, the more anachronistic became claims of the state controlling the "commanding heights of the economy", especially in the face of a poorly performing public sector. A growing reliance on the private sector for growth was thus increasingly probable.

Among the short-terms changes, it must have been clear to Indira Gandhi by 1980 that the politics of garibi hatao was running out of steam: anti-poverty policies like land reforms had proven difficult to implement [Kohli 1987]; ineffective socialism had hurt economic growth [Kohli 2004: 270-77]; and by contrast, putting the weight of the state behind private producers had helped agricultural production, leading to the green revolution in the 1960s. The economic lessons must have been hard to ignore. Politically too, Indira Gandhi and her advisors might have calculated that a realignment with big capital may not be too costly, in part because the poor were already loyal to her, but also because state support of business may lead to higher growth and thus to lower inflation, an outcome that India's largely poor electorate may appreciate.

The three components of the new model of development that Indira Gandhi adopted from 1980 on – and that has pretty well been pursued by subsequent governments – were: prioritisation of economic growth as a state goal; supporting big business to achieve this goal; and taming labour as a necessary aspect of this strategy. The shape of the new model emerged slowly, but quite, quite surely. First, let us take the issue of prioritising growth. Within six months of coming to power, Indira Gandhi's government put out a new industrial policy statement that put "maximising production" as its top priority [Paranjape 1980:1593]. Between then and 1982, a year she dubbed the year of "productivity," India's development strategy underwent a "dramatic change": jettisoning redistributive socialism, a move hailed by the Indian press at the time, development was now to be pursued by "growth first," focusing on improvements in production and productivity [Nayar 1989: 349].

Indira Gandhi established powerful committees to study how this major transformation was to be implemented: among them were the L K Jha Committee to study the overhaul of economic administration; the Abid Hussain Committee to review trade; and the M Narasimham Committee to consider financial reforms. These three senior bureaucrats were well regarded by the Indian business community.[7] While this long-term process was initiated, with its important signalling effect,[8] numerous policy measures were also adopted right away to give concrete meaning to the "growth first" policy. These all indicated considerable convergence of views between the government and that of Indian big business (say, as expressed by the Federation of Indian Chambers of Commerce and Industry or FICCI) concerning the factors impeding growth: constraints on and the lack of governmental support for business; labour activism; inefficiency of the public sector; and decline in public investments, especially in infrastructure.[9] Notice also how the diagnosis within India of factors impeding growth departed from that offered by the emerging "Washington Consensus" on development of the time. While there was some shared emphasis on deregulation and the inefficiency of the public sector, for the most part, Indian business and government advocated a much more activist state: one that will spend more, control labour more, and support capital more actively. The shared elite policy preferences within India were thus clearly more pro-business than pro-market.

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

Second, if expansion was to be encouraged, there was the question of financing the expansion. The government initially liberalised credit for big borrowers but there was much back and forth on the policy.[10] Additional policies for the provision of finance were instead twofold. The government provided some tax relief to big business to encourage investment. More important, the government altered the legal framework, as well as provided incentives, to encourage the private sector to finance new investments by raising resources directly from the public.[11] As Pranab Mukherjee, the finance minister from 1982 on commented:

> An area of strength for the industrial sector today is the highly favourable investment climate, which has prevailed since 1980. This is a result of a series of policy measures implemented with the conscious objective of creating an environment conducive to industrial dynamism. Many of these measures have responded to the felt needs of the corporate sector...the annual budgets for the years 1980-85 have a distinct philosophy. Incentives were provided to encourage savings and channel them into productive investment...The government has actively encouraged the corporate sector to mobilise the financial resources it needs for investment and modernisation directly from the public. This policy has been highly successful. The total amount of capital issued by the private corporate sector increased from a little over Rs 300 crore in 1980-81 to Rs 529 crore in 1981-82, and further to Rs 809 crore in 1983-84. This is an expansion of 170 per cent in three years [Mukherjee 1984: 58-59].

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

In addition to creating a new pro-business and anti-labour context, that was consistent with its growth-first policy, the Indian government also sought to restructure its own economic role. Of course, it is important to reiterate that what we are discussing here is India, and not some well constructed, cohesive and brutal developmental state; this is not a world in which governments pick winners, corporatise interest groups, and balance budgets. Within the limits of India's fragmented state power, the scope of political reordering was nevertheless impressive. Unlike those following the "Washington Consensus", the Indian state in the 1980s never considered cutbacks in public expenditures that may be recessionary; there was widespread agreement instead in India that public investment in infrastructure "crowds in" rather than "crowds out" private investment. Accordingly, Indira Gandhi sought new revenues. Given political limitations – e g, the inability to tax more widely or effectively – and tax concessions to both investors and well-off consumers – to keep up demand – the main source of new revenue was indirect, excise and customs duties. With these new revenues, and some borrowing at home and abroad, the government kept up the pace of public spending (Table 2), contributing to growth.

With revenues declining from direct taxes on the one hand (resulting from tax concessions for big business), and growing expenditures, including modernising defence and sustaining investment in infrastructure on the other hand, the fiscal pressure on budgets was significant. In line with its new priorities – enhancing production mainly via the private sector – the government sought to cutback some of its traditional expenditures. The most significant was limiting new investments into public sector enterprises; the new mantra instead was to improve their efficiency partly by better capacity utilisation (read less labour strikes), and partly allowing them to revise upwards the prices they charge for their output. The latter was also consistent with socialism taking a back seat. Other changes of the same genre were cut in subsidies to the public distribution system, and the abandonment of the food for work programme in 1982. While budget deficits and the size of the public debt grew during Indira Gandhi years, it was downright modest in comparison to what followed in the Rajiv period.

Finally, one should take note of some of the changes in India's economic relations with the outside world.[12] As an oil importer, the second petroleum price hike in 1981 increased India's import costs significantly. A commitment to increasing industrial growth was also going to require imports of machinery and other technology. Anticipating a foreign exchange squeeze, India in 1981 entered a loan agreement with the IMF for nearly $5 billion over a few years. India's pro-business policies had already been moving in a direction that the IMF found "encouraging", though not quite the "structural adjustment" package more commonly demanded. It is notable that the IMF did not insist that India cut back its public expenditures; apparently Indian policy-makers convinced the IMF of the need to keep up public investments in order to accelerate economic growth via the private sector [Sengupta 2001: Ch II].[13]

What India did do at the time was to open up the economy somewhat to both foreign investors and to foreign goods. Import liberalisation in 1981 was especially far from trivial, but also proved to be short lived. The import bill rose sharply, without a commensurate increase in exports. A variety of Indian businessmen reacted sharply to the threat of cheaper imports and demanded protection.[14] The Indian government obliged; import restrictions were imposed again in the budget of 1983-84, around the same time as India terminated its IMF agreement, even before taking advantage of the full loan [Basu 1983]. If one ever needed evidence to support the claim that the primary commitment of the Indian state at this time was to established Indian businesses rather than to any general principle of creating free markets and a global opening, here it is. This was also a pattern that would repeat itself during the Rajiv Gandhi years – more on this below – and was not fully abandoned even during the more sharply liberal 1990s.

To sum up the discussion so far, Indira Gandhi during the first half of the 1980s abandoned a commitment to redistribution, and recommitted herself to a "growth first" model of development. These priorities, in turn, led her to tilt the policy process in favour of big business, against labour, and to restructure the state's own role in the economy towards growth promotion. There were some halting efforts to open up the economy as well. While this model shared some policies recommended by the "Washington Consensus" on development, it was considerably more statist and more explicitly growth-oriented; it was also more pro-business than pro-market. India's nationalist-capitalist model of development from 1980 on thus started to share some important traits with east Asia, where highly interventionist states commonly ally with business and against labour, and only selectively link their economies to the world, often more via trade than capital. Of course, state power in India is considerably more fragmented and checked by democratic forces than, say, in a South Korea under Park Chung Hee. These differences were also consequential: budget deficits remained an issue as direct taxes were hard to collect and expenditures were hard to limit; mercifully, labour could never be fully tamed; and the state itself remained "soft", creating numerous problems of inefficiency in the bureaucracy and public management. The shift in development strategy also created significant political problems, especially how to win the support of a majority, where the majority is poor, or near-poor, and the rhetoric of socialism and of garibi hatao are slowly being put on the back burner. While this is no place to discuss these issues, Indira Gandhi's flirtation with ethnic politics in this period, especially themes of Hindu chauvinism and interfering with Sikh politics, was part and parcel of the new political economy [Kohli 1991].

The growth-first, pro-business, and anti-labour shift initiated by Indira Gandhi basically continued under her successor, Rajiv Gandhi. Leaving aside a lot of rhetorical flourishes, as well as a fair amount of back and forth on specific policies, Rajiv Gandhi continued the policy changes initiated by Indira Gandhi, moving a little faster in some areas, and little slower in others. By the end of his rule some significant changes in the domestic political economy and a few changes that altered India's links with the world were put in place. Most significantly, state control of such activities of private Indian firms as entry into production, production decisions and expansion in size were eased even further. Indian business groups were also provided significant concessions on corporate and personal taxes, as well as assurances about future patterns of taxation. On the external front, some import barriers came down, though not dramatically, some import quotas were removed, and there was some devaluation; for the most part, however, the internal changes were more significant than the external ones.

Three important political economy observations concerning the Rajiv period need to be made [Kohli 1989]. First, irrespective of what actual reforms were implemented in this period, Rajiv Gandhi and his advisors decided from the onset to emphasise a break from the past. Whereas Indira Gandhi's growing embrace of big business was increasingly straining her commitment to socialism, Rajiv Gandhi dropped the pretense of socialism altogether and openly committed his government to a new "liberal" beginning.[15] Among Rajiv's important economic advisors at this point were individuals like L K Jha, Manmohan Singh, Montek Singh Ahluwalia and Abid Hussain. These individuals were also critical players under the earlier Indira Gandhi period, and some of them, especially Manmohan Singh and Montek Singh Ahluwalia, played a decisive role in the policy shift in 1991. Two conclusions thus seem warranted: stressing continuity or change was as much a political decision as it had to do with the substance of policy reforms; and more important, the decision to undertake major reforms of the economy was already very much on the mind of key policy-makers during the 1980s, who were then waiting for an appropriate political moment, which finally emerged with the "crisis" of 1991.

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

Finally, it is important to note that the policy pattern was more pro-business, especially pro-big Indian business, rather than anything else. Much of internal policy reform – such as eliminating many licensing requirements, removing further restrictions on how big businesses can be, and opening up areas reserved for the public sector to the private sector – helped big rather than small or medium private businesses. Moreover, whenever conflicts arose over external opening, especially on issues of foreign investment, but also on trade, the government accommodated the demands of Indian business groups. Spokesman for FICCI, as well as government representatives, such as L K Jha, often reiterated openly that the "pace of domestic liberalisation" would continue but "external liberalisation was not really an objective of the policy" [Kohli 1989:315].

Indira and Rajiv Gandhi dominated the Indian political economy during the 1980s. This was also the decade in which India's economy made a break through, moving beyond the "Hindu growth rate" to a more rapidly growing economy. One central suggestion here is that this shift in economic performance was triggered by the pro-business policy shift engineered by the two Gandhis. Prior to this period, during the 1970s, Indira Gandhi accentuated the democratic socialist content of Nehru's statist model of development. Given the organisational and the class characteristics of the Indian state [Kohli 1987; also see Bardhan 1984], however, Indira Gandhi's efforts at redistribution failed and the democratic socialist tilt evolved into anti-capitalist populism, hurting economic growth. After returning to power in 1980, Indira Gandhi essentially abandoned the redistributive thrust of her rhetoric and policies, prioritised economic growth as the state's main goal, and sought to slowly but surely reorder economic policies to achieve this goal. The story of economic policy changes during the 1980s just recounted is mainly this story of the making of a new pro-business, growth-oriented model of development in India.

The new growth strategy produced both higher rates of investment and improvement in the efficiency of investment [see Virmani 2004B], contributing to an improvement in the growth rate, especially in industry. The government's commitment to growth was evident, first in sustaining relatively high levels of public investments in the 1980s (Figure 3). This investment helped ease a variety of infrastructural bottlenecks, such as in coal, power and railways; it might also have contributed to higher growth rate via a boost to overall demand.[16] More important than the recovery of public investments was the changing behaviour of the private sector.

Assuming that businessmen react to favourable opportunities for profit making, it is reasonable to suggest that the government's new pro-business policy regime in the 1980s was responsible for the rising share of corporate investments in GDP evident in Table 2 and Figure 3. Other evidence also supports the claim that private sector companies grew at a relatively rapid pace during the 1980s: whereas the paid-up capital of private companies grew at an average annual rate of 7.3 per cent during the 1970s, the growth rate during the 1980s was nearly double, 14.3 per cent; also, the number of private companies during the 1980s grew at an annual average rate of 13.5 per cent, compared to a growth rate of 3.3 per cent for public sector companies [Pederson 2000: 268; also see Virmani 2004B: 35]. We also know that private investment in India tends to be more efficient than public sector investment. It follows that the state's pro-business tilt thus contributed to a higher rate of growth via the enhanced role of the private sector in the Indian economy. While the major beneficiaries were established big business firms, the relative ease of entry and growth enabled new players like the politically well connected Reliance to also emerge as giants, competing with the likes of Tatas and Birlas.

If the partial impact on growth of changing governmental commitments on growth can be traced via changing policies and enhanced investments, both public and private, our understanding of why and how the productivity and the efficiency of the economy also improved remains rather diffuse.[17] Some of the underlying factors were probably not related to short-term policy changes; these might include the building stock of technology and management in the economy, the establishment of a variety of producer networks, sufficient demand in the economy, an adequate tax base, and the presence of a sizeable working class. Among policy related changes, firms might have become more productive because many of them by the 1980s were producing more consumer than capital goods, technology imports were easier, and so was the availability of foreign exchange, enabling ready availability of a variety of scarce inputs and thus helping the utilisation of industrial capacity at a relatively high level. Internal competition also must have put pressure on some firms to economise, though for others, near monopoly type of growth, and thus achievement of economies of scale, might have helped produce a similar outcome. The precise causal impact of such factors on productivity is hard to establish; what does seem clear is that the shift in the governmental policies and the enhanced role of the private sector helped improve, not only the rates of investment, but also the efficiency of the economy.

While the new pro-business strategy of the two Gandhis was indeed responsible for accelerating India's economic growth rate, it also created numerous other problems. Two sets of problems have been mentioned all along but are worth reiterating. Let us call these sets, political and political economy problems, respectively. The state's narrow ruling alliance with business not only relegated a variety of distributional concerns to second order priorities, but also created the important political problem of how to mobilise majorities in a poor society. The fact that Congress leaders resorted to mobilising a variety of ethnic sensibilities in politics – something hardly new to India, but especially evident again after 1980 – was deeply related to this narrowing of the ruling alliance; these developments also opened up political room for the subsequent political growth of the Bharatiya Janata Party (BJP). And on the political economy front, given the nature of power in the Indian state, the embrace of a state-capital-alliance-for-rapid-growth model of development could never fully replicate east Asia; India's authority structure was and remains too fragmented, and given democracy, the underlying class basis of state power could never be too exclusively pro-business. The clearest economic manifestation of these political traits was the slow but steady building up of fiscal pressures: the inability to collect more revenues on the one hand, and the inability to limit a variety of public expenditures on the other hand. Even some of the external borrowing mainly fed internal fiscal imbalances. The growing fiscal and balance of payment difficulties, in turn, helped create the "crisis" of 1991. EPW

(To be concluded next week)

Email: kohli@Princeton.EDU

Notes

1 My statist argument, in turn, builds on a number of earlier important studies, especially Johnson 1982; Amsden 1989; Wade 1990; Evans 1995.

2 Two economists have recently and independently provided a nearly identical interpretation of the Indian experience [Rodrik and Subramanian 2004]. It is encouraging for a political scientist trespassing into the territory of economists to see at least some economists thinking along parallel lines.

3 For a variety of reasons elaborated elsewhere, I have in my recent work replaced the term "developmental states" with a different concept, namely, cohesive-capitalists states [Kohli 2004: 383-86]. For the purposes of this paper, however, I am continuing to use the more popular concept of developmental states.

4 It should be noted that some of those sympathetic to India's liberalising reforms in 1991 tend not to find the growth pick up of the 1980s all that puzzling, maintaining instead that this growth was not sustainable [e g, Srinivasan and Tendulkar 2003; Panagariya 2004]. This view is not fully persuasive because the underlying fiscal problems towards the end of the 1980s were not of crisis proportions and the pressure on balance of payments was at least in part generated by unforeseen external circumstances. As to fiscal issues, note that interest payment on government debt constituted about 17 per cent of government expenditures at the end of the 1980s and 31 per cent at the end of the "liberalising" 1990s [Mohan 2000, Table 5b, p 2029]. The external debt service ratio in 1988 at 29.2 per cent was high but was much lower than the 36.4 per cent average of "all moderately indebted low income countries". India's short-term debt was also relatively low (Mookerjee 1992, Table 1). The pressure on maintaining payments on foreign debt was, in turn, exacerbated around 1991 by a sharp drop in remittances by non-resident Indians that at the time constituted nearly a third of India's export earnings (Kapur, forthcoming, Figure 4.2). This drop (and the threat of a drop) was fuelled by such unpredictable external circumstances as the disintegration of India's major trading partner, the Soviet Union, and the first Iraq war and the related increase in oil prices, both creating a sense that devaluation may be imminent. So, while the macroeconomic problems were real, the government also used the occasion to do what it already wanted to do.

5 It should be noted that assessment of productivity trends raises important measurement issues, especially the measure of real value added that is adopted. Balakrishnan and Pushpangadan (1994) thus adjust for changing price of material inputs and challenge the claim that industrial productivity in India improved in the 1980s.

6 I have gathered the factual details cited in this paper mainly from three sources: *The Times of India*; *Economic Times*; and *Economic and Political Weekly*. Specific citations are provided only when seemingly controversial or debatable observations are made.

7 I interviewed these three senior bureaucrats in the 1980s in connection with another study [Kohli 1991].

8 Note that some scholars (especially Rodrik and Subramanian 2004; but also, De Long 2003) hold that such "signalling" was somehow sufficient to trigger India's growth acceleration. While sympathetic to their general analyses, I do not agree that mere signalling was sufficient in India to provoke behavioural changes. Businessmen reacted to concrete policy changes that I document below.

9 See, for example, the lead editorial, 'All for Production' in *Economic and Political Weekly*, Review of Management, August 1980. Reporting on Indira Gandhi's "two well-publicised meetings with selected group of industrialists and businessmen" the editorial noted that "it was...made quite clear to the industrialists...what the government was most concerned about just now was higher production. Of course, this precisely has been the industrialists position always...(they) have been haranguing the government about the urgent need to remove alleged fetters on larger production…the prime minister herself and her senior cabinet colleagues told the industrialists quite explicitly that the government accepted the position...the government further accepted that industrialists needed to be given incentives to raise production." Also see B M, 'FICCI's Blueprint', *Economic and Political Weekly*, January 26, 1980, p 135, where the FICCI's policy preferences at the time are outlined.

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

11 A useful study of the otherwise neglected subject of politics of private equity markets in India is Echeverri-Gent, forthcoming.

12 Many observers of India, especially those outside of India, often judge the "progress" of India's "reforms" or of "liberalisation" mainly by this yardstick. This is understandable, though for different reasons for different actors. First, some serious scholars, often economists, are deeply convinced that global integration of an economy is the key to improving efficiency and growth of an economy. Armed with this "theory", they often look for evidence of external liberalisation – or the lack of it – as key events that will trigger meaningful change. Second, there are those in the international business community, as well as their spokesmen, whose primary interests are opportunities for investment and trade in a potentially large market like India. And finally, there are a variety of other observers – associated with international development agencies or journalists – for whom some combination of ideas and interests leads to rigid (or opportunistic) mindsets that one is tempted to label, ideological. While the focus on the opening of the economy to the outside world is thus understandable (or at least, comprehensible), it can also be myopic, especially if one wants to understand some of the key economic dynamics of a giant sized country.

13 It may be worth speculating that this exception was related to the fact that India did not owe any huge sums of money to foreign creditors. In this light, one wonders if the main purpose of subsequent "structural adjustment" programmes imposed on many Latin American and African countries was mainly to repay loans rather than facilitate growth. In a private conversation, (in September 2004), Joseph Stiglitz suggested to me that, to his mind, the main aim of "structural adjustment" programmes was probably to induce recessions, thus reducing demand for imports, and thus saving foreign exchange to pay back foreign creditors.

14 By mid-1982, for example, FICCI was arguing against trade liberalisation. The demands to restrict imports, however, were not universal. The Birlas were arguing against rayon imports and the Tatas against the dirt cheap Bulgarian soda ash. Select public sector industries were also arguing against cheap imports of computer components. Those benefiting from cheap imports, however, also made some noises but did not prevail; these included some in the textile industry who wanted to import shuttle-less looms and glass manufacturers who wanted cheap soda ash. See, 'Clamours against Liberalisation', *Economic and Political Weekly*, July 10-17, 1982, pp 1135-36.

15 During his very first budget, therefore, the word "socialism" was not even mentioned once. Of course, when faced with declining popularity later during his tenure, Rajiv reembraced "socialism". By then, however, the image of a break from the past had stuck.

16 Rodrik and Subramanian (2004) find that public investments in the 1980s did not impact growth, though they do allow that the relationship holds with some time lag. Most economic analysts of India find instead a strong association between public investments and higher growth rates [see, for example, Nagaraj 2003]. Even analysts considered "pro-liberalisation", but committed to growth, worry about declining public investments in India [see, for example, Mohan 2000]. Joshi and Little (1994:328) also concluded that "the high level of demand in the 1980s", which was of course in part related to high public expenditures, contributed to improved productivity and growth in the 1980s.

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