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Source: *Economic and Political Weekly*, Vol. 19, No. 35 (Sep. 1, 1984), pp. 1511-1517

Published by: [Economic and Political Weekly](#)

Stable URL: <http://www.jstor.org/stable/4373508>

Accessed: 15/04/2011 22:20

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Political Economy of Slow Industrial Growth in India

Ashutosh Varshney

THIS reports puts together in an organised form the discussion that took place in a conference sponsored by the Social Science Research Council on the 'Political Economy of Slow Industrial Growth in India'. Held at the Center for International Studies, MIT, in October 1983, this two-day long conference brought together economists and political scientists, both from within the United States and outside, to discuss the problem of slow industrial growth in India, particularly since the mid-sixties. The participants were Isher Ahluwalia (ICRIER, New Delhi), Pranab Bardhan (Berkeley), Richard Eckaus (MIT), Francine Frankel (University of Pennsylvania), Roger Grawe (World Bank), Atul Kohli (Princeton), Robert Lucas (Boston University), Norman Nicolson (USAID), George Rosen (Illinois), Barney Rubin (Yale), Amartya Sen (Oxford), T N Srinivasan (Yale), David Szanton (SSRC), Lance Taylor (MIT), Norman Uphoff (Cornell), Ashutosh Varshney (MIT) and Myron Weiner (MIT).

The discussion in the conference was structured around Pranab Bardhan's Radhakrishnan Memorial lectures delivered earlier at All Souls College, Oxford University.¹ Amartya Sen was the chief discussant and Myron Weiner chaired the proceedings.

In this report, I have not presented the themes of discussion in the order in which they came up in the conference; rather, for ease of exposition, I have given them a different ordering. The first part of the report deals with the background of the conference. Against this background are then presented the key themes that emerged in the conference. And finally I have summarised the issues that were touched upon but could not be discussed due to time constraints.

THE DEBATE IN INDIA

Over the last few years, slowdown of industrial growth, particularly since the late sixties, has attracted a great deal of scholarly attention in India. This ongoing debate is in marked contrast to the relative consensus that prevailed in the professional economic circles in the sixties. Improvement in the balance of payments situation and an increase in the rate of savings were identified as factors that would accelerate the growth rate. This, however, did not happen, even as the balance of payments situation improved and the rate of savings went up markedly from 9 per cent of the GDP in the early fifties to 22 per cent in the early eighties. Many explanations have been offered to solve this paradox (Bhagwati

and Srinivasan, 1975; K N Raj, 1976; Ashok Mitra, 1977; Vaidyanathan, 1977; Srinivasan and Narayana, 1977; Patnaik and Rao, 1977; Deepak Nayyar, 1978; Shetty, 1978; Sukhamoy Chakravarty, 1979; Desai, 1981; Bagchi, 1981; Patnaik, 1981). These explanations, some mutually reinforcing, others mutually conflicting, have highlighted the following set of factors: poor agricultural performance despite the Green Revolution, relative price movements resulting in a shift in terms of trade against industry, unequal income distribution and resulting lack of demand, slowdown in import substitution, declining levels of public investment and increasing inefficiencies in the industrial structure resulting from governmental controls and policies.

Political scientists have not focused on industrial policy as such but an overall direction of policies and the paradoxes, 'irrationalities' and politics thereof (Frankel, 1978; Kothari, 1975, 1980, 1982, 1983; Kaviraj, 1982). They have sought to explain politically policies that a number of economists find 'irrational' on economic grounds. Changing relationship between state and society, variously conceived, has been the major concern of political scientists and the explanations given are, at the risk of some simplification, basically of two generic types: state centred and society centred. The state centred explanations² draw attention towards the combined processes of (a) increasing state power, (b) shift in the system management strategy of the political elite, from institution-building and an accent on policy as the primary vehicles of management (as in the Nehru years) to patronage, subsidies and rhetoric (as in the post-Nehru phase), and (c) increasing privatisation of public resources by the political leaders and bureaucracy — in other words, mounting state 'meddling' with the economy leading to policies that are *ad hoc*, policies that maximise the narrow interests of the state elite, policies that are irrational in systemic, collective terms.

The alternative explanation has been society centred. According to this, the capacity of the Indian state to govern has decreased due to mounting demands being placed on state resources. The state, however, is inherently incapable of mobilising additional resources which could satisfy all these demands and yet maintain a respectable level of financing of growth.³

Aside from this scholarly debate, and related to it, the gap between India's potential

and its performance provides another background factor. Pre-conditions of high growth, most scholars agree, did exist in India: a large domestic market and resource base, a substantial entrepreneurial class, a well developed and large cadre of scientific and technical manpower, a relatively stable political system and an experienced bureaucracy, considerable involvement of the international aid community. To all this has been recently added, as mentioned earlier, the high savings rate and a large inflow of foreign exchange through remittances from Indian migrants abroad. And yet industrial growth has not picked up.

Why this incommensurability? How far do the available explanations account for the slow industrial growth? Are there other alternative explanations? On what yardsticks can we say that there has been a slowdown? Is the slowdown after 1965-66 a secular or cyclical process? What does it mean for future policy? These were the central questions before the conference.

KEY THEMES OF DISCUSSION

Before explanations for a slowdown could be examined or given, there was the initial question of what reference points should be chosen in relation to which the slowness of industrial growth could be demonstrated. Of the three yardsticks mentioned — slow in comparison with (a) some other period, (b) some other countries, and (c) potential — there was some disagreement on the first two (and considerable agreement on the third). A derivative of this disagreement was the view that slowdown of growth was not the right question to ask. India failed, according to this view, on distribution, not on growth.⁴

Periodisation is essentially a matter of choosing a dividing line (or a set of cut-off points) on the basis of some explicit and defensible criterion. There was some disagreement on what this dividing line should be. Most participants favoured the mid-sixties as a cut-off point. The planning process was interrupted around this time, and it never recovered its erstwhile importance again. Agriculture ran into a deep crisis that led to the initiation of a new agricultural strategy. And finally, the rates of growth for the industrial sector before and after 1965-66 have been found to be different to a statistically significant degree. The data set used to support this claim is reproduced in Table 1 which documents three important trends: (i) the growth rate of value added in the industrial sector as a whole declined from 7.6 per cent per annum in the period 1959-60 to 1965-66 to 5.5 per cent between 1966-67 and 1979-80; (ii) if we follow the use-based classification, then most of this deceleration is heavily concentrated in sectors producing basic goods and capital goods with intermediate goods and consumer goods showing no significantly different

TABLE 1: GROWTH RATES OF SUB-PERIODS AND TESTS OF DECELERATION^a — USE-BASED AND IN-PUT-BASED CLASSIFICATION
(1959-60 to 1965-66: Period I; 1966-67 to 1978-79: Period II)
(Per Cent Per Annum)

	Value added		Value of Output	
	I	II	I	II
(A) Use-based classification				
Total	8.0	5.7	8.8 ^c	6.5 ^c
(1) Basic goods	11.0	6.0	12.2 ^c	7.2 ^c
(2) Intermediate goods	5.7	4.4 ^b	9.4	6.1
(3) Capital goods	15.4	6.8	15.8	7.3
(4) Consumer goods	4.7	5.6 ^b	5.9	6.2 ^b
(a) Durables	11.5	11.5 ^b	12.3	12.6 ^b
(b) Non-durables	4.2	4.9 ^b	5.7	5.7 ^b
(B) In-put-based classification				
(1) Agro-based	3.7	4.1 ^b	5.9	5.1 ^b
(2) Metal-based	14.1	6.6	14.6	7.1
(3) Chemical-based	8.2	8.4 ^b	11.3	11.2 ^b

Notes: (a) The figures in the Table show an antilogarithm of the relevant regression coefficient minus 1, where the equation estimated is of the form $\text{Log } y = a + a'D + bt + b'Dt$. All data are at 1970-71 prices.

(b) Statistically not significantly different from the growth rate of the earlier period.

(c) Excluding electricity and gas.

Source: Ahluwalia, I J, 1983.

trend; and (iii) if we go by the input-based classification, then metal-based industries show the largest deceleration.

Table 2 provides a detailed breakdown of these categories into various industries and trends in their respective growth rates. Of the industries that went through the sharpest deceleration, basic metals, metal products, electrical and non-electrical machinery, and transport equipment were the most important due to their large weights in the value added in industry.

Based on the industrial production data, the earlier studies, it may be added, had concluded that deceleration affected all industry-groups except the durable consumption goods (electrical goods, cars, motor cycles, bicycles). If the National Accounts data are used, reported Isher Ahluwalia on the basis of her new study, then deceleration is found to be concentrated in capital and basic goods only.⁵ Consumer and intermediate goods grew slowly throughout the period of 1959-60 to 1978-79 but did not show a significant slowdown after 1965-66. The growth rate of non-durables as a category (also called mass-consumption goods) did not decelerate as is argued sometimes, though it is true that durables grew at a faster rate after the mid-sixties. This finding has a bearing on the point sometimes made about the impact of income distribution on industrial growth through the demand factor.

There were alternative views about the periodisation, however. According to one, "growth has gathered pace since 1976 and it may well be that ten years from now we shall regard 1956-65 as a period of high growth and 1966-75 as a period of low growth — that we

are facing what is basically a cyclical process in a binary mould".⁶ This view nonetheless concluded that the binary mould was worth pursuing for some time because it is too early to assess the overall trend in the decade after 1975-76.

The second alternative view did not end with such a qualified agreement. Rather, through various steps in the argument it came to the conclusion that neither the periodisation nor the argument based on this periodisation about growth slowing down was particularly meaningful. According to Amartya Sen who took this view, why growth slowed down was not itself the right question.

1965 is, in Sen's view, not a convincing break for there is no uniquely acceptable reason for it to be an automatic or rational choice. If 1973 is chosen as a break instead, a case can be made that growth picked up thereafter. Depending on the cut-off point chosen, the question of whether growth slowed down would thus admit of different answers, which renders the exercise of periodisation somewhat arbitrary. The only meaningful way of answering the question is to compare India's performance internationally. This, if done, suggests strikingly different conclusions. For example, if we compare India's industrial growth performance in the last two decades with that of Low Income Countries (LICs) in general, we find that India's growth rate declined from 5.4 per cent per annum in the sixties to 4.4 per cent per annum in the seventies, whereas that of LICs dropped from 6.6 per cent to 3.6 per cent. Thus one could say that there is a slowing down in LICs in general; India on this reading in fact slowed down less. The problem, in other words, is

not the slowing down of growth; rather it is slow growth itself and on this view India is not a special case — slow growth is a general problem of LICs. So the question to ask should be: why does this problem persist in the low income countries rather than single out India for the specificities of its growth. Inter-country comparisons reveal, according to this view, another important result: the striking contrast between India and China in dealing with problems related to conditions of life. China's literacy rate by now is 70 per cent, India's 36 per cent; the incidence of infant mortality in China is 81, in India it is 121; and life expectancy at birth in China is 67, in India it is 52. Thus, despite a relatively similar growth rate — and here we are talking about GNP per capita rather than industrial growth rate — China has far outperformed India on 'positive freedoms', which could be termed as the end of growth (the latter not being an end in itself).⁷ On this view, then, growth is not where India failed; distribution is where it did. And the latter is the more meaningful problem to discuss.

Several objections to this view were raised. With regard to 1973 as a break, it was pointed out that the oil crisis did not affect India as much as it did other countries, partly because 50 per cent of the energy consumed in India is non-commercial, and partly because not being export dependent, the international recession generated by the oil crisis did not hurt India much. And finally remittances from the Middle East partially cushioned India from the impact of the oil crisis. Similarly, the comparison of India with LICs in general was incorrect because the pre-conditions of growth in India were vastly superior. Given this potential, India should have by now been a middle income country co-ranking with Mexico and South Korea. If inter-country comparison within the LIC group is to be pursued, the only comparable cases are China and India. And this comparison is not simply warranted on equity grounds; even the overall economic growth rates, despite being relatively similar, called for a comparative analysis. For it had to be kept in mind, according to one participant, that, compared to India, China started in 1950 from a much higher base — yields were higher, the ratio of sown area to available land was very high — which made its potential for future growth smaller. Conversely, India's lower starting base implied a larger potential for growth. Achievement of similar growth rates, given this difference in starting points, makes China's performance much superior and India's sluggish growth worth reflecting on.⁸ India, in other words, has done badly on both growth and equity, not simply on the latter.

The explanations offered for slow growth were of two types: 'proximate' explanations on which there was considerable agreement, and 'foundational' or underlying explanations

TABLE 2: GROWTH RATES OF SUB-PERIODS AND TESTS OF DECELERATION^a —
DETAILS OF USE-BASED CLASSIFICATION
(1959-60 to 1965-66: Period I; 1966-67 to 1978-79: Period II)

Code	Industry Group	Weights		Per Cent Per Year			
		Within Category	In Total	Value added		Value of Output	
				I	II	I	II
	Total		1.00	8.0	5.7	8.8	6.5
(1)	Basic Goods	1.00	0.31	11.0	6.0	12.2	7.2
	Salt	.01	—	15.7	0.4 ^b	18.6	0.5 ^b
	Fertilisers and heavy chemicals	.10	0.03	16.3	12.7 ^b	18.8	11.7
	Cement	.04	0.01	8.5	1.9 ^{b,c}	9.1	4.8
	Basic metals	.27	0.08	15.9	5.4	13.4	6.6
	Electricity	.27	0.09	9.3	9.0 ^c	—	—
	Mining	.31	1.10	7.3	2.9	7.8	3.8
(2)	Intermediate Goods	1.00	0.19	5.7	4.4 ^c	9.4	6.1
	Textile spinning	.39	0.07	4.7	2.7 ^c	7.3	2.7
	Wood and Cork	.02	0.01	2.1 ^b	5.7 ^c	6.8	4.7 ^c
	Newsprint	—	—	8.6	4.0 ^c	9.5	5.3
	Leather and fur	.02	—	1.0 ^b	3.0 ^c	1.0 ^b	3.0 ^c
	Rubber products other than footwear	.09	0.02	3.6 ^b	18.3	9.6	8.8 ^c
	Chemicals other than fertilisers and pharmaceuticals	.19	0.04	12.7	8.1 ^c	18.3	9.6 ^c
	Petroleum products	.08	0.01	3.6	5.7	8.8	12.6 ^c
	Non-metallic mineral products other than glass products	.08	0.01	7.2	4.4	10.0	6.0
	Bolts, nuts, nails, etc	.10	0.02	11.3	1.7	12.9	1.9
	Storage batteries and drycells	.03	0.01	7.1	6.4 ^c	7.8	10.1 ^c
(3)	Capital Goods	1.00	0.05	15.4	6.8	15.8	7.3
	Hand tools and small tools	.03	—	31.5	3.1	31.2	2.2
	Non-electrical machinery other than office equipment	.36	0.05	20.3	7.9	21.2	8.3
	Electrical equipment other than consumer goods	.21	0.03	19.2	11.9	19.2	11.0
	Transport equipment other than consumer durables	.40	0.06	11.1	3.5	11.4	4.2
(4)	Consumer Goods		0.35	4.7	5.6 ^c	5.9	6.2 ^c
(a)	Durables	1.00	0.04	11.5	11.5 ^c	12.3	12.6 ^c
	Furniture and fixtures	.11	0.01	11.5	6.0	12.4	6.6
	Hurricane lanterns	.06	—	10.2 ^b	4.4 ^c	9.0	8.1 ^c
	Commercial office and household equipment	.06	—	18.8	9.4 ^c	6.9	12.8 ^c
	Electrical fans, telecommunications	.31	0.01	10.0	9.3 ^c	11.7	11.2 ^c
	Motor cars, motor cycles and bicycles	.27	0.01	13.9	12.5 ^c	16.7	13.3
	Miscellaneous	.19	0.01	15.1	18.3	12.1	18.4
(b)	Non durables	1.00	0.31	4.2	4.9 ^c	5.7	5.7 ^c
	Food other than beverages and salt	.24	0.08	0.3 ^b	3.8 ^c	4.4	4.8 ^c
	Beverages	.02	0.01	11.2	6.8 ^c	11.0	8.9 ^c
	Tobacco	.07	0.02	1.3 ^b	1.1 ^{b,c}	1.6 ^b	1.7 ^{b,c}
	Textile weaving	.32	0.10	4.1	4.6 ^c	5.8	5.9 ^c
	Footwear, etc	.01	—	13.8	14.4 ^c	15.7	14.6 ^c
	Paper products except newsprint	.07	0.02	10.8	7.2 ^b	12.2	7.4
	Printing and publishing	.07	0.02	8.0	1.1 ^b	8.8	2.4
	Rubber footwear	.01	—	9.9 ^b	-7.6	7.6	1.5 ^{b,c}
	Drugs, pharmaceuticals, etc	.13	0.04	11.0	9.5 ^c	11.6	10.6 ^c
	Glass and glass products	.02	0.01	4.6	1.8 ^c	8.6	3.3
	Metal products not elsewhere included	—	—	15.6	1.3	14.9	1.3 ^b
	Electrical lamps	.02	0.01	12.7	11.0 ^c	12.7	14.5 ^c
	Miscellaneous	.02	0.01	7.6	3.7 ^c	8.5	4.8 ^c

Notes : (a) The figures in the Table show the antilogarithm of the relevant regression coefficient minus 1, where the equation estimated is of the form

$$\log Y = a + a'D + bt + b Dt. \text{ All data are at 1970-71 prices.}$$

(b) Statistically not significantly different from zero.

(c) Statistically not significantly different from the growth rate of the earlier period.

Source : Ahluwalia, I. J., 1983.

on which disagreements were substantial.

PROXIMATE CAUSES

Two mutually reinforcing proximate explanations were given. One associated deceleration in industrial growth with deceleration in public investment and the other pointed to the rise in capital output ratios. For both, statistical evidence was provided. This evidence is summarised below.

The growth rate of fixed capital formation in the public sector dropped from 11.3 per cent per annum in the period 1950/51 — 1965/66 to less than its half, 5.3 per cent in the period 1966/67 — 1980/81. This was stated to be particularly critical for both quantitative and qualitative reasons: quantitative because the state is involved in "directly manufacturing basic and capital goods, owning more than 60 per cent of all productive capital in the industrial sector, running eight of the top ten industrial units in the country..."⁹ qualitative because the state has a virtual monopoly of vital industries like power, fuel and transport. These infrastructural inputs affect the entire industrial sector, a comprehensive supply side linkage, that, added to the role of public investment in creating demand for capital goods, makes public investment absolutely crucial to the functioning of the industrial sector. Any sustained cutbacks therein would inevitably hurt the entire sector. As it turned out, the cutbacks in investment in crucial sectors such as the railways were particularly severe. Its share in the net domestic capital formation in the public sector declined from 16.6 per cent per annum in the period 1960/61 — 1965/66 to around 7.5 per cent in the period between 1966-67 and 1974-75, dropping further down to 4.2 per cent per annum in the period thereafter.

Attention was also drawn to the fact that in India the stimulation effect of public investment overpowers the crowding out effect. According to an econometric study quoted in the conference, the elasticity of private corporate investment with respect to public investment of the previous year is as high as 0.73, a result that independently corroborates the crucial role of public investment in the Indian industrial sector.

In the last few years, however, public investment has picked up again though it has not reached the peak attained in the mid-sixties. Transfers of household sector savings through nationalised banks have largely accounted for this. Moreover, the rate of gross fixed capital formation (both public and private) has also gone up. In 1980-81, this rate was 17 per cent (at 1970-71 prices), an investment rate that compares well with some richer middle income countries. Still, a growth rate normally commensurate with such high investment rate has not resulted. The second and supplementary proximate explanation — high and rising incremental capital output ratios — was thought to be the reason for the incommensurability. This rise, it was argued, is not simply due to a relative shift in the

pattern of recent industrial involvement towards relatively capital-intensive and/or long-gestation industries like chemical fertilisers, petro-chemicals and electricity generation; rather, all industry groups show a rise in capital output ratios, but it is particularly pronounced in the public sector. In sectors where both public and private enterprises operate, the capacity utilisation ratio of public enterprises is normally lower by 15 to 20 percentage points.¹⁰

How does one account for these two phenomena presented as proximate explanations? Are there some deeper forces — political and/or economic — at work? The discussion on foundational or underlying causes addressed these questions. In addition, there was also the associated question of the policy implications that these explanations had.

UNDERLYING EXPLANATIONS

The principal underlying explanations and their policy implications, on both of which no consensus could be reached, can be classified into four categories.

(i) That slow growth was an inevitable result of the overall industrial policy regime which, because of comprehensive controls and a systematic blunting of foreign and domestic competition, led to inefficiencies, misallocation of resources and creation of a high cost industrial structure. The way out is to liberalise the economy.

(ii) That (i) is a stagnationist argument. It could well be the case that inefficiencies themselves were a result of inadequate aggregate demand. Since the mid-sixties the government policies have been inadequately expansionary; the problem of slow growth could be solved by pumping aggregate demand *in a planned and systematic way* through higher public investment and/or better income distribution.

(iii) That public investment has declined because resource mobilisation has been the overarching constraint. This in turn is due to the fact that the vast agriculture sector remains untaxed. With limited public resources, the state has had to finance a large part of both agricultural *and* industrial growth in addition to meeting the equity goals which have been becoming increasingly politically pressing. Given the inherent limitation of the Indian state to mobilise resources from agriculture, the only realistic source of finances is foreign investment.

(iv) That inefficiencies have certainly existed but in and of themselves they do not explain why public investment declined and though they can be held to partly account for rising capital output ratios, the fact remains that the industrial policy regime after the mid-sixties has not been any more restrictive than in the period before. It is more important to inquire why an inefficient regime has been perpetuated, what interests it serves, and if the answer lies in the political structure, then liberalisation may not be an easy policy matter as (i) would imply; it may require institu-

tional rearrangement.

THE INEFFICIENCY ARGUMENT

Quite a few participants took this position.¹¹ The state, according to this argument, "has developed a stranglehold on the industrial sector. Though this need not have meant that it strangulates it, it is in fact what it seems to have succeeded in doing".¹² Nearly all the elements of the industrial policy regime — ranging from matters like investment, capacity creation, technology choice, prices, foreign collaboration to the entire import substitution strategy — have had a 'growth-chocking effect'.

The import substitution strategy, warranted to be sure in certain situations such as protection of infant industries, was extended to cover the entire spectrum of manufactured goods regardless of the comparative costs of import *versus* indigenous production: "India import substituted everything" and not only infant industries, even "elderly incompetents" were protected. The result was a high cost industrial structure, which, given absence of foreign competition, "had no dynamism of its own". Besides, high costs rendered exports uncompetitive in the world market leaving a potentially important source of additional demand pretty much untapped. To those who argued that world recession provided little scope for exports and/or exports constituted a low fraction of India's GDP, it was pointed out that there was no evidence of external demand being a constraint on Indian exports because India's share of world exports has been constantly declining. The fact that exports were a low fraction of GDP was no argument either, "for in a demand deficient economy with excess capacity in many sectors and substantial underemployment, the magnitude of the export multiplier is independent of the initial level of exports".¹³

There is another side to the effect of import substitution strategy on growth. It has been sometimes argued that the slowdown in import substitution after the mid-sixties was itself a reason for the deceleration of industrial growth. Import substitution had provided avenues for automatic expansion of demand before the mid-sixties, which was eroded in the second period. But a slowdown in import substitution or its lessening effect on growth, said some participants, was hardly surprising. South Korea, Singapore, Taiwan have all been through a phase of import substitution, but they are still growing fast because they adopted the strategy in a 'graduated framework' keeping costs in mind unlike India which developed no rational cost-criterion for the *degree and duration of protection* for foreign competition. In other words, the very continuation of this strategy was growth-dampening.

Other elements of industrial policy had similar effects. Licensing industrial capacity led to pre-emption of domestic competition by the early entrants; in many cases of excess

capacity, regulations that excess capacity not be used even if demand existed increased costs to the economy; scale economies were not exploited due to the restrictions on large houses through the MRTP Act; regulations on the choice of technology, on pattern of investment down to the product level and price and distribution controls created inordinate and costly delays for 'everything had to be cleared by the government'. At any rate, periodic reviews of regulatory measures were required in order to reorient measures in accordance with the changing cost and production structure. This was not done. The criteria of regulation became increasingly *ad hoc*. 'Regulatory aspects' of the industrial policy over time overwhelmed the 'developmental aspects' exerting a heavy toll on industrial growth. Rising across-the-board capital output ratios, and negative growth of total factor productivity, reported by Ahluwalia on the basis for an analysis of 20 industry groups at the two-digit level of disaggregation over the two decades since 1959-60, were the biggest manifestations of accumulating inefficiencies. This negative growth in factor productivity stands in sharp contrast to developments in countries like South Korea and Turkey for which such data are available for the same period; they show a positive growth of 3.7 per cent and 1.3 per cent per annum respectively for these two countries.¹⁴

Liberalisation, in this view, is essential if growth is to be stimulated. Liberalisation measures so far have been quite *ad hoc* and partial. What is required is: (i) a step-up in public investment but *only* in critical infrastructure sectors — indeed even power generation could be de-nationalised; (ii) a more well thought out, systematic and ultimately comprehensive liberalisation of the economy. This could be initiated step by step, i.e. in a cost-minimising way. A 'one fell swoop approach' can neither be expected nor is it desirable; and (iii) a revamping of Centre-state relations toward greater decentralisation — economic, political and administrative — so that a climate of incentives and independence of action at lower levels is produced, a climate that would complement the forces of competition and efficiency that would result from liberalisation.

This view of industrial deceleration in India met with varying levels of disagreement. The other three explanations, outlined earlier, even while accepting some factual details of this argument, differed substantially in their assignment of primacy.

AGGREGATE DEMAND VIEW

Diametrically opposed to the inefficiency argument was the aggregate demand view,¹⁵ according to which all the evidence of inefficiency, excess capacity and rise in capital output ratios could simply be 'an artifact of low performance' in which case the lines of causation are running in the opposite direction, i.e. low aggregate demand is causing inefficiencies. The conservative, non-expan-

sionary macro-economic policy of the Indian government since the mid-sixties, contrasted to the expansionary previous phase, was stated to be proof of this.

Two pieces of evidence were given to support the argument that the system was not being 'pushed hard'. First, with regard to mobilising foreign savings, it was argued that India was 'surprisingly underborrowed', a desirable thing in the early eighties but a clear sign of conservatism in the early seventies when debt was not a problem and credit was easily available in the Eurocurrency markets. For investment to increase, savings had to go up and one way of doing this was to increase foreign savings through an increase in imports and or financial inflows. India did not choose this path. A second index is provided by the terms of trade shift. When an expansive macro-economic policy is followed by a country, the terms of trade shift in favour of agriculture as a corollary. But in India, the terms of trade have tended to shift in favour of industry of late, an index of there being not enough macro-economic demand pressure. The solution then is to pump aggregate demand by either raising public investment or changing income distribution (or both). This would take care of excess capacities and inefficiencies and improve the capital output ratios. This argument was further elaborated to include how some potential difficulties of this strategy could have been, or could be, tackled. 'Pushing the system hard', it was admitted, could conceivably run into some bottlenecks. Balance of payments problem could turn out to be one such bottleneck and if agricultural supplies are relatively inelastic in the short run, inflation could result. A second order consequence of inflation could be wage increases in the indexed sector and reduction of incomes in the non-indexed sector where incomes are in fixed monetary units. This would clearly entail an income distribution against the non-indexed sector.

Pushing the system, thus, could potentially create many difficulties. But they are not inevitable. It depends on how policies are pursued. The policy issue is how far the government can push the system without running into these problems. The Indian policy-makers, according to this view, have simply not thought this way. Occasional forays into unplanned expansion might have existed but there is no evidence of a planned expansionary thrust since the mid-sixties. The reasons for the absence of this thrust are not, however, exactly clear. Inflation sensitivity of the Indian system, remarked another participant disagreeing with this analysis, was one of the principal reasons for both the objective absence of an expansionary interest as well as the undesirability of having it. Given India's per capita income, even a 20 per cent rate of inflation could cause havoc if the system is pushed. And this is not simply intuitive. Empirically too, all the years of acute price rise in the past have created political

instability, the mid-sixties and the two pre-emergency years being the most recent examples. Policy-makers as a consequence are acutely sensitive to this issue — and with considerable justification.¹⁶

A second criticism of the aggregate demand view was that it did not quite fit with the high savings rate that India has recently had. If savings are high enough and not being efficiently utilised, then the solution is to use them efficiently rather than pump in more public investment. On the aggregate demand view, however, it was precisely when the ratio of savings to GDP was high that the system needed to be pushed by either public investment or income distribution: for given investment demand, a rise in savings rate will, it was argued, immediately reduce output growth. Investment or public spending has to rise with savings rate to maintain growth.

RESOURCE CONSTRAINT ARGUMENT

The underlying cause of the decline in public investment, according to this argument,¹⁷ is the failure of the Indian state to mobilise adequate levels of resources. This failure, responsible for the crisis that overtook economic planning by the end of the third plan and continues in various forms until today, is primarily due to the inability of the Indian government to tax agricultural income that accounts for nearly 40-45 per cent of the GNP. As a result, since the late fifties but particularly since the mid-sixties, India's plans have been constantly marked by budgetary short-falls; there has simply not been enough at hand to finance both agricultural and industrial development at desired levels. Not only this, a substantial part of the limited public resources has had to be diverted towards rural poverty programmes too. Shortage of resources has repeatedly led to cutbacks in industrial plans.

The Indian experience stands in sharp contrast to China, which succeeded in mobilising agriculture surpluses after the formation of collectives and used them to finance agriculture development. As opposed to the internal financing of agriculture which made it possible for China to allocate a mere 7-10 per cent of her capital budget to agriculture in the first three plans and yet achieve satisfactory agricultural growth rates, India allocated 32 per cent, 22 per cent and 23 per cent to agriculture in the first three plans respectively and had to continue, for the sake of agricultural growth, at these levels in later plans too. Such high allocations to agriculture, coupled with expenditures incurred on rural development programmes and subsidies to farmers and urban consumers, could only be maintained at the cost of industrial investment. "Not even the acceleration in the savings rate from the late 1970s has been very helpful in easing the scarcity of public investment for individual development for the bulk of this improvement comes from the savings of the affluent from households (that are still

beyond the arm of the tax collector)".¹⁸

Given that incapacity to tax agricultural income is a structural problem; "the only realistic source of additional finance for industrial development, apart from commercial loans in private capital markets, now appears to be multinational corporations".

The main criticism of this view was that both the present savings rate of 23 per cent (of GDP) and the present tax rate of 20 per cent were high enough for a developing economy. Only China and Indonesia, it was pointed out, had higher savings rates. While it may be true that the urban sector is overtaxed, the fact remains that the system is generating enough resources. At India's per capita income, a higher tax and savings rate would be rather difficult to achieve. The resource using rather than resource mobilising capacity seems more problematic. Moreover, even if the rural rich are taxed, the impact of this taxation on growth may not be substantial. If the share of agriculture in GDP is 40 per cent, and the top 20 per cent of agrarian population which is to be taxed holds 50 per cent of agricultural income then theoretically 20 per cent of national income can be taxed. If the tax rate is assumed to be 20 per cent, then four per cent of income can be mobilised and given a capital output ratio of between three and four, a one per cent additional growth would at best result.¹⁹ That even one per cent additional growth is substantial was the response to this criticism.

'CONFLICTS IN THE DOMINANT COALITION' ARGUMENT

Different from all three preceding viewpoints while incorporating some of their elements, this argument sought to locate the decline in public investment and rising capital output ratios in the power structure that has evolved in India over the last decade and a half.²⁰ Bardhan presented this argument in two steps: (a) that a decline in public investment and rising capital output ratios were strongly linked with the deceleration in industrial growth; (b) that the foundations of these proximate causes, however, lay in the heterogeneous and conflictual nature of India's dominant coalition.

This coalition consists of three, proprietary classes: the capitalist class, the agricultural rich, and the professionals including white-collar workers. The third class, not customarily included in the proprietary classes, is also part of this coalition, for

... if physical capital can be the basis of class stratification, so can human capital be in the form of education, skills and technical expertise. In a country where the overwhelming majority are illiterate or drop-outs at the primary education level, the educated elite enjoy a high scarcity value of their education and profession. By managing to direct educational investment away from the masses, they have been able to protect their scarcity value and by requiring licence giving powers at various levels of bureaucracy some of them have increased

their capacity to multiply this rental income. It seems the old rentier class in Indian society deriving its income from absentee landlordism has now been replaced by the new rentier elements in the privileged bureaucracy ... (Bardhan, 1983, pp 28-9).

It is the activation of conflicts in this dominant coalition which, given India's democratic polity, has had deleterious consequences for economic growth. The conflict between the urban and rural classes, considerably muted earlier on, has over the last decade taken a rather militant form reflected in the increasing incidence of farm price and terms of trade agitations and characterised often as a struggle between *Bharat* and India. Conflicts between the professional classes and the urban proprietary classes, both in trade and industry, have not acquired the present militancy of the urban-rural divide but mounting distrust and resentment nonetheless marks this relationship. Private capitalists resent the licensing powers of the professional class and the latter in turn, "partly out of the lingering Brahminical culture that identifies money-making in trade and industry with greed dishonesty", and partly out of the state-proclaimed "modern socialist rhetoric", are quite hostile to private capital accumulation. In any event, they take full advantage of their official privileges by extracting "bureaucratic rents"

This intra-coalition conflicts explains why despite a trend towards a high savings rate, current expenditures end up consuming the bulk of the resources and public investment even in sectors as crucial as railways, power and irrigation has not been adequate. "When diverse elements of the dominant coalition of the proprietary classes pull in different directions and when none of them is individually strong enough to dominate the process of resource allocation", so the argument goes, "one predictable outcome is the proliferation of subsidies and grants to placate all of them with the consequent reduction in available surplus for public capital formation" (Bardhan, p 36). Subsidies range from high price supports for farm products, low prices for fertilisers, irrigation, power and subsidised credit for farmers to underpriced public sector products and credit for industrialists and export subsidies to exporters. Subsidies on just three items — food, fertilisers, and exports — exceeded 15 billion rupees in 1980-81, which was roughly half of the total gross capital formation in the public manufacturing sector in that year. The salary demands of professionals and white-collar workers have also grown at a staggering pace. And finally, political democracy with its emphasis on numbers and organisation has made segments outside the dominant coalition — unionised workers, small traders, etc — increasingly vocal about a bigger share of the state pie. This has elicited two responses from the Indian state: periodic financial appeasement combined with recurrent repression.

The latter in particular has meant increasing outlays on expanding police and paramilitary forces; "Thus keeping all the heterogeneous elements of the dominant coalition" happy, guarding the fortress and alternatively coaxing and coercing the intermediate groups banging at the gates, leave for the state a dwindling share of the revenues for reinvestment...The Indian political economy has become an elaborate network of patronage and subsidies" (Bardhan, p 38).

Apart from contributing to the decline in public investment, these political trends play havoc with the management of the public sector too. Rise in capital output ratios and low capacity utilisation may be partly related to technical difficulties or lethargy generated by sheltered domestic market but a large part is also due to the politics of patronage. Arbitrary transfers of efficient managers, use of senior managerial positions as 'political sinecures', 'feather-bedding' and 'overstaffing', irrationally located projects, plundering of public sector goods by the henchmen of influential politicians, lack of managerial autonomy in input choice, employment, pricing and technology — these are all reflections of a labyrinthine and heterogeneous patron-client regime.

There were two main criticisms of this political economy view. The first criticism was that "an explanation of this kind had the danger of sounding terribly plausible". After all, these three classes are present in South Korea too but there the heterogeneity is not a drag on growth. Besides, contrary to the popular impression, the South Korean state is heavily involved in the economy as well. How is it that a heterogeneous coalition and state intervention in South Korea have not prevented high growth whereas in India they have slowed it down? Perhaps democracy, this critique continued, is a variable and in the absence of democracy, one of the groups could have won out in India. But at any rate the political mechanism through which such contrasting results possibly obtain needs to be examined and *without such a systematic political comparison*, the dominant coalition thesis is a "bit too comforting".²¹ In South Korea, responded Bardhan, the coalition is socially and politically less heterogeneous, and certainly much less conflictual. Expressions like "Korea, Inc" symbolise this.

What was simply a possible hypothesis in the first critique was a full-fledged explanation in the second. It was argued that all the fast growing developing countries of today were 'authoritarian dependent', not 'democratic reformist', and that democracies by virtue of their inherent characteristic of allowing groups to compete for state resources were singularly incapable of producing high growth. The cause of slow growth then lies not in the existence of a dominant coalition but in the democratic process itself.²² (Even in advanced industrial societies, current expenditures tend to mount due to competing demands.) The most crucial difference bet-

ween the authoritarian and democratic systems is the capacity of the state in the former to insulate itself from society, and this insulation provides room for substantial policy manoeuvrability, including obtaining conditions like rigid labour discipline, cutting consumption down to the minimum level, and attracting foreign capital. In third world democracies, stringent labour discipline is hard to achieve, cutting consumption down is problematic and dependence on foreign capital a political liability. "The result may well be sluggish growth but it is also accompanied by stable inequalities, democratic freedoms and maintenance of an element of national pride." In the third world, it was further argued, 'economic rationality' works when authoritarian conditions exist: in democracies 'wasteful use of resources' is simply a way of achieving political stabilisation. Being a system of the latter kind, India's industrialisation, in other words, would at best 'muddle through' rather than 'take off'.

This view was counter-critiqued by many participants. The main thrust of the counter-criticisms was that it was only a few authoritarian countries that were growing fast; a large number of them were in fact growing slower than India. No unique set of allocation of resources, it was pointed out, is characteristic of either economic rationality or authoritarian systems. Both admit of multiple ways of allocating resources, making the postulated connection between economic rationality and authoritarianism weak. Nor were there enough observations on the basis of which one could plausibly make the reverse connection between democratic systems and resource-use for political stabilisation rather than economic growth. The response to this counter-critique was that authoritarianism was a necessary but not a sufficient condition for high growth.

UNADDRESSED ISSUES

The discussion, though quite comprehensive, could not exhaustively cover the entire range of issues raised. The issues listed below were briefly touched upon or indirectly discussed: (i) the impact of agricultural performance on industrial growth; (ii) the associated question of the implications of relative price movements or terms of trade for industrial performance; (iii) the issue of whether the state in India has become less autonomous and/or powerful *vis-a-vis* society, or alternatively, it has become a colossal monstrosity, with what impact in either case on policy, and what could be the indices of it; and (iv) the data problems involved in policy research in India where, compared to other democracies, policy making is objectively quite closed rendering a rigorous documentation of pressures, interests and considerations at work in policy making very difficult and making political analysis of necessity inferential.

Notes

[The author is grateful to Pranab Bardhan, Richard Eckaus, Robert Lucas, Lance Taylor

and Myron Weiner for their comments on an earlier draft of this report.]

- 1 In addition to Bardhan's (1983) paper, there was another finished paper by Isher Ahluwalia (1983). The rest of the participants prepared notes on Bardhan's paper or responded orally in the conference. Wherever I quote finished papers, the citation is in the main text. Where I quote from the memos prepared, the author of the memo is cited in the footnotes.
- 2 Kothari and Kaviraj, from different analytical angles, have presented these explanations (see References). I have reconstructed the essentials of their positions.
- 3 Francine Frankel has been taking this position for some time.
- 4 Position taken in the conference by the discussant, Amartya Sen.
- 5 Ahluwalia, 1983, p 2.
- 6 Ashok Desai in a written note to the conference.
- 7 According to Sen's calculations, the growth rates of GNP per capita of India and China are the same over the last two decades, after allowing for the unreliability of Chinese growth data. According to the "World Development Report, 1983", whose statistics on Chinese growth Sen questions, the Chinese GNP per capita grew at 5 per cent per annum in the period 1960-81, as opposed to India's 1.4 per cent over the same period. China's GNP per capita in 1981 is reported to be \$ 300, India's \$ 260. In 1960, if the figure of 5 per cent is correct, Chinese GNP per capita, Sen argued, must have been \$ 108 as opposed to India's \$ 194 (extrapolating backwards from the WDR figures on India — GNP per capita of \$ 260 in 1981 and a growth rate of 1.4 per cent in GNP, per capita). Sen does not find the extrapolated Chinese figure for 1960 credible. Instead, he believes, the Chinese GNP per capita in 1960 was roughly similar to India and if that is true, then the growth rates of the two countries in GNP per capita are roughly similar too (for there is not much difference between their GNP per capita figures in 1981).
- 8 Position taken by Frankel.
- 9 Bardhan, 1983, p 19.
- 10 All figures from Bardhan, *ibid*.
- 11 Position taken by Isher Ahluwalia, Robert Lucas and T N Srinivasan.
- 12 Srinivasan's note to the conference.
- 13 Note to the conference by Robert Lucas.
- 14 Ahluwalia, *op cit*. Lance Taylor disagreed. According to him, growth in total factor productivity is just a residual and "explains nothing". It can be arithmetically shown to be small or negative *if and when* output growth is slow.
- 15 Lance Taylor held this view.
- 16 Bardhan's critique of Taylor's position.
- 17 Argument advanced by Francine Frankel.
- 18 All figures and quotes from Frankel's note to the conference.
- 19 Lance Taylor's instant calculation.
- 20 The key argument developed by Bardhan around which the conference was structured.
- 21 Sen's critique of Bardhan.

22 Kohli's position. All quotes that follow are from his note to the conference.

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