



## THE INDIAN ECONOMY SINCE INDEPENDENCE IN INDIA

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### **Abstract**

India's economic reforms began in 1991 under the Narsimha Rao Government. By that time the surge in oil prices triggered by the Gulf War in 1990 imposed a severe strain on a balance of payments already made fragile by several years of large fiscal deficits and increasing external debt as was discussed before. Coming at a time of internal political instability, the balance-of-payments crises quickly ballooned into a crisis of confidence which intensified in 1991 even though oil prices quickly normalized. Foreign exchange reserves dropped to \$1.2 billion in 1991, barely sufficient for two weeks of imports and a default on external payments appeared inevitable. The shortage of foreign exchange forced tightening of import restrictions, which in turn led to a fall in industrial output. Of the rural electorate, only about 14 per cent had heard of reforms, whereas the comparable proportion in the cities was 32 per cent. Further nearly 66 percent of the graduates were aware of the dramatic changes in economic policy, compared to only 7 per cent of the poor, who are mostly illiterate. In contrast, close to three-fourths of the electorate – both literates and illiterates, poor and rich, urban and rural – were aware of the 1992 mosque demolition in Ayodhya; 80 per cent expressed clear opinions about whether the country should have a uniform civil code or religiously prescribed and separate laws for marriage, divorce, and property inheritance; and 87 per cent took a stand on caste-based affirmative action.

**Key Words:** *Economic, Reforms, Foreign, Exchange, Demolition, Ayodhya, Inheritance.*

### **India Wins Freedom**

On 14 August 1947, Nehru had declared: "Long years ago we made a tryst with destiny, and now the time comes when we shall redeem our pledge. The achievement we celebrate today is but a step, an opening of opportunity, to the great triumph and achievements that await us." He reminded the country that the tasks ahead included "the ending of poverty and ignorance and disease and inequality of opportunity". These were the basic foundations on which India embarked upon its path of development since gaining independence in 1947. The purpose of this talk is to analyze how much has India really achieved in the last 55 years in fulfilling the aspirations on which it was founded.

### **Indian Planning Process**

The objective of India's development strategy has been to establish a socialistic pattern of society through economic growth with self-reliance, social justice and alleviation of poverty. These objectives were to be achieved within a democratic political framework using the mechanism of a mixed economy where both public and private sectors co-exist. India initiated planning for national economic development with the establishment of the Planning Commission. The aim of the First Five Year Plan (1951-56) was to raise domestic savings for growth and to help the economy resurrect itself from colonial rule. The real break with the past in planning came with the Second Five Year Plan (Nehru-Mahalanobis Plan). The industrialization strategy articulated by Professor Mahalanobis placed emphasis on the development of heavy industries and envisaged a dominant role for the public sector in the economy. The entrepreneurial role of the state was evoked to develop the industrial sector. Commanding heights of the economy were entrusted to the public sector. The objectives of industrial



policy were: a high growth rate, national self-reliance, reduction of foreign dominance, building up of indigenous capacity, encouraging small scale industry, bringing about balanced regional development, prevention of concentration of economic power, reduction of income inequalities and control of economy by the State. The planners and policy makers suggested the need for using a wide variety of instruments like state allocation of investment, licensing and other regulatory controls to steer Indian industrial development on a closed economy basis.

The strategy underlying the first three plans assumed that once the growth process gets established, the institutional changes would ensure that benefits of growth trickle down to the poor. But doubts were raised in the early seventies about the effectiveness of the 'trickle down' approach and its ability to banish poverty. Further, the growth itself generated by the planned approach remained too weak to create adequate surpluses- a prerequisite for the 'trickle down' mechanism to work. Public sector did not live upto the expectations of generating surpluses to accelerate the pace of capital accumulation and help reduce inequality. Agricultural growth remained constrained by perverse institutional conditions. There was unchecked population growth in this period. Though the growth achieved in the first three Five Year Plans was not insignificant, yet it was not sufficient to meet the aims and objectives of development. These brought into view the weakness of economic strategy. We discuss the failure of the planning process in more detail in the next section.

A shift in policy was called for. The Fifth Plan (1974-79) corrected its course by initiating a program emphasizing growth with redistribution. To accelerate the process of production and to align it with contemporary realities, a mild version of economic liberalization was started in the mid 1980s. Three important committees were set up in the early 1980s. Narsimhan Committee on the shift from physical controls to fiscal controls, Sengupta Committee on the public sector and the Hussain Committee on trade policy. The result of such thinking was to reorient our economic policies. As a result there was some progress in the process of deregulation during the 1980s. Two kinds of delicensing activity took place. First, thirty two groups of industries were delicensed without any investment limit. Second, in 1988, all industries were exempted from licensing except for a specified negative list of twenty six industries. Entry into the industrial sector was made easier but exit still remained closed and sealed.

Hence, the roots of the liberalization program were started in the late 80's when Rajiv Gandhi was the Prime Minister of India, but the reach and force of the reform program was rather limited. There were political reasons as to why this program could not be enhanced which we talk about later.

### **Objective this Paper**

The main objective is this paper as follows The Indian Economy Since Independence in India

### **The Failure of the Planning Process**

While the reasons for adopting a centrally directed strategy of development were understandable against the background of colonial rule, it, however soon became clear that the actual results of this strategy were far below expectations. Instead of showing high growth, high public savings and a high degree of self-reliance, India was actually showing one of the lowest rates of growth in the developing world with a rising public deficit and a periodic balance of payment crises. Between 1950 and 1990, India's growth rate averaged less than 4 per cent per annum and this was at a time when the developing world, including Sub-Saharan Africa and other least developed countries, showed a growth rate of 5.2 % per annum.



An important assumption in the choice of post-independence development strategy was the generation of public savings, which could be used for higher and higher levels of investment. However, this did not happen, and the public sector-instead of being a generator of savings for the community's good-became, over time, a consumer of community's savings. This reversal of roles had become evident by the early seventies, and the process reached its culmination by the early eighties. By then, the government began to borrow not only to meet its own revenue expenditure but also to finance public sector deficits and investments. During 1960-1975, total public sector borrowings averaged 4.4 % of GDP. These increased to 6 % of GDP by 1980-81, and further to 9 % by 1989-90. Thus, the public sector, which was supposed to generate resources for the growth of the rest of the economy, gradually became a net drain on the society as a whole.<sup>1</sup>

### **I will now try to give some reasons for the deterioration of the public sector in India.**

1. The legal system in India is such that it provides full protection to the private interests of the so called 'public servant', often at the expense of the public that he or she is supposed to serve. In addition to complete job security, any group of public servants in any public sector organization can go on strike in search of higher wages, promotions and bonuses for themselves, irrespective of the costs and inconvenience to the public. Problems have become worse over time and there is little or no accountability of the public servant to perform the public duty.
2. The 'authority' of governments, at both center and states, to enforce their decisions has eroded over time. Government can pass orders, for example, for relocation of unauthorized industrial units or other structures, but implementation can be delayed if they run counter to private interests of some (at the expense of the general public interest).
3. The process and procedures for conducting business in government and public service organizations, over time, have become non-functional. There are multiplicity of departments involved in the simplest of decisions, and administrative rules generally concentrate on the process rather than results. There is very little decentralization of decision-making powers, particularly financial powers. Thus, while local authorities have been given significant authority in some states for implementing national programmes, their financial authority is limited

Hence during early 90's it was imperative for India to correct its clearly faulty developmental process. There have been several reasons put forward for the failure of the developmental path which necessitated the reforms of Manmohan Singh in 1991. The way I would approach the analysis is through the approach of comparing and contrasting the viewpoints of two of the most prominent Indian economists of our times.

### **The Bhagwati-Sen Debate**

Jagdish Bhagwati and Amartya Sen, probably the two most influential voices amongst Indian economists, represent the two divergent ways of thinking about the development path. Though formally no such debates exists, apart from occasional jibes against Sen in the writings of Bhagwati, I believe by scrutinizing their positions a lot of introspection can be done. As Bhagwati says "my view as to what went wrong with Indian planning is completely at odds with that of Prof Sen". My objective in this section is bring out the intellectual divergence amongst these two great minds and possibly to learn something from that.



Let us start with the points on which they agree. I think the fact that India needs an egalitarian development path is quite well acknowledged by both of them. The Nehruvian dream of an egalitarian growth process was what both of them would endorse. As Bhagwati says “I have often reminded the critics of Indian strategy, who attack it from the perspective of poverty which is juxtaposed against growth, that it is incorrect to think that the Indian planners got it wrong by going for growth rather than attacking poverty: they confuse means with ends. In fact, the phrase “minimum income” and the aim of providing it to India’s poor were very much part of the lexicon and at the heart of our thinking and analysis when I worked at the Indian Planning Commission in the early 1960’s”. The key strategy that defined the resulting developmental effort was the decision to target efforts at accelerating the growth rate. Given the immensity of the poverty, the potential of simple redistribution was considered to be both negligible in its immediate impact and of little sustained value. Accelerated growth was thus regarded as an instrumental variable; a policy outcome that would in turn reduce poverty. He goes on to argue “Those intimately associated in India’s plans fully understood, contrary to many recent assertions, the need for land reforms, for attention to the possibility of undue concentration of economic power and growth in inequality. These ‘social tasks’, which of course also can redound to economic advantage, were attended to and endlessly debated in the ensuing years, with reports commissioned (such as the Mahalanobis Committee report on income distribution in 1962) and policies continually revised and devised to achieve these social outcomes”.

If we follow the writings of Sen on the other hand, in his recent book “Development As Freedom”, Sen argues that “the usefulness of wealth lies in the things that it allows us to do- the substantive freedoms it helps us to achieve....an adequate conception of development must go much beyond the accumulation of wealth and the growth of gross national product and other income-related variables. Without ignoring the importance of economic growth, we must look well beyond it”. I don’t think that there is any divergence of view on this front with that of what Bhagwati says. It is worth mentioning at this juncture that this has been a common misconception amongst economists about the divergence of two different developmental paths. It is often misunderstood that Bhagwati’s view stresses just on economic growth while Sen argues against economic growth and the importance of markets. The above paragraphs reveal that this is certainly not the case. Both of them is sufficiently concerned with economic growth as well as the basic issues of poverty, health and social issues.

### **The Points of Divergence**

I believe the real disparity concerns the means of achieving these common goals. Bhagwati’s arguments can be summarized as follows. The development process consists of two steps. As a first step, a growth accelerated strategy would generate enhanced investments and whose objective was to jolt the economy up into a higher investment mode that would generate a much higher growth rate. The planning framework rested on two legs. First, it sought to make the escalated growth credible to private investors so that they would proceed to invest on an enhanced basis in a self-fulfilling prophecy. Second, it aimed at generating the added savings to finance the investments so induced. His argument crucially rested on the following logical theory. For the higher growth rate to achieve it is very important for the economy concerned to be open. If the effective exchange rate for exports over the effective exchange rate for imports (signifying the relative profitability of the foreign over the home market), ensured that the world markets were profitable to aim for, guaranteeing in turn that the inducement to invest was no longer constrained by the growth of the domestic market. It is worthwhile to recount India’s performance as far as the public sector savings is concerned, which was considered a major hindrance towards the success of the Indian plans. Continuing with the argument, the generation of substantial export earnings enabled the growing investment to be implemented by imports of



equipment embodying technical change. If the Social Marginal Product of this equipment exceeded the cost of its importation, there would be a ‘surplus’ that would accrue as an income gain to the economy and boost the growth rate.

The role of literacy and education comes at the next stage. The productivity of the imported equipment would be greater with a workforce that was literate and would be further enhanced if many had even secondary education. Now his argument is based on the fact that the enhanced growth would demand and lead to a more educated workforce. Thus he considers that primary education and literacy plays an enhancing, rather than initiating role in the developmental process.

Sen on the other hand considers a larger view of development. He believes that questions such as whether certain political or social freedoms, such as the liberty of political participation and dissent, or opportunities to receive basic education, are or not “conducive to development” misses the important understanding that these substantive freedoms are among the constituent components of development. Their relevance for development does not have to be freshly established through their indirect contribution to the growth of GNP or to the promotion of industrialization. While the causal relation that these freedoms and rights are also very effective in contributing to economic progress, the vindication of freedoms and rights provided by this causal linkage is over and above the directly constitutive role of these freedoms in development.

I think that it is precisely at this point where some of Sen’s writings on economics and philosophy should be considered. According to Sen, economics as a discipline has tended to move away from focusing on the value of freedoms to that of utilities, incomes and wealth. This narrowing of focus leads to an under appreciation of the full role of the market mechanism. For example, take the example of the most important finding on the theory of the markets- the Arrow-Debreu equilibrium. That theorem shows that a competitive economic system can achieve a certain type of efficiency (Pareto efficiency to be precise) which a centralized system cannot achieve, and this is due to reasons of incentives and information problems. But if we suppose that no such imperfections do exist and the same competitive equilibrium can be brought about by a dictator who announces the production and allocation decision, then are these two outcomes the same? In a much celebrated paper, Sen brings out the distinction between “culmination outcomes” (that is, the only final outcomes without taking any note of the process of getting there) and “comprehensive outcomes” (taking note of the process through which the culmination outcomes come about). Along these lines we can argue that Sen would disagree with Bhagwati’s point of view in that it does not consider the “comprehensive outcomes”. Though the outcomes may be the same if we bring about a simultaneous increase in investments in education, health and other social activities, with that of growth, as against a framework where growth brings about a derived demand for those activities (a la Bhagwati), these are not the same thing.

So as we can see, the primary difference in the approach is that Bhagwati argues that poverty and social dimensions can be taken care of in the second step of the development process while Sen argues that social opportunity is a constitutive element in the developmental process. In this respect it is helpful to scrutinize the East Asian case, where countries like Japan, South Korea, Taiwan (so called Asian Tigers) achieved phenomenal rates of growth in the 80’s and much of the early 90’s. The interesting fact about these countries is that they achieved this with a significant high record on the social dimensions. Both Bhagwati and Sen has commented directly on the achievement of these countries. As Bhagwati states “The East Asian investment rate began its take-off to phenomenal levels because East Asia turned to the Export promotion (EP) strategy. The elimination of the ‘bias against



exports', and indeed a net excess of the effective exchange rate for exports over the effective exchange rate for imports (signifying the relative profitability of the foreign over the domestic market), ensured that the world markets were profitable to aim for, guaranteeing in turn that the inducement to invest was no longer constrained by the growth of the domestic market as in the IS strategy".

I personally think that there is nothing disputable in this analysis but it does not strengthen his argument that the social achievements in these countries followed their phase of growth. In fact the pioneering example of enhancing economic growth through social opportunity, especially in basic education, is Japan. Japan had a higher rate of literacy than Europe even at the time of the Meiji restoration in the mid nineteenth century, when industrialization had not yet occurred there but had gone on for many decades in Europe. The East Asian experience was also based on similar connections. The contrasts between India and China are also important in this aspect. The governments of both China and India has been making efforts for some time now to move toward a more open, internationally active, market-oriented economy. While Indian efforts have slowly met with some success, the kind of massive results that China has seen has failed to occur in India. An important factor in this contrast lies in the fact that from a social preparedness standpoint, China is a great deal ahead of India in being able to make use of the market economy. While China was deeply skeptical of markets, it was not skeptical of basic education and widely shared health care. When China turned to marketization in 1979, it already had a highly literate people, especially the young, with good schooling facilities across the bulk of the country. In this respect, China was not very far from the basic educational situation in South Korea or Taiwan, where too an educated population had played a major role in seizing the economic opportunities offered by a supported market system.<sup>2</sup>

## Conclusion

Let us go back to Bhagwati-Sen debate which was used as a theoretical underpinning for my analyses on the developmental process since Independence. As Bhagwati argues, "India had a major setback in her planning process when she turned inwards following the balance of payments crises in 1956-57. The explicit strategy of an IS strategy (Import Substitution) was desired then, reflecting the economic logic of elasticity pessimism that characterized the thinking of Indian planners. The result was that the inducement to invest in the economy was constrained by the growth of demand from the agricultural sector and the public sector savings. But agriculture has grown nowhere by more than 4 per cent per annum over a sustained period of over a decade. And we discussed the issue of public sector savings earlier. By contrast, the East Asian investment rate began its take-off to phenomenal levels because East Asia turned to the Export Promotion strategy. In that case, the world markets were profitable to aim for, guaranteeing in turn that the inducement to invest was no longer constrained by the growth of the domestic market as in the IS strategy." Hence the liberalization program of Manmohan Singh in 1991 was a welcome step towards achieving the logic which has been argued by Bhagwati. Unfortunately, the second step of the developmental process, that of derived demand for education and other social issues, have been far from being realized atleast a decade after the reform process.

On the other hand, Sen's contention that the planning process failed was because of the government's complete neglect throughout of issues on literacy, health and other social indicators. The fact that the reform process did actually achieve a higher growth rate in the 90's with the opening up of the economy is actually received quite encouragingly by Sen (as against some assertions made on the contrary). But I personally believe that he is critical of the fact, that in spite the achievement in the growth rate, the governmental neglect on the above mentioned issues still continues. In fact during the 90's the concerns have become more stark in some sense, whereas India has achieved a respectable



growth rate while on the other hand problems on literacy, health, living conditions continue to exist at an increasing rate. So he would argue that the reform process is largely an incomplete work. Nonetheless, given the rhetoric of the ‘market economy’ being so loosely used in a lot a contexts, a voice like Amartya Sen is extremely important. Otherwise we would be left gloating in our achievements without sufficient introspection in the neglected dimensions of our economy.

## **References**

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