UNIT 39 THE POLITICAL ECONOMY OF LIBERALISATION

Structure

39.1 INTRODUCTION

Any consideration of the economic history of India over the past few decades must address some central questions. What were the causes of the crisis in the early 1970s, and how were these overcome? What caused the shift from the so-called "Hindu rate of growth" of economic activity, of around 3.5 per cent per annum, to the higher rates of around 5.6 per cent per annum achieved from the 1980s onwards? What were the political economy configurations associated with changing economic policies, especially "liberalisation"? How did these changes impact upon the material conditions of the Indian people, and did they involve corresponding changes in society and polity? This Unit briefly considers each of these questions in turn.

39.2 EXPANSION AND GROWTH OF INDIAN ECONOMY

To begin with, however, a broader look at the overall trends may be useful. Table 1 presents decadal compound rates of growth since the early 1950s, for Gross Domestic Product and per capita Net National Product at constant 1993-94 prices. It is evident that real GDP growth rates increased to a higher level in the latter two decades. Increases in per capita income were even more marked because of the fall in the rate of population growth.

Table 1: Annual rates of growth of national income

(per cent)

Period (year starting April)	Gross Domestic Product	Per capita Net National Product
1950-52 to 1960-62	3.9	1.8
1960-62 to 1970-72	3.5	1.2
1970-72 to 1980-82	3.5	1
1980-82 to 1990-92	5.6	2.9
1990-92 to 2000-02	5.6	3.5

Notes: 1. Both GDP and NNP are measured in constant 1993-94 prices.
2. Rates of growth are compound annual rates for the three-year averages.

Source: CSO, *National Accounts Statistics*, various issues

As Table 2 shows, this growth has been associated with some amount of structural change, although perhaps not as much as might be expected. Investment rates have increased over time, which is only to be expected in a developing economy achieving higher rates of per capita income, but the rate of increase actually slowed down, until the last decade shows almost no change in the investment rate. Meanwhile, the share of agriculture in GDP has fallen along predictable lines in the course of development, but there has been little increase in the share of the secondary sector, which has not changed at all since the early 1990s. Rather, the share of the tertiary sector has increased dramatically, to the point where it now accounts for around half of national income.

Table 2: Structural change in the Indian economy

Per cent of GDP

Period (year starting April)	Investment rate	Primary	Secondary	Tertiary
1950-52	15.5	59	13.4	27.6
1960-62	19.4	53.1	17.3	29.6
1970-72	23.8	46.6	20.4	33.0
1980-82	22.0	41.3	21.8	36.9
1990-92	26.0	34.4	24	41.6
2000-02	26.2	26.1	24.7	49.2

Source: CSO, *National Accounts Statistics,* various issues.

Such changes in output shares were not accompanied by commensurate changes in the distribution of the workforce. The proportion of all workers engaged in agriculture as the main occupation has remained stubbornly above 60 per cent, despite the collapse in agricultural employment generation of the most recent decade and the fall in agriculture's share of national income. It is also intriguing that the higher rates of investment of the last two decades have not generated more expansion of industry, but have instead been associated with an apparent explosion in services, that catch-all sector of varying components.

39.3 ECONOMIC POLICY: THE BACKGROUND

The economic policy regime erected in the 1950s had its roots in the freedom struggle itself. The economy had been dominated by metropolitan capital and metropolitan commodities in the pre-independence period. Freedom meant freedom from this domination; and this could not be ensured without giving the state in independent India a major role in building up infrastructure, expanding and strengthening the productive base of the economy, setting up new financial institutions and regulating and coordinating economic activity. This was necessary even for building capitalism itself, although it was proclaimed by some to be also a means of transition to socialism. State capitalism and state intervention were essential instruments for the development of a relatively autonomous Indian capitalism, displacing metropolitan capital from the pre-eminent position it had occupied in the colonial economy.

There were a number of features of India's post-Independence growth strategy that structurally limited the potential of the system. To start with, despite talk of land reform, of providing "land-to-the-tiller" and curbing the concentration of economic power, little was done to attack or redress asset and income inequality after Independence. The worst forms of absentee landlordism were done away with, but the monopoly of land remained intact in most of rural India. And while some monopolistic practices were curbed, asset concentration in the industrial sector was never really challenged. Rather, India's monopolists were able to use state intervention as a device to consolidate and expand their monopolistic positions.

One consequence of the persistence of asset and income inequality was that there were definite limits to the expansion of the market for mass consumption goods in the country. Employment and income growth in the private sector was limited. And the large mass of peasantry, faced with insecure conditions of tenure and often obtaining only small shares of the outputs they produced, had neither the means not the incentive to invest. The prospect of increasing productivity and incomes in rural India (which was home to the majority of its population) in order to stimulate domestic demand was therefore restricted. The absence of any radical land redistribution meant that the domestic market, especially for manufactured goods, remained socially narrowly based. It also meant that the growth of agricultural output, though far greater than in the colonial period, remained well below potential. For the country as a whole, the benefits of such agricultural growth as did occur was largely confined to a relatively narrow stratum of landlords-turned-capitalists and sections of rich peasants who had improved their economic status. Meanwhile, industrial growth was not sufficiently employment generating to create large increases in demand from this source.

Under these circumstances, continuous growth in State spending was essential for the growth of the market since it was the key element in whatever overall dynamism the system displayed. Further, given the strength and assertiveness of the domestic industrial capitalists, the government was not in a position to discipline them to the extent that would have been required to launch an East Asian style mercantilist strategy. The stimulus for growth had to be internal, even though the autonomous expansion of the domestic market was constrained by the inequality of asset distribution.

So the basic stimulus to growth during the early post independence years came from the State itself. It provided domestic capitalists with a large once-for-all market for manufactures by widening and intensifying trade protection and displacing imported goods from the domestic market. It sought to expand that market through its current and capital expenditures and it supported the domestic capitalist class by investing in crucial infrastructure sectors and directing household savings to finance private investment through the creation of a number of industrial development banks.

This strategy did pay dividends during the decade and a half immediately following Independence. In this period rates of industrial growth were creditable by international standards, India built up a diversified industrial base, and the public sector expanded rapidly enough to provide crucial infrastructural services, industrial raw materials and capital goods to sustain industrial growth even when the foreign exchange available to import these commodities was limited. (Chakravarty, 1987) By the mid-1960s, however, not only was the once-for-all stimulus offered by import substitution exhausted, but the ability of the State to continue to provide the stimulus to growth was also undermined by its inability to raise adequate resources. In consequence, aggregate growth decelerated leading to the "secular stagnation" of the late-1960s and 1970s.

39.4 THE CRISIS OF ECONOMIC *DIRIGISME*

DIRIGISME

An expression of French origin suggesting the policy of state direction and control in economic and social matters.

The interventionist regime that was set up in the 1950s had serious internal contradictions which contributed to an erosion of its social stability as well as of its economic viability. This propelled it towards a situation where, given its social base, it could not summon the will for any alternative viable responses to the changed international economic context. Thus, the development of international capital markets and consequent access to private capital flows added tensions to a regime which had been based on certain critical assumptions relating to the binding foreign exchange constraint. This interplay between the changing external context and the accentuating domestic contradictions within the earlier regime gave rise to the totality of circumstances that permitted the overt shift in policy making in favour of neoliberal economic reforms. Thus, while the speculation-engendered crisis of 1990-91 provided the immediate occasion for the "economic reform" package, there were fundamental internal contradictions and structural features that had led up to it.

There were three mutually reinforcing and interrelated contradictions that aborted the objectives of this basic model. First, the state within the old economic policy regime had to simultaneously fulfil two different roles that were incompatible in the long run. On the one hand it had to maintain growing expenditure, in particular investment expenditure, in order to keep the domestic market expanding. At the same time, however, the state exchequer was the medium through which large-scale transfers were made to the capitalist and proto-capitalist groups, so that the state effectively became the most important instrument for primary accumulation by the domestic capitalist class in its various manifestations. Of course, there were other instruments as well, some of which were more direct (such as the eviction of tenants from agricultural land, private encroachment on common and publicly owned resources such as forests from whose use the poor were simultaneously excluded). But the state exchequer was the most significant via media, through mechanisms such as tolerance of fairly widespread and growing tax evasion, a variety of subsidies and transfers, and through lucrative contracts and procurement policies.

These contradictions reflected the class character of the Indian state, which was the focus of much discussion during the first three decades after Independence. Kalecki (1964) sought to explain the nature of state intervention in what he called an "intermediate regime", that is one representing the interests of the urban lower middle class and rich peasantry. In such a regime, the conflict of these groups with feudal landlords and the large capitalist "comprador" elements in the economy, as well as the weakness of the lower middle classes in terms of their inability to perform the role of dynamic entrepreneurs on a large scale, would necessitate a form of state capitalism, with very specific internal contradictions and limits to its growth. K. N. Raj (1973) applied this concept to the Indian case, although his interpretation met with some controversy, essentially with respect to the characterisation of the state and the implications thereof.[1] Others, by contrast, recognised the nature of the state as an (uneasy) alliance between the rural landed classes and the big industrial bourgeoisie, influenced also by the interaction with metropolitan capital (Patnaik, 1974; Mitra, 1977; Chandra, 1988; Bagchi, 1991). Some analyses (such as Bardhan, 1984) moved the focus away from class to interest groups, and viewed the Indian public economy as an elaborate network of patronage and subsidies, chracterised by "pressure-group politics". Still others (Rudolph and Rudolph, 1987) treated the state as an autonomous "third actor", with great power because of the resources it controlled, for which class politics was marginal and subordinate to other social formations such as religion, caste and language communities. The present analysis takes an incorporative view, which stresses that both the nature of the Indian state and the functioning of markets have been shaped by social and historical processes, and also affected subsequent class configurations..

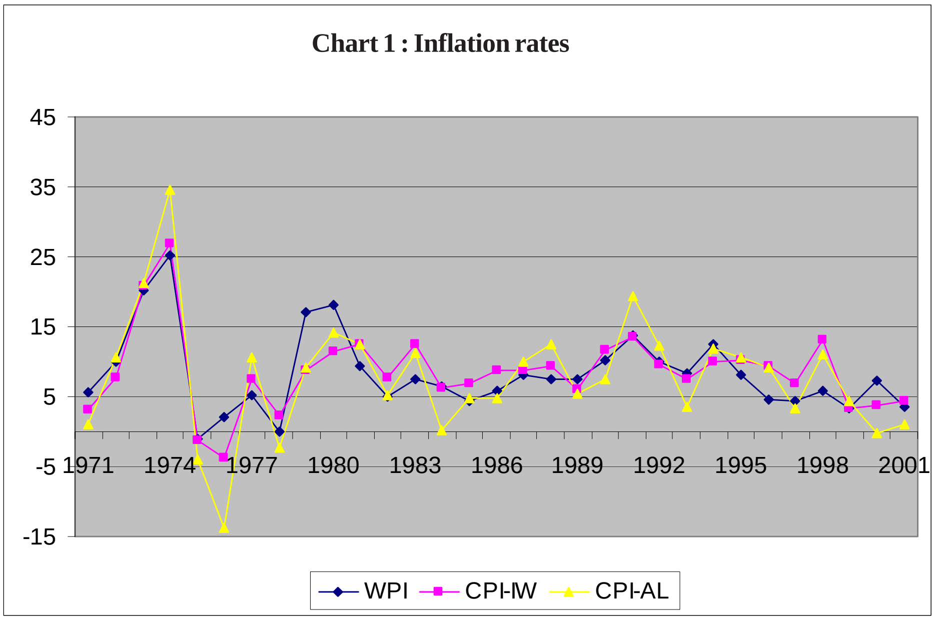
These contradictions played out directly in affecting industrial activity. After fifteen years of rapid industrial expansion in the 1950s and the early 1960s, there was a

1 For example, it was severely criticised, inter alia, by E.M.S. Namboodiripad (1973).

DIRIGISTE REGIME

A regime that indicates state controlled economic and social matters.

dramatic decline in the rate of manufacturing growth during the next fifteen years. By the early 1970s, the crisis of the *dirigiste* regime was already apparent, and there were various pressures building upon the import-substituting strategy of the earlier decades. The oil shock of 1973 added to domestic inflationary pressures to create the dramatic increases in prices of the period 1973-75, which was also a time of much enhanced socio-political unrest in the country.



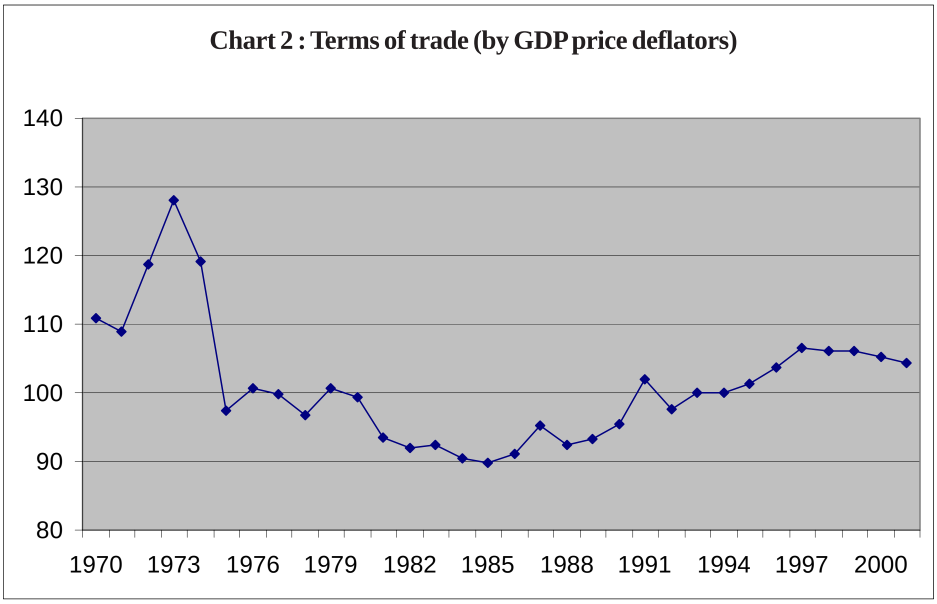
Source: RBI, *Handbook of Statistics on the Indian Economy*, 2002-03.

Chart 1 indicates the extent of extreme price volatility in the early 1970s, which has not been experienced with such intensity in any later period. The reduction in rates of inflation occurred from the beginning of the 1980s. This is noteworthy because worldwide rates of inflation were not as low in the 1980s as they were in the 1990s, and so the control over inflation in the 1980s essentially reflected changes within the Indian economy.

39.5 THE ECONOMIC RECOVERY OF THE 1980s AND 1990s

In the 1980s, the escape from the growth impasse of the earlier period was enabled by an increase in the fiscal stimulus to the economy provided by government spending, financed increasingly by external commercial borrowing. In addition, there was substantial liberalisation of imports, especially of capital goods and components for manufacturing, which imparted an impetus to final good production based on newly imported inputs. One reason why the model of public sector-led expansion could continue for some more time without generating higher inflation was of course this import liberalisation.

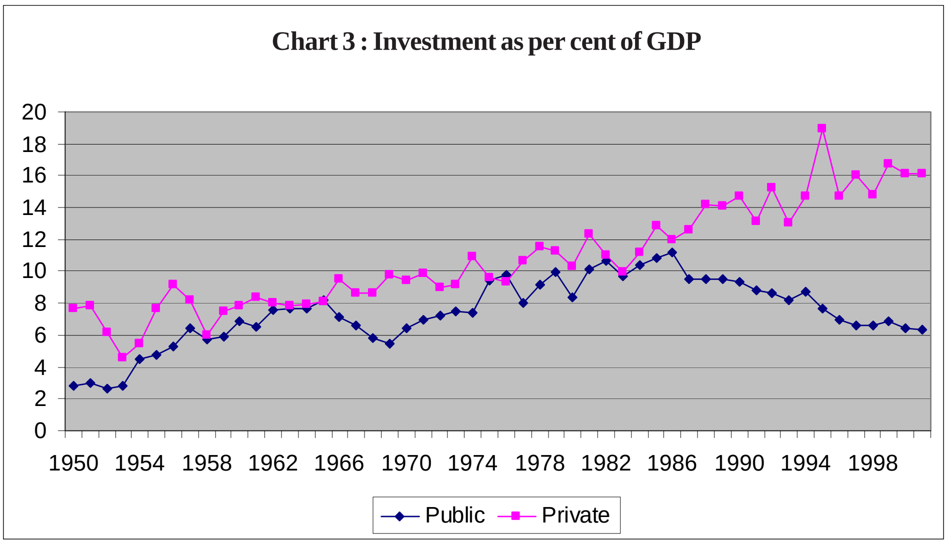
However, some role was also played by the intersectoral terms of trade, as indicated in Chart 2. The first half of the 1970s marked a peak in terms of the relative price of agricultural goods, but after 1977, and through to around 1985, such a tendency was effectively contained and the domestic terms of trade were generally favourable for industrial expansion. In turn, this pattern of the terms of trade can be partly explained by the fact that world agricultural prices were declining over the 1980s. But what was more significant was that growth after 1980 in the Indian economy generated much less employment than before, and therefore implied much less demand for food than would have been the case with more employment-intensive expansion.



Source: CSO, *National Accounts Statistics*, various issues

Thereafter, while intersectoral terms of trade for agriculture remained low compared to the early 1970s, from the mid-1980s onwards for about a decade Indian agriculturalists were relatively protected from the international movement of terms of trade against primary products. The liberalisation of imported manufactured goods that started from the 1980s, also played a role in ensuring that terms of trade improved to some extent for agriculture. The domestic relative prices for agriculture worsened again in the late 1990s, when trade liberalisation exposed farmers to declining world prices.

The 1980s experience suggests that over this period, notwithstanding the limited liberalisation, Indian economic growth still depended on the fiscal stimulus that government expenditure provided, rather than on an expansion of exports. Since such government expenditure was not accompanied by tax and other measures aimed at mobilising additional resources, but was financed through borrowing, the excess demand in the system was bound to spill over in the form of either inflation or a current account deficit. Keeping inflation under control through imports enabled by trade liberalisation, in turn required more external borrowing to finance the growing current account deficit.



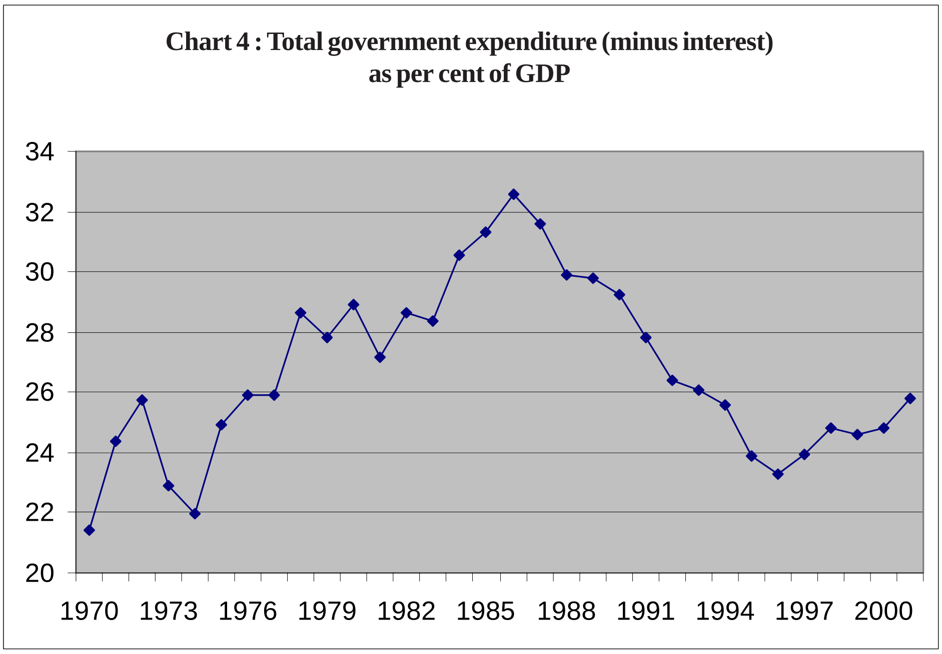
Source: CSO, *National Accounts Statistics*, various issues.

In the first two decades after Independence, a leading role in economic growth was played by public investment, which had strong positive linkages with private investment in both agriculture and industry. Chart 3 shows that public investment as a share of GDP continued to increase over much of the 1980s (and peaked in 1986-87), and this no doubt acted as a positive stimulus to private investment over this period. However, after 1987, public and private investment trends diverged quite sharply. Public investment declined quite sharply as a share of GDP, falling back to the levels of the early 1970s, while private investment continued to increase, such that aggregate investment rates remained broadly stable.

Some observers have interpreted such a tendency to mean that Indian entrepreneurs have broken out of state dependence, and that economic liberalisation has created a surge of animal spirits such that private investment no longer requires state activity to be buoyant. The combination of deregulation and trade liberalisation, according to this view, has created a virtuous pattern of growth whereby the state can reduce its expenditure and allow private investors to fill the gap in investment.

There is no doubt that the process of import liberalisation (which began in the mid-1980s and was accelerated in the 1990s) did lead to some increase in manufacturing activity in particular, as the pent-up demand for a range of consumer goods was sought to be met through increased import-intensive production. However, this really reflected a once-for-all increase in the domestic market, which tapered off over time, especially because it did not involve large increases in employment in these sectors.

However, just looking at public investment alone may give a misleading sense of the full nature of the fiscal stimulus, especially in the 1980s. Government expenditure of all kinds has played a crucial role in generating more employment and therefore more direct and indirect demand for private activity. These linkage and multiplier effects were especially strong in the period from 1975 to 1986. Chart 4 indicates that this was a period of very large increases in the share of total government



Sources: Ministry of Finance, *Public Finance Statistics of India*; and CSO, *National Accounts Statistics*, various issues

expenditure (minus interest payments from which it is assumed that the marginal propensity to consume is low) to GDP.[2] This was clearly the basis for the high growth rates observed in the 1980s, since the positive effects of such expenditure operate immediately as well as with a time lag.

The effects of state expenditure were particularly marked in rural India in the second half of the 1980s. This was a period when, along with a rapid increase in all sorts of subsidies and transfers to households from government, there was a very large increase in expenditure on the rural sector by State and Central governments. More generally, throughout the period political developments tended to give rural interests greater power and they were able to command an improvement in the historically low share of government expenditure benefiting rural areas. This flow of resources involved an expansion of 'rural development' schemes with an explicit redistributive concern, as well as the greater accessibility of the rural elites to the varied benefits of aggregate government expenditure. There were various rural employment and IRDP programmes as well as a plethora of special schemes for a variety of identifiable 'target' groups. While these programmes were less than entirely successful in reaching target groups, they still represented a fairly massive net transfer to rural areas. This was instrumental in causing the rural employment diversification of that period as well as allowing for a greater spread of economic growth in the country than has been achieved subsequently.

Chart 4 suggests that this positive fiscal stimulus declined after 1986. In the 1990s, while the proportion of state expenditure to GDP decreased, economic liberalisation measures such as reduced import tariffs and domestic duty rates, caused the total tax-GDP ratio to decline, so the fiscal deficit still remained high, albeit with a lower positive stimulus. Further, in the early 1990s, financial liberalisation measures significantly increased the cost of government borrowing, such that total interest payments of central and state governments became ever more significant, and accounted for as much 7.3 per cent of GDP on average by the turn of the decade.

The question that arises is, what allowed the rate of growth in the period after the mid-1980s to be maintained despite the apparent decline in the fiscal impetus after 1986? First, while the fiscal stance was reduced, it was still quite significant, above 26 per cent of GDP, until around 1993. Thereafter, there was high growth for a period in the mid-1990s, caused in particular by the once-for-all spurt provided by import liberalisation, as discussed below. This is also indicated by the spurt in private investment in the mid-1990s, as evident from Chart 3. Private investment as a share of GDP reached a peak in 1995, and thereafter stabilised at around 16 per cent of GDP. Meanwhile, the fiscal stimulus, which had been falling continuously, started increasing again around 1998, although it still remained below the levels of the early 1980s. The tapering off of growth in the latter part of the 1990s (from a compound rate of 5.8 per cent per annum in the period 1989-91 to 1995-97 to a lower compound rate of 4.6 per cent in the period 1995-97 to 2000-02) should be seen in this context. What this essentially shows is that the Indian economy remains critically dependent upon levels of state expenditure to ensure growth, despite the periodic stimuli provided by liberalisation, exports and so on.

2 There are several reasons for believing that increases in interest payments by government are likely to have lower multiplier effects. Most government securities are held by economic agents whose marginal propensity to consume is very low. In India, a significant proportion is held by banks, whose increased returns from such investment do not tend to translate into greater spending by the system as a whole.

39.6 ECONOMIC REFORMS IN THE 1990s

The explicit aims of the neoliberal economic reform process adopted from 1991 onwards were: (i) to do away with or substantially reduce controls on capacity creation, production and prices, and let market forces influence the investment and operational decisions of domestic and foreign economic agents within the domestic tariff area; (ii) to allow international competition and therefore international relative prices to influence the decisions of these agents; (iii) to reduce the presence of state agencies in production and trade, except in areas where market failure necessitates state entry; and (iv) to liberalise the financial sector by reducing controls on the banking system, allowing for the proliferation of financial institutions and instruments and permitting foreign entry into the financial sector. These were all based on the notion that greater freedom given to private agents and market functioning would ensure more efficient and more dynamic outcomes. The government's aim was also to restructure production towards areas of international "comparative advantage" (defined in static rather than dynamic terms). These areas were also seen as inherently more labour-intensive, which led to the further prediction that, after an initial brief period of net job loss, such a strategy of trade liberalisation would actually create more employment over time in more sustainable ways.

These aims translated into successive changes in the pattern of regulation in different sectors as well as in aggregate macroeconomic policies. By the early years of the current century, therefore, the Indian economy had undergone the following policy changes:

- very substantial reduction in direct state control in terms of administered prices and regulation of economic activity;
- privatisation of state assets, often in controversial circumstances;
- rationalisation and reduction of direct and indirect tax rates, which became associated with declining tax-GDP ratios;
- attempts (typically unsuccessful) to reduce fiscal deficits which usually involved cutting back on public productive investment as well as certain types of social expenditure, reducing subsidies to farmers and increasing user charges for public services and utilities;
- trade liberalisation, involving shifts from quantitative restrictions to tariffs and typically sharp reductions in the average rate of tariff protection, as well as withdrawal of export subsidies;
- financial liberalisation involving reductions in directed credit, freeing of interest rate ceilings and other measures which raised the cost of borrowing, including for the government;
- moving to market determined exchange rates and liberalisation of current account transactions;
- allowing a significant degree of capital account liberalisation, including easing rules for Foreign Direct Investment, allowing non-residents to hold domestic financial assets, providing easier access to foreign commercial borrowing by domestic firms, and even allowing domestic residents to hold foreign assets.

It has already been observed that the transition to a higher economic growth trajectory was associated in the 1980s with the fiscal stimulus provided by the state in a context of import liberalisation. In the 1990s, this fiscal stimulus was much weaker, declining in the first part of the decade and only increasing somewhat from 1997 onwards (Chart 4). The growth performance was more uneven, with deceleration in agricultural output growth and fluctuating performance in manufacturing. Since the 1990s liberalisation was not accompanied by any new dynamism in the commodity-producing sectors of the economy[3], the expansion of services proved to be crucial over this later period, as evident from Table 3.

Table 3: India: Growth rates by sector

(Average annual rates of output growth)

	Primary	Secondary	Tertiary
1971-72 to 1979-80	2.22	4.64	4.87
1981-82 to 1989-90	3.37	6.95	7.04
1991-92 to 1999-2000	3.30	6.98	8.35
1985-86 to 1989-90	5.72	8.66	8.83
1991-92 to 1994-95	3.77	8.04	6.40
1995-96 to 1999-2000	1.95	4.99	7.20

Note: The figures are based on data with 1993-94 as base year.

Source: CSO, *National Accounts Statistics*, various issues

Despite the weakened fiscal stimulus, both in terms of public investment and aggregate expenditure, the role of the state remained crucial, since it was the state that determined the contours of tax reductions, deregulation and other policies that allowed for economic growth based on a relatively small and dominantly urban section of the population. The explosion in consumption by the upper quintile of the population (discussed below and shown in Chart 5) fed this growth, and meant that it involved increased inequality, both across regions of India and within regions across different economic and social categories. There was also a widening gap between incomes in agriculture and non-agriculture, such that the ratio of per worker domestic product in non-agriculture to that in agriculture increased from about 2 in the 1950s to well over 4 in the 1990s.

The period since 1990 was marked by very low rates of employment generation. Rural employment in the period 1993-94 to 1999-2000 grew at the very low annual rate of less than 0.6 per cent per annum, well below the rate of growth of rural population. Urban employment growth, at 2.3 per cent per annum, was also well below that of earlier periods, and employment in the formal sector stagnated. The Census of India also suggests that there was dramatic deceleration in employment defined in terms of the number of main workers, with greater increases in the number of "marginal workers" (that is, those having employment for less than 183 days in the year). Further, the quality of employment deteriorated, with increases in casual and part-time work rather than regular, as well as greater fragility of contracts.

3 This lack of dynamism was despite the fact that the revision in base years for the national income accounts led to substantial increases in estimated income. The new series of national income, with 1993-94 as base, not only increased the GDP estimates but also pointed to a higher rate of growth than in the old series for both overall and agricultural incomes. Thus, the GDP estimate for 1993-94 was about 9 per cent higher according to the new series than the old, both overall and in agriculture. Also, between 1993-94 and 1997-98 (the last year for which old series estimates are available), agricultural GDP as per the new series rose by a total of 14.2 per cent as compared with 8.37 per cent according to the old series. Total GDP between these years increased by 31.3 per cent as per the new series as compared with 30.4 per cent in the old series.

Table 4: Growth rates of employment

(per cent change per annum)

	Rural	Urban
1983 to 1987-88	1.36	2.77
1987-88 to 1993-94	2.03	3.39
1993-94 to 1999-2000	0.58	2.27

Note: Employment here refers to all workers, Principal Status plus Subsidiary Status

Source: Based on *NSS* employment rates and *Census* population figures

Agricultural employment showed the sharpest deceleration of all, with absolute declines in the number of people usually employed in agriculture over the 1990s. Part of this was due to technological and cropping pattern changes that reduced labour demand in agriculture. In addition, the growth of landlessness (as cultivation became less viable given the squeeze on the peasantry because of rising input costs and falling or stagnant crop prices) also had an impact, since peasants using family labour tend to use labour more intensively than farmers using hired labour.

For urban India, the deceleration and even decline in organised sector employment was one of the more disturbing features of the period after 1990, especially given that industrial output increased manifold and the service sector (in which much of the organised employment was based) was the most dynamic element in national income growth.[4] This was due to the collapse in public sector employment, since private organised sector employment did not increase fast enough to compensate.

The formal feminisation of work was still relatively less developed in India compared to many other Asian countries, although there is evidence that there was some increase during the peak period of the 1990s. Women's urban employment was mostly in services and to some extent in home-based work as part of subcontracting networks that extended all the way from large (even multinational) companies down through various subcontracted units to women working on a piece-rate basis at very low wages. (Ghosh, 2004)

There are several reasons why the pattern of growth over the 1990s did not generate sufficient employment even in the urban areas. Several "economic reform" measures worked against the interests of most small producers, who accounted for not only the most labour-intensive forms of urban production but also the dominant part of urban manufacturing employment. The reduction of priority sector credit allocation, the shift in emphasis in terms of financing investment from banks to the stock market and the removal of various export subsidies from which small-scale exporters benefited, all militated against the interests and viability of such enterprises. Meanwhile public investment in vital urban infrastructure declined considerably both as share of GDP and in per capita terms, and public sector "cost-cutting" and other practices reduced the efficiency and accessibility of the infrastructure because of inadequate maintenance. These not only created important bottlenecks for all producers, they also added to costs in general, which affected the economic viability of small enterprises.

4 The only positive feature in employment patterns was the increase in opportunities for the educated groups, largely related to the expansion of IT-enabled services in metropolitan and other urban areas. However, while this feature, along with that of software development, received much international attention, it still remained too insignificant in the aggregate economy to make much of a dent in overall employment.

In addition, there was the pressure coming from newly freed imports becoming available at lower average rates of tariff. Such import competition was particularly difficult for small scale producers to meet, not only because of the greater control of many large companies over distributive networks, but also because small companies were typically unable to match the huge advertising budgets of larger companies and multinationals in particular. Meanwhile, as manufacturing exporters strove to become or remain competitive in an increasingly difficult international environment, they were forced not only to find various ways of making labour more "flexible" than ever (through lower wages and more insecure working conditions), but also to adopt relatively capital-intensive new technologies that could ensure the quality and consistency that were required in world markets. This meant that even relatively small producers who were earlier the most labour-intensive employers, were no longer large sources of potential employment generation.

From the early 1970s until the late 1980s, there was a secular trend towards declining incidence of poverty (in terms of the proportion of population with consumption below the officially determined poverty line). Subsequently, the evaluation of trends in poverty was made more complex by certain changes in methodology in the main official consumer expenditure surveys, which have made the recent survey data non-comparable with earlier estimates. Nevertheless, the basic conclusion appears to be that the rate of decline of poverty has slowed down and become much more uneven. Other indicators point to disturbing changes in patterns of consumption. Thus, per capita foodgrain consumption declined from 476 grams per day in 1990 to only 418 grams per day in 2001, and even aggregate calorific consumption per capita declined from just over 2200 calories per day in 1987-88 to around 2150 in 1999-2000.[5] Meanwhile, declining capital expenditure by the government was associated with more infrastructural bottlenecks and worsening provision of basic public services. All these features: decelerating employment growth, declining access to food for ordinary people, and worsening coverage and quality of public services, had particular impact upon the condition of ordinary women.

The external sector appeared to provide the most positive indicators over the later period, with overall stability in the balance of payments and a relative absence of the boom-and-bust cycles that marked some other emerging markets. To some extent this reflected the relatively limited extent of capital account liberalisation over much of the period, and the fact that the Indian economy was not really "chosen" to be a favourite of international financial markets until the very recent period from 2002. Meanwhile, the greatest stability to the balance of payments was imparted by the substantial inflows of workers' remittances from temporary migrant workers in the Gulf and other regions, which amounted to more than all forms of capital inflow put together.

39.7 THE POLITICAL ECONOMY OF LIBERALISATION

There is no doubt that, whatever the external pressures upon the state, the neoliberal reform process could not have occurred without what was at first conditional and

5 Of course, it has been argued that this can represent a positive diversification of consumption away from foodgrain that is associated with higher living standards. But in other countries it is has typically been the case that aggregate foodgrain consumption did not decline because of indirect consumption of grain (for example, through meat and poultry products that require feed). In any case, the overall decline in calorific consumption (covering all food products), even for the bottom 40 per cent of expenditure catories in population, suggests that the optimistic conclusion may not be warranted.

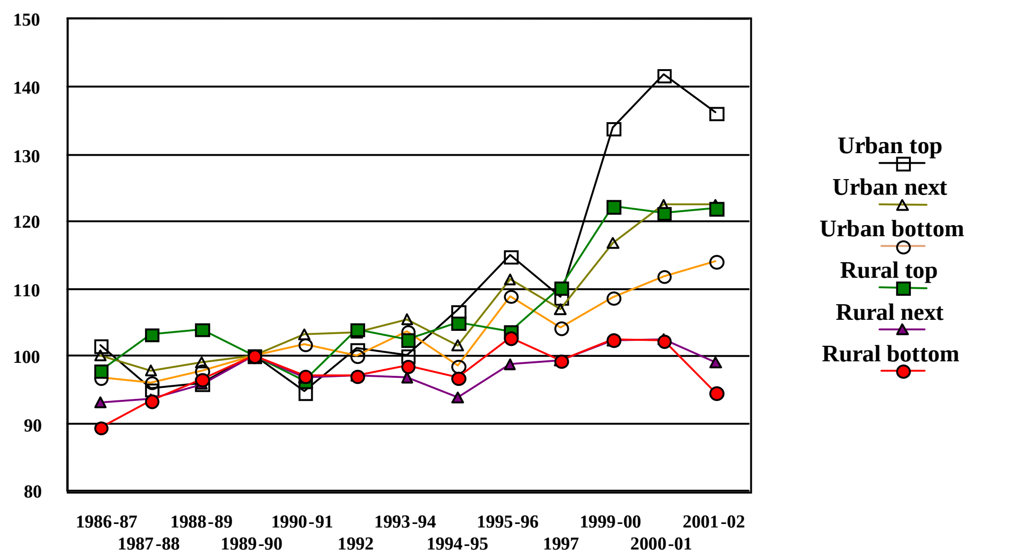
subsequently more unqualified support extended to it by various elements of the domestic large capitalist class, along with other social groups with substantial political voice, such as the middle classes. To some extent this can be explained by the proliferation and diversification of the Indian capitalist class that took place during the years of import-substituting growth and later. The emergence of new capitalists operating outside the traditional bases of existing monopolistic groups, such as trade, finance, services of various kinds and operations abroad by Non-Resident Indian groups, was an important factor. These new entrants sought to diversify into manufacturing, and therefore welcomed deregulation and also, because of access to newer technology, were less averse to import competition.

This created a direct challenge for several of the traditional monopolies, which had in the past been protected by the barriers to entry created by the state's industrial and trade policies. Such established large capital found its relative position worsening in the economy over time. To reverse this decline, it looked for new avenues, including expansion abroad through the export of capital and by moving into areas previously reserved for small-scale entrepreneurs. So even the established big businesses that were, to start with, the beneficiary of state controls of various kinds, began to chafe against these controls at a certain stage. Among certain other sections such as the agricultural capitalists the economic regime change met with qualified approval. Rich farmers were hostile to the withdrawal of subsidised inputs and directed credit, but still favourably anticipated the prospect of exporting at favourable prices in the international market. This meant that a substantial section of domestic capital was willing to make compromises with metropolitan capital, in the hope of being able to better its own prospects as a junior partner, both in the domestic as well as in the international market. It was therefore in favour of import liberalisation and a retreat from state interventionism.

In addition, there was support for economic liberalisation from other quarters: from new businessmen involved in what were essentially "parallel market" transactions; a section of the top bureaucracy; and perhaps more significantly, the large and politically powerful urban middle classes, along with more prosperous rural farming groups, whose real incomes increased in the consumption-led boom of the 1980s. The latter groups actively began to desire access to international goods and gave potency to the demands for trade liberalisation. And of course the technological and media revolutions, especially the growing importance of satellite television, imparted a significant impetus to the international demonstration effect, which further fuelled liberalising and consumerist demands. This process was given further stimulus by the accelerated globalisation of a section of Indian society. Apart from the media, one major instrument of this was the postwar Indian diaspora. The "NRI phenomenon", by means of which a qualitatively significant number of people from the Indian elites and middle classes actually became resident abroad, contributed in no small measure to consumerist demands for opening up the economy. The important of Non-Resident Indians was not only because they were viewed as potentially important sources of capital inflow, but also because of their close links with dominant groups within the domestically resident society.

Despite (or rather, because of) the imbalanced and unequal economic growth pattern of these years, there was a definite improvement in material conditions for a substantial section of the upper and middle classes. Since these groups had a political voice that was far greater than their share of population, they were able to influence economic strategy to their own material advantage. So the local elites and middle classes were not only complicit in the process of integration with the global economy, but active proponents of the process. This becomes clear even from data on the distribution of consumption expenditure by different fractile groups. As Chart 5 suggests[6], in the 1990s and until 2002, the urban top 20 per cent of the population (in terms of per capita household consumption categories) experienced increases in per capita consumption which were the most rapid in post-Independence history. The other groups that also appear to have increased per capita consumption significantly were the next 40 per cent of the urban population and the top 20 per cent of the rural population. By contrast, the per capita consumption of the bottom 40 per cent of the rural population actually declined over this same period. Such patterns not only give some idea of the spread of the "gainers" of the economic growth process, but also indicate the political constituency for the liberalising reforms of the 1990s.

Chart 5 : Indices of real per capita consumption by fractile groups



Source: Abhijit Sen and Himanshu (2004) based on *NSSO*, various rounds.

While the neoliberal economic reform programme entailed a changed relationship of government interaction with economy and polity, it was not a "withdrawal of the state" so much as a change in the character of the association. Thus, while the state effectively reneged on many of its basic obligations in terms of providing its citizens access to minimum food, housing, health and education, it was still the case that state actions were essential in determining the way in which markets functioned and the ability of capital to pursue its different goals. Government and bureaucracy remained crucial to economic functioning; in fact the overall context became one of greater centralisation of economic and financial power. Many had believed that a "retreat of the state" and the exposure of the economy to the discipline of the market would cut out arbitrariness of decision-making and the corruption that is inevitably associated with it. What happened instead in the Indian economy during this period of neoliberal structural adjustment was an increase in the levels of corruption, cronyism, and arbitrariness to unprecedented levels. For example, the privatisation exercise became another vehicle of primitive accumulation by private capital as it acquired public assets cheaply. With the wider corruption that increasingly pervaded the system, the "discipline of the market" proved to be a chimera.

6 This chart is based on NSS data. However, data for 1999-2002 used a 30day/365 day mixed recall while the uniform 30 day recall was used in previous years. Data have been made comparable using linking factors from those surveys for which data were available by both recalls.

The increased income inequalities over this period have accentuated certain longer-term structural features of Indian society, whereby more privileged groups have sought to perpetuate and increase their control over limited resources and channels of income generation in the economy. This in turn has involved the effective economic disenfranchisement of large numbers of people, in rural India as well as among the urban poor.[7] These concomitant trends of greater economic and financial centralisation and increased income inequality in turn operated to aggravate various regional, fissiparous and community-based tensions. While the roots of such tensions are obviously complex, these conflicts both emerged from the prevailing material contradictions and contributed to them.

This situation was neither inevitable nor permanent. The economic context of India in 2004 was one in which the need to rethink, modify and revise at least some of the economic strategy of the recent past, was becoming increasingly obvious. In particular, the supposed emphasis on fiscal discipline, which had not been reflected so much in actual declines in the fiscal deficit to GDP ratios, but in compression of important productive public expenditure with high linkage and multiplier effects, required reversal. The neglect of important policy issues with respect to agriculture could not continue. In addition to greater emphasis on public expenditure with high direct and indirect effects on employment generation, addressing the issue of higher resource mobilisation from the rich had become urgent. Further, it was necessary to counter some of the adverse effects of trade liberalisation on employment, apart from more directly addressing the basic structural issues of asset and income inequality and the persistence of low-productivity employment mentioned above, which remained so significant in the Indian economy.

39.8 SUMMARY

This module considers the political economy configurations associated with changing economic policies in the Indian economy, especially "liberalisation". While real national income has grown at a faster rate since the 1980s compared to the earlier decades, there has been less structural change than might have been expected. Some features of economic backwardness persist, such as substantial poverty, a high dependence upon agriculture as the largest employer, and continuing underemployment in the economy.

In Independent India, the persistence of asset and income inequality meant that there were definite limits to the expansion of the market for mass consumption goods in the country, so continuous growth in government spending was essential for the growth of the system. This was effective in the first two decades after Independence, but the interventionist regime that was set up in the 1950s had serious internal contradictions. While the state had to increase its own expenditure, it could not really tax the rich and also became the most important instrument for primary accumulation by the domestic capitalist class. By the mid-1960s, the once-for-all stimulus offered by import substitution was exhausted, and government spending could not increase because of the state's inability to raise adequate resources. In consequence, aggregate growth decelerated leading to the "secular stagnation" of the late-1960s and 1970s.

In the 1980s, the escape from the growth impasse of the earlier period was enabled by an increase in the fiscal stimulus to the economy provided by government spending, financed increasingly by external commercial borrowing. In addition, there was substantial

7 By the middle of 2004, the resentment created by these inequalising processes was already finding electoral expression, in elections to the national parliament as well as to several state assemblies.

liberalisation of imports, especially of capital goods and components for manufacturing, which imparted an impetus to final good production based on newly imported inputs.

The neoliberal economic reforms of the 1990s were based on the notion that greater freedom given to private agents and market functioning would ensure more efficient and more dynamic outcomes. The government's aim was also to restructure production towards areas of international "comparative advantage". By the early years of the current century, therefore, the Indian economy had undergone the following policy changes: very substantial reduction in direct state control in terms of administered prices and regulation of economic activity; privatisation of state assets; reduction of tax rates; cutback of public productive investment as well as certain types of social expenditure; trade liberalisation; financial liberalisation; liberalisation of current account transactions; and a significant degree of capital account liberalisation.

The transition to a higher economic growth trajectory was associated in the 1980s with the fiscal stimulus provided by the state in a context of import liberalisation. In the 1990s, liberalisation was not accompanied by any new dynamism in the commodity-producing sectors of the economy, and so the expansion of services proved to be crucial.

While the neoliberal economic reform programme entailed a changed relationship of government interaction with economy and polity, it was not a "withdrawal of the state" so much as a change in the character of the association. But by 2004 the need to rethink some elements of that strategy were becoming increasingly evident.

39.9 EXERCISES

1) Analyze the contradictions that paralyzed the interventionist regime set up in the 1950s.
2) Why has state spending been so important in sustaining rates of economic growth in the post-indepedence period?
3) Examine the process of economic recovery in the 1980s.
4) Critically assess the impact of liberalization on the Indian Economy.

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Notes

M.A. History

List of Courses

Course Code.	Title of the Course	Credits
MHI-01	Ancient and Medieval Societies	8
MHI-02	Modern World	8
MHI-03	Historiography	8
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MHI-05	History of Indian Economy	8
MHI-06	Evolution of Social Structures in India Through the Ages	8
MHI-07	Religious Thought and Belief in India	8
MHI-08	History of Ecology and Environment: India	8

MHI-05 History of Indian Economy

Block-wise Course Structure

Block-1	:	Historiography, Environment and Economy
Block 2	:	Emergence and Structure of Complex Economy
Block 3	:	Early Medieval Economy and Its Continuities
Block 4	:	Expansion and Growth of Medieval Economy-1
Block 5	:	Expansion and Growth of Medieval Economy-2
Block 6	:	Trade and Markets
Block 7	:	The Rural Economy
Block 8	:	Craft Production, Technological Change and Industrialization