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SUMMARY SHEET

Political Economy

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1 Political Economy: Concept

Political economy offers a framework of analysis that is wider than conventional economics. **Conventional economics** has **markets** at the **center of analysis**. **Society** is seen as an **aggregation of individuals as rational agents maximizing their utility or profit**. In this view of the economy, **markets solve practically all problems** of interest to the economist. These include **production** (namely, what and how much to produce along with the technique of production); **exchange** (or what prices various goods and services should be fetching); **distribution** (or the claims of different 'factors' of production on national income); and **growth** (the rate and pattern of growth of national income). The **state** or its agent, the government of the day, **exists on the sidelines** of the market economy **without playing an essential role** in it.

You may be wondering how political economy is different from this conventional view.

Political economy *is* ***equally concerned with the four basic economic processes*** *just mentioned. However, its* ***approach is different in three fundamental ways****.*

- First, **individuals** in society are first and foremost **members of social classes**. The **social classes relate to the economy in specific ways**, for example as **owners of capital, workers, landlords, peasants, bureaucracy** and so on. The **distribution of economic power among the social classes** and its **impact on policies of the state** are of particular importance to political economists. Individuals are thus **social individuals**, their **activities** and **behaviour** being **conditioned by the social class to which they belong.**
- Secondly, while markets are important as an economic institution, **political economy views the historical, social and political forces underpinning markets to be more fundamental**. It is **these forces that determine the nature and functioning of markets.**
- Finally, the **state** is an **integral** part of the **economy**. Its econo**mic policies mediate the interests of social classes**. Often, there is a **conflict of interests** and the **state** must **deal with them** one way or another.

2 Underdevelopment at the Time of Independence

Indian independence from British rule in **1947 raised hopes of a new India**. **Two and a half centuries of colonial experience** (from c.1700 to 1947) left our **economy in ruins.** Both **agriculture** and **industry** were characterised by **extremely low levels of productivity**. This implied **mass poverty,** widespread **disease** and **ignorance**. Any hope of **improving** the general **standard of living** on a sustained basis rested on the creation of a **firm economic foundation**. This was the **major challenge** before India after independence.

There was a **second challenge** as well. This related to **nation-building** in the vast sub-continent. ***A diverse society deeply divided by language, geography, caste, religion and feudal power structures*** was to be

transformed into a modern democracy based on **universal suffrage** and commitment to a **national constitution.**

Any programme of **economic reconstruction could not rely exclusively on private enterprise** (or market economy) and required an **active role of the state** (or, roughly speaking, the public sector). In fact, the **development of private enterprise** itself depended heavily on the **basic economic foundation** to be **created by the state**. The **programme of economic reconstruction** therefore had to be executed in the context of **a 'mixed' economy** with clearly demarcated areas for the market and the state. Moreover, such an **economic leadership of the state** was to **operate within the political framework of democracy**. This was undoubtedly a **great social experiment** with no parallel in history. It was eagerly awaited by the world divided into two major power blocks led by the United States of America and Soviet Russia.

To **understand the problem of underdevelopment** in India at the time of independence, we need a **historical perspective**. **India's colonial experience** provides that perspective. ***The framework of political economy requires that we look at colonial impact on broad sectors of the economy and social classes.***

Since the eighteenth century, the world economy has been transformed by two major forces: (i) **Industrial Revolution**, and (ii) **colonialism**. These forces combined to divide the world into 'developed' and 'developing' economies.

Industrial Revolution in Western Europe, especially Britain, led to significant **increases in productivity** of **labour** and **prosperity** there. However, the benefits of that revolution **did not spread over to much of Asia, Africa and Latin America because of colonialism**. These regions became especially **impoverished** after they **became colonies**. **Industrial Revolution** and **colonialism** operated in **tandem** because the countries that **prospered** were **imperial powers of Europe** and the countries which were **impoverished** were their **colonies**.

India's colonial experience, primarily under the British, spanned two and a half centuries, from c.1700 to 1947. The period from 1700 to 1857 was marked by the rule by East India Company, while the period from 1858 to 1947 witnessed direct rule by the British Crown. The two sub-periods presented different kinds of British interests in India and therefore economic policies for India. The **trading activities of East India Company**, often involving **underpayment, coercion and violence, damaged local merchants, peasants and weavers**. **Indian agriculture and peasantry** received a major **setback** through land revenue settlements. Both the zamindari and ryotwari systems of land settlement led to a **new class of intermediaries between the tiller and the company**. The **peasantry** was weighed down by **onerous revenue demands** of the company and margins of intermediaries even during famines. Because **revenue payments** had to be made in **cash**, farmers were forced to **shift cultivation** from food crops to **commercial crops**. They became **market-dependent for food grains.**

Under the **combined weight of revenue demands, usury and rack-renting**, peasants were **forced to sell their lands** to merchants and moneylenders or **become tenants** on the estate lands. The simultaneous **decline of rural crafts and urban industry** meant that **crafts persons and industrial workers** joined the **ranks of the rural landless and the poor**. The **intermediaries** emerged as the **new dominant social class. Neither the company nor intermediaries showed any interests in the long-term development of agriculture** through investments.

These **tendencies** only **worsened** during the **rule by the crown**. A shift from company rule to direct rule by the crown became imminent as **British industry required India** to be both a **major source of raw materials** and an **assured market** for British manufactures. These considerations did **force the imperial power to invest** in India in the **selected sectors** of **irrigation** and **transport network to port towns**. As **manpower requirements** of civil and revenue administration grew, **liberal English education was introduced.** However, **increasing commercialization of agriculture** to serve British interests **did not provide any relief to the peasantry** that continued to reel under revenue demands and the combined hold of landlords, merchants and moneylenders on the rural economy. **Labour** employed in **British tea, coffee and rubber plantations** in India lived in **slave-like conditions**.

Indian industry also suffered a **major decline** under the crown rule. **Competition from British manufactures** meant a **decline in demand** for domestic handlooms, metals, tools, glass, paper products and so on. This **ruined millions of artisans and craft industries**. The decline of traditional industries was not compensated by the development of modern industries. As **British capital** was mainly directed to **banking, commerce, shipping and insurance**, **no foundation** was laid for the development of **heavy industries**. There was **no scope for nurturing a native entrepreneurial class**. This phenomenon of decline of traditional industries and the lack of development of modern and heavy industries is known as **de-industrialisation.**

3 Development Thinking

On attaining **independence** India had to reckon with the **challenge** of building from scratch an economy that could promise a **life of security and dignity** for the millions within an acceptable time frame. Leaders of the nationalist movement were aware that freedom from foreign rule was not the ultimate goal. Nationalist writings and regional social reform movements also bear testimony to an understanding of what we today call '**human development**'. The **Gandhian approach** to economic development emphasised **voluntary limitation of wants, sustainable use of natural resources and self-sufficient village communities.** Although this approach did generate some debate before and after independence, the **modernising approach of Nehru**, stressing growth in **commodity production** and **capital stock** found favour with both congress workers and the left-wing politicians. *In terms of **development thinking**, there was a **general consensus** among **all classes** on two issues: (i) that **industrialisation** was the **key to economic growth**, and (ii) that the **state** must take the **lead** to initiating the **process of economic growth**.* Both the **'Bombay Plan'** prepared by leading industrialists even before independence and the **Industrial Policy Resolution of 1948** bore testimony to this **consensus**. **Industry**, unlike agriculture, has the potential of **unlimited expansion of output, employment and productivity**. Its development is imperative for **transferring the huge reservoir of underemployed labour from low productivity agriculture**. On the other hand, **modernisation of agriculture required industrial inputs** such as farm machinery, irrigation and transport equipment and fertilizers. **Active role of the state in industrialisation** was envisaged on two grounds. First, a **native class of industrialists was yet undeveloped**. Secondly, the quantum of **resources required for creating basic industries and infrastructure being huge**, and the **risks** of such large projects being **very high**, private enterprise could not be relied up on to take the lead in industrialisation.

An **important idea that emerged** out of this development thinking was that of **planning**. This **idea** and its **formal acceptance** as a vehicle for carrying out the programme of industrialisation had two major sources. At the political level, **Prime Minister Nehru** was **impressed** by the industrial achievements of socialist planning in **Soviet Union** after the Russian Revolution. The **Industrial Policy Resolution 1948** accepted the idea of planning as a **time-bound process of achieving prespecified targets through prioritised allocation of investments**. The IPR demarcated broad areas of action for the government (public sector), the big private industry and the traditional industry. A **Planning Commission** as a **non-statutory advisory body** was set up with the Prime Minister as the chairman. At the theoretical level, planning was **inspired** by the **experience of post-War reconstruction in Eastern Europe**. The literature that grew out of this experience emphasised the **advantages of coordinated industrial investments**. These included **complementarities, linkages, spread effects and externalities of a major industrialisation programme**. Since markets either did not exist or could not adequately signal these advantages in a backward economy, a plan was thought to be essential. Accordingly, the First Five Year Plan (1951-55) was put together rather hastily based on a meagre data base of the Indian economy. A target rate of growth of national income over the plan period was derived from an estimated saving rate and an estimated capital-output ratio.

A technically more sophisticated plan model was developed by the **physicist turned statistician P.C. Mahalanobis.** This model emphasized a **conscious bias towards heavy industry** and came to be known as the Nehru-Mahalanobis strategy. The **Mahalanobis model** became the **bedrock** of the Second Five Year Plan (1956-60) and all subsequent **plans until the early 1990's**. The final version of the **model divides** the **economy into two sectors**: the **capital goods sector** and the **consumer goods sector.** The model demonstrates how **long-term rate of growth of the economy would be the maximum** if the share of **annual investment going into the capital goods sector increased progressively**. However, the country had the **technical option of importing capital goods** rather than produce them at home. This option was ruled out as there was a **shortage of foreign exchange reserves**. The development of a domestic capital goods industry would then have a double advantage. First, the country could save **on its meagre foreign exchange resources** and secondly, it could reap the **benefits of creating a base for industrial growth**. It is also important to note that **certain critical components** of infrastructure such as power and transport networks **cannot be imported**. They must be **erected domestically**. Such items are known as **'non-tradables'**. Each five-year plan will have separate components for the public and private sectors giving out targets of growth and investment. Thus, a **state-led import-substituting industrialisation strategy** with a **bias towards heavy industry** through five-year plans came to be established in India. ***In the following section, we shall evaluate the career of this system of development planning in India. Our focus, again in the spirit of political economy framework, will be on in sectors, institutions, social classes and the state.***

4 Development Planning

We can identify the **following four major components of the Nehru-Mahalanobis strategy:**

1) The need for a **comprehensive programme of import-substituting industrialisation** to break out of the syndrome of centuries of economic backwardness; 2) A conscious **bias towards heavy industries**; 3) The commanding **role of the state in a 'mixed' economy** with a private sector; and 4) The need to carry out the programme in a **framework of five-year/annual plans**.

Translating the first three strategic choices into implementable plans, a policy framework was needed. First and foremost, the **separate domains of operation** for the **state** (public) sector and the **private** sector were demarcated. For this, the policy instrument of **reservation of industries** for the two sectors was implemented. According to the Industrial Policy Resolution 1956, the **public sector** was to cover, apart from **defence** production, **atomic energy** and **railways**, the core industries of **coal, iron** and **steel**, **shipbuilding, communications**, **heavy machinery** and **heavy electrical**. The **private sector** had an **exclusive schedule of industries**. However, it could enter some areas reserved for the public sector subject to a **system of licensing**. **Small and village industries** also had a list of **items reserved** for them. The scope of industrial licensing was wide. In addition to regulation of entry into particular industries, **licensing covered capacity, production level, product mix and import of technology and capital goods.** There were **wide-ranging import controls**, covering **quantitative restrictions** and **tariffs**, to protect and promote home industry. **Controls on foreign exchange** were also put in place. Planned industrial development thus involved a **plethora of controls**.

The **era of planning** with the **dominant role** for the **public sector** and an **elabourate system of controls**, licensing and permits operated for at least three and a half decades, viz. from **1956 to 1990**. The career of planning must be evaluated against the objectives set out for planning. It is important to take a dispassionate and balanced view of the outcome of Nehru-Mahalanobis strategy. There were **significant achievements** but also **significant failures**. Development planning **helped the economy overcome some constraints** but it was also subject to new constraints.

In the **first half of the twentieth century** Indian economy suffered a **near stagnation** in growth. As compared to this, **real national income (at 1948-49 prices)** grew at an average of **four per cent per annum** during **1950-90.** By itself, this was a significant achievement. A second major achievement was that a **solid foundation for industrial development** was laid during this period. Apart from **basic infrastructure**, key **basic and capital goods industries** were established. As envisaged by the plan strategy, the public sector took the lead role in building this base. The **private sector** achieved a **significant growth** and **diversification** in intermediate and consumer goods industries. This would not have been possible without the foundation laid by the public sector. The **size of the public sector**, measured as its share in gross domestic product (GDP), rose from **ten per cent** in the early **1960's** to **24 per cent** in the early **1990's**. The economy built up **production** and **technological competencies** and **manpower** and **skills** in a host of industrial lines. This implied that the country became **self-reliant** (i.e., not critically dependent on imports) over a **wide range** of industrial goods and services.

There were **two major failures** of planning over a long haul of nearly four decades. First, the **overall rate of economic growth**, respectable though it was historically, **did not translate into an appreciable rise in average standard of living in India**. As against the **overall growth of four per cent per annum**, growth in **per capita income averaged only 1.8 per cent per annum**. This was well below the plan targets. The proximate reason for this was **population growth**. Following a decline in the death rate after independence, **population growth in India averaged 2.1 per cent per annum**. Given the large base of India's population, this amounted to huge additions to the stock of population year after year.

A **second major failure** of development planning in India has been a **very slow growth of employment**. Although Indian **economy grew appreciably** over the four decades under reference, **Indians did not benefit from either employment growth or productivity growth**. The **share of agricultural sector in GDP steadily declined**, but there was **no corresponding decline in the concentration of workforce in agriculture**. The **non-agricultural sectors of the economy**, whose **share in GDP rose sharply**, **did not generate opportunities** of productive employment on a scale necessary to ease pressure on agriculture. This **asymmetry between economic growth and employment** growth holds the key to the **paradox of economic growth** and **persistence of absolute poverty** in India. In particular, **employment growth in manufacturing sector was extremely low**. This is because, contrary to the original intent of Mahalanobis, **traditional and small-scale industries have not been developed.**

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.

The long-run growth of the economy at four per cent mentioned above is an average. It hides significant fluctuations in growth year to year or plan to plan. There were also **unexpected 'shocks'** to the economy induced by **weather, wars, internal emergency and international developments**. The **lowest average growth** occurred in the **Third Plan (1961-66).** In this period India had **wars** with China and Pakistan, apart from **famines**. This led to the **suspension of planning** for three consecutive years (1966-69). The **Fourth Plan** (1969-74) saw **India's second war with Pakistan**, the **Bangladesh war** and the **First Oil Shock of 1973.** The **Fifth Plan** (1974-79) witnessed declaration of **internal emergency** and the **Second Oil Shock**. The economy posted **negative growth in 1979-80.**

It would, however, be **wrong to attribute the failures of planning to these unanticipated shocks**. There were **specific constraints** on economic growth that were operating and these were well known to planners. There were **four major constraints**: **food, savings, foreign exchange and demand**. They were also interrelated. Overcoming them required a policy framework beyond controls and licensing, institutional changes and political mobilisation, apart from dealing with class interests and conflicts. We must consider the constraints briefly.

A **growing output of food grains is absolutely crucial** in a situation of **growing population** and **additional purchasing power** that plan expenditure generates. Yet a **proliferation of small holdings**, **traditional technologie**s of farm production under mainly **rain-fed conditions** and the specific characteristics of agrarian markets meant that food grain output was not elastic with respect to demand. The consequent

rise in food prices fuels general inflation. In the 1950's and early 1960's India was **dependent on food imports**. This was not a long-term solution.

To deal with the institutional aspects of **agricultural backwardness**, **land reforms** were vigorously debated as a means to **increase productivity and production** in agriculture. However, comprehensive land reforms, especially a **radical redistribution of land**, were a **non-starter** given that the ***Indian state was dominated by landed interests.*** Consequently, **India had only token land reforms** in terms of abolition of intermediaries and legal protection of tenants. A **way-out to increased food production** without radical land reforms was found in **new agricultural technology**. Better known as **Green Revolution technology**, this involved **short-duration high yielding varieties** of seeds of rice and wheat, **controlled application of water** through irrigation and **chemical fertilizer**. This **yield-raising technology** was initially adopted in the **more favourable regions of Punjab, Western Uttar Pradesh and deltaic regions** and took a long time to diffuse to other regions. This **technology was combined with a policy of food procurement and buffer stocks, along with minimum support prices**. This policy did succeed in achieving sel**f-sufficiency in food grains** but ***led to other contradictions in terms of regional and social inequalities***, **land degradation** due to **intensive cropping** and **decline of water tables** in several regions following extensive use of ground water for irrigation. ***The agricultural policy also started a conflict of interest between industrialists and large farmers whereby the relative prices of agricultural commodities and manufacturing, known as intersectoral terms of trade, became a major political issue.***

A **second constraint** related to **shortage of savings**. The **huge investment demands for new industrial projects** coupled with a **low rate of saving** in the economy and **limited possibility of foreign investment** meant that the **plans depended heavily on budget deficits**. In the context of low elasticity of supply of wage goods, especially food, and **long gestations periods of industrial projects**, this led to high rates of price inflation. The **burden of taxation inevitably fell on indirect taxes**. This contributed among other things to **increased inequality**.

Thirdly, **shortage of foreign exchange resources** meant **limited ability to import critical capital equipment**. The **cost of imports also was high** because of a **fall in the exchange rate**. At the same time, **Indian exports** were **not cost competitive** in the international markets. All these cumulated into an **endemic pressure on account of balance of payments**.

Finally, because of the various mechanisms operating to sustain **mass poverty in the country**, the economy has faced a **persistent problem of insufficiency of domestic demand**. This is despite the fact that India has a potentially huge home market given the size of her population. All these constraints operated to ensure that **economic growth and development** in the era of planning **was low and halting**. Planning could not get over the structural problems of poverty and unemployment.

This is despite some radical measures such as **nationalisation of scheduled commercial banks** in **1969** by Indira Gandhi. Bank nationalisation did achieve **expansion of banking facilities** throughout the length and breadth of the country, besides **directing credit to agriculture** and household and small industry. Such **measures were not by themselves sufficient to make a dent on mass poverty**. In fact, by the **late 1960's** it became clear that **two decades of planned economic development had not improved the general levels of living of people**. This was because **planning had not delivered on expansion of productive employment** for labour at large. Indira Gandhi's subsequent call for **GaribiHatao** (Banish Poverty) took a turn towards **various poverty alleviation programmes** without reorienting industrialisation for growth of productive employment.

5 The Regime of Economic Liberalisation

The **year 1991** marks an **important landmark** in the history of Indian economy. For in this year, the country adopted **comprehensive macro-economic reforms**. The reforms were to replace the Nehru-Mahalanobis strategy with policies aimed at **reducing the role of the state** including the public sector, **dismantling of**

controls, **opening up the economy** to foreign trade, investment and finance. We survey the background, the process and the general outcome of this ongoing programme of economic liberalisation.

The **switch to a regime of economic liberalisation** was driven by a **crisis of balance of payments. Government finances were in a bad shape** thanks to **regular fiscal deficits.** The country's **foreign exchange resources** were at a record **low**. Early 1991, foreign reserves were not adequate to finance even a month of imports. **Inflation was high**. There was **political instability** with frequent changes in government. Internationally, the **turbulent situation** in the **Middle East** and the **collapse of the USSR** meant that the **remittances** from non-resident Indians **declined sharply** and the panic-stricken **NRIs** actually sought to **withdraw their foreign currency deposits** in India, making our payments position even more precarious. Driven by this **acute payments crisis**, India contracted a huge **loan of 3.6 billion SDR** (Special Drawing Rights, an international reserve asset) from the International Monetary Fund (**IMF**) in **June 1991**. However, the loan came with the **condition** that India, as loan recipient, would carry out **comprehensive economic reforms**.

*There was also an important **shift in the intellectual climate worldwide** at the time.* The **new approach to managing the world economies**, including the developing countries, recommended an **enlarged role for the market (as against the state)** and **deregulation of foreign trade and financial markets**. Promoted by the World Bank and the IMF, the approach came to be known as '**Washington Consensus**'. It **replaced the older 'development consensus' of the 1950's** which favoured pursuit of **autonomous industrialisation strategies** including **protection of domestic industry** by the developing countries. The change in the intellectual climate was also occasioned by the **success stories of several East Asian countries.** ***Liberal economic policies followed earlier in the 1980's by President Reagan in the US and Prime Minister Thatcher in Britain lent political support to the shift. Not in the least, the decline of Keynesian macro-economics and its replacement by orthodoxy in the academia and the policies of central banks in the West were an influence.*** Meanwhile, there was a **tremendous growth in global finance capital** which came to **dominate trade in goods, services and investment**. ***Multinational banks and corporations controlling the global finance were mounting pressure on all economies to open up their markets to it.***

The **programme of liberalisation adopted by India** in 1991 had two major components: (1) **stabilisation** and (2) **structural adjustment**. Both are based on the conviction that the **economy works best** when it is **left to market forces with minimal state interference**.

The **programme of stabilisation**, recommended by the **IMF**, seeks to **stabilise prices, budget and balance of payments deficits and exchange rates** in the short run. There are **two instruments** for achieving **stabilisation**. The **first is deflation**, or **reduction of aggregate demand**, particularly through **reduction in government expenditure. Deflation** is supposed to **improve balance of payments** through r**educed imports**. Deflation would **bring down the price level** and therefore take the exchange rate to a realistic level. The **second component** is **monetary policy**. A **tight monetary policy** and the resulting **high interest rates** would **attract private capital flows** into the economy.

Structural adjustment, the other major component of the liberalisation programme, is recommended by the **World Bank**. It is focused on **long-run growth and efficiency**. According to this, a developing country will place itself on to a **high and efficient growth path** when it **aligns domestic prices with international prices** and its resources shift to private uses and exports. On this belief, the Bank would recommend **complete liberalisation** of **foreign trade in goods, investment, technology and finance**. In addition, it recommends **deregulation** and **privatisation** in the domestic economy.

The Fund-Bank prescriptions are thus a complete reversal of 'development consensus' and the Nehru-Mahalanobis strategy.

The Fund-Bank package of reforms would obviously affect the interests of certain social classes while they may damage the interests of other classes. Which section of India should bear the burden of

adjustment? This, of course, was a **hard political choice**. While India accepted the package in full, it had to adopt a particular sequencing of reforms that would meet with least political resistance. The **external sector, domestic private industry and financial sector were favoured for reforms**. **Agriculture and the public sector have hardly been touched so far.**

On the **external front**, major reforms have been implemented. Practically **all restrictions on trade have been removed**. Peak **customs duties have been reduced**. **Capital flows** of both direct and portfolio types have been **freed**. The **exchange rate** is more or less **market determined**.

The **new industrial policy of 1991** brought out **far-reaching changes**. **Industrial licensing** was effectively **abolished** and **limits on investment were softened** through amendments to Monopolies and Restrictive Trade Practices (MRTP) Act. The new policy **permits mergers and acquisitions** among companies.

Reforms in the financial sector spanned banking, government securities market and deficit financing following the recommendations of the **Committee of the Financial System**, better known as the **Narasimham Committee**. To **improve profitability** of banks, **strict limits were placed on government borrowing from banks**. The policy envisaged **reduction in the non-performing assets** (NPAs), **improvement of capital adequacy** of banks and **reduction** in cash reserve ratio (**CRR**) and statutory liquidity ratio (**SLR**).

The **post-reform**, especially **since 1996-97** saw a **clear acceleration in the growth** of Indian economy. The same period saw a **striking growth of the tertiary sector**, while **agriculture** posted a **steady decline** as a share of GDP. **Growth of employment remains dismal**. **Deflationary policy** has meant that **government expenditure**, especially on **capital account**, has **declined**. This has **especially affected agriculture** and created a **scenario of agrarian distress**. There was a **spate of farmer suicides** all over the country and **traditional, labour-intensive industries** such as handlooms have **suffered**. **Poverty ratio** remained as **high** as 37 per cent in 2004-05. Despite all the focus of reforms, the **share of secondary sector**, in particular manufacturing, in GDP **has not shown a marked growth**. The **service sector growth**, while it has been **impressive**, has been **concentrated on selected sub-sectors** such as **financial services, information technology, real estate and public administration** with limited opportunities for ordinary labour for productive employment. The **foreign exchange reserves**, thanks to IT exports and large inflows of short term capital, have **improved**. These gains have been lost, however, after the **global economic crisis** since **2008**. This period has seen again a stress **on balance of payments**, **high inflation** combined with a **tight monetary policy** and **slippages on fiscal deficit targets**. A **paradox of the reform process** for a long time was that **agriculture sector** and the **public sector** remain **untouched**, **excepting the policy of disinvestment** in public sector enterprises. The **long-term objective**s of economic development – **elimination of structural poverty, unemployment and inequality – remain unfulfilled** after both the major shifts in economic policy in independent India.

Even so, the very process of economic reforms faced a political constraint. The decline of hegemonic national political parties and the emergence of coalitional politics after the 1980's has led to a lack of consensus on the pace and pattern of economic reforms. According to the dominant view, more through-going reforms are needed to realise the full growth potential of the Indian economy.

6 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 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 technolog**y, 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**.

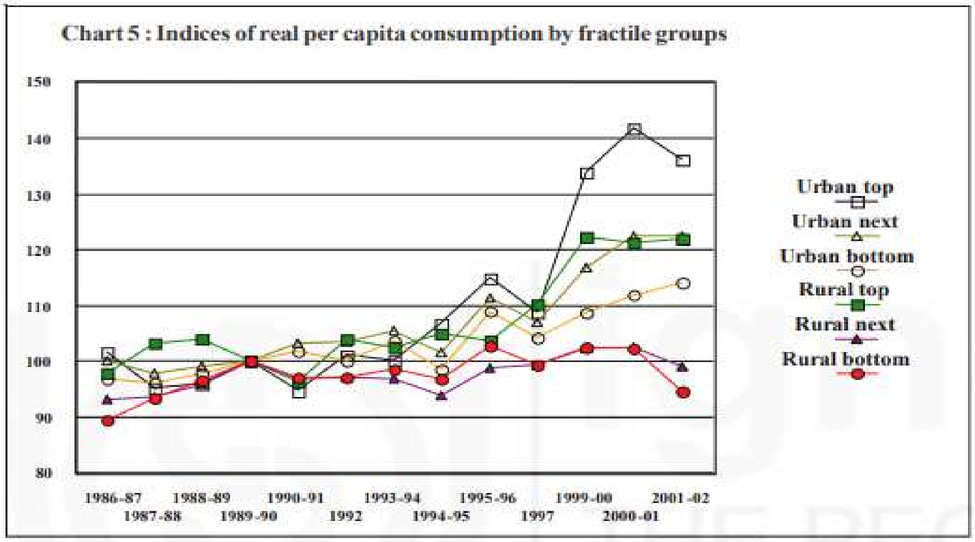
In addition, there was **support for economic liberalisation from other quarters:** from **new businessmen** involved in what were essentially "parallel market" transactions; a section of the **top bureaucracy**; and perhaps more significantly, the **large and politically powerful urban middle classes**, 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 importance 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 the following chart suggests, 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.**

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**.



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

The **increased income inequalities** over this period have **accentuated certain longerterm 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. 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 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.