

## Indian Economic & Political History

• What is the great divergence?

The great divergence refers to the major social and economic shift that occurred around the 18<sup>th</sup> and 19<sup>th</sup> centuries, wherein several countries around the world experienced a reversal of fortunes - a few for the better and most of the others for worse.

Countries that emerged prosperous from the great divergence include the Western European nations, most of which were colonial rulers, former colonies like and the United States, Australia, etc. On the other hand countries like India and China, which were the richest until as late as the 1800's, both in terms of population and wealth lost out on their economic prosperity as a result of the great divergence and the repercussions are still visible in form of the considerable difference b/w the PCI of these countries and their western counterparts.

India was a colony of the British empire, while China, although never colony, was a sub-ordinate to the Western powers. Pre-colonisation or prior to the emergence of the European nations, both these countries enjoyed undisputed economic dominance, while their soon-to-be masters were comparatively much poorer. The Industrial Revolution of the 19<sup>th</sup> century, which started in England played the role of game changer. On one hand Industrialisation coupled with major positive institutional

reform drove economic growth in the colonial ~~so~~ rulers' countries and in a select few of their colonies, on the other, different levels of Industrialisation led to the great divergence, which ultimately saw the economic downfall of many countries, most of which were European colonies.

### STAGES OF INDIAN COLONISATION

→ Mughal empire collapsed after the death of Aurangzeb.

→ Rise of regional powers : Nawabs of Awadh & Bengal, Marathas in West, Nizam in the South. Dismantling of unity.

→ EIC establishes supremacy after Plassey : 1757.

Buxar : 1764

Anglo - Mysore war : 1767 - 99.

Anglo - Maratha : 1775 - 1818.

Anglo - Sikh : 1845 - 49.

\* Extractive institutions in the agrarian economy existed before colonisation. Land revenue was the major channel of large - scale exploitation.

After 1757 → EIC got diwani rights in Bengal → they could raise land revenue

1<sup>st</sup> stage of colonisation →

1757 - 1858 : Company rule

1858 - 1947 : Crown / Government rule

- Since the Zamindars were not benefitting from the tax collection system, there was a massive sell-out of Diwani rights by them to random people like merchants & Bankers who had no connection with the land and thus the problem became complicated. [The finance people were losing out on money since EIC had now taken over the land as well]
- To curb corruption within the company employees, they decided to experiment with Land Reforms Act. (property rights)
- There were no checks & balances on the power of the Zamindars
- Deflation leads to an increase in burden of fixed amount. Prices fell. This benefitted the EIC since they were continuously extracting a fixed amount.
- This happened in Bengal and continued for 150 years. These states have more or less not been able to recover even today.
- Setting up of extractive institutions was both intentional & unintentional

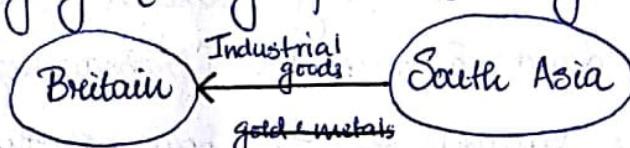
A commercial entity had suddenly become political. They had monopoly power. They ↑ed the selling price of Indian goods exponentially. While the cost price was technically zero. The company did not have to pay anything.

- \* Balance of Trade : India has to sell something to the U.S and earn U.S. dollars to maintain balance of trade  
Two ways: Sell goods / sell assets

Britain got precious metals from Spain, Portugal, etc who in turn got them from South American colonies.

Mercantilism : Economic doctrine used to define national wealth wherein wealth was equal to the total stock of precious metals.

The rise in imports from India to Britain rose significantly more than the British exports to India. Moreover they were paying nothing for Indian goods.



unidirectional flow

→ TRIBUTE'

- ↖ Luxury products consumed by the former aristocratic class
- Urban industries in India fell.
  - Disruption of internal Indian trade.

Textile was the most important industrial good in the first half

of the 19<sup>th</sup> century.

They were not looking for markets in India.

India was now giving away its manufactured goods for free.

Central pivot: land Revenue

By the end of it, extractive institutions had set in.

2<sup>nd</sup> phase of Colonisation (1857-1947 - after the Sepoy Uprising)

- ① 1858: EIC lost its monopoly in trade. [Competitors in Britain were unhappy].
- ② Adam Smith: Critique of monopoly and mercantilism. Champion of free trade.
- ③ Industrialisation had unfolded. They could sell their textiles at much cheaper prices in the world market.

Tariff on Indian goods was increased steadily b/w 1797-1814. They bought this time to experiment and generalised its new technology.

Now Britain needed its colonies for market. America had extremely protective trade policies.

↓  
Now de-industrialization starts in India.

Now it is exporting raw materials.

↳ Colonial pattern of trade.

Market for Indian goods is gone.

They needed to find a commodity that they could carry to England as tribute.

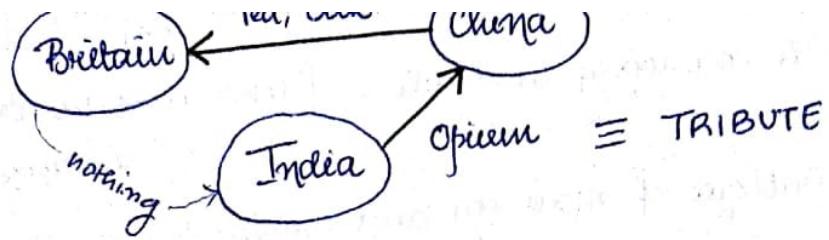
↓ this was

Opium: probably the largest state-sponsored drug trafficking.

↳ Produce in India

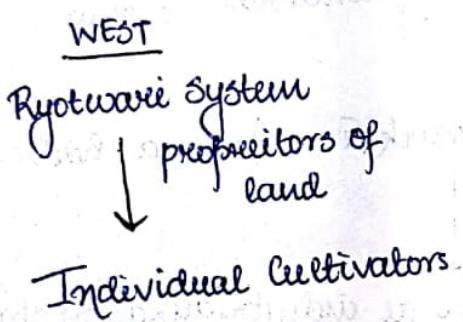
↳ Sell to China in exchange for tea and silk.

[The BOP with China was maintained using Indian Opium in huge quantities].



Q. What is the notion of tribute? How was it extracted? Explain it with reference to existing trade policies, at that time.

→ The fate of different parts of the country depended on the time they came under the British rule.



EAST  
Zamindari System



By the time they moved to the West, the EIC had gained administrative control. Earlier, they were just a company and thus could not manage individual cultivators.

\* Whenever you get property rights over something → it becomes a commodity

↓  
It can be bought & sold.

: Now land became a commodity. The land market developed more aggressively in the western part owing to the greater number of land owners.  
Cultivators > Lamjindare.

Before the modern era, the wealth of a monarchy was the number of people it commanded.

however, the contract was short period. Their objective was to improve the institutions, but their greed for land revenue led them to undermine them.

↓ [high levels]

Drove a large section to sell their land. This led to polarisation in terms of affluence. More prominent in Western region.

Mahalwari System: North-Western region.

90-100 years  
massive change → M

They were trying to retain the existing systems.

They were much more cautious this time.

Rent burden fell on the entire village.

Again high rents led to inequality. Small farmers sold off their lands.

Therefore, India emerged as an independent nation with highest levels of rural asset inequality.

In the 2<sup>nd</sup> stage: Commercialization of Indian agriculture.

However, this was forced & artificial commercialization.

↓ higher rent obligations

Debt cycle.

Concentration Ratio  $\equiv$  measure of inequality [0-1]

more unequal.

Inequality persisted in the agrarian institutions even after independence.

Asset inequality prevents access from financial formal credit market  
and Reforms after Independence was a failure.

[Find out what the other Asian countries did  
with land reforms before their industrial  
take-off].

EIC was dissolved after it lost monopoly with  
trade. It had already lost its commercial  
character.

3<sup>rd</sup> phase of Colonisation: Crown Rule

Revenue of land revenue ↓

↓  
Trade had gone ↑ (greater commerciali-  
zation)

British wanted some  
people to like them in  
order to rule. They needed  
political allies. They chose the  
Zamindars. The revenue share  
of the crown ↓ed. Zamindars  
became landlords → wealthy.  
However, rural inequality had  
already kicked in.

↓  
British Capital goods now find a  
market in India. Infrastructure in  
India is booming.

↓  
Britain's industrial production → huge profit

Britain had made way too much profits. It had to invest in the remotest of places.

→ chunk goes to U.S., Canada, etc. Some foreign investments came to India.

↓  
Fantastic expansion of Railways \*\*.  
Britishers were guaranteed a 5% rate of return on this investment. Most expansive and expensive railway construction model in the world.

\*\* They needed infrastructure to move their troops and raw materials & capital goods. It gave them control over territory.

These institutions that started springing up from 1830's was to create a unified national economy.

↓  
one nation - One currency

Thuggees

↓  
Thugs / bandits in Eastern India.

Pindaris

↓  
Mercenaries in Western India who became bandits after the mutiny.

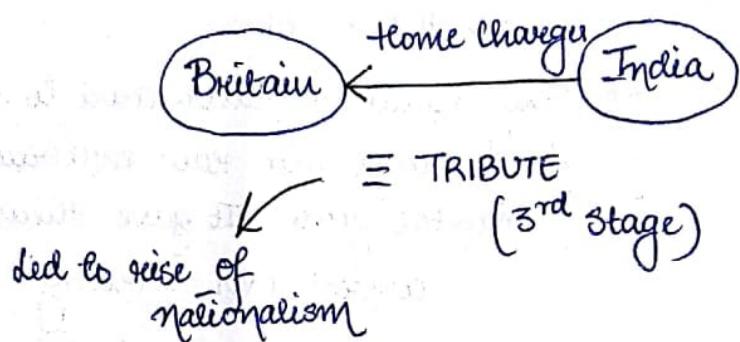
major law and order problem.

Universities came up. However, no focus on primary education. No scientific institutions. Only humanities. They wanted the populace to learn English, that's it.

That is why we had to set up costly institutes like IIT & IIM, because there were none.

limited liability: Your share of loss only depends on your share of the company.

Engineering was never allowed to flourish. Since, India became the destination for machine goods, never a producer / manufacturer



Under the facade that they are protecting India, they kept on charging Indians.

Britishers argued that they were providing services for which they were charging us.

The nationalists argued that the taxes we are paying is getting drained to England and is not adding to the Indian Economy.

India - Britain relation

1<sup>st</sup> stage → EIC

3<sup>rd</sup>

Crown

Trade Pattern

Industrial goods from India taken

Lot of goods were coming in

Form of tribute

Manufactured goods

Opium to China

Home charges

Effect on industries

Textile industry still there

Deindustrialization starts

Deindustrialization complete Modern industries set up

Decline of traditional industries & rise of modern industries happened simultaneously since the 1850s.

Home charges were a bunch of payments made by Indians as per government orders.

Land as a revenue source had collapsed:

- Growth of commerce and arts
- They wanted the Zamindars as allies
- Influx of machine and capital goods.

### Modern Industries

- Unified economy
- Uniform currency
- Modern education

Requires

After 1813, when EIC lost monopoly, dozens of enterprises entered India to send up modern firms. They did not bring in capital.

→ Economic critic of the British

This was Europeans entering India.

Extremists

Moderates

Gandhian

These firms remained important till the 1950s.

Home charges was seen as a massive outflow of what could've been invested in India.

These were the companies that shifted opium to China. They were called Agency houses.

- They acted as agents for particular firm in London.
- Business agents for others against a fee.

Jagat Seth was the official Banker to the Nawab of Bengal.

↳ Probably - the richest banker in the world.

Banians: Beginning of the coming back of Indians in the modern business. The agency firms supplied the scarce entrepreneurial skills.

Business in Calcutta collapsed twice in the 1820s & 1830s.

Indigenous Bengali businessmen receded from the scene.

{ This is when the Marwaris entered the scene.

In Bombay, the Parsis were the pioneers.

In Ahmedabad, the Hindus and Jains (localites) since British interference was lesser.

Skewed development.

In Britain, the common people with good commercial understanding commercialized their industries.

① Why is occupational background important?

(a) In industries, profits do not come instantaneously.

In order to become an industrialist, you need to have longer term vision.

(b) Trading and merchant background on the other hand is much more short term and there might be a tendency to move capital from industry to financial activities for quick profits.

② Did community & religion play an important in Indian industrialization?

Migrant communities (minority) were often found to be trading

more successful in business than the host communities.

Jute became important because it was the packing material for all industrialised goods.

∴ the modern industries were started by the Europeans & controlled by the Europeans. Kolkata had become the sink for foreign capital.

Indians were present significantly in the small collieries since the coal mining technology was excessively simple.

The English popularised tea across the world, except the U.S.

\*. Boston Tea Party.

Lord Cornwallis was the army general who lost America, was sent to Bengal and came up with the idea of Permanent Settlement.

- The locals had no role to play, even though Calcutta had become the centre of modern industries.
- Marwaris: their role as merchants & bankers declined, thereby in search of business they came to Calcutta.
  - They became agents to the Europeans. They made everything available to the Europeans.
- The Sotts wouldn't allow the Marwaris to enter the industry. The Marwaris capitalised during WWI.
- G.D. Birla defied European monopoly and set up his jute mill. By the 1930s, the Marwaris had conquered the Eastern industries and could easily buy these industries from the British.

B. In Bombay, the reason was much more muted. They needed Indians to step up and sustain business, since this region was revenue-deficit. The Parsis responded.

Parsis took part in opium trade. Here the profits went to the Indians. Bengal opium profits went completely to the British.

Cotton industries grew in Bombay & Surat, using British technology and machinery.

#### RISE OF MODERN INDUSTRIES - TIMELINE

EIC under pressure from private European traders



1813: EIC loses monopoly, traders enter



They brought in no capital. Source of finance - deposits of company servants. They gain reputation, they receive loans from London and raise Indian Capital. Act as Banks.



Named Agency houses. Act as business agents for others against a fee. Often agents of a firm in London.



China trade and indigo trade



Assisted by Indian agents: banians. Comeback of Indians in modern business.

## The Calcutta Story

All modern industries were controlled by the Europeans.

Jute, Tea plantations, major collieries.

[though coal fires were mainly run by the Indians]

localities had no role to play, albeit

Calcutta had become the sink of foreign capital. Complete profits went to the British.



Moreover [with their expertise in networking] came in search of business, made themselves indispensable to the British and became a critical component of business in Calcutta.



Operated in trading and amassed capital in trade, finance and speculation.



There was widespread discrimination and hostility towards them. They capitalised after WWI.

- Established new jute mills and collieries.

[G.D. Birla was the pioneer]

- Steady purchases of shares in European companies.

Forced their way into boardrooms & took over firms.



Bitter business fight coloured by racism.

less innovation & growth. Local / Indigenous communities : competitors.

## The Bombay narrative

Colonized later. Systems were comparatively relaxed and racism muted.

↓  
Revenue-deficit area. Dependence on merchants and Bankers necessary to sustain business.

↓  
Replaced Surat as main port. Parsis in Surat responded. Took part in opium trade.

Were economically more independent and prosperous and apparently westernised.

Maintained loyalty.

↓

Malwa opium was grown indigenously in a princely state; controlled by Indian merchants and shifted to China and they earned profits.

↓

Parsis started off as traders in opium & raw cotton, became formal brokers, diversified into cotton industry.

↓

Their sons learned at British firms. Racism or discrimination was non-existent and cotton industry grew in Bombay & Surat with Parsis at the helm.

↳

→ Bombay benefitted due to larger ethnic and communal diversity; dynamic atmosphere; healthy competition. Communities: collaborators.



Industries showed greater flexibility towards innovation and changing conditions.

The less dramatic story of Ahmedabad

It already existed for several centuries.  
One of the theatres of long-drawn Maratha-Mughal wars. Merchants & traders started leaving Ahmedabad.



Stability provided by the British administration brought them back. At the same time, that Paria set up in Bombay, textile industry flourished; Manchester of India.



Textile industrialists came from traditional banking backgrounds. System depended on trust. Localites trusted them. Then they used to finance their own needs. They paid back interest + commission (from sales proceeds)



No British interference. These were Indians (mainly Hindus) setting up businesses.

C	B	A
Occupa- tional Background	Tradew, Shipbuilders	Financial
Attitude of colonial state	Hostile attitude towards Marwars, Competition b/w communities.	Relatively much more positive, collaborative
Minority status & religious background.		British were not dominant
Bombay		Conflict of interest - competition with the British industry.
		PRODUCT COMPETITION
	Parsis - initially a majority in Bombay, owners of land. Became a minority later, but were already top players in industries.	Majority community dominates.
	Competition b/w Manchester vs B.A. ↓ Factory Act & import duties → threat to Indian industries (no protection) [however, the main threat came from Japanese textiles, whose technology was more superior & dominated Asian markets]	Rise of nationalist movement ↓

Dadabhai Naoroji : 'Poverty and un-British rule in India'.

*daissez faire* : hands-off attitude

Industries require protection in their infancy stage because they do not have economies of scale.

PnB set up in 1890's as a swadhi bank. Entire capital was funded in by Indians.

Phases of Industrialisation

↳ 1<sup>st</sup> phase: 1850 - 1914

2<sup>nd</sup> phase: India lacks machine goods industry.

Excess production, excess demand

↳ depreciation of machinery

↳ But cannot import from England (WWI)

↳ Britishers realised that they need to encourage manufacturing industry.

[Tata Steel set up in 1907, but there was no encouragement]

3<sup>rd</sup> phase: Interwar Period: Britishers under constant criticism do something for Indian industries. Because of this minimal protection, there is large-scale diversification.

↳ Indians have become capital-demand.

4<sup>th</sup> phase: Excess demand. Machines running 24x7. Depreciation of machines. nothing being produced

The 2 lessons from the WW → Focus on heavy industries after independence.

### Indian Planning

Critique of Laissez Faire → lessons from WW

Private industrialists requested

Govt. to take charge of planning

[Unique to India].

Soviet Russia was apparently immune to the Great depression.

Rapid development during those years. They followed 5-year plans under communist regime.

World became plan-conscious.

USA and Germany adopted the Planning Policy.  
They grew rapidly under Roosevelt and Hitler.

Economic Advisory Council in Britain. Britain now defected from Laissez-Faire and thought about bringing in Planning in India.

(B)  
ASSOCHAM, FICCI (I)

They developed independently because European and Indian interest were at loggerheads.

Import - substitution policy: Substitute imports with domestic production (G.D. Birla)

National Planning Commission (Boat at helm)

Conflicts with Gandhian ideology - oppose machines & industrialisation. They take away jobs. Violent towards approach in people.

Department of Planning & Development set

up by the British and they invited leading businessmen. Document: Bombay Plan, 1944.

[Private sector has come up with a national strategy for 15 years, even before independence]

## IMPACT OF PLANNING ON ECONOMIC GROWTH

Views within Congress Party post independence

Nehru's Support for  
Planning to  
modernise India

Close control over  
investment

Gandhian View  
Village Centric

Pro-market view  
By Sardar Patel

No control  
Create wealth,  
dressing industry  
flourish.

Free-Market form

the Congress Party

48' : Gandhi is assassinated. His power / influence ↓.

50' : Sardar Patel passes away. Free-market policies diminish within

Why Planning is necessary in an agrarian economy like India?

- Direct investment towards manufacturing.
- Direct investment to heavy industry.
- Prevent investment in non-priority sectors.
- Deficiency of capital necessitated Planning.
- Reduce location concentration & holding concentration.

Focus on Capital goods & Social Services to become self-reliant as  
soon as possible.

The need to industrialize.

heavy machinery that can  
produce more goods.

If you do not  
invest here, you will  
perpetually be

Presence of strong institutions boosts the confidence of the economy.

Socialist Economies

→ Industry completely controlled by govt.

Mixed Economies

Private Sector free to invest.

### India

Private Sector subject to extensive

Planning.

If Govt. is regulating the Pvt. industry

- (1) Protection from outsiders. Barriers to imports.
- (2) Barriers to new entrants.
- (3) Ensuring economic efficiency.

Such stringent licensing norms were needed to ensure investing efficiency.

### PROBLEMS

→ Instead of decreasing it, holding concentration Tech.

→ Barriers to entrepreneurship.

Argument for taxing consumption: If people consume, tax revenue ↑.

If they don't, they save.  
↑ in capital for further investing.

Argument for taxing income: Ready resources available with govt. You can't control the savings of a household.

Estate duty - Tax on inherited property.  
Wealth tax - Tax on the wealth one held.

Because of focus on self-reliance, there was not much emphasis on exports.

### NEHRU & INDIAN PLANNING

Vocalists of planning: Nehru, Ranade, M. Visvesvarayya.

↳ need to transform an agrarian economy into an industrial one.

National Planning Committee: Bose - 1937

Chairman: Nehru

#### Nehruvian Ideologies

- Greatly influenced by Marx's philosophy of history
- Admired the Soviet experience in transforming a primitive agrarian economy into a modern industrial one.
- Soviet methods not fully applicable to India.  
Greater merit in following a gradualist path, which takes more time to achieve similar results, but at minimal social costs of growth.
- Believed in the combination of both public and private institutional changes to bring structural reforms.
- Methods of economic management: top-down & bottom-up approaches.

Components of Nehruvian model from the 1950s to 1980s.

- Public sector was to spearhead industrialization. Focus on capital goods production to accelerate self-reliance and provide the foundation for further industrialization.
- Resources / Capital would come from a Progressive Tax system.
- Resources for economic development were to come from internal sources.
- Agriculture and small cottage industries were responsible for large-scale employment.
- Emphasis on science & technology to modernise the economy.
- Policy of land reforms to diminish holding concentration.
- Considerable measure of local self-governance → Panchayati Raj.

How did Nehru get his ideas accepted by the entire country?

1. No other coherent alternative available. Gandhians were for the people and wanted village - centric development, but were not quite clear regarding the agenda. Sardar Vallabhai Patel advocated free-market policies, wherein he called for investments to flourish.

With the assassination of Gandhiji & death of Sardar Patel, their ideologies lost vehement support, while Nehru's emphasis on 'non-alignment' and 'planning' looked like a credible prospect.

2. The agents of social change or 'cadres' for Nehru, became the members of superior civil service / bureaucracy. They were the least parochial and best educated.

among most social groups and they believed in change which could be steered from the above by the competent and enlightened ones.

Q. What according to Chakravarty have been the merits and demerits of Nehru's specific choice?

Chakravarty presents both sides to Nehru's specific choice of trusting the Indian bureaucracy to be the agent of social change.

The successes include:

- ✓ Creation of diversified industrial structure
- ✓ Diffusion of scientific & technological knowledge across a broad spectrum.
- ✓ Maintenance of GDP growth rate at 4-5% for over 40 years.
- ✓ Steady increase in saving rates
- ✓ Prevention of famines
- ✓ Avoidance of violent swings in policy regimes.

The major areas of under-achievement include:

- Low literacy levels
- Inefficient secondary school system
- Insufficient provision of health-care
- Growth of unemployment
- Prevalence of caste and sex-based discrimination
- Unchecked powers on the bureaucracy handed them greater power & people's participation & mobilization of local resources via the community

development programmes became casualties in the process.

→ Failure to push land reforms beyond the first stage of abolishing intermediary tenures.

q. Why was the Shahab nobis committee not able to resolve their issues.

Several factors prevented adequate formulation and implementation of any redistributive strategy of growth.

↳ Chinese Border war

Armed conflict with Pakistan

2 severe droughts

Consequences:

- Desire to prevent inflation led to drastic cuts in plan investment in major industrial sectors.
- In many industries, significant investment had already taken place and these cuts led to capacity surplus.
- Pressing need to reduce the magnitude of grain imports led to the adoption of the green revolution.

q. Chakravarty's critique of the 'Green Revolution'.



Profound adverse effects on distribution of income & balance of power in rural & semi-rural areas.

Focus was only on increased cereal production for which international technology was deployed.

While wheat output grew, rice & other coarse grains lagged behind.

Land reform was worst hit as only large-sized farms derived the maximum benefit at the expense of public money.

Chakravarty argues for the lack of 'import substitution' strategy, which could've helped in export expansion. However, this required a more imaginative long-term policy framework.

Q. What is the author's take on Nehru being a socialist?

The author believes that Nehru did not view socialism as being the state ownership of means of production or institutionalisation of central planning. He viewed it as a way of conflict resolution in a society that was plagued with divisive forces, as a scientific approach to social & economic problems.

The author feels that Nehru sought a peaceful transition towards a more human social & economic order, which necessitated growth of productive forces to sustain itself. Nehru was a statesman-planner, who felt that there is no alternative to socialism, but also aware of difficulties it would pose to a economically backward country like ours.

Developing countries were discouraged from exporting agricultural goods and commodities since these products will compete in the markets with goods from the colonies and get very low returns.

Social control over banking - control on where the banks lent

### LIBERALIZATION IN THE EIGHTIES

Poverty alleviation = 'GAREEBI HATAO', when she returned to power in 1971.

Why was there a direct attack on poverty?

- In 50-60s, policymakers felt that high growth rates would ensure poverty alleviation.
- In 70s, it was clear that both land & holding concentrations were ↑ing.

Direct attack:

→ Welfare schemes

→ Heavy subsidies

→ These coupled with heavy industrial investment led to capital deficiency. Growth rates ↓.

Efficiency of investment in the public sector was low.

Why were agricultural growth rates ↑ in 70's?

↳ 'Green Revolution slide'

Despite ↑ agricultural growth, poverty persisted.  
↳ Failure of land Reforms. In most countries,  
people had direct control  
over land.

absence of complementary  
reform(s) ↓  
→ access to good agricultural  
high dependence on  
monsoons made these more → → ↑ crop insurance  
important → Protection measures  
→ Proper enforcement.

China → Communist / Marxist Revolution. Elimination of a particular  
class of land owners and distribution among  
the peasants.

Taiwan → Confiscation of land from the Japanese and  
redistribution among peasants.

\$  
South Korea

Agricultural tax rates have been 0. Rich landowners  
paid no taxes.

Minimum wages ended up being of no help because  
the farmers were tenants and the  
rent of the land was higher than  
the wages they received. So this  
amount could not be used to improve  
standard of living.

Healthcare & primary education ↓↓. Large workforce entering  
the industry & unskilled.

How to transfer surplus to the peasants.

1. Land Reforms

2. Taxation

3. Minimum Wages.

Government turned a blind eye to unlicensed capacity because this was driving demand  $\Rightarrow$  growth.

In the pri. sector, firms have to depend on the Govt. in order to be successful.

Indian development policies highly biased towards the elite.

Cureative healthcare & higher education instead of preventive healthcare & Primary education.

Primary emphasis was on modernisation.

Reliance started the fashion of selling stocks.

Middle classes could participate in the capital markets because of setting up of stock exchanges in the 70s.

Liberalising a heavily protected economy in a democracy was a ~~big~~



#### Issues

- local industry (public & private)
- Pricing competition
- concerns on self-reliance  
[local firms may not survive]
- Sequence of liberalisation

Big bang reform: Opening up the economy simultaneously.  
↳ Govt. wanted to ensure competition

#### Political challenges

- Bureaucracy - loss of power/influence
- Congress Party, Opposition Parties
- Labour Unions

If you reduce tax, tax revenue is expected to increase because of unified tax compliance.

## COMMAND & CONTROL

### 1. Reasons for low growth in the 60s.

- 2 wars diverted capital to defence spending
- successive monsoon failures; reliance on food-aid
- Inefficiencies and low returns from public sector investments
- Resource Scarcities
- Export Pessimism :
  - heavy focus on import substitution industrialisation & ignorance towards export led model.
  - Excessive pre-occupation on self-reliance w/o regard to efficiencies or economies of scale.
  - licensing system hampered private investment.
  - This depleted foreign exchange reserves and created inefficiencies in investment.

- High devaluation of the Indian Rupee
- Continuation of location & concentration holding in the Private Sector.

### 2. Economic & Political impact of low growth.

- Economic Crisis & popular discontent
- Political Instability : Syndicate & Young Turks  
Poor performance in 1967

3. What happened after Indira Gandhi came to power in 1971

→ Radical Agenda

- Appointment of Monopolies Commission
- Ban on investments greater than 3 or 5% by large business houses
- Limitations on entry of foreign capital
- Conversion of loans to equity to create joint ventures

→ MRTP Act

[Monopolies & Restrictive Trade Practices]

Categories in Indian Industry

- Small - scale
- Medium - scale
- Large industrial houses ( $> 20\text{cr}$ )
- Dominant undertakings (market share: 33%)
- Foreign firms & subsidiaries

Applied to only pri. sector firms ; Objective:

- Prevent concentration of power
- Control monopolies
- Prohibit monopolistic & restrictive trade practices

→ Foreign Exchange Regulation Act

- Additional restrictions on foreign investment
- Foreign firms had to become Indian under Companies Act by dividing 40% of foreign shareholding

- For higher holdings restrictions on profit transfer & acquisition of property applied.
- Maximum permissible equity holding was 74%.

→ Increase in Taxation

- Corporate & income taxes as a way of collecting additional revenue and tool of social policy
- Very high rates of taxation.

→ Increased control on Pvt sector investment

- Joint-sector concept
- Clauses for conversion of loan to equity in loan agreements
- limits on salaries & allowances
- Specific Approvals

Treatment of Pvt. Sector

### LIBERALIZATION IN THE EIGHTIES

4. What was the impact of policy changes?

- Greater political stability, but implications on economic policy.
- Ig's focus / stress on poverty alleviation as both types of concentration were increasing. Direct attack on poverty via heavy subsidies & welfare schemes.
- Emphasis on public sector investments for creating employment
- ↑ in investment without internal liberalization  
↳ continuation of inefficiencies in investment

- '71 wave, '73 oil price shock, low industrial growth  
 ↳ growth rates < 3%, stagnant  
 PC GDP

5. why were agricultural growth rates ↑ in the 70s?

- Targeted investments to reduce dependence on food aid.
- Achieved self-sufficiency in food
- Shift from monsoon-dependence by investments in irrigation & extension services
- Green Revolution: ↑ yielding seeds, chemical fertilizers & pesticides, water sufficiency through irrigation projects.

6. Despite ↑ agricultural growth, poverty persisted. why?

- Failure of land Reforms in reducing concentration holding due to the absence of ↓ land reforms  
 ↓  
 complementary reforms
- In a monsoon dependent country like ours, these are very important.
  - Access to good agricultural credit
  - ↑ crop insurance
  - Protection measures
  - Proper enforcement

Political Power of the landowners, inability of

- Farmers to mobilize and poor financial support system rendered land reforms ineffective.
- Failure of taxation & minimum wages for redistribution of surplus.
  - Tax rates on agriculture were 0, landlords need not pay tax as well.
  - Minimum wage farmers were primarily tenant farmers and rent obligation was often higher than the min. wage.
- No improvement in standard of living
- Growth was spatially concentrated. Select states & districts.
- Income disparities continued despite the Govt. procuring at Minimum Support Price.

#### 7. How did many private firms benefit from additional controls?

- Via a process of adjustment that included
- Violation of capacity restriction: 24% operated in excess of licensed capacity
  - Creation of unlicensed capacity
    - Investments made w/o licensees
    - Easily got away & govt issued licenses
  - Non-operation or under-utilization of licenses
    - to prevent rivals from gaining licenses
    - to create scarcity & drive up prices
  - lobbying to prevent legislation

→ Deliberate flouting of regulations

### 8. Reasons for liberalization:

→ Disillusionment with socialism

◦ Failure of controls led to a change in attitude towards fvt. industry

◦ It was clear that economic policy was not working

→ Export-led growth model & borrowing for investment was seen as more successful in East Asia & Latin America.

→ Support for market friendly policies among middle classes, who were impatient with slow growth & not benefiting from fvt. sector profits.

→ Pressure from international agencies like IMF.

#### Indira Gandhi

→ Relaxation in imports of manufactured goods

◦ Tariff and quantitative restrictions reduction

→ Price de-control of steel & cement prices

→ Grant of licenses w/o reference to Plan projections of demand

#### Rajiv Gandhi

→ Attempt to shift from state controlled import substitution model to liberal stuff.

→ Reduction of personal & corporate taxes

→ Abolition of estate duty

→ Reduction of import duties

→ De-licensing of 25 industrial primarily in the ECGT

- Increased emphasis on efficiency of investment. → Increase in investment slabs in MRTP act.
- Implementation of L.K. Jha Commission recommendations wherein 20 industries were placed under automatic licensing. Incentives to high-tech industries & technology-intensive sectors.

→ No fundamental shift from the past.

what are good institutions?

- Enforcement of property rights for a broad cross-section, so that they have incentives to invest.
- Constraints on actions of elites, politicians and other powerful groups.
- Some degree of equal opportunity for broad segments, to incentivise investments, especially in human capital.

Why did the colonisers set up different institutions in different colonies?

Europeans imposed different sets of institutions in different colonies.

### Extractive

- In colonies where there were large populations that could be employed cheaply or taxed.
- In places where there were resources to be extracted.
- The Europeans themselves did not settle there, the disease environment was unfavorable, they cared little about welfare.

### Positive

- In colonies where there was little to be extracted, most of the land was empty, and disease environment was favorable.
- They created settler societies, replicating & improving good European institutions.
- They developed laws & institutions to protect themselves.

- No constraints on power of the elites and no civil or property rights for a broad cross-section.
- More conducive to investment and economic growth.
- They surged ahead when industrialization offered new scope for investment.

Q. Why did bad institutions persist after de-colonisation?

- Distribution of political power determines the evolution of institutions.
- Any major change creates winners and losers and the potential losers are often powerful enough to resist change.

Institutional change can happen when

- (a) The groups that favor change become more powerful than the potential losers.
- (b) When societies can strike a bargain with the potential losers to compensate them after the change or protect them from the adverse consequences.