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# An Economic History of India

## Introduction

India as it is today, a country unified by a central government is a relatively recent phenomenon in contrast to the length of time over which the Hindu religion has been in existence. Not only is Hindu society more complex than Chinese society, but unlike China there has never been any continuous development of either institutions or bureaucracy in the case of India (Morris 1963).

Parts of modern-day India came under British rule from the year 1757, under the control of the East India Company, following the Battle of Plassey. The East India Company had been granted a trading charter by Queen Elizabeth I at the end of December 1600. The Company established hubs in Mumbai (Maharashtra), Chennai (Tamil Nadu) and Kolkata (West Bengal). The states of India can be seen in Map 2.1. The Mogul rulers granted a 'diwani' to the Company. This effectively allowed the Company to collect taxes and administer Coastal India. However, after 1813 the Company's monopoly on trade with India was broken with the passage of the Charter Act 1813. This act allowed private British citizens to also trade with India. After 1833, the


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**Map 2.1** Map of India.
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Company lost the power to trade and purely became a ruling power in its own right. Following the Great Sepoy Mutiny of 1857, the British crown dissolved the Company and the governance of India was taken over by the British crown in 1858. Just as Europe emerged into an era of free trade in the second half of the nineteenth century, mainly due to the abolition of the Corn Laws, India also became integrated into the single market of the British Empire. While British rule offered peace and security, traditional Indian agriculture became commercialised and the self-sufficiency of traditional Indian village life dissipated (Desai 1968). Traditional village artisans had to rely on the land to live, but due to debt owed to moneylenders land ownership became polarised in the hands of the moneylenders. While the urban handicrafts industry

declined, mechanised factory production as well as mining and plantation industries thrived (Desai 1968). At the same time, the volume of exports and imports also saw an increase.

The opening of the Suez Canal in 1869 facilitated increased trade between India, Europe and Britain. India gained independence from the British Crown on the 15th August 1947. Independence also involved the partition of India to create East and West Pakistan. Partition caused many economic problems for India because irrigation works, centres of jute production as well as centres of wheat and cotton production were located in Pakistan (Desai 1968). The mills were located in India. The railway transport network was also becoming disjointed by partition. On partition India lost 33% of its irrigated land to Pakistan (Kaushal 1979). Throughout the British era rule of India, Company and Crown, the enduring policy followed was one of treating India has a market for the sale of products produced by British factories as well as by the supplier of raw materials to British factories (Desai 1968). The expansion of railway, river and road networks in India by the British facilitated the implementation of this economic philosophy. This is because it led to the market integration of India. Nevertheless, there are those who would not agree that British colonial rule decimated the economy of India and turned it into a cycle of backwardness.

One of the features of the Indian economy at the end of the nineteenth century was the development of the cotton textile industry by Indian entrepreneurs (Morris 1963). The latter suggests that it was at this time that the Indian economy also saw a rapid expansion of the jute and coal mining industry aligned with the development of the railway network. Nevertheless, the government of India favoured a balanced budget, did not espouse any program for economic development and required that all investments yield a rate of return very quickly (Morris 1963). This investment doctrine ensured that infrastructure development was at the same time constrained and limited due to a lack of public sector expenditure. The lack of infrastructure in turn acted as a disincentive for indigenous entrepreneurs to start new businesses which would have facilitated economic growth (Morris 1963).

## Commercialisation of Agriculture and De-Industrialisation

After 1860 circumstances caused subsistence village farmers to produce crop for export. The impact of the commercialisation of Indian agriculture was that crop production became more specialised and localised in certain regions of the sub-continent (Kaushal 1979). According to the latter sugar cane was cultivated in the Decean, jute in Bengal, wheat in the Punjab and cotton in Berar. Indeed, by the eighteenth century increased investment had localised agriculture, manufacturing and commerce in West Bengal, Gujarat, Bihar and Uttar Pradesh (Habib 1982). A number of factors caused the commercialisation of agriculture in India (Kaushal 1979), although agriculture has been to some extent commercialised since medieval times (Washbrook 1994). First, the expanding rail and road network ensured that surplus crop could be transported to areas of shortage from areas of surplus. In addition, the development of port facilities also meant that crop could be exported. The construction of the first railway lines was authorised in 1849. Second, the Suez Canal reduced travel time between London and India by 36 days with a distance reduction of 3000 miles (Kaushal 1979). Third, steamships also reduced travel time and storage constraints in comparison with sail-based ships. Fourth, the American Civil War reduced the supply of cotton to the British who in turn transferred their demands to Indian farmers. Fifth, the introduction of money facilitated trade, rent and tax collection and replaced what had been a barter economy. The Government of India was given the sole right to issue currency in India in 1861 by the passing of the Currency Act. In the nineteenth century, banking activities related to supporting land tenure and money changing in order to provide funds for state operation (Bayly 1975). However, by the end of the 1920s banking facilities were better developed in some areas (Punjab, Uttar Pradesh and the Mumbai, Kolkata and Chennai Presidencies) of India compared to other areas [Bihar, Orissa, Central Provinces, Assam and the Indian States (Kaushal 1979)]. The Reserve Bank of India was nationalised in 1948. Finally, the development of new irrigation facilities allowed for an increase

in the area of cultivatable land available to Indian farmers. The Banking Regulation Act of 1949 established the foundations of a sound Indian banking system (Kaushal 1979). For example, the Act required that every bank operating in India should maintain a reserve fund in the country with the Reserve Bank of India and keep 20% of all disclosed profits in the reserve fund (Ghosh et al. 2003). The commercialisation of Indian agriculture gave way to village subsistence existence, increased demand for Indian agricultural produce as well as the rise of the money lender. The latter was primarily because farmers needed access to credit to buy seeds and other materials needed for crop cultivation. Before the arrival of the British, the money lender occupied a subordinate position in village life. As crop cultivation became commercialised, farmers turned to moneylenders for credit. The moneylenders charged very high interest rates. With farmer's land as collateral for credit, unrepaid credit meant that the money lender could kick the farmer off the land. As a result, many farmers became dispossessed (Kaushal 1979). This was only possible because the British put in place legal jurisdiction under the civil courts which facilitated the legal enforceability of legal contracts after their rule began in 1818 (Kranton et al. 1999). The latter suggests that the enforceability of loan contracts was put in place in order to increase the liquidity of the loans market.

The decline of Indian cottage industries can be associated with the deindustrialisation of the Indian subcontinent under British rule. This could be associated with the fact that by the late eighteenth century, rising wages incentivised entrepreneurs to invest in innovation (Broadberry et al. 2009). As a result, improvements in technology and the capital-intensive nature of production in Britain implied that it was cheaper and more efficient to produce in Britain than in India. Therefore, it was logical for Britain to produce and for India to export its raw materials to Britain. However, for many centuries before the arrival of the British, it can be argued that there had been a flourishing textile and iron industries (Kaushal 1979). Indeed, according to the latter the East India Company (EIC) was set up in order to ship Indian-produced goods to Britain rather than the other way around. Nevertheless, the EIC did establish the urban centres of Mumbai, Kolkata and Chennai. Until 1914, over fifty percent of factories in India

were located in Mumbai and Kolkata, with a smaller proportion in Chennai (Roy 2012). The latter suggests that a much higher proportion of auxiliary services such as banking and insurance and capital and labour markets were also to be found in Mumbai and Kolkata.

Traditional Indian industry can be classed as peasant arts and crafts, village subsistence industries, village art industries and urban arts and crafts. While at the village level, industry was flexibly organised under individual artisan level. However, in cities traditional Indian industry would have been organised along the lines of guilds. A number of reasons have been attributed to the decline of traditional Indian industries (Kaushal 1979). These reasons included the demise of local royal dynasties and their replacement by British rule, the peace and relative security brought by British rule, the adoption of western lifestyle by Indians and the emergence of machine manufactured goods. The demise of royal families meant that there was no longer the same level of demand for traditionally produced goods, and peace and security meant that traditional weapons of warfare were no longer required. British policy in India also necessitated the export of raw materials from India for British manufacture rather than the export of manufactured goods from India to Britain, as discussed above. The exported raw materials were then used to manufacture goods in Britain just to be exported to India. This contributed to the demise and decay of Indian manufacturing industry and the dominance of the countries rural agricultural. The East India Company itself made advances in cash and raw materials in order to buy the finished products of Indian artisans who were constrained only to sell to the Company and to no other Europeans or natives. Indian artisans were thus economically constrained by Company policy. The destruction of the Indian handloom and spinning wheel shifted the traditional balance between agriculture and industry towards agriculture and thereby caused one of the biggest social revolutions in Asia in which the tenant farming sector would increase in size but the village industry sector would dramatically decline. The conquest and the malleability of Indian society and economy to meet the needs of the conqueror was the fault of the people of the subcontinent themselves. A society so diverse in language, culture, religion and even political and familial allegiances made it susceptible to little if any change while increasing

its susceptibility to the 'divide and conquer' policy adopted by the British (Stokes 1973).

By 1914, India's industrial structure was represented by a burgeoning coal, cotton, jute and textile industry allied with an expanded railway network. India was still dependent on its manufactured goods, including consumer goods, that is, exports from Britain. Even though the Tata Iron and Steel Company started operations in 1912, Indian heavy industry in the context of machine tools, chemicals and electrical equipment had yet to emerge. However, the mechanisations needed to process primary commodities such as sugar, cotton, jute and petroleum did emerge but not in significant magnitude (Kaushal 1979). The result was a reliance on old machinery and cheap labour to replace machinery for the manipulation of raw materials, (Tomlinson 2013). Nevertheless, by the start of the Second World War the base of Indian industrial structure had changed and expanded to include the production of cement, paper, pig iron, steel ingots, cycles and textiles (Kaushal 1979). The development of these industries was largely due to import substitution policies and the imposition of tariffs on certain goods by Tariff Boards between 1923 and 1939 (Kaushal 1979). However, the Tariff Board also recognised that one of the limitations to Indian productivity was the overmanning of machinery (Gupta 2011). This inevitability would lead to diminishing returns to scale and increasing marginal costs in the short run. Mumbai in particular saw increasing concentrations of capital and production. However, the underdevelopment and vulnerability of Indian industry became visible on the outbreak of the Second World War when supplies of raw materials were cut off. Nevertheless, due to the loss in productive capacity of the British due to German bombing and Japan's entry into the war resulted in the expansion of the Indian cement, iron and steel, sugar, cotton and textiles industries (Kaushal 1979).

## The Post-independence Period 1947–1990

India gained independence from Britain in 1947. However, as a result, the country was partitioned losing parts of the intact country to form East and West Pakistan. One of the immediate economic effects of this

partition was that India retained the majority share of cotton and jute processing and production capacity with the newly formed Pakistan retaining share of the sources of raw materials. The Indian government established the National Planning Commission in 1950. The objective of government economic policy in India has been to promote rapid and balanced economic development with equity and justice (Dandekar 1988). The first five-year plan was launched in the first half of 1951. It covered the period from the second quarter of 1951 to the first quarter of 1956. The main objectives of the first five-year plan were to confront the imbalance in the Indian economy caused by independence and then partition; and to bring about balanced economic development by progressively changing the socio-economic framework of India (Kaushal 1979). The focus of the first five-year plan lay, in successive order, with agriculture and irrigation, transport and communication, social services and power and industry. The major focus of the first five-year plan was the control of imports through the implementation of a licensing system; and targeted planning in selected industries (Mohan and Aggarwal 1990). Although the first five-year plan did not focus on the further development of industry, industrial growth and good agricultural harvests improved the supply side of the economy. While the planning commission recognised that the first five-year plan had been satisfactory in meeting its objectives, it did note that considerable progress needed to be made in the field of education specifically with regard to primary and secondary school enrolment rates as well as with the supply of qualified teachers. The second five-year plan commenced in the second quarter of 1956, and while it was much larger in size it was especially aimed at development, focusing on the development of key and basic industries (Kaushal 1979). The main objectives of the second five-year plan was to reduce income and wealth inequality in Indian society by generating better employment prospects, facilitated by a 24% increase in national income from 1956 to 1961 (Kaushal 1979), allied with the development of basic and heavy industries. The second five-year plan did emphasise investment in the further development of Indian industry with 24% of the total budget devoted to investment in heavy industries, machine building and basic metals. While the increase in industrial growth in the first five-year plan was

attributed to more efficient use of existing capacity, industrial growth during the second five-year plan was attributed to the increase in productive capacity. However, some may argue that a few big steel mills were added superficially to a primitive economy in which all production was still labour-intensive (Nurkse 1957). Nevertheless, total national income grew by 20% rather than the objective of 24% in the period encompassing the second five-year plan (Kaushal 1979). Both the first and the second five-year plans were implemented on the basis of the Harrod-Domar growth model formulation. Furthermore, the forecasted economic growth associated with the five-year plans was based on the Harrod-Domar model. In this case, according to the model it was assumed that if consumption took place in successive periods of time and investment in capital goods was higher in current periods of time, then the level of economic growth would be also higher (Mohan and Aggarwal 1990). This line of thinking also followed in subsequent five-year plans, and the mathematical models on which the plans were based became ever more mathematically sophisticated. The third five-year plan was launched in the second quarter of 1961 but was developed in the late 1950s when India was experiencing a trilogy of crises, food, financial and foreign exchange. While there was greater emphasis on the development of industry in the third five-year plan and the industrial growth rate was greater than that under the second five-year plan, inflation added to costs and the unsure level of foreign aid contributed towards uncertainty and disorganisation of the industrial sector (Kaushal 1979). It may have been due to lack of resources and uncertainty and to the trilogy of crises in the late 1950s which caused the third five-year plan not to be as successful with inflation of 32% higher in 1965–1966 and then it had been between 1960 and 1961 (Kaushal 1979). However, the economic growth rate in the first fifteen years of India's planned economy exceeded the economic growth rate in the eight years after economic liberalisation policies were implemented in 1991 (Chaudhuri 2002). Furthermore, the latter suggests that the increased non-plan counter inflationary payments to government and industrial workers reduced the funds available for plan investment. Both the second and the third five-year plans emphasised the development of basic and heavier industries over the industry for the manufacture

of consumer goods. The plans also emphasised a growing role for state investment. So, by the end of the third five-year plan the state had a majority stake in the production of fertilisers, petroleum, steel, machine tools, power generation and electrical equipment (Kaushal 1979). In the fourth five-year plan, the government recognised that the plans were leading to a regional imbalance in the distribution of productive capacity. Another feature of India's industrialisation under the plans was the concentration of power amongst some families.

The origins of central planning in India lies not with the Nehru dynasty but with the British government due to their enactment of the Defence of India Rules under the Defence of India Act 1939 (Mohan and Aggarwal 1990). Within the Rules are enshrined the covenants of economic control of prices and production. The government of India was empowered to continue with wartime controls under the India (Central Government and Legislature) Act 1946. Between the end of the war and central planning proper, numerous other pieces of legislation such as the Foreign Exchange Regulations Act, the Import-Export (Controls) Act and the Capital Issues (Continuance of Control) Act (Mohan and Aggarwal 1990). Some would argue that the embracement of central planning and the 'license raj' under the Nehru dynasty was misguided, even though it was based on the heavy industrialisation achievements of the Soviet Union, and led to decades of underdevelopment (DeLong 2001). This ensured that India missed out on the economic growth of the East Asian tiger economies which had embraced a more mixed economy. Byrd (1990) attributes four reasons for the failure of central planning to bring prosperity to India. First, central planning was embraced on the basis of misaligned objectives and the means for developing those objectives. In other words, India simply did not have the tools required in order to achieve plan objectives (Mohan and Aggarwal 1990). Second, policy was implemented in a counter-productive manner. Third, as a direct result of the way in which economic policy was implemented, there arose powerful interest groups who blocked much needed reform at the same time as acquiring significant public resources. Lastly, economic policy was inflexible and change in economic policy was necessitated by a change in economic circumstances. Whereas the objective of India's central planning had

been to promote rapid economic development with equity and justice, in reality central planning resulted in increasing disparities between the agricultural and the non-agricultural sectors (Dandekar 1988).

## Reform and the Post-reform Period 1991–2015

The objective of the 1991 economic reforms was to improve India's poor growth performance and reduce poverty by increasing the levels of employment and output in the economy (Chaudhuri 2002). The catalyst for India's 1991 economic crisis was falling foreign exchange reserves to pay for imports and rising external debt. The 1991 economic crisis was a direct result of the economic reforms instigated by the Indian government in the 1980s (Ahluwalia 2002). The main feature of the 1991 economic crisis was that government revenue was falling short of its expenditure. This was primarily due to two reasons. First, foreign exchange reserves began to dry up because of the collapse of the former Soviet Union. The latter was a major market for Indian exports. Second, the first Gulf War reduced employment opportunities for Indians in the Middle East. As a result, remittances from non-resident Indians began to fall. These two factors in addition to the external debt situation created a foreign exchange crisis for India. Following financial assistance from the IMF, India was conditionally required to implement an economic liberalisation plan in 1991. As a result, the industrial licensing system was abolished, interest rate ceilings were removed and trade and FDI regimes were also liberalised. The economic reforms were designed to stimulate other drivers of the economy besides government such as entrepreneurship and free market forces. The exchange rate regime was also made more flexible, starting with the devaluation of the Indian Rupee in July 1991 (Panagariya 2004). Agricultural exports became more competitive and increased. But, growth in the Indian agricultural sector was slowing in the 1990s, and this could have been stymied by increased investment in rural infrastructure. Nevertheless, around this time, the budgets of state governments were becoming more and more negative. As a result, public sector investment in rural infrastructure was becoming less and less (Ahluwalia 2002).

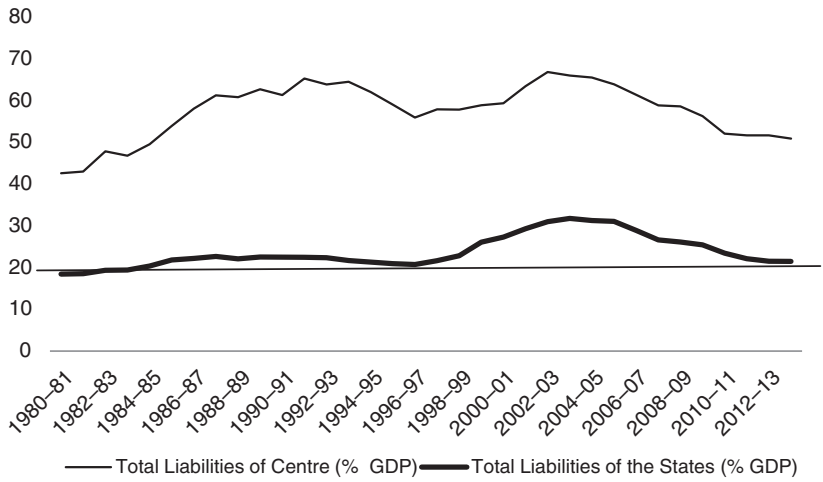


**Fig. 2.1** Total liabilities of centre and states (% GDP).
*Source* Compiled by author using data from Indiastat

Figure 2.1 shows the total liabilities of the central government and India's states between 1980 and 2013. It can be seen from Fig. 2.1 that central government debt was at a peak around 1992 and 2003, around which time state-level debt was also reaching a peak. Furthermore, since the 1980s state-level debt has been above 20% and central government debt has been above 45%. The higher the level of debt, then the higher will be the level of interest payments. It becomes easier in this case to see why public sector investments in infrastructure will have been squeezed given the extent of central government and state-level debt. Nevertheless, during the post-reform period the rate of economic growth in some states was noticeably higher than it was in other states. For example, Madhya Pradesh, Rajasthan, Maharashtra, Gujarat, West Bengal and Tamil Nadu experienced higher rates of economic growth in the period 1991–1998 than did other Indian states (Ahluwalia 2000). Datt et al. (2002) suggest that the disparities in the economic growth rates between Indian states are mainly due to the pre-existing level of rural and human development in these states. Therefore, in order for all states to benefit from high levels of national economic growth, state-level differences in rural and human capital development should

be addressed as a priority. In this context, according to Ahluwalia (2000), economic liberalisation gave Indian states greater freedom to pursue individual initiatives associated with attracting domestic and foreign investment. This economic liberalisation is very similar to what happened in China during the reform years. Nevertheless, the impact of this increased investment would depend on the level of rural and urban infrastructure development within and between each state. Moreover, the post-reform period was also characterised by rising regional disparities, particularly in the unorganised sector (Das et al. 1996).

Foreign direct investment reforms meant that there could be 100% foreign ownership in Indian industrial sectors excluding airlines, banks and insurance firms. Before the reforms private sector involvement in the industrial sector was limited and this only led to accumulating inefficiency in the sector. This inefficiency was remedied by the imposition of a restrictive trade policy. This only served to exacerbate problems for the Indian economy and led to the 1991 crisis. However, since the 1991 reforms, there have also been reforms in other sectors of the economy with the express purpose of allowing private sector entrepreneurial involvement as well facilitating foreign trade and investment. But the economic reforms of the early 1990s were more rigorous than those economic reforms which had taken place in the 1980s. However, it is arguable that the economic impact of these economic reforms was not as far reaching as they could have been due to a lack of infrastructure investment, an overhaul of the labour market; and continuing non-import tariffs on goods. For example, in 1995, the textile and garment sector was protected by non-tariff barriers (Pursell et al. 2008). However, quotas on the imports of manufactured and agricultural goods were lifted in 2001 due to the intervention of the WTO following a complaint by the USA (Ahluwalia 2002). Nevertheless, the economic reforms of 1991 included a return to a balanced budget for the government, domestic manufacturing and external trade, agricultural policy, financial sector deepening, a shift towards private enterprise and the development of society (Ahluwalia 2002). According to the latter, the public-sector monopolisation of industry was restricted to only three industries following the 1991 economic reforms. These industries included defence, the railways and atomic energy generation (Ahluwalia 2002). However,

public sector enterprises still dominate in the finance, heavy industry and mineral and petroleum extraction sectors (Khanna 2015). The share of the public sector in the economy may have declined, signifying a shift in capital and financial accumulation towards business conglomerates. However, the strength of the public-sector enterprises still facilitates a globalising India, the cheap development of technology and drugs as well as increasingly social investment (Khanna 2015).

It had been hoped that as the 1991 economic reforms would allow the public-sector savings levels as a percentage of GDP rise in order to reduce government non-domestic borrowing. If the Indian government was able to borrow from domestic savers in order to fund a budget deficit, then this would be less risky for the country in contrast to the situation where the government borrowed from non-domestic savers. However, the economic reforms did not have the intended effect of increasing the level of public sectors savings as a percentage of GDP. This can be seen clearly from the graph below which charts the changes in the level of public savings as a percentage of GDP from the eighth to the tenth five-year plan.

Figure 2.2 clearly shows that during the eighth five-year plan, 1992–1997, public savings in India actually fell. During the ninth five-year

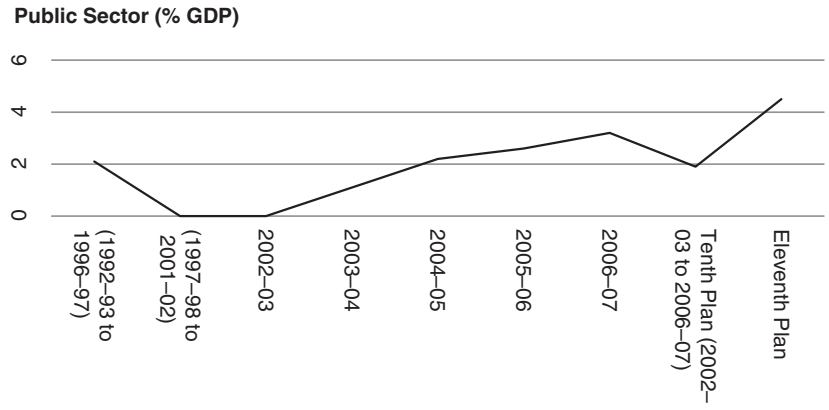


**Fig. 2.2** Indian public sector savings as percentage of GDP: eighth five-year plan to eleventh five-year plan.
*Source* Compiled by author using data from Indiastat

plan, 1997–2002, the level of Indian public savings fluctuated around the 0%. It only began to rise during the tenth five-year plan from 2002 to 2007, falling again in 2008 due to the global economic crisis; and at the start of the eleventh five-year plan. However, total private sector savings in the Indian economy was rising from the eighth to the eleventh five-year plan, with small fluctuations over the years. At the same time between 1990 and 2008, the government's budget was a deficit except in 2000 and 2007. Ahluwalia (2002) asserts that government budget deficits do not implicate an increase in public sector investment, but that they do imply that private sector investment is squeezed out. Theoretically, this would occur because in order to borrow more money, the government would have to offer lenders a higher interest rate, thereby pushing up interest rates and making it more expensive for the private sector to be able to borrow. Nevertheless, looking at the data it is difficult to see how these assertions can be true. The percentage change in private and public sector investment in India between 1992 and 2004 is shown in Fig. 2.3, below where investment in each year,

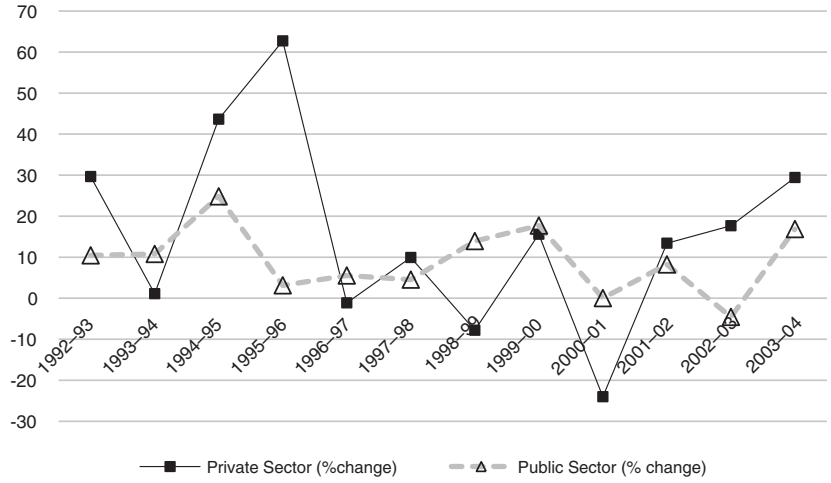


**Fig. 2.3** India—Percentage changes in private and public investments—1992–2004 **Source* Compiled by author using data from Indiastat. *Notes* *1993–1994 base period

prior to the calculation of percentage change, was adjusted so that the base period was 1993–1994.

For the two decades before 1980, the Indian economy achieved a consistent annual rate of economic growth of 3.5%. However, in the 1980s, this rate of economic growth increased to 5% and in the 1990s to 6% (Kotwal et al. 2011). Moreover, in subsequent years the change in India's economic growth was far higher. From 1950 to 1980 India's average economic growth was 1.7% while between 1980 and 2000 this figure rose to 3.8% (Rodrik and Subramanian 2005). The latter suggests that the surge in India's economic growth rate after 1980 occurred because of the pro-business policies followed by the Congress-led government. These pro-business policies allowed domestic firms to expand, rather than facilitating the entry of foreign firms into the Indian market. These policies allowed for capacity expansion by domestic firms, a reduction in corporate taxes and the removal of price controls. The reduction in corporate taxes allowed domestic firms to increase retained profits which could then be used for reinvestment and capacity expansion. The removal of price controls would mean that the firms could more efficiently allocate the factors of production so as to increase retained profits which could then be used to finance capacity expansion. In other words, the Indian economic reforms of the 1980s were very much pro-business rather than pro-market (Rodrik and Subramanian 2005).

Unlike, the case of a country such as China, where economic growth has taken place due to an inflow of foreign direct investment; and the export of light manufactured goods, it is not so easy to identify the sources of India's economic growth. Similarly, India never had a high level of savings which would have been the source of much needed investment. A high level of savings contributed to Japan's investment in its economy by being the source of funds for government borrowing. Nevertheless, India's improved economic growth in the 1980s, 1990s and in subsequent years ensured that more and more Indian's were lifted out of poverty, although perhaps and not at levels similar to China. But it is not easy to see the origins of India's economic growth as one would be able to do for China. This is especially in the light of the fact that in India no specific sectors have been targeted for investment

and development at a national level (Kotwal et al. 2011). Furthermore, in comparison to China's manufacturing sector, India's manufacturing sector is smaller and contributes less to India's GDP than does China's. On the other hand, India's service sector is bigger than China's and contributes more to its GDP than does China's services sector contribute to its GDP. Some would argue according to Kotwal et al. (2011) that the main constraints faced by the Indian economy include a lack of access to credit, unfavourable labour policies to firms with greater than ten employees as well as the small size of firms in the Indian economy. While firms with more than ten employees fall under the auspice of the Factories Act which governs worker's health and safety and working hours, the preponderance of firms in the Indian economy is small family enterprises do not. These small-family enterprises with less than ten employees fall under unregistered or unorganised manufacturing (Kotwal et al. 2011).

Another immediate constraint on India's economic growth would be the lack of infrastructure (Ahluwalia 2000). The latter classifies industrial infrastructure (energy, transport, communications) as well as agricultural infrastructure (irrigation, rural electrification, rural road density and land development). The upgrading of a highway as part of the Golden Quadrangle (GQ) project resulted in a big increase in manufacturing output amongst firms situated along the highway (Ghani et al. 2014). According to the latter, the increase in manufacturing output resulted because the improved highway allowed firms to more efficiently allocate the factors of production. Furthermore, a reduction in transport costs may have allowed firms profits to rise. With increased profits, the firms would have been able to reinvest in new plant and machinery replacing workers, for example. Melchior (2010) suggests that for big countries such as India, internal trade amongst its states is an important factor which contributes to regional economic growth. Nevertheless, the size of internal trade depends on the extent of the abundance and the quality of infrastructure at state level. The greater the amount of infrastructure and the higher the quality of the infrastructure at state level, then the lower will be the transport costs incurred by importers and exporters of good produced at state level. Lall (2007) conducted a study of public infrastructure spending in twenty-four Indian states between

1981 and 1996. The results of the study indicated that high levels of public infrastructure expenditure, especially in transport and communications were a significant contributor to regional economic growth. In other words, the levels of public infrastructure expenditure in one state also caused positive externalities for trade in neighbouring states. States which were lacking in the receipt of public infrastructure expenditure benefited more from an increase in such expenditure than did states with a higher level of infrastructural base.

Despite the formidable constraints faced by the Indian economy with respects to its economic growth, what could have caused the economy to expand by the rates it did in the 80s, 90s and in subsequent years? According to Kotwal et al. (2011) liberalisation of the Indian economy in the 1990s allowed Indian firms to import technology, to which they did not previously have access to. As a result, some firm's productivity increased, whereas those firms who could not compete went out of business. The effect of this was that resources were reallocated from the inefficient to the efficient firms in the economy. As a result, there was a tendency for the economy to be dominated by a few large firms. Chaudhuri (2002) found that the economic reforms implemented in 1991 did not generate the desired levels of output or employment growth. In fact, the value added by the registered manufacturing sector to the Indian economy up to 1999 was less than the value added during the second and third five-year plans. Moreover, the growth of the registered manufacturing sector was also much higher during the 'mild' economic reforms of the 1980s when the strong hand of the government in the economy remained undiminished despite the introduction of some market forces into the economy (Chaudhuri 2002). The latter finds that a second impact of the economic reforms of the 1990s is that the Indian economy has developed more on the basis of manufacturing consumer goods than capital-intensive goods. In other words, the manufacture of capital-intensive goods in the Indian economy declined at the expense of an increase in the manufacture of consumption goods. At the same time, Indian firms were able to import more capital goods than ever before due to the lifting and easing of import controls. As Kotwal et al. (2011) noted, it was the access to better technology which facilitated competition between Indian firms. This resulted in the reallocation

of resources from less efficient to the more efficient firms in the economy. It would seem that it was this which allowed the Indian economy to grow in the 1990s by as much as it did. Nevertheless, Indian economic growth averaged 9% in the early 2000s but fell to 6% in 2008 in the aftermath of the global credit crunch, regaining momentum in 2011 to achieve an economic growth rate of 9%, but falling to 5% in 2012–2013 (Bhagwati et al. 2012).

The question remains as to which of India's states benefited from the economic reforms. This specific question was addressed by Arora and Ratnasiri (2015). More specifically, the latter sought to address three issues in the context of India's economic reforms and the spread of economic growth amongst its states. First, how comparable is the well-being of India's States. Second, what factors have been impacting on the economic growth of India's states, before and after the economic reforms. Third, where there are differences in state's well-being as this arisen due to differing factors impacting on the economic growth of each state. The specific components of well-being at state level which were investigated were knowledge, health, income, technology and infrastructure. It was found for example that states with a higher level of infrastructural development than other states benefited more from the development of the financial sector (Arora and Ratnasiri 2015). In states with a higher level of financial sector development, the growth rate of GDP per capita was higher than in states in which the level of financial development was lower. This positive relationship between the level of financial sector development and levels of economic growth has also been confirmed by Kendall (2007). It is easy to see why the level of financial development is greater in states with a higher level of infrastructural development. Firms will view states with a high level of infrastructural development more favourably compared to other states as being places where their profits maybe higher due to lower transport costs. The results also suggested that there was a negative relationship between the growth rate of GDP per capita and agricultural output. The implication of this finding is that states with a large agricultural sector would have low growth rates of GDP per capita compared to states which have a larger service sector. There is also evidence of a positive relationship between the growth rate of GDP per capita and

the literacy rates (Arora and Ratnasiri 2015). Intuitively it would follow that states with a large services sector would also benefit from having a high literacy rate. But the findings also indicate that high literacy rates also benefitted states in which knowledge, health, income, technology and infrastructure are less well represented. In this case, it is hard to see how. A high level of literacy in such states would mean that the level of skilled worker migration to better endowed states would be just that bigger. It would also appear that the services sector has been the main driver of economic growth at state level (Arora and Ratnasiri 2015). However, the latter suggests that this is symptomatic with an economy being in the later stages of development. This has to be refuted on the basis that India's manufacturing sector was decimated, annihilated almost in the time that India was part of the British Empire. However, to some this view is controversial (Morris 1963). States which embraced the economic reforms by removing regulations which hindered business activity also achieved higher levels of economic growth than states which were less business friendly.

## State of Economic Reforms in India

According to Jourmard et al. (2015), various economic reform initiatives have been started in India. These initiatives include the National Manufacturing Policy (NMP) of 2011. The aim of the NMP is to boost the manufacturing sector's contribution to GDP to 25% and create an additional 100 million jobs by 2022. The 'Make in India' initiative was launched in 2014. The 'Make in India' program extends the NMP by easing access to India's markets for foreign investors (Jourmard et al. 2015). The Delhi–Mumbai Industrial Corridor (DMIC) aims to expand infrastructure and industry across a six-state region and thereby develop an industrial zone. The DMIC was set up in partnership with Japan. India has also had Special Economic Zones (SEZ's) for over fifty years. However, since 2006 there has been a reliance on private developers to create the zones and to invest in building the infrastructure (Jourmard et al. 2015). The SEZs feature flexible labour regulations,

favourable tax rates and offer a more conducive environment for business creation. Nevertheless, whereas imports into the SEZ's are tax and tariff free, while the sale of goods from the SEZ's to the rest of India are considered as imports into India (Jourmard et al. 2015). The main differences between Indian and Chinese SEZ's are that in the case of the latter there is greater state involvement, and the SEZ's have strong linkages to the domestic economy. Labour laws and regulations were non-existent when the SEZ's were set up in China in the late 1970s. There were also no environmental regulations in place. The Chinese government provided all the infrastructure in the SEZ's, overseas multinational corporations (MNC's) brought technology and training to China and its workers. In return, the MNC's paid less tax than did domestic Chinese firms, and they were allowed to repatriate profits made in China to their home countries.

According to Dabla-Norris and Kochhar (2015), the momentum of economic growth has been falling not just in India but also across the spectrum of all emerging economies. At the same time, Indian policy makers have faced less room for manoeuvre, following the global credit crunch of 2008, in terms of formulating an economic policy which would be able to address the internal and the external challenges faced by the Indian economy. However, the constrained policy arena is not the only problem faced by the Indian economy. In this regard, India's economic growth is being restrained by the limitations which are being placed on aggregate supply. Current research suggests that 66% of the fall in Indian economic growth can be attributed to the bureaucracy required to start and implement projects as well as to the lack of connectivity in the Indian economy due to either poor or missing infrastructure (Dabla-Norris and Kochhar 2015). The current global economic outlook lends itself to the idea that emerging economies such as India will face less economic growth in the future as well as reduced sources of external finance. This raises the spectre of whether India's future economic growth is sustainable solely on the basis of past economic reforms; and if not what further economic and structural reforms are required to be implemented in order for the Indian economy to become the dynamo that was the Chinese economy.

The analysis of aggregate growth drivers in the Indian economy over the period 1970–2010 reveals a number of interesting findings (Dabla-Norris and Kochhar 2015). First, the largest contributor to the Indian economy and to the economies of other emerging countries has been capital deepening and to a lesser extent TFP growth. Second, India in contrast to China experienced more capital deepening in the twenty years up to 2010 in comparison with the previous two decades. Third, all emerging economies experienced a reduction in the contribution of efficiency gains and technology to economic growth. Fourth, India is behind other comparable emerging economies with regard to the levels of TFP, labour market performance, capital-output ratios and human capital development. The poor capital output ratios were perhaps due to the low level of infrastructure development in India, in particular the transportation, energy and telecommunications sectors. This particular finding acts as a spur to suggest that the Indian economy needs substantial further investment in soft (human capital) and hard (transportation, energy and telecommunications) infrastructure in order to facilitate and sustain the level of economic growth experienced by the Chinese economy in the years following the start of the economic reforms in 1978. However, this by itself will not suffice to ensure the 'take-off' of the Indian economy. Further, necessary conditions are that the labour market be deregulated so that firms can employ workers on their own preferential terms, and the level of bureaucracy in the Indian economy is reduced so that foreign multinational firms can enter and set up business with minimal paperwork. Furthermore, these firms should then be allowed to face minimal paperwork in their day-to-day operations. Allied with property rights foreign multinational firms could be provided with hard infrastructure and reduced regulations within the framework of a special economic zone. Dabla-Norris and Kochhar (2015) find that India has a low employment to population ratio. This reflects extremely restrictive labour market regulations, such as the ability of firms to sack employees and dispute regulation for example, which need to be dismantled in order to ensure a lot more flexibility in the labour market. The level of development of human capital in India has measured by the average years of schooling is also

low in comparison with other emerging economies (Dabla-Norris and Kochhar 2015). This may seem to contradict the reality that the services or knowledge-based sectors contribute more to India's GDP than does its manufacturing sector. However, India has a large population and only a fraction of that population needs to be educated to at least undergraduate level in order for the Indian economy to be services oriented leaving a substantial part of the population still illiterate. India still has much spare capacity in its economy to allow for both productivity growth and catch-up convergence, because the level of its TFP is just 17% of that of the USA while Korea's is at 60% of the US level of TFP (Dabla-Norris and Kochhar 2015). While TFP growth may result from the effective usage of labour and technology, it can also result from the structural transformation of the economy and a redeployment of resources from underproductive sectors to low productive sectors. In this case, while China and India had similar levels of employment in the agriculture sector in the 1990s, India currently has more workers in the agriculture sector than does China (Dabla-Norris and Kochhar 2015). Low productivity with a larger number of workers in India's agricultural sector implies underemployment. China's economic growth achieved a take-off by the reallocation of underemployed labour in the agricultural sector to the manufacturing sector facilitating TFP growth. However, in India's case the services sector has always been in prominence during the reform period while manufacturing experienced expansion in the post-reform period followed by shallow growth between 1998 and 2002; and an upturn after 2002 (Dabla-Norris and Kochhar 2015). Nevertheless, according to the latter productivity in the agricultural sector remains stagnant. Dabla-Norris and Kochhar (2015) suggest that productivity from India's past economic reforms have peaked so that now new economic reforms need to be put into place such that productivity in the agricultural sector is boosted; the financial system is allowed to develop and 'deepen'; labour market regulations are reformed; and the dynamism of the services sector is maintained. However, in the context of special economic zones foreign firms should be provided with hard infrastructure, property rights, negligible bureaucracy and preferential policies in terms of profit repatriation and tax on profits.

## National Highways Development Project (NHDP) 2001

The National Highways Authority of India (NHAI) was established by an act of parliament in 1988, becoming operational in 1995 (NHAI 2016). The NHAI is responsible for maintaining, developing and managing India's national highways; and it operates from the basis of business principles. Furthermore, the NHAI is able to raise funds in order to supplement government resources (NHAI 2016). The NHAI manages the implementation of the National Highways Development Project (NHDP). The purpose of the NHDP is to improve 49,260 km of road networks so that their condition matches international standards (NHAI 2016). According to the latter, the NHDP is to be completed through a number of phases, Phase 1–Phase VI. Phase 1, as depicted in Table 2.1, consists of completing the Golden Quadrilateral (GQ) which consists of connecting the cities of New Delhi, Mumbai, Chennai and Kolkata by road. Phase II of the NHDP consists of building the North-South and the East-West corridors (NHAI 2016).

According to the latter, the North-South corridor is a road network which will connect Srinagar, the capital of the state of Kashmir, with Kanyakumari in the state of Tamil Nadu in the South, while including a road link to Cochin in the state of Kerala. On the other hand, the East-West Corridor will connect Silchar in the state of Assam to Porbandar in the state of Gujarat. Phase III consists of connecting the state capitals and other important places to the GQ and the two corridors of Phases I and II, respectively (NHAI 2016). The latter suggests that in Phase IV, highways with single lanes will be converted into dual-lane highways with shoulders which are paved. Phase V will focus on building six-lane

**Table 2.1** NHDP Phase 1: The golden quadrilateral

| Route | Kilometres | Miles |
|---|---|---|
| Delhi–Kolkata | 1453 | 902 |
| Chennai–Mumbai | 1290 | 801 |
| Kolkata–Chennai | 1684 | 1046 |
| Delhi–Mumbai | 1419 | 882 |

*Source* Compiled by author using data from NHAI (2016)

highways, while Phase VI of the NHDP will focus on building expressways (NHAI 2016). All phases of the NHDP are being implemented simultaneously, although Phase I is more or less complete.

In the context of the economic impact of GQ, it has been found that the rate of output formation by new firms located close to the highway network was at twice the levels compared with the period before the GQ upgrade was implemented (Ghani et al. 2014). According to the latter, the GQ upgrades improved the allocation of the factors of production in such a way as to shift production from less efficient plants to more efficient plants. Moreover, the GQ upgrades facilitated an increase in the economic activity in India's intermediate sized cities which underperformed in contrast to similar-sized cities in China (Ghani et al. 2014).

## Special Economic Zones

The Special Economic Zone (SEZ) Act was passed in May 2005 (Dey et al. 2015). In order to establish SEZs, the government used the Land Acquisition Act 1894 to acquire land from poor farmers without paying them adequate compensation. Therefore, the establishment of the SEZs came under increased political scrutiny resulting in political deadlock and delays (Dey et al. 2015). A development commissioner is in charge of each SEZ and is responsible for attracting investment to the SEZ as well as for developing it. There has been renewed competition amongst India's states in order to establish SEZs and to attract foreign investment by offering tax and other incentives (Sharma 2009). There are 130 functioning Special Economic Zones (SEZs) in India and of these 18 are in the southern Indian state of Tamil Nadu (De 2011). The latter suggests that the government of India has given approval for the establishment of a further 19 SEZs with pending approval for 71 SEZs. Furthermore, SEZs which will be able to accommodate the production of a range of products are being developed in Tirunelveli and Perambalur districts (De 2011). Moreover, according to the latter there are proposals to develop new industrial parks in Madurai, Perundurai and Erode districts in Tamil Nadu. The economic and the industrial potential of the state of Tamil Nadu has enticed 240 of the 725 Japanese firms in India to be located in Tamil Nadu.

## National Manufacturing Policy

The National Manufacturing Policy (NMP) was initiated in 2011, and it has six objectives (Joumard et al. 2015). First, this enables the manufacturing sector to contribute up to 25% of GDP by 2022, as well as increasing the growth of the manufacturing sector by up to 14% over the medium term; second, to create 100 million jobs in the manufacturing sector by 2022; third, to ensure that economic growth is inclusive by developing and increasing the skill set of rural workers and the urban poor; fourth, the purpose of the NMP is to increase the technological depth of manufacturing; fifth, the global competitiveness of Indian manufacturing should be enhanced; and lastly, the NMP aims to ensure that the economic growth resulting from the growth of the manufacturing sector should be sustainable. Furthermore, according to Joumard et al. (2015), the emphasis of the NMP will be on supporting and developing industries in which India has a strategic advantage, industries which are capital-intensive and industries in which employment is intensive. Under the realms of the NMP, the special focus sectors will be automobiles, pharmaceuticals and medical equipment. These sectors also represent the small and medium enterprises as well as the public-sector enterprises. Another 'plank' of the NMP is the establishment of National Investment and Manufacturing Zones (NIMZs). The latter are areas in which manufacturing factories, infrastructure and domestic dwellings are all concentrated with the intention of capturing agglomeration economies (Joumard et al. 2015). Moreover, the latter states that this is in combination with flexible labour policy and reduced regulations. The policy tools which will be used to implement the NMP are supply-side policies: for example, a reduction and simplification of business regulations, the closure of inefficient factories whilst protecting the employability of the labour force, the development of green technology, increasing worker's productivity through further training, and a favourable trade policy (Joumard et al. 2015). However, despite the best of intentions, the latter suggests that the progress towards a comprehensive implementation of the NMP package as fallen far short of expected progress as of 2014.

## Make in India

In order to boost the manufacturing sector and increase job creation, the 'Make in India' campaign was launched by Prime Minister Modi in September 2014 (Joumard et al. 2015). The 'Make in India' campaign has three arrows. The first arrow is the reduction in the bureaucracy and laws and regulations which make it expensive for firms to do business. This would be associated with India's restrictive labour laws and bureaucratic FDI policies. However, the first arrow would also be associated with upgrading old infrastructure as well as adding new infrastructure in order to low firm's transport costs and thus bring about agglomeration economies. The second arrow would focus on reducing information asymmetries by providing foreign investors with a dedicated team which would aim to resolve queries within 72 h (Joumard et al. 2015). The third arrow would focus on giving faster clearances to foreign investors through the provision of an e-biz style online portal. Through this portal it would be possible for foreign investors to receive clearances on investment proposals within a timeframe of 3 months. Government departments involved in the application chain would set an objective of simplifying the approval process to make it more efficient resulting in faster approvals than would be the case. The 'Make in India' campaign would focus on creating jobs in twenty-five sectors of the economy in which India could be classified as a potential world leader (Joumard et al. 2015). These sectors include pharmaceuticals, engineering, defence equipment, textiles and electronics. The 'Make in India' campaign is closely linked to the National Manufacturing Policy and builds on it by constructing improved manufacturing links with foreign investors.

## National Investment and Manufacturing Zones (NIMZs)

NIMZs are a central part of the National Manufacturing Policy, and they became a focus of policy in 2011. While NIMZs are similar to SEZs, they do not encompass either preferential tax policies for

foreign multinational corporations or export requirements. However, with NIMZs the emphasis will be on providing a supportive business friendly environment. According to Joumard et al. (2015), the NIMZs will encompass factories for manufacturing goods, residential areas for workers, infrastructure logistics as well as mechanisms for environmental protection. The set-up of the NIMZs will be to 'capture' agglomeration economies. This will be enhanced through the use of flexible labour policies within the zones, efficient approval processes for foreign firms and investors, employee training programs as well as incentives for the use of green technology (Joumard et al. 2015). The latter suggests that eight of the seventeen approved NIMZs are within the DMIC.

## Delhi–Mumbai Industrial Corridor

The Delhi–Mumbai Industrial Corridor (DMIC) was started in 2007 and is a joint venture between the government of India and that of Japan (Dey et al. 2015). According to the latter, one of the main objectives behind the establishment of the DMIC was to link the economically backward areas of India with its dynamic regions by using a transport corridor to enable the movement of factors of production and goods from one region to another (Dey et al. 2015). Furthermore, the DMIC was started by the Government of India in order to take advantage of the economic benefits arising from the electrification of the railway line between Vadodara in Gujarat and Jawaharlal Nehru Port near Mumbai, the Western Dedicated Freight Corridor (DFC) (De 2011). Nevertheless, the DMIC would incorporate the building of rail and road links between India's interior and selected ports on its west coast. The primary purpose of the DMIC is to establish a manufacturing and trading hub, incorporating nine industrial zones, a high-speed freight line, three ports, six airports, a six-lane highway and a power station, in India which is of international standards supported by world-class infrastructure as well as by institutional policy.[1] According to the latter, the DMIC will encompass seven Indian states including Delhi, Uttar Pradesh, Haryana, Rajasthan, Gujarat,

Madhya Pradesh and Maharashtra, and will consist of two phases, Phase I and Phase II. The former is scheduled to be implemented between 2008 and 2012 and the latter between 2013 and 2018. But due to delays Phase 1 will not be completed until 2017.[2] Furthermore, the DMIC project is supported with technical and financial aid from Japan, its purpose being to develop an industrial belt encompassing all sides of the Western DFC.[3] The agency which is in control of developing the DMIC is a Special Purpose Vehicle called the Delhi–Mumbai Industrial Corridor Development Corporation (DMICDC) set-up in 2008. The purpose of the DMICDC is to facilitate industrial investments in the regions encompassing the DMIC, provide project development services as well as raise finance for the project.[4] The government of India retains 49% ownership of the project with the Infrastructure Leasing and Financial Services Limited holding 41% and the Infrastructure Development Finance Company Limited holding the balance.[5] Expenditure on the project is likely to be split between the government of India and the private sector with the private sector paying more. The implementation of the DMIC represents the initiation and ongoing joint participation of private and public sector financial partnerships. For example, besides the government of India, the DMIC project involves the Japan Bank for International Cooperation as well as the Public-Private Infrastructure Advisory Facility, which is essentially a financially multidonor international organisation (Dey et al. 2015).

## Notes

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2. Ibid.
3. Ibid.
4. Ibid.
5. Ibid.

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