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# Achieving Development Success

## Strategies and Lessons from the Developing World

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## Democracy, Diversity, and Development: India's Strategy and Outcomes

*Nirvikar Singh*<sup>1</sup>

### 1 Introduction

India's economy seems to invite animal metaphors, particularly those of the lumbering elephant or caged tiger. The former is consistent with a culturally or environmentally deterministic view of the country, or perhaps inspired by its size, which hinders nimbleness. The latter obviously suggests that there have been shackles placed on the economy, implicitly by policy makers. The experience of the last few years seems to have been favourable to the latter view, and invites a re-examination of India's development strategy. What has that strategy been, and to what extent can it be considered a success?

A key factor in assessing the success of India's development strategy has to be the country's diversity and size. This is not to argue for exceptionalism, but these characteristics have been important in shaping the country's progress. Even when considering economic development, it is critical to acknowledge the role of political institutions. Democracy in India, however, imperfect, has survived and deepened over the last six decades. It has provided an important institutional backdrop for the recent economic success of the country. In fact, one can credibly assert that the design of robust, sustainable democratic institutions is the greatest achievement of India's strategy of development. Within this context, of course, there are myriad details of economic policy-making,

<sup>1</sup> This is a substantially revised and shortened version of a study written for UNU-WIDER's conference on 'Country Role Models for Development Success'. I am grateful to Augustin K. Fosu, Vijay Kelkar, T. N. Srinivasan, Jessica Wallack, and the discussant, Amelia U. Santos-Paulino, for very useful comments on the earlier draft, and to Lisa Winkler for help with preparation of the final version. Remaining shortcomings are entirely my responsibility. The views expressed here do not reflect those of UNU-WIDER or affiliated organizations.

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including successes as well as setbacks, which have shaped India's development experience. This chapter provides an overview and assessment of these dimensions of strategy. The structure is as follows. The next section describes and assesses India's development success. Section 3 discusses the strategies and policies that lay behind the outcomes, as well as challenges of implementation. The final section concludes with current and possible future lessons from the Indian case.

### 2 Sizing up success

How successful has India been in its development strategy? Using the colonial period as a benchmark, India certainly has done well. Its GDP growth and improvements in human development indicators post independence were both well above the colonial era, and this accelerated progress began almost immediately after independence. This achievement came while preserving a democratic political system, with minimal reliance on outside help,<sup>2</sup> and accompanied by the development of a rich set of governance and private-sector institutions for delivering food, health, shelter, and education to a much greater proportion of the population than ever before in the region's history. Infrastructure investment was greater than before, industries were developed in support of modernization goals, and higher education, in particular, grew dramatically. India also sustained relatively low inflation rates, preventing the kind of tax on the poor that has been characteristic of Latin American economies, several of which have experienced hyper-inflations of varying severity. Table 7.1 summarizes some aspects of India's economic growth performance after independence.<sup>3</sup>

On the other hand, as early as the 1960s, several East Asian countries began to outstrip India's economic performance. Their example became the basis for a shift in mainstream academic views of development, especially toward emphasizing the benefits of openness to international trade. However, in India this period was marked by political impulses that restrained economic policy changes in that direction. There was also the argument of Indian exceptionalism, based on its size, diversity, and large hinterland, setting it apart from new industrializers such as South Korea or the city states of Hong Kong and Singapore. By the 1980s, India's relative lack of success became more apparent, with the cumulative impacts of decades of higher growth in

<sup>2</sup> The quantum of foreign aid was relatively low. However, India did receive critical help in the form of food supplies when domestic production faltered, and targeted assistance in specific areas such as setting up technology institutes and improving agricultural practices.

<sup>3</sup> The periodization in Table 7.1, up to 2006, is due to Panagariya (2008), and is justified there: briefly, the argument is based on classifying broad policy stances in different periods.

Table 7.

Period
1951-65
1965-81
1981-88
1988-2006
2006-07
2007-08
2008-09
2009-10
2010-11

Source: The World Bank, *World Development Indicators*, two years ago.

Table 7.1

Births attended  
GNI per capita  
Immunizations  
months; Life expectancy  
Mortality rate  
Mortality rate  
School enrollment

Notes: \* = year  
Source: World Bank

East and Southeast Asia  
a major factor in the  
early 1990s. India's  
grew more slowly than  
it lagged behind. China and  
China and other developing  
other developing countries  
Growth in India's  
economic stagnation  
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Table 7.1. Aggregate and sectoral growth rates

Period	GDP	Agriculture, forestry and fishing	Industry	Manufacturing	Services
1951-65	4.1	2.9	6.7	6.6	4.7
1965-81	3.2	2.1	4.0	3.9	4.3
1981-88	4.8	2.1	6.3	7.1	6.3
1988-2006	6.3	3.4	6.5	6.8	7.8
2006-07	9.6	4.2	10.6	14.3	11.2
2007-08	9.3	5.8	8.1	10.3	10.7
2008-09	6.8	-0.1	3.1	4.2	9.3
2009-10	8.0	0.4	8.3	8.8	9.7
2010-11	8.6	5.4	7.8	8.8	9.2

Source: The periodization in the table is from Panagariya (2008: table 1.2) and is justified there. The estimates for the last two years are from the Reserve Bank of India (2011, 2012: tables 1.1), and thus are not finalized.

Table 7.2. Comparative development indicators, 2010

	Low income	India	China	Middle income
Births attended by skilled health staff (% of total)	40	53**	99	71*
GNI per capita, Atlas method (current US\$)	528	1,330	4,270	3,765
Immunization, measles (% of children ages 12-23 months)	78	74	99	86
Life expectancy at birth, total (years)	58	65	73*	69*
Mortality rate, neonatal (per 1,000 live births)	33	32	11	22
Mortality rate, under-5 (per 1,000)	108	63	18	51
School enrolment, pre-primary (% gross)	104	118	111	109

Notes: \* = year 2009, \*\* = year 2008.

Source: World Bank (2010).

East and South-East Asia. China's embrace of the profit motive removed size as a major conceptual defence of India's strategy for development, and by the early 1990s, China's growth record clinched the argument. Even though India grew more rapidly in the 1980s than in previous post-independence decades, it lagged far behind China in its growth rate. Table 7.2 compares India to China and to developing country averages in terms of per capita income and other development indicators.

Growth in the 1980s was aided by some reforms, as well as a macroeconomic stimulus that turned out to be unsustainable (Panagariya 2008), and an external payments crisis in 1991 forced some dramatic changes in economic policy. Essentially, openness to international trade was increased dramatically through tariff reductions and replacement of import quotas by tariffs, and the scope of domestic industrial licensing was drastically reduced. Despite some differences among various empirical studies, the best evidence suggests that productivity growth accelerated in the 1980s and thereafter (Bosworth, Collins, and Virmani 2007; Bosworth and Collins 2008), potentially representing

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a 'structural' shift in the growth trajectory.<sup>4</sup> In the 1990s and subsequently, India has been one of the fastest growing economies in the world, and it is this last period that can be unequivocally characterized as a success in terms of economic development.

A dissection of India's growth performance, however, offers some support for an exceptionalist view. The reason is that India has not grown through the conventional route of producing and exporting labour-intensive manufacturing goods, with quality and variety increasing over time. That pattern of development has theoretical (Grossman and Helpman 1991) as well as empirical (Hausmann, Hwang, and Rodrik 2006) backing, and seems to fit the case of many East and South-East Asian economic successes. India, instead, has followed a growth path that has been characterized by capital and skill intensities that are out of line with other countries at similar per capita income levels (Kochhar et al. 2006).

Aggregate capital-intensity in India's economy had long been identified as relatively high, and was a consequence of policies that pushed heavy industrialization. India's restrictive laws on hiring and firing labour have also contributed to a bias toward capital, though often (because of other policy restrictions) without allowing firms to grow enough to reap economies of scale. High capital-intensity was also arguably caused by inefficient use of capital associated with the control regime, including domestic licensing and prohibitive trade restrictions. More recently, India's incremental capital-output ratio (ICOR) has declined somewhat, suggesting better use of capital.<sup>5</sup> Furthermore, investment rates in India have gone up in the past decade, especially in the last few years (Table 7.3). They are now approaching the levels observed in past East Asian successes, though still below China's.<sup>6</sup>

Despite improvements in capital use, India's capacity to generate employment in labour-intensive manufacturing still remains limited. As a result, there has been limited absorption of the rural labour force into manufacturing—this would have been the classic development model. Instead, Indian manufacturing has been, and remains unusually skilled labour-intensive. The roots of this situation can be traced to the overall development strategy and its particular implementation through industrial and trade policy. An important

<sup>4</sup> On structural changes in the Indian economy, see Cortuk and Singh (2011) and the references therein.

<sup>5</sup> According to calculations presented in Mohan (2008: table 1), the ICOR was 6.0 in the period 1965–81, and has varied between 3.6 and 4.6 in various sub-periods thereafter. Mohan argues that the period before 1965 was also a relatively successful growth episode, with low ICORs, though growth rates were lower because of lower savings and investment rates. See also Mohan's Table 8 for ICOR calculations based on an alternative periodization to Panagariya's, and comparisons to other countries.

<sup>6</sup> In a more disaggregated analysis, Sen (2007) specifically identifies private equipment investment as the key driver of growth in India.



Table 7.3. Gross domestic savings and gross domestic capital formation

Year	Gross domestic saving (% of GDP)	Gross domestic capital formation (% of GDP)
1954-55	9.1	9.3
1959-60	10.8	12.3
1964-65	11.6	13.8
1969-70	14.0	14.5
1974-75	15.7	16.5
1979-80	19.8	20.3
1984-85	18.2	19.6
1989-90	21.8	24.3
1994-95	24.4	25.5
1999-2000	24.8	25.9
2004-05	32.4	28.7
2005-06	33.5	30.3
2006-07	34.6	31.3
2007-08	36.9	32.9
2008-09	32.2	32.0
2009-10	33.7	30.8

Source: Government of India (2011: A-10).

aspect of the overall strategy that played into this mix was a bias toward higher education (as measured by private and social rates of return) compared with primary education. Labour laws which bite more stringently for unskilled versus skilled workers have also been a factor. Finally, it is arguably the case that social stratification, operative over two millennia and reinforced by colonization, has tilted policies in this direction.

If manufacturing has not been as significant a contributor to India's economic growth as is the case for more typical development paths, what has filled the gap? The services sector in India has received considerable attention as one of the engines of the country's recent growth (Singh 2006a). The sector has contributed over half of GDP growth since the 1990s.<sup>7</sup> The share of services in India's GDP is an outlier with respect to typical shares for countries at similar per capita income levels. On the whole the services sector also displays some of the skill-intensity that characterizes Indian manufacturing. This is particularly true of areas in which India is best known as a global competitor, namely, information technology (IT)—specifically software

<sup>7</sup> To some extent, India's growth has been marked by a shift (as measured by share of GDP) from agriculture to services rather than to manufacturing. Kochhar et al. (2006), analysing the period 1980-2000, find no correlation between growth and the share of manufacturing or of labour-intensive industries, but do find a small positive relationship between growth and the share of services. Using state level data for 1993-94 to 2003-04, Singh (2006a) creates a more general structural change index, and finds no correlation between the index and initial year per capita state domestic product levels, but a negative correlation between growth and the structural change index.

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development—and IT-enabled services (ITES, e.g. business process outsourcing, customer service, medical transcription, and financial research). Note that even seemingly low-skilled areas such as call centres require levels of education and English language proficiency that are possessed by less than 10 per cent of the population.

Other areas of services that require education and skills beyond what would be required in typical factory jobs include financial services, and many components of tourism, where there is interaction with foreign visitors. On the other hand, trade and transportation are less skill-intensive, and one of the characteristics of service sector growth in India has been its breadth, across a very heterogeneous sector. In some countries, though not in Indian data, infrastructure services such as electric power and water supply are included in the service sector. In any case, the power sector is clearly one which has not grown as rapidly as targeted, even after policy reform and the growth acceleration, and it, along with service sub-sectors such as transportation, has been a constraint on growth (Singh 2006a). Another infrastructure sector, telecommunications, has grown very rapidly, driven by rapid technological change, and pressure from India's successful new IT industry (Singh 2004a).

Software and ITES have been export-oriented from the start, and in some ways, their progress follows the classic development path. Initially, India's software programmers were characterized by some observers as akin to sweatshop workers, though obviously with much higher education and skill levels. However, there has been a significant climb up the value added ladder, so that India's software firms now provide a wider range of, and more complex, services. Global competition has played a role in this evolution, as has the skill-bias of the Indian workforce.

It has been argued that the success of India's IT and ITES industries was the result of the post-independence development strategy focused on modernization and growth through industrialization. Certainly, the creation of top-notch engineering and technology institutes as part of that strategy, and the availability of their graduates, contributed to the success of India in this dimension.<sup>8</sup> However, software was never seen as an independent activity in IT—policy attention was all on hardware design and manufacturing. Furthermore, telecommunications development was stifled by a perspective that characterized the industry as providing a luxury service rather than a basic need. Software development was able to fly beneath the policy radar (it was not subject to the worst industrial policy controls), and then spur telecommunications reform through its initial success (Murthy 2004). This was the key

<sup>8</sup> An indirect route for positive change was the success of many of these graduates in developed countries, particularly the US—this diaspora then provided a source of knowledge and pressure for policy reform in India. See Kapur (2010) for a recent analysis of this argument.

factor in its success, rather than a deliberate design of development strategy and application of industrial policy (Singh 2004b).

The success of the software development industry involved building direct relationships with business customers, and development of management expertise. Both these factors led to spillovers that generated the ITES industry in India, and thereafter contributed to successful new manufacturing efforts in areas such as automotive components, and to IT-based development in financial services. New microeconomic evidence also establishes the positive productivity impacts of IT investments by Indian manufacturing firms (Gangopadhyay, Singh, and Singh 2008). The world-class rating of India's software industry also has been perceived as boosting the overall level of confidence of young, educated people in India (Kapur 2002), as well as increasing incentives for acquiring specific training and education. In sum, the importance of the IT industry in India has arguably greatly exceeded its direct contribution to growth.

The acceleration of India's growth in the late 1980s and thereafter has also had a positive feedback effect, through the creation of a substantial middle class (Singh 2006b). The domestic appetite for consumer goods, both durables and non-durables, has spurred foreign and domestic investment to meet this growing demand. Rising incomes and demographic changes have also encouraged savings. A final factor in this mix has been improved efficiency in financial intermediation, through a combination of entry of new private firms, organizational reform of public-sector financial firms, and substantial regulatory reform in the financial sector. In some ways, this combination of growth factors is quite different from the initial development strategy, which was geared toward a much more limited set of consumer goods and financial services. Undoubtedly, a retreat from government control and intervention was necessary for the latest trends to be possible. Recent articulations by policy makers of the financial sector as an engine of growth are very different from the classic Indian suspicion of merchants, traders, and other intermediaries that persisted in earlier post-independence India.

### 3 The development strategy: Rationale and implementation

The concept of a development strategy implicitly assumes a role for government. Even putting aside the extreme state intervention that characterized the Soviet Union, successful European models of development such as Germany and France, did rely on direction from the state. The experience of capitalism in its imperialist form created a mistrust of the market institutions that underpin the capitalist system, in former colonies as well as other countries on the periphery of the system. This attitude affected views of international and

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domestic trade, international and domestic finance, and domestic production in agriculture and in industry. Such attitudes are well documented among leaders and intellectuals in India. India's approach to development strategy represented a pioneering attempt by a non-Western ex-colony to achieve higher standards of living through conscious and deliberate creation of institutions and policies, and through active state participation in, and direction of, the process of development. It emphasized modernization through self-reliance, while enhancing social and economic equity.

The centrepiece of India's development strategy was modernization through industrialization. Private industrial effort was viewed as inadequate for the task. Underlying this view was a realization that infrastructure has public-good aspects, or positive spillovers that could lead to under-provision if left entirely to the private sector. Even non-infrastructure sectors such as steel, chemicals, or machine tools may be subject to co-ordination or linkage issues that require a 'big push', further supporting public intervention. Thus, India's leaders embarked on a programme of government occupation of the 'commanding heights' of the economy (Bhagwati and Desai 1970). An alternative approach of using tax and subsidy instruments to influence private actors was, one can conjecture, viewed as infeasible, given the limited scope of the tax base and quantity of revenue at the time. Public-sector enterprises were created to take leading roles in all industries and sectors viewed as central to the industrialization programme, including steel, chemicals, and engineering, as well as trade and finance.

Unlike the Soviet model, private property was not discarded, and democratic institutions were successfully created and implemented. This approach reflected British influence, particularly that of the Fabian socialists. In this context, bureaucratic control—by civil servants reporting to elected politicians—became an important feature of the development strategy. This manifested itself in multi-layered indicative planning exercises, administrative discretion in the allocation of financial capital, private-sector industrial location decisions, pricing decisions, and numerous other discretionary restrictions on private economic activity. This approach of bureaucratic control can be partly traced to negative views of merchants and commercial activities more generally, which pre-dated colonial rule (Lal 1988).

A second key dimension of India's development strategy was with respect to international trade and finance. In addition to negative perceptions of the results of international openness that were formed during the colonial period, there were two academic arguments for policies that restricted international trade and finance. The first was the older infant industry argument, which suggested that initial protection from external competition was essential to industrialization, so that firms and industries could develop sufficiently to compete internationally. This view also included restrictions on foreign

investment and technology transfer, again because these would stunt the growth of domestic industries. The second argument was a more modern perspective of export pessimism, which held that exports of goods in which developing countries had natural comparative advantages, such as primary products, were subject to inelastic demand, and therefore unlikely to be an engine of growth.<sup>9</sup> In general, therefore, international openness was seen as threatening, without significant countervailing benefits.

While industrialization was viewed as the linchpin of development strategy, policy makers certainly understood the importance of agriculture, since it provided (and still provides, sixty years later) the largest source of employment in the economy. The potential for modernization of agriculture was not fully realized until the innovations that enabled the green revolution in the 1960s, but this was preceded by considerable government attention to creating the institutional and physical infrastructure necessary to improve agricultural productivity, including irrigation works and dams, rural roads and markets, credit co-operatives, price support programmes and extension programmes for education and training of farmers. Land reform was also understood as a way of improving productivity as well as distributional equity, but limited progress was made on that front due to political obstacles, namely, opposition from politically powerful landed interests. However, positive coalitions also emerged: individual bureaucrats, visionary entrepreneurs, and enterprising politicians together played a role in agricultural development, as did foreign expertise (Kohli and Singh 2005).

A third, significant dimension of development strategy pertained to improving the well-being or capabilities of the population, by public provision of minimum levels of basic services in areas such as health and education. These had never been the particular concern of the State in India, though the British had begun to improve public health and sanitation along the lines of European progress in the nineteenth century. As a result of the latter, the population growth rate had increased by independence, but average life expectancy and educational attainment were both very low at that time. Tackling these aspects of impoverishment was also, therefore, conceived of as part of development. At the same time, higher education was promoted as critical to the main goal of modernization through industrialization.

On the international front, India was historically a significant trading nation, and only the colonial experience, involving discriminatory British policies against Indian goods, contributed to formulating a development strategy that emphasized self-reliance after independence. Prohibitive tariffs

<sup>9</sup> This view was associated particularly with the work of Singer (1949) and Prebisch (1959), though this brief mention does not do justice to the many other dimensions and nuances of their respective theses.



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and extremely restrictive quotas constituted the trade dimension of the policy framework. Foreign direct and portfolio capital investment was also highly restricted, mostly through outright prohibitions. Even in areas where investment was allowed, it was on a case-by-case discretionary basis. Similarly, technology transfer, which would require foreign exchange payments or associated investment, was also severely limited through a process of discretionary approval (Marjit and Singh 1995). In practice, bureaucratic controls made restrictions much tighter than they might appear to be on paper. Finally, capital flows abroad, or indeed, any flows of foreign currency out of the country were greatly restricted. There were early calls for an overhaul of the foreign trade regime (Bhagwati and Srinivasan 1975), but these took time to be heard.

A key component of these policies was an overvalued exchange rate, which inhibited exports, and created an artificial scarcity of foreign exchange. As a result, a black market in foreign exchange flourished throughout India's early decades. Even after the Bretton Woods system of fixed exchange rates was abandoned in 1971, India continued to maintain a somewhat overvalued rate. In addition to making exports expensive, this policy made imports cheap, and the ostensible goal was to restrict imports through tariffs and quotas to those inputs that would be required for import substituting industrialization. Only in the 1980s did a significant depreciation of the rupee begin, and this process of market alignment accelerated further in the 1990s, so that after a few more years, the exchange rate was market determined, albeit with heavy intervention by the Reserve Bank of India (the central bank) to control volatility.<sup>10</sup>

The re-orientation of exchange rate policy, together with making the rupee convertible on the current account, fostered an export boom, which contributed to India's growth from the 1980s onward (Joshi and Little 1994; Chand and Sen 2002; Panagariya 2005). At the same time, import restrictions were greatly reduced. Inflows of technology and capital inputs that permitted modernization of the Indian industry increased in this period. In some cases, Indian firms faced severe competitive challenges, especially from imports of cheap manufactures from countries such as China, and export competitiveness remains difficult to maintain. Even now, despite recent gains, India's trade share remains relatively small, especially compared to the other Asian giant, China (Table 7.4).<sup>11</sup> Nevertheless, increased openness to international trade, and a more rational trade policy regime, have been hallmarks of a shift in development strategy that occurred in the 1990s (Srinivasan and Tendulkar 2003).

<sup>10</sup> More recently, such intervention has diminished greatly, and the exchange rate currently floats relatively freely.

<sup>11</sup> In addition to Panagariya (2006), the source for Table 7.4, see also Srinivasan (2006).

Table 7

Exports of  
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Source: Panagariya (2006), base (1980-82).

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## Democracy, Diversity, and Development: India

**Table 7.4.** India and China in world trade

	INDIA				CHINA			
	1982	1990	2003	2010	1982	1990	2003	2010
Exports of goods and services as % of GDP	6.2	7.2	13.8	21.5	11.7	16.2	29.6	29.6
Imports of goods and services as % of GDP	9.0	9.3	15.6	24.8	9.4	13.2	27.4	25.7
Exports of goods and services as % of world trade	0.5	0.5	0.9	1.8	1.1	1.3	5.2	9.2
Imports of goods and services as % of world trade	0.8	0.7	1.0	2.3	0.8	1.1	4.9	8.4

Source: Panagariya (2006), World Bank World Development Indicators (<data.worldbank.org>), WTO Statistics Database (<stat.wto.org>).

It should be noted that India's external engagement has relied very little on external borrowing. Aid flows have never been substantial or persistent, and have almost disappeared as a significant contributor to the economy, though there is some project-related borrowing from multilateral agencies, and remittances from diaspora Indians have been significant for some years. India's external debt is very low, and its maturity structure does not indicate high risks of an external crisis. There has been some recent increase in external borrowing by Indian corporations, and portfolio flows and foreign direct investment (FDI) have become larger just in the last few years. The gradual easing of restrictions on FDI is helping to increase competition and makes quality upgrading more likely. In many aspects of international engagement, India's development path differs from both Latin America and East Asia, and is reflective of continued conservative monetary management, and financial intermediation that is somewhat better than typical for countries with similar levels of income.

India has also made relatively unheralded progress in aspects of governance that provide the underpinnings of its development strategy. In the last decade, it has significantly improved the efficiency of its tax system, including direct and indirect taxes. Better administration of the income tax, reductions in penal rates that promoted evasion and corruption, and most recently, the introduction of a value added tax, have all helped to improve the revenue side of government, and reduce distortions created by the old system. There has been less progress on the expenditure side of government, and inefficiency of expenditure, as well as severe distortions caused by subsidies for rural water, power, and fertilizer, all remain. Also in the realm of governance, macroeconomic management on the monetary side has always been a relatively bright spot in India. Inflation has been managed well, and financial scandals and crises have mostly been avoided. In the financial sector, improvements in

## Achieving Development Success

bank efficiency, the creation of consumer credit and mortgage markets, and modernized and transparent stock markets have all played a role in supporting domestic economic activity.

In each of the dimensions of India's development strategy, three sets of problems arose with implementation. First, policy measures often were inferior ways of achieving avowed goals. Second, the system of discretionary bureaucratic control created classic 'vested interests' that prevented reform. Third, the short-run political logic of governing India often conflicted with long-term economic rationality. In all of these cases, vigorous debate on economic ideas did take place, and helped over time to move policies, and implicitly India's development strategy, in the right direction. The three types of difficulties with implementation are elucidated next.

First, policies were often misguided, because economic principles were not always well understood. Quantitative controls, case-by-case discretion for approvals, and outright prohibitions permeated all aspects of the economy, including industry, agriculture, and international trade and finance. Even when taxes and tariffs were used, so that the price system and markets could do some of the work of resource allocation, there were often multiple, arbitrarily high, and non-transparent rates, which encouraged evasion and distorted decision-making. A major example of price distortion occurred with the exchange rate, which was kept artificially high, contributing to a fulfilment of the attitude of export pessimism. Competition policy was not applied in an economically rational manner, and in any case was undercut by the artificial restrictions placed on industrial capacity. In the realm of social welfare, a major example of policy sub-optimality—one that has still not been corrected—has been in the design and application of laws designed to protect the interests of labour in the organized industrial sector.<sup>12</sup>

Second, once policies were in place that created distortions, situations almost invariably arose where there were beneficiaries of these distortions, through the economic rents created.<sup>13</sup> Customs officers and income tax officials became notorious for extracting payments in return for ignoring punitive restrictions or tax rates, but all government bureaucrats were put in positions where they had the potential to profit from the lawful or unlawful exercise of their discretionary control. In many cases, politicians became eager collaborators in, or even drivers of this process, to claim their share of the rents. Even in the current liberalized regime, some of these problems remain. Of course,

<sup>12</sup> In particular, the laws, or their interpretation, can make it impossible to fire workers, even if the firm has ceased to be operational, or is effectively bankrupt. Some court interpretations have even extended protections to workers' heirs.

<sup>13</sup> India was one of the cases that led to the coining of the term 'rent-seeking society' (Krueger 1974). See Singh (2004a) for a conceptual framework for considering India's governance institutions.

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## 4 Lessons

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policy restrictions and entry barriers also created rents for private economic actors—industrial license holders, middlemen in agricultural markets, licensed foreign exchange dealers, import license holders, and so on. These groups also developed interests in preserving the status quo. Indeed, there was a long period after independence in which economic controls steadily increased, as more and more groups and organizations sought to create rent-seeking opportunities.

Third, India's size and diversity required considerable attention to creating winning political coalitions—in this respect, India is quite distinct from state-led industrializers such as France, Germany, or Japan. A system in which the government occupied the commanding heights became a natural tool for seeking political advantage. Examples include the spread of all kinds of subsidies, especially to numerically important rural voters. These have reached ridiculous extremes, such as commitments of free electric power and water for farmers. Another example has been the nationalization of banks in 1969, designed to create a populist image and electoral appeal for then-Prime Minister Indira Gandhi as she sought to consolidate political power. Essentially, these exercises in competitive populism were often driven not by economic logic, however imperfectly applied, but by political imperatives. Once the new interest groups were created, as beneficiaries of the transfers or economic rents, they made it difficult to reverse the process, as discussed in the previous paragraph.

#### 4 Lessons

India has a long way to go before it reaches developed country status, and its income levels lag behind those of China, and even more behind, Latin America. It is easy to make a list of challenges—this 'unfinished business' represents an ongoing lesson of the Indian case. One danger is that of increasing income inequality and increasing regional inequality (Rao and Singh 2005; Singh and Srinivasan 2005). These trends can create political instability, or lead to growth that peters out, leaving a wealthy class connected with the global market economy, and significant numbers of poor people. Reductions in public investments in health, education and infrastructure, and tendencies for the upper income groups to effectively secede into gated communities and private transport can accentuate this danger. Policy responses that re-introduce controls and exacerbate rent-seeking would be another threat to sustained high growth. One of the lessons of the Indian development model was its ability to balance different interests through formal democratic processes as well as informal political bargaining, albeit at the cost of higher growth. The

## Achieving Development Success

challenge now is to create a new social contract that softens the growth-equity trade-off, so that both can be better achieved.

Social stratification naturally inhibits equity: many of the poorest parts of India, with the worst human development indicators, have high proportions of tribals or Dalits (former untouchables). Interestingly, the software industry provides an example of what is possible. Initially, the view of computer science as a cerebral activity with high social status made it attractive for upper castes in India, especially in the South, where quota systems had restricted access to government jobs for the highest castes. Over time, however, the industry has attracted entrants from all backgrounds. Global competition has promoted a meritocratic, relatively egalitarian culture in the industry. Women, too, are increasingly drawn into a specialty that does not suffer from the traditional social constraints associated with other disciplines such as civil and mechanical engineering. In general, growth and urbanization have begun to chip away at traditional manifestations of social stratification. If policies are designed that improve access to education through targeted subsidies and supply increases, rather than increased use of quotas, this can also be a potential lesson of the Indian case, that globalization and liberalization can even promote equity.

Other areas where India's slow progress provides a negative lesson include agricultural development, infrastructure, and labour market reform. Agriculture remains one of the country's biggest challenges, though agricultural modernization cannot be a substitute for growth in labour-intensive manufacturing. New investments are required throughout the agricultural value chain, but these also require innovations in risk management and adjustment assistance that have been slow to develop, especially for agricultural producers. Many of the changes required have to do with relaxation of controls, but others require institution building, which is more difficult. Improvements in agricultural growth—and rural development more broadly—will address some of the concerns with respect to inequality, and have a value from that perspective as well. As agricultural productivity increases, labour will be freed up and must be absorbed into industry and services. Indian policy reform must be geared toward creating the conditions for large-scale labour-intensive manufacturing, for the domestic as well as the international market. This may be the single most important change needed in India, for sustained growth—it represents a very traditional, but logically sound goal for development strategy (e.g. Kelkar 1999; Srinivasan 2007; Panagariya 2008).

India's size can limit the lessons that might be drawn for other developing countries, which are almost all an order of magnitude smaller in total population. However, since economic reform has led to some decentralization of economic policy, the differential recent experiences of the Indian states provide additional benchmarking information. A fairly straightforward lesson

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from the overall Indian case is that both initial conditions and policy matter. Several states or sub-national regions which were favourably positioned to engage with the global economy have grown faster since the economic reforms of the 1980s and 1990s. At the same time, states that were not necessarily so well placed, and were lumped together as 'sick', have diverged somewhat, arguably as a result of differences in economic policy.<sup>14</sup>

At the national level, the change in India's growth rate and prospects, following policy reforms that opened up the economy to foreign trade and investment and substantially removed domestic industrial controls, seems to provide strong support for the view that policy matters (e.g. Panagariya 2008), though this view is still not unanimous. To the extent that the various policy reforms constituted an overall shift in thinking, they together represent a change in development strategy, similar to what occurred in many countries after the fall of the Berlin Wall. A reading of speeches by prominent reformers such as the current prime minister and finance minister of India support the case for a conceptual shift from 'governing the market' (Wade 1990) to 'enabling the market'. India's experience provides support for this perspective on development strategy. It is also plausible that some of the areas where India faces significant challenges, such as agriculture and higher education, are precisely ones where reform has been almost non-existent, leaving the old control regime with artificial scarcities and allocation distortions in place.

However, it should also be clear that the lessons from India do not support any extreme version of market orientation. The standard economic arguments for public intervention in certain areas are also borne out by the Indian case. In fact, the Indian State spread itself too thin by trying to run all manner of industries, either by direct ownership or through elaborate discretionary controls, and it is plausible that this was a contributing factor to the slow progress in areas such as basic health, nutrition, and education. The national government as well as state level governments are still struggling with the reorientation that is required for them to become focused vehicles for the delivery of public goods and services. A similar struggle is occurring with respect to reforming the provision of law and order, property rights protection, taxation, and arm's length regulation of industries where market forces alone may not guarantee efficient competition.

A less clear-cut boundary for the government's role lies in the realm of industrial policy. This chapter has argued that there is little evidence for the

<sup>14</sup> The illness metaphor was played on in the acronym BIMARU, which approximates the Hindi word for 'sick', and stands for Bihar, Madhya Pradesh, Rajasthan, and Uttar Pradesh. The second and third of these have shown improved performance, particularly in human development indicators, since the 1990s, and this can be plausibly traced to policy improvements.

## Achieving Development Success

success of industrial policy as a component of India's development strategy after independence. Rodrik (2006) makes a modern, general case for government intervention, based on the view that economic development is fundamentally driven by structural change in the economy, and that this change is 'fraught with externalities and spillovers of all kinds'. However, the nature of government intervention and industrial policy as conceived by Rodrik is quite circumscribed, being more indicative and oriented toward information exchange through 'public-private institutional arrangements'. It is unobjectionable that achieving this would be a useful step in meeting future development challenges.

If India's development successes and setbacks offer some lessons for other countries on balancing the role of government and market in development strategy, perhaps its most important lesson comes from its political institutions. Democracy in India, however, imperfect, has survived and deepened over the last six decades. It has provided an important institutional backdrop for the recent economic success of the country. If anything, it has begun to provide a vehicle for more vigorous competition among politicians to serve long-term constituent interests (Singh 2007).<sup>15</sup> Democracy has also allowed the media and civil society organizations to operate relatively freely in India, bringing greater transparency and accountability to markets and governments. The design of robust democratic institutions must be considered the greatest achievement of India's strategy of development.

If one recalls the chaos of India's partition in 1947, it is clear that achieving sustainable democracy was not a foregone conclusion. To some extent, the heterogeneity of India, and the lack of any single axis of social domination made it easier to sustain the institutions created from 1947 onward: the contrast with Pakistan is perhaps telling in this regard. The same heterogeneity also created problems of multiple vetoes (Bardhan 1984). However, greater federalism and economic decentralization have helped break some of those previous logjams (Singh 2007). The final lesson from the Indian experience is that carefully designed political institutions that can manage competing interests effectively are an achievable goal, as well as a supportive backdrop for development.

<sup>15</sup> The dual importance of political and economic competition emphasized in our discussion of India is not dissimilar to the independently developed thesis of Weder and Weder (2008) for the Swiss case, as part of this project: 'This paper argues that economic competition and political contestability are two key determinants of the successful development of the Swiss economy in the nineteenth and twentieth century'. This similarity in the analytical examination of the development of two such different countries (in size, history, and environment) suggests a value to the exercise undertaken in this 'country role models' project.

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