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# From Dirgisme to Neoliberalism: Aspects of the Political Economy of the Transition in India

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*This paper argues that internal contradictions arising from the inability of the post-Independence Indian state to introduce the institutional changes and adopt the interventions needed for successful import-substituting industrialisation, had resulted in a crisis in that growth strategy by the mid-1960s. Yet the transition to neoliberalism occurred only after a decade-and a half, and in accelerated fashion only after two decades. The paper would trace this lag to the timing of changes in the international financial system that was a prerequisite for liberalization. It would argue that once the transition occurred and gained momentum India emerged as a successful instance of neoliberal growth because of the foundations created in the import substituting years, her fortuitous ability to avoid severe balance of payments and financial crises, and the human face which governments were forced to adopt given the compulsions of democracy in a populous country with significant poverty.*

***Keywords:*** *Neoliberalism, India, Industrial Growth, Finance Capital, Planning*

Over the last two decades or more, the developing world has shifted out of development strategies involving a highly interventionist and often developmentalist state to one that has been widely characterised as a neoliberal strategy. Neoliberalism is of course an ambiguous and loosely defined term, even when restricted to the economic sphere. So it would be useful to clarify the sense in which it is being used in this context. In what follows, neoliberal theory and practice are taken as referring to: (i) the use of the rhetoric of market fundamentalism, in which the market or ostensibly "free economic exchange" is presented as the most efficient mechanism to work the economic system, to pave the way for the increasingly unfettered functioning of private capital, both domestic and foreign; (ii) the use of the notion of a minimalist state, to be realised by dismantling its developmentalist version, to legitimise the shift of various terms of trade and mechanisms of distribution in favour of the owners of capital and their functionaries and conceal the conversion of segments of the state apparatus into sites for primitive accumulation; and (iii) the pursuit of a regime of accumulation where the home market and deficit-financed state expenditure are replaced by exports and debt-financed private expenditure as the principal stimuli to growth.[1]

Despite a degree of commonality across developing countries with respect to the transition to a neoliberal strategy, there is no unanimity on the factors that accounted for this transition. Some attributed it to "government failure." That is the very idea that the state would be able to garner adequate information, ensure that there are no agency problems and successfully direct development was brought into question. Others saw a neoliberal strategy as being more "efficient" in the allocation of resources and therefore capable of ensuring sustained growth, unlike the interventionist alternative. Yet others see the transition not as result of some objective choice among alternatives, but as reflective of changes in the relative strengths of different classes.

In what follows, this paper examines India's post-Independence development experience to identify the factors that led to the failure of interventionist, import-substituting strategies, assess the options that were available in the context of that failure and understand why "neoliberalism" emerged as the preferred alternative. Post-independent India was one of the classic cases of State-led economic development. Not only was the State highly interventionist, but over time the economy included a sizeable public sector, especially in areas of

[1] This is because inequality of asset ownership and incomes limits the expansion of an income-driven, mass consumption market at home, and dependence on finance limits deficit-financed, public expenditure.

infrastructure and basic industries. The "mixed" economy which thus came into being within the political framework of a parliamentary democracy made the Indian experiment novel and unique and the Indian industrialization strategy was seen as a model for other developing countries with a reasonably-sized home market.

State intervention, especially after the mid-1950s, attempted to influence the pace and pattern of industrialization by: (i) insulating the domestic market from excessive import competition, (ii) regulating the inflow of foreign capital and mediating the interaction of domestic and foreign capital; (iii) investing in infrastructure, basic and heavy industries and closing gaps that may not be filled by private players because of lumpy investments, long gestation lags and uncertain profits; (iv) using controls on capacity creation and production and the tax-cum-subsidy regime to influence the allocation of investment; and (v) putting in place a regulatory regime that attempted to reduce industrial concentration and ensure a more regionally dispersed industrial sector.

Given this background, India's transition in 1991 to a liberal and open industrial policy regime was an event of great historical significance. The question as to why and how the transition occurred, the effect it had on the pace and pattern of industrial growth, and employment generation and distribution are still being debated. This paper attempts to trace the evolution of India's industrialization since Independence, to partly explain the transition and to assess the impact of alternative policy regimes on the pace and pattern of growth.

There are two alternative ways of periodizing industrialization during the six decades since Independence: in terms of episodes of growth and deceleration; and in terms of the policy regime in place. The former warrants dividing the whole period into three phases: (i) the immediate post-Independence years stretching from 1950 to 1964, when Indian industry grew at creditable rates compared both with earlier phases of industrialisation and with the pace of industrialization in many similarly placed developing countries; (ii) the period from the mid-1960s to the late-1970s referred to as one of 'secular stagnation' when compared to the preceding phase; and (iii) the years since the 1980s when growth has not only risen on average and remained high for a relatively long period of time, but showed signs of further acceleration after 2002. (Table 1)

When seen in terms of policy, we can speak of three phases, two of which coincide with the growth-based periodization, and one that does not. The first was the period of *dirgisme*, with a highly interventionist State leading development between the early 1950s and the middle of the 1960s. In the second phase—the middle of the 1960s to the end of the 1980s—interventionism remained in place, but because of evidence that intervention had not been

**Table 1.** Annual Trend Rates of Growth of Output

| | Total | Manufacturing | Mining& Quarrying | Electricity |
|---|---|---|---|---|
| 1950-51 to 64-65 (a) | 7.2 | 7.1 | 5.9 | 13.6 |
| 1965-66 to 79-80 (b) | 4.7 | 3.8 | 6.9 | 6.2 |
| 1965-66 to 74-75 (b) | 4.3 | 2.7 | 9.4 | 3.8 |
| 1975-76 to 84-85 (c) | 4.9 | 4.3 | 6.6 | 7.3 |
| 1985-86 to 94-95 (d) | 6.2 | 6.2 | 4.2 | 8.3 |
| 1995-96 to 04-05 (e) | 5.5 | 5.8 | 2.7 | 5.0 |
| 2000-01 to 06-07 (e) | 7.3 | 7.9 | 4.0 | 4.8 |

Notes: a) Based on series with base 1950-51 =100; b) Based on series with base 1970 =100; c) Based on series with base 1970 =100; d) Based on series with base 1980-81 =100; e) Based on series with base 1993-94 =100.

*Source*: Computed from figures on Index of Industrial Production reported in Reserve Bank of India (1961; 1971; 1981; 1991; 1995; 2009).

implemented as originally planned and had therefore not managed to realise its multiple objectives it was losing its legitimacy. This triggered a contradictory phase in policy where the strengthening of some measures of intervention was accompanied by a creeping process of limited liberalization. Finally, the third phase began in 1991-92 when, in the wake of the balance of payments crisis of 1991, the government opted for an accelerated process of liberalization.

India's transition in 1991, initially through a programme of "structural adjustment", entailed a regime of "liberal imports", substantial dilution of regulations governing foreign investment, a progressive removal of administrative controls, a strictly limited role for public investment, the privatisation of publicly-owned assets over a wide field, the easing of capital controls and domestic financial liberalisation that did away with targeted lending at differential interest rates. Underlying this transition was a changed international conjuncture.

To say this is not to whitewash the fundamental flaws of the dirigiste regime, or to gloss over its basic contradictions, but merely to avoid making facile judgements about it. Both the advocates of neo-liberal reform and its critics trace the transition to the factors leading up to the development impasse of the late 1960s and 1970s in India. This was a period when growth decelerated substantially relative to that recorded during the first fifteen years after Independence. This deceleration was not accidental or exogenously determined. Going behind the socialist rhetoric of the 1950s, it is clear that there were a number of features of India's post-Independence growth strategy that structurally limited the potential of the system. To start with, despite talk of land reform, of providing "land-to-the-tiller" and curbing the concentration of eco-

nomic power, little was done to attack or redress asset and income inequality after Independence. The worst forms of absentee landlordism were done away with, but the monopoly of land remained intact in most of rural India. And while some monopolistic practices were curbed, asset concentration in the industrial sector was never really challenged. Rather, India's monopolists were able to use state intervention as a device to consolidate and expand their monopolistic positions.

One consequence of the persistence of asset and income inequality was that there were definite limits to the expansion of the market for mass consumption goods in the country. Employment and income growth in the private sector was limited. And the large mass of peasantry, faced with insecure conditions of tenure and often obtaining only small shares of the outputs they produced, had neither the means not the incentive to invest. The prospect of increasing productivity and incomes in rural India (which was home to the majority of its population) in order to stimulate domestic demand was therefore restricted. The absence of any radical land redistribution meant that the domestic market, especially for manufactured goods, remained socially narrowly based. It also meant that the growth of agricultural output, though far greater than in the colonial period, remained well below potential.

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

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

This strategy did pay dividends during the decade and a half immediately following Independence. In this period rates of industrial growth were creditable by international standards. India built up a diversified industrial base, and the public sector expanded rapidly enough to provide crucial infrastructural ser-

vices, industrial raw materials and capital goods to sustain industrial growth even when the foreign exchange available to import these commodities was limited (Chakravarty, 1987). By the mid-1960s, however, not only was the once-for-all stimulus offered by import substitution exhausted, but the ability of the State to continue to provide the stimulus to growth was also undermined by its inability to raise adequate resources. In consequence, aggregate growth decelerated leading to the "secular stagnation" of the late-1960s and 1970s.

There were three mutually reinforcing and interrelated contradictions that aborted the objectives of this basic model. First, the state within the old economic policy regime had to simultaneously fulfil two different roles that were incompatible in the long run. On the one hand it had to maintain growing expenditure, in particular investment expenditure, in order to keep the domestic market expanding. At the same time, however, the state could not mobilise adequate resources through taxation and the exchequer was a medium through which large-scale transfers were made to the private sector, so that the state effectively became the most important instrument for primary accumulation by the domestic capitalist class in its various manifestations.

This contradiction between these two different roles of the state was manifested in the government's revenue account. This was in surplus until the end of the 1970s, but thereafter turned to growing deficit, despite increasing resort to indirect taxation and hikes in administered prices. The implications of this growing fiscal crisis were obvious: the government could either cut back on its own investment or maintain it through increased borrowing. The period from the mid 1960s to the late 1970s witnessed the first option being chosen, while from the early 1980s the second option was dominant. But such government borrowing, and the subsequent increase in public debt, in turn generated pressure for changes in economic strategy.

The second contradiction lay in the inability of the state to impose a minimum measure of discipline among the capitalists, without which no capitalist system anywhere can generate sustained growth. One consequence was, for example the failure of domestic capitalists to diversify from serving the protected and lucrative domestic market to the competitive export market in order to earn a part of the foreign exchange expenditure their activities entailed. This absence of a collective discipline in turn meant that a successful transition could not be made from the Nehruvian-style interventionist regime to an alternative viable capitalist regime with a different kind of state intervention, such as in Japan and South Korea, where state intervention was based on close collaboration between the state and capital, and the simultaneous enforcement of fairly rigorous discipline among the capitalists. This meant that the only feasible alter-

native to the earlier dirigisme instead became a process of deregulation and liberalisation.

The third contradiction had its roots in the social and cultural ambience of a developing country like India. Metropolitan capitalism has been characterised by continuous product innovation, with newer goods constantly entering the market and even creating new lifestyles. But in India, as we have seen, the market for industrial goods was limited from the early stages, with additional purchasing power dominantly accruing to a comparatively narrow social segment which in turn provided the main source of growth in demand for manufactured consumer goods. This social segment, as in most other such developing countries, was eager to emulate the lifestyles and consumption patterns of the metropolitan centre. Therefore it was not satisfied with having more domestically produced goods; rather, its demand was increasingly for the new goods produced in the metropolitan centres, which could not be locally produced using only indigenous resources and technology.

This created an imbalance between the possibilities of domestic production and the patterns of domestic demand, since much of the additional demand for consumer goods came from richer social groups. While this was sought to be contained to some extent by import controls, such controls inevitably gave rise to clandestine imports. In any case, this basic imbalance increased over time because of further innovations in the metropolitan economies. This created powerful and growing pressure among the more affluent groups in society for a dismantling of controls on both domestic production and imports, regardless of the effects on the balance of payments and erosion of the viability of the domestic manufacturing sector. The international demonstration effect has been a powerful instrument in the hands of metropolitan capital in its efforts to prise open the markets of developing countries, and India is no exception.

The net result of the working out of all these contradictions has been evident in the Indian economy for quite some time. Changes in the rate of growth of manufacturing production over the decades provide a barometer of the possibilities of productive accumulation. In the period 1951 to 1965, manufacturing output grew at an average annual rate of 7.1 per cent, but the subsequent 15 years (1965-80) saw this rate fall to only 3.8 per cent. By the first half of the 1980s, manufacturing growth was slightly higher at an annual rate of 4.3 per cent, but in the decade beginning 1985-86 it touched 6.2 per cent and after a deceleration immediately thereafter rose again to 7.9 per cent during 2000-01 and 2006-07. Thus, after 15 years of rapid industrial expansion in the 1950s and the early 1960s, there was a dramatic decline in the rate of manufacturing growth during the next 15 years. Even though the growth-rate picked up some-

what in the early 1980s, it was still nowhere near the rates witnessed in the first 15 years of planning. It is only after the mid-1980s that a pronounced boom occurred once again in Indian manufacturing.

The fact that the 15 years after the mid-1960s which were characterised by a relative stagnation in manufacturing output also witnessed a decline in the rate of growth of public investment is well-known. This decline meant, as discussed earlier, that in promoting primary accumulation of capital, the state could not adequately fulfil its other role of expanding the domestic market. This adversely affected a number of industries which catered to mass consumption or those with strong linkages to public investment. In addition, the sluggish rate of public investment added to infrastructure constraints upon private economic activity.

These were the factors that underlay the development impasse of the late-1960s and 1970s. Any effort on the part of the state to accelerate growth through deficit-financed expenditures either resulted in inflation or in a balance of payments problem, or in a combination of the two. The state was constrained to avoid both of these outcomes beyond a certain limit.

## The 1980s Recovery

Since this feature of Indian political economy did not change subsequently, the revival of growth in the 1980s appears puzzling at first glance. The return to economic buoyancy cannot be attributed to the emergence of any new source of stimulus to growth. Exports during these years were by no means remarkable enough to stimulate growth in an economy as large as that of India. And the factors which had earlier constrained the expansion of the mass market were still operating. This implied that the stimulus to growth, as before, had to come from the state (Chakravarty, 1987; Patnaik, 1995).

And this is essentially what happened. There were three new features which characterized the 1980s, which allowed the economy to escape from the growth impasse of the earlier period. First, there was a big increase in the fiscal stimulus to the economy provided by government spending. Second, there was substantial liberalization of imports, especially of capital goods and components for manufacturing. Third, associated with both of these, there was a shift to relying on external commercial borrowing by the state to finance the increases in the consequent fiscal and current account deficits.

In terms of fiscal stimulus, there was a significant increase in the total fiscal deficit as a share of national income. The gross fiscal deficit of the central and state governments together averaged 9.5 percent of GDP at current market

prices in the second half of the 1980s and touched 10.1 percent in 1990-91. This was not due to any increase in the share of public investment, but largely the result of a decline in the share of public savings, reflected in the burgeoning revenue deficit (which rose from an average of 2.8 percent of GDP during 1985-86 to 1989-90 to 4.5 percent in 1990-91). Current expenditures of the State grew at a rate which outstripped by far the growth in tax and non-tax revenues, despite hikes in indirect taxation and in administered prices.

The second new feature was the liberalization of imports of capital goods and components required for a number of commodities catering to luxury consumption, especially of electronics and automobiles. This was based on the argument—explicitly stated by some government officials—that since even the small segment of the population that demanded such goods amounted in absolute terms to a fairly large number, the economy could grow on the basis of such an industrialization strategy whose benefits would eventually "trickle down" to the poorer sections of the population as well.

The import liberalization of the late 1980s was not tied to a larger export effort; its main immediate thrust was towards producing more goods—luxury goods —for the domestic market. In 1985-86, the very first year that the policy was introduced, there was a dramatic increase in balance of payments deficits, with the current account deficit increasing to 2.26 percent of GDP. While it reached a plateau thereafter, this still reflected a very large increase in non-oil imports, since there was a significant reduction in India's oil import bill between 1984-85 and 1988-89 owing to the development of the Bombay High oilfield. But for the import profligacy, the trade deficit would have declined significantly in absolute terms since mineral oil and related products accounted for nearly a third of India's import bill at the start of the 1980s.

Meanwhile, remittance inflows during this period had flattened out and "soft loans" were becoming more and more difficult to come by. In this context, the maintenance of a high, even though steady, absolute level of the trade deficit, and the related need to finance large current account deficits, turned out to be an extravagance that could not be sustained. It should be noted that more than 40 per cent of the increase in import value between 1984-85 and 1988-89 (barring what was effectively re-exported) was on account of machinery and transport equipment, including components, which went to a significant extent into the production of a variety of goods for upper income groups.

The third new feature was a systematic resort to commercial borrowing from abroad. As the trade and current account deficits went up in the latter half of the 1980s, and access to soft loans dwindled, there was increasing recourse to external commercial borrowings. This in turn contributed, with a lag, to large

current account deficits because of the need for debt servicing, and eventually necessitated further borrowing. Debt has a habit of escalating rapidly, feeding upon itself. As fresh debt was contracted even to pay off old debt, the terms at the margin became stiffer, the maturity period shorter and hence the rate of escalation of debt increased as well. The debt in dollar terms nearly quadrupled during the 1980s, from around $20 billion in 1980 to nearly $82 billion in 1990; debt to banks and private individuals increased more than 10 times from just under $2 billion to more than $22 billion. By 1990, India's debt-service payments absorbed foreign exchange amounting to nearly one-third of the value of exports.[2]

It is the combination of these three features which explains the State's ability to pull the economy out of the impasse it faced during the late 1960s and 1970s. Of course it can be asked why the earlier successive governments—which were after all just as desperate to revive growth - could not adopt a similar strategy. To answer this we need to look at developments outside the country, which influenced India's medium-term growth prospects significantly. The rise to dominance of finance capital in the international economy was the most important of such developments.

## Changed International Conjuncture

Until the early 1970s, the private international financial system played only a limited role in recycling financial surpluses to the developing countries. Capital flows to developing countries, barring a few unusual exceptions like South Korea, were through official bilateral and multilateral channels. The period immediately after the first oil shock saw a dramatic change in this scenario. Since oil surpluses were held mostly as deposits with the international banking system based in and controlled by the developed world, the private financial system there became a powerful agent for recycling surpluses. This power was immense. The expenditure that was fuelled by such credit in both the developed and developing worlds generated further surpluses with the oil producers, who then deposited these surpluses with the transnational banks, who, in turn, could offer further doses of credit. By 1981, OPEC countries are estimated to have accumulated surpluses to the tune of $475 billion, $400 billion of which was

[2] While this increase in external debt was not quite as rapid and extensive as had occurred in the previous decade in some Latin American economies, it was nevertheless very significant in terms of India's balance of payments.

parked in the developed industrial nations.

This power of finance was all the more significant because a slowdown in productivity growth in metropolitan industry was already bringing the postwar industrial boom to a close, and this process was being hastened by the contractionary response to the oil shocks. As a proportion of world output, net international bank loans rose from 0.7 per cent in 1964 to 8.0 per cent in 1980 and 16.3 per cent in 1991. Relative to world trade, net international bank loans rose from 7.5 per cent in 1964 to 42.6 per cent in 1980 and 104.6 per cent in 1991 (World Bank, various issues).

Two other developments contributed to the increase in international liquidity during the 1970s and 1980s. First, the United States had built up large international liabilities during the Bretton Woods years, including those resulting from expenditures on the Vietnam War and its policing efforts elsewhere in the world. The explosion of the Eurocurrency market in the 1970s reflected this. This was sustained by the confidence in the dollar stemming from the immediate post-War hegemony of the US, which made it as good as gold. Such international confidence in its currency allowed the US to ignore national budget constraints on its international spending and resulted in an expansion of liquidity in international financial markets.

Second, the changing demographic structure in most of the advanced countries, with baby boomers reaching the age when they would emphasize personal savings for retirement. This was accentuated by changes in the institutional structures relating to pensions, whereby in most industrial countries, public and private employers tended to fund less of the planned income after retirement, requiring more savings input from employees themselves. All this meant growing demand for more variety in savings instruments as well as higher returns, leading to the greater significance of pension funds, mutual funds and the like in financial markets.

The resulting massive increase in international liquidity found banks and non-bank financial institutions desperately searching for the means to keep their capital moving. At first, there were booms in consumer credit and housing finance in the developed industrial nations. But when those opportunities petered out, a number of developing countries were discovered as the "emerging markets" of the global financial order. Capital in the form of debt and equity investments began to flow into these countries, especially those that were quick to liberalize rules relating to cross-border capital flows and regulations governing the conversion of domestic into foreign currency.

From the point of view of governments in certain developing countries, this growth in international finance appeared positive. Some of them needed the

liquidity to finance their post-shock deficits. But for others, which were not willing to undertake the structural reforms that would involve attacking the very landed and industrial interests they represented, and were therefore stuck without an alternative in the face of the development impasse after the 1960s, the new situation appeared to offer a lifeline. They could now experiment with the alternative of opening up their economies, integrating with world capitalism and hope to derive at least some of the benefits of whatever growth occurred in the world system. This was certainly true of India in this period.

This option did not exist earlier, since the very process of opening up would have involved a rise in the current account deficit to levels not warranted by their access to finance through the development aid network. The resulting balance of payments problem would have necessitated an immediate reduction in growth, ensured through a State-led deflation. Larger access to international finance seemed to allow for the possibility of running larger current account deficits, permitting the State to liberalize the economy and hope that in the medium term this would trigger an increase in exports. Liberalization, which was not a relevant option under the earlier international financial framework, was all of a sudden a real and even attractive option.

Thus, this congruence of interests—of the developing countries to borrow and the banks to lend—resulted in the fact that the current account deficit was for almost a decade and a half no constraint on growth in at least some underdeveloped countries. The fall-out of this scenario is now history. Right through the 1970s and 1980s—and of course definitely by the 1990s—governments in one developing country after another combined more liberal growth strategies with huge budget deficits financed with international borrowing. This also served to neutralize at least partly, the adverse effects on domestic growth that trade liberalisation had. In fact, during those years many developing countries actually recorded rather creditable rates of growth. Typically, these were then attributed to liberalisation rather than to reckless pump-priming by domestic governments, which the irresponsible lending practices of the international banking system had in turn encouraged.[3]

Seen in this light, the revival of growth in India during the 1980s is far easier to explain. Exploiting the access to foreign exchange that was afforded by the rise to dominance of finance internationally, the government chose to pump-prime the system. Rising government expenditure, however, was not accompanied by an increase in resource mobilization through rising taxes. The fiscal stimulus was financed through rising deficits, including a rising deficit on the

[3] These issues are discussed in more detail in Chandrasekhar and Ghosh (2004).

revenue account of the government's budget. The demand stimulus resulting from such expenditure was serviced by domestic industry with the help of imported capital goods, intermediates and raw materials, imports of which were liberalized. This essentially meant that the import intensity of domestic production rose. But such growth was not constrained by inadequate access to foreign exchange, since it was accompanied by an increase in foreign borrowing from the IMF, the international commercial banking system and non-resident Indians. Fortunately for India, this was the time when remittances from Indian workers, especially in the Gulf, to sustain the consumption expenditures of families left behind in the country, provided the country with a fortuitous inflow of foreign exchange. Despite this, India's foreign debt to GDP ratio doubled during the 1980s. It was when international creditors chose to shut off such credit at the end of the 1980s that India ran into the balance of payments crisis of 1990-91, which provided the grounds for advocates of reform to push through an IMF-style stabilization and adjustment strategy.

## The 1990s and After

If this was the set of factors that triggered the growth turn around in the 1980s, how did growth manage to remain high and even accelerate after the 1991 crisis. Annualised month-to-month rates of growth of the manufacturing Index of Industrial Production indicate that after touching a trough in September 2001, growth as captured by this index staged a medium term recovery to peak at 17.6 per cent in November 2006 (Chart 2). Though there are signs of a downturn in industrial growth since then, the period between 2001 and 2006, when formal employment in the organised manufacturing sector stagnated or declined, was one of accelerating, and on average high, growth. Going by GDP estimates the Indian economy had moved on to a higher growth trajectory during the years since 2003-04 with growth averaging close to 9 per cent per annum. What the sectoral GDP estimates suggest is that this high growth characterized the manufacturing sector as well.

Taking a long view, we find that industrial growth as captured by the Index of Industrial Production (IIP), which averaged 9 per cent in the second half of the 1980s, slumped immediately after the balance of payments crisis of 1991. However, a recovery followed, with manufacturing growth rising to a peak of 14.1 per cent over the three-year period 1993-94 to 1995-96. This led many to argue that liberalization had begun to deliver in terms of industrial growth. But the boom proved short-lived, and industry entered a relatively long period of

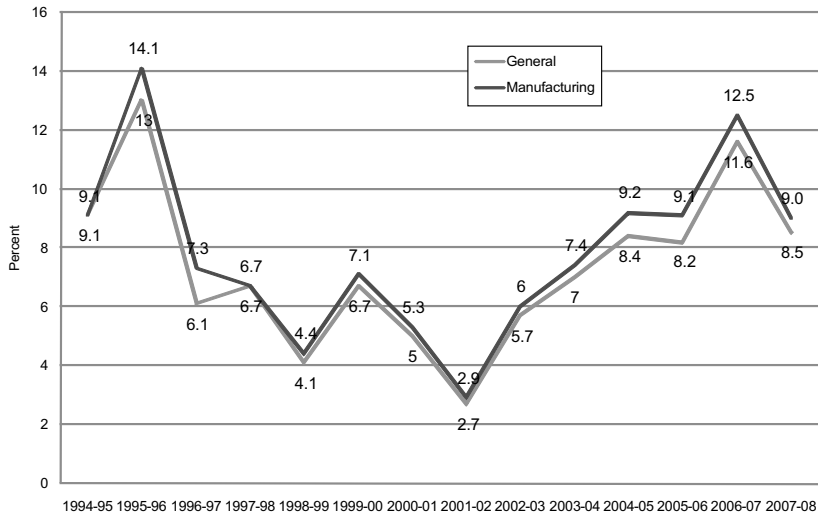


**Chart 1.** Annual Rate of Growth of the Index of Industrial Production

*Source*: Computed from figures provided by Government of India, Ministry of Statistics and Programme Implementation, Central Statistical Organisation. Available at http://mospi.nic.in/iip_table3.htm.

much slower growth, with fears of an industrial recession being expressed by 2001-02.

Since then the industrial sector has once again recovered, with rates of growth touching the high level s of the mid-1990s by 2004-05 (Chart 1). Even though the peak of 1995-96 has not been equalled, growth was creditable and sustained over the five years ending 2007-08.

An additional cause for comfort is that there appear to be significant differences between the mini-boom of the mid-1990s and what occurred recently. The 1993-1995 "mini-boom" was the result of a combination of several once-for-all influences. Principal among these was the release after liberalization of the pent-up demand for a host of import-intensive manufactures, which (because of liberalization) could be serviced through domestic assembly or production using imported inputs and components. Once that demand had been satisfied, further growth had to be based on an expansion of the domestic market or a surge in exports. Since neither of these conditions was realized, industry entered a phase of slow growth.

What was surprising, in fact, was that growth was not even lower. Economic liberalization and fiscal reform were bound to adversely affect manufacturing growth. To start with, import liberalization results in some displace-

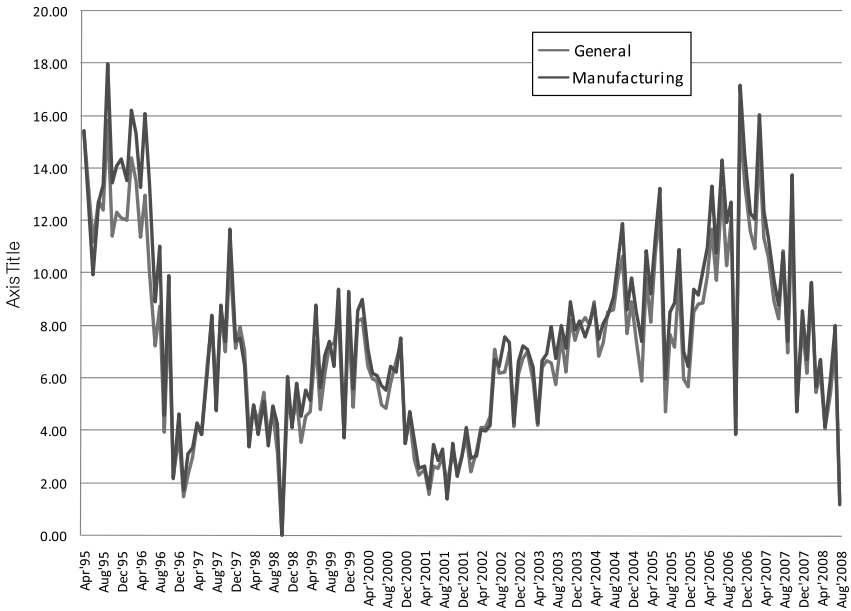


**Chart 2.** Month-to-Month Annualized Rates of Growth of Industrial Production

*Source*: Computed from figures provided by Government of India, Ministry of Statistics and Programme Implementation, Central Statistical Organisation. Available at http://mospi.nic.in/iip_table3.htm.

ment of existing domestic production directly by imports and indirectly by new products assembled domestically from imported inputs. Second, the reduction in customs duties resorted to as part of the import liberalization package and the direct and indirect tax concessions that were provided to the private sector to stimulate investment, led to a decline in the tax-GDP ratio at the Centre by between around 1.5 percentage points of GDP over the 1990s. This implied that so long as deficit-spending by the government did not increase, the demand stimulus associated with government expenditure would be lower than would have otherwise been the case. Third, after 1993-94 the government also chose to significantly restrict the fiscal deficit as part of fiscal reform. Success on this front is a late 1990s phenomenon, when the stimulus provided to industrial growth by state expenditure was substantially smaller than was the case in the 1980s. These were among the factors that slowed industrial growth after the mid-1990s.

If the stimulus to industrial growth was dampened after the late 1990s, what explains the recent recovery in industrial growth? That recovery was in

**Table 2.** Decile-wise Mean Consumption Expenditure at 1993-94, 1993-94 and 2004-05 Prices

| Consumption deciles | Mean Consumption | | Growth (%) |
|---|---|---|---|
| RURAL | 1993-94 | 2004-05 | |
| 1 | 116.25 | 121.05 | 4.13 |
| 2 | 154.03 | 157.95 | 2.54 |
| 3 | 178.18 | 181.74 | 2.00 |
| 4 | 200.75 | 205.02 | 2.12 |
| 5 | 224.27 | 229.08 | 2.14 |
| 6 | 250.84 | 256.37 | 2.21 |
| 7 | 282.38 | 289.11 | 2.38 |
| 8 | 324.59 | 334.13 | 2.94 |
| 9 | 395.59 | 409.99 | 3.64 |
| 10 | 687.19 | 783.92 | 14.08 |
| Total | 281.40 | 296.84 | 5.48 |
| URBAN | | | |
| 1 | 154.46 | 171.71 | 11.17 |
| 2 | 212.38 | 234.38 | 10.36 |
| 3 | 252.15 | 282.97 | 12.23 |
| 4 | 291.82 | 332.00 | 13.77 |
| 5 | 334.90 | 388.37 | 15.97 |
| 6 | 383.90 | 455.62 | 18.68 |
| 7 | 448.70 | 538.74 | 20.07 |
| 8 | 541.47 | 651.49 | 20.32 |
| 9 | 691.72 | 845.83 | 22.28 |
| 10 | 1268.80 | 1688.94 | 33.11 |
| Total | 458.04 | 559.01 | 22.04 |

*Source*: Computations based on National Sample Survey Organisation, Department of Statistics, Government of India (1997; 2006).

large measure due to the increases in private consumption and housing investment resulting from two important developments. One is the much faster increases in income in the top deciles of the population. It is known that these do not get effectively reflected in consumption expenditure surveys and inequality calculations based on them, because these surveys inadequately cover the upper income groups. Yet a comparison of the mean real per capita consumption expenditure by decile groups indicates that the rate of growth of mean consumption expenditure in the highest decile in both rural and urban areas rose much faster than in the other decile groups. Moreover, not only did aggregate

mean consumption expenditure in the urban areas increase at a rate (22 per cent) much faster than in rural areas (5.5 per cent), but in the urban areas the rates of growth of such expenditure in the top five deciles, (which ranged between 19 and 33 per cent) was much higher than in lower five deciles (between 10.4 and 16 per cent). This meant that there would have been some diffusion of luxury consumption to those below the topmost deciles in the urban areas.[4] The other is the sharp increase in credit financed housing investment and consumption, facilitated by financial liberalization. Credit-financed consumption and investment played an extremely important role in keeping industrial demand at high levels. Credit served as a stimulus to industrial demand in three ways. First, it financed a boom in investment in housing and real estate and spurred the growth in demand for construction materials. Second, it financed purchases of automobiles and triggered an automobile boom. Finally, it contributed to the expansion in demand for consumer durables.

An important point to note here is that even though there was a slowdown in the flow of foreign loans to India after the 1991 crisis, the financial liberalisation that accompanied the adjustment process attracted capital in other forms such as equity investments that contributed to liquidity in the system. Hence an important way in which integration has influenced the process of growth in India is its impact on the role played by credit in financing private consumption and investment. Total bank credit grew at a scorching pace from 2005 onwards, at more than double the rate of increase of nominal GDP. As a result, the ratio of outstanding bank credit to GDP (which had declined in the initial post-liberalisation years from 30.2 per cent at the end of March 1991 to 27.3 per cent at the end of March 1997) doubled over the next decade to reach about 60 per cent by the end of March 2008. Thus, one consequence of financial liberalisation was an increase in credit dependence in the Indian economy, a characteristic imported from developed countries such as the USA. This increase in credit could appear to be positive inasmuch as it reflected a greater willingness on the part of banks to lend: the growth in credit out-performed the growth in deposits, resulting in an increase in the overall credit-deposit ratio from 55.9 per cent at end March 2004 to 72.5 per cent at end March 2008. This increase was accompanied by a corresponding drop in the investment-deposit ratio, from 51.7 per cent to 36.2 per cent, which indicates that banks were shifting away from their earlier conservative preference to invest in safe government securities in excess of what was

[4] Inequality in consumption expenditure as measure by the gini coefficient rose from 0.286 to 0.305 in rural areas and from 0.344 to 0.367 in urban areas during this period.

**Table 3.** Personal Loans as per cent of Total Outstanding Credit of Commercial Banks

| | 1996 | 2000 | 2007 |
|---|---|---|---|
| State Bank of India and Associates | 9.5 | 10.7 | 22.0 |
| Other Nationalised Banks | 9.1 | 10.9 | 15.8 |
| Foreign Banks | 8.8 | 17.1 | 24.8 |
| Regional Rural Banks | 10.5 | 18.8 | 20.5 |
| Private Sector Banks | 9.7 | 7.9 | 37.3 |
| All Scheduled Commercial Banks | 9.3 | 11.2 | 22.3 |

*Source*: Reserve Bank of India (1997-2008).

required under the statutory liquidity ratio (SLR) norm (Data in this and the subsequent four paragraphs are from Committee on Financial Sector Assessment, 2009).

However, rapid credit growth meant that banks were relying on short term funds to lend long. From 2001 there was a steady rise in the proportion of short-term deposits with the banks, with the ratio of short term deposits (maturing up to one year) increasing from 33.2 per cent in March 2001 to 43.6 per cent in March 2008. On the other hand, the proportion of term loans maturing after five years increased from 9.3 per cent to 16.5 per cent. While this delivered increased profits, the rising asset-liability mismatch increased the liquidity risk faced by banks.

These changes do not appear to have been driven by the commercial banking sector's desire to provide more credit to the productive sectors of the economy. Instead, retail loans became the prime drivers of credit growth. The result was a sharp increase in the retail exposure of the banking system, with overall personal loans increasing from slightly more than 8 per cent of total non-food credit in 2004 to close to 25 per cent by 2008. Of the components of retail credit, the growth in housing loans was the highest in most years. As Table 3 indicates, the (new) private banks were the most enthusiastic adopters of such a strategy, followed by foreign banks.

This rapid increase in credit and retail exposure, with inadequate or poor collateral, would have brought more tenuous borrowers into the bank credit universe. A significant (but as yet unknown) proportion of this could be "sub-prime" lending. According to one estimate, by November 2007 there was a little more than Rs.400 billion of credit that was of sub-prime quality, defaults on which could erode the capital base of the banks. To attract such borrowers, the banks offered attractive interest rates below the benchmark prime lending rate (BPLR). The share of such loans in the total rose from 27.7 per cent in March

2002 to 76.0 per cent at the end of March 2008. This increase was especially marked for consumer credit and reflected a mispricing of risk that could affect banks adversely in the event of an economic downturn.

The point to note is that compared to the mid-1990s the growth of credit in recent years has been explosive, facilitated in part by the liquidity injected into the system by the large inflows of foreign financial capital in the form of equity and debt. In the wake of this increase in liquidity, expansion in credit provision has been accompanied by an increase in the exposure of the banking sector to the retail loan segment. The share of personal loans in total bank credit has doubled in recent years rising from 12.2 per cent at end-March 2001 to 24.7 per cent at end-March 2007.[5] Much of this has been concentrated in housing finance, with housing loans accounting for 51 per cent of personal loans in 2007. But purchasers of automobiles and consumer durables have also received a fair share of credit. The importance of credit-financed private consumption and investment for growth has been flagged in recent times by the Finance Ministry. Despite being an ardent votary of financial liberalization and being committed to a policy of minimal government intervention, it has often chosen to push public sector banks into reducing interest rates every time there is any sign of a slowing of credit growth. It is not non-intervention that liberalization involves, but a form of intervention that uses the financial sector as means of stimulating the demand needed to keep private sector growth going.

Another element of change in the factors contributing to industrial growth during the current boom as opposed to that in the mid-1990s is the stimulus provided by exports. In the early and mid-1990s high growth was accompanied by high imports, with exports growing, if at all, in areas where India was traditionally strong. In recent years, the share of India's traditional manufactured exports such as textiles, gems and jewellery and leather in the total exports of manufactures has declined, while that of chemicals and engineering goods has gone up significantly. This would have stimulated growth. While exports are by no means the principal drivers of manufacturing production, they play a part in sectors like automobile parts and chemicals and pharmaceuticals where Indian firms are increasingly successful in global markets.

All this suggests that Indian industry has been experiencing a transition. While during the first four decades of development industrial growth was almost solely dependent on the stimulus offered by government expenditure and the support provided by public investment in infrastructure, there are signs

[5] Computed from figures on Sectoral Deployment of Bank Credit for different years available at www.rbi.org.in.

that other sources of demand such as private consumption demand and exports are playing an important role in recent times. Further, the recent industrial buoyancy suggests that these new stimuli have, unlike during much of the 1990s, neutralized the adverse effects that import liberalization and fiscal contraction had on industrial growth.

## The Pattern of Demand

The nature of the stimuli underlying recent industrial growth does have implications for the pattern of demand. An important implication of debt-financed manufacturing demand is that it is inevitably concentrated in the first instance in a narrow range of commodities that are the targets of personal finance. Commodities whose demand is expanded with credit finance vary from construction materials to automobiles and consumer durables. These commodities, which serve or deliver products that can serve as the collateral for the debt that finances their purchase, must be in the nature of durables and are more-often than not the products of metal- and chemical-based industries and therefore tend to be more capital intensive and are characterised by relatively high productivity and high rates of growth of productivity.

Conventionally, the pattern of industrial growth is analysed on the basis of the used-based indices of the Index of Industrial Production. This, however, is not too enlightening because it just suggests that Basic, Intermediate and

**Table 4.** Pattern of Growth as per Use-Based Indices: 1993-94 to 2997-08 (per cent)

| | Basic Goods | Capital Goods | Intermediate Goods | Consumer Goods | | | General Index |
|---|---|---|---|---|---|---|---|
| | | | | Total | Durables | Non-durables | |
| Trend Rate of Growth 1993-94 to 2007-08 | 5.2 | 8.8 | 6.5 | 7.5 | 9.7 | 6.8 | 6.6 |
| Weighted Contribution to Aggregate Growth | 1.9 | 0.8 | 1.7 | 2.1 | 0.5 | 1.6 | 6.6 |
| Proportionate Contribution to Aggregate Growth | 28.1 | 12.3 | 26.1 | 32.4 | 7.9 | 24.1 | 100.0 |

*Source*: Computed from figures provided by Government of India, Ministry of Statistics and Programme Implementation, Central Statistical Organisation. Available at http://mospi.nic.in/iip_table6.htm (Index of Industrial Production, M/o Statistics and PI).

Consumer Non-durable Goods each contributed about a quarter of the aggregate industrial growth rate over 1993-94 to 1999-00, with Capital and Consumer Durable Goods contributing the rest (Table 4). Since each of these sectors is very diverse, it is difficult to infer much from this evidence about either the nature of demand or its biases in terms of capital intensity.

A more disaggregated picture of the pattern of organised industrial sector growth can be drawn based on movements in net value added at the three-digit level in industries covered by the Annual Survey of industries (ASI). To adjust the series for changes in prices, the three-digit level industries have been matched with appropriate combinations of commodities covered in the series on Wholesale Price Industries with base year 1993-94 published by the Office of the Economic Adviser in the Ministry of Commerce and Industry, Government of India.[6] Where a perfect match for a particular three-digit industry group was not available, price indices for three-digit groups have been arrived at by weighting the index of each commodity within the group with the relative weight attached to it in the WPI. Using these indices, figures on value added at the three-digit level have been deflated to compute inflation-adjusted values for each year. Figures on capital formation have been deflated in the case of all industries using the implicit deflator for capital formation derived from the National Accounts Statistics of the CSO. Analysis has been restricted to the period 1993-94 to 2003-04 and to those three-digit industries for which data are available from the ASI and price indices can be computed from the WPI series with 1993-94 as base.

One feature which emerges from the resulting series on net value added is the wide variation in growth at the three digit level with high growth being concentrated in relatively few industries. Consider Chart 3 which gives the distribution of the trend rates of growth in the real net value added by 3-digit industry groups in the registered manufacturing sector for the period 1993-94 to 2003-04. It should be clear that there is wide variation in growth performance with a few sectors recording remarkably high rates of growth, though data problems may be exaggerating figures at the two tails.

One way of calculating the contribution of the fastest growing industries to the overall rate of growth of these 52 three-digit level industries, is to multiply the compound rate of growth in any particular three-digit industry (implicit in the real net value added in 1993-94 and 2003-04) with the share of value added in this industry relative to all 52 industries in the base year, and divide the resulting figure by the sum of the weighted growth rates of net value added all 52 industries. The top 3 growth contributing industries during the period 1993-94

[6] These figures are available at http://www.eaindustry.nic.in/.

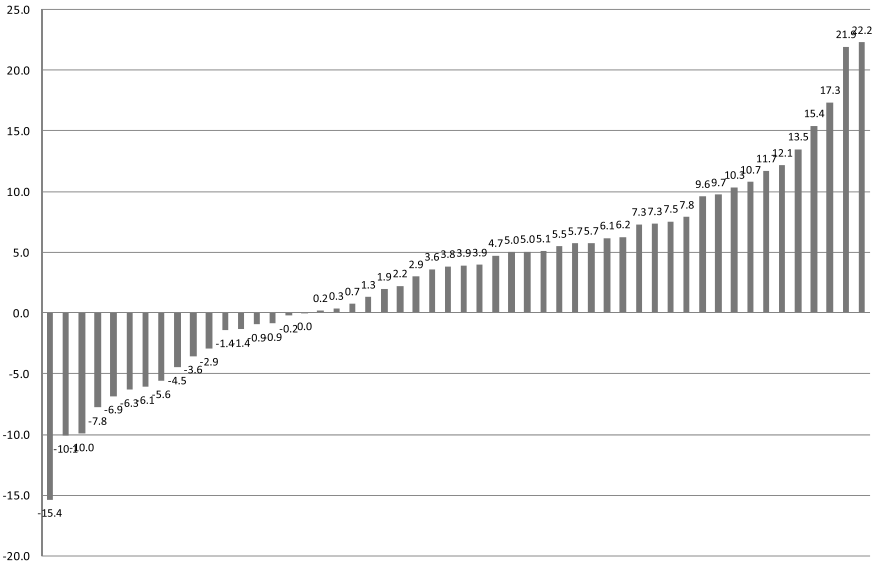


**Chart 3.** Distribution of Rate of Growth of Net Value Added 3-Digit Industrial Groups (%)

*Source*: Computed from data available from the Central Statistical Organization's Annual Survey of Industries collated in EPW Research Foundation (2007).

to 2003-04 accounted for 38 per cent of the growth in all industries, with the figure for the top 5 rising to close to 55 per cent, the top 10 to almost 75 per cent and for the top 15 to almost 90 per cent. There were 39 industries that recorded a positive rate of growth for this period. If we restrict our analysis to those industries that registered a positive rate of growth over the period, the picture of concentration still persists (Table 5). The top 3 growth contributors over the period 1993-94 to 2003-04 accounted for more than a third of growth in all industries with a positive rate of growth, with the figure for the top 5 rising to close to 50 per cent, the top 10 to more than two-thirds and for the top 15 to almost 80 per cent. This pattern of growth distribution characterised the two sub-periods into which the whole period has been divided.

Table 6 identifies the industries that fall in the category of highest growth contributing industries. It should be clear that these consist largely of the metal and chemical industries gaining from the credit financed construction and consumption boom, including areas like automobiles, television receivers and computing equipment. The leading sectors also include many chemical industries that feed luxury consumption, like refined petroleum products. Finally, the leaders include those industries that may have benefited from new export opportunities such as iron and steel and chemicals.

**Table 5.** Contribution of Fastest Growing Industries to the Aggregate Rate of Growth

| | Contr. to VA Gr 1993-94-2003-04 | Contr. to VA Gr 1993-94-1998-99 | Contr. to VA Gr 1998-99-2003-04 |
|---|---|---|---|
| Top 3 | 34.21 | 38.97 | 37.36 |
| Top 5 | 49.00 | 47.66 | 52.50 |
| Top 10 | 67.19 | 63.45 | 75.43 |
| Top 15 | 79.12 | 74.40 | 85.60 |

*Source*: Computed from data available from the Central Statistical Organization's Annual Survey of Industries collated in EPW Research Foundation (2007).

**Table 6.** Three-Digit Industries with the Fastest Rates of Growth of Real Net Value Added During 1993-94 and 2003-04

| Code | Industry Name |
|---|---|
| 271 | Manufacture of basic iron & steel |
| 242 | Manufacture of other chemical products |
| 232 | Manufacture of refined petroleum products |
| 241 | Manufacture of basic chemicals |
| 359 | Manufacture of transport equipment n.e.c. |
| 269 | Manufacture of non-metallic mineral products n.e.c. |
| 341 | Manufacture of motor vehicles |
| 291 | Manufacture of general purpose machinery |
| 272 | Manufacture of basic precious and non-ferrous metals |
| 289 | Manufacture of other fabricated metal products; metal working service activities |
| 252 | Manufacture of plastic products |
| 300 | Manufacture of office, accounting and computing machinery |
| 251 | Manufacture of rubber products |
| 323 | Manufacture of television and radio receivers, sound or video recording or reproducing apparatus, etc. |
| 160 | Manufacture of tobacco products |

*Source*: Computed from data available from the Central Statistical Organization's Annual Survey of Industries collated in EPW Research Foundation (2007).

## Implications for Productivity

Thus, there appears to have been a shift in the pattern of demand that results partly from the increases in income inequality that are associated with more liberalized and open economic regimes, partly from the role of credit financed consumption and partly from the effects of the kind of exports that have been occurring in the more liberalised environment. Industries producing commodities whose demand is driven by factors such as these, tend to be more capital intensive and are characterised by relatively high productivity and high rates of growth of productivity. Higher labour productivity is also the outcome of the combination of import liberalization and rising inequality. This is because (i) tastes and preferences of the elite in developing countries are influenced by the "demonstration effect" of lifestyles in the developed countries, and therefore new products and processes introduced in the latter very quickly find their way to the developing countries when their economies are opened, and (ii) technological progress in the form of new products and processes in the developed countries is inevitably associated with an increase in labour productivity, so that increased imports of technology imply increased productivity. Hence after trade liberalisation, labour productivity growth in developing countries is exogenously driven and tends to be higher than prior to trade liberalisation, leading to a growing divergence between output and employment growth. Prabhat Patnaik (2006) argues that for these reasons a combination of high output growth and low employment growth is a feature characterising many developing countries during the years when they opened their economies to trade and investment.

This lack of correspondence between output and employment growth must be because average labour productivity in manufacturing has grown so fast, that the effects of the higher rate of increase in output on employment growth would have been more than neutralized. This indeed appears to be the case. According to estimates quoted in the Planning Commission's Eleventh Plan Document, GDP per worker in manufacturing which grew at 2.29 per cent per annum during 1983 to 1993-94 accelerated to 3.31 per cent between 1993-94 and 2004-05 (Planning Commission, Government of India, 2008: 83). It is to be expected that this acceleration would have been sharper in the case of organized manufacturing, because of the effects of reform.

This factor, together with the industrial "restructuring" associated with liberalisation, has resulted in a sharp and persistent increase in labour productivity (as measured by the net value added at constant prices generated per worker) in the organised manufacturing sector during the years of liberalisation has been.

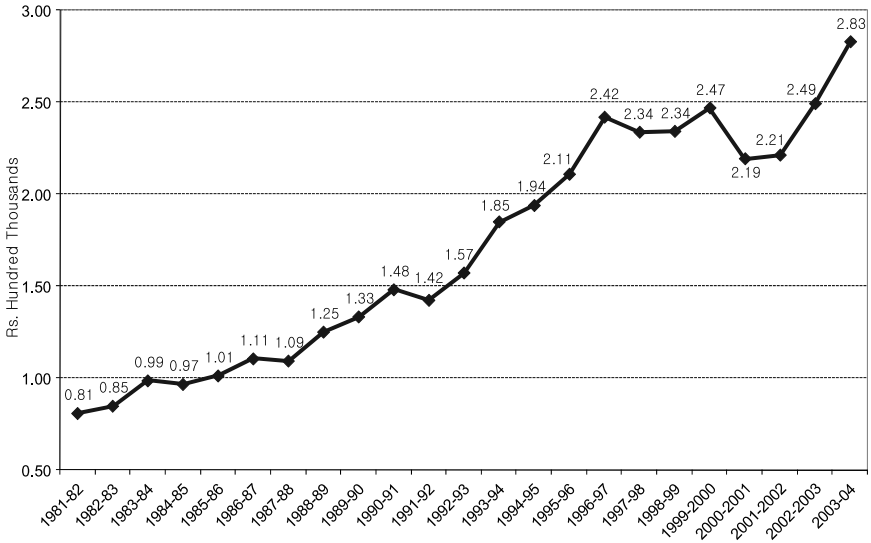


**Chart 4.** Value Added Per Worker at Constant 1993-94 Prices: Organised Manufacturing

*Source*: Computed from data available from the Central Statistical Organization's Annual Survey of Industries collated in EPW Research Foundation (2007).

**Table 7.** Growth, Productivity and Capital Intensity

| Rank Correlation Coefficient of Rate of Growth of Net Value Added with | |
|---|---|
| Average Productivity 1993-94 to 1995-96 | 0.2 |
| Productivity Growth 1993-94 to 2003-04 | 0.48 |
| Average Capital-Labour Ratio 1993-94 to 1995-96 | 0.25 |

*Source*: Computed from data available from the Central Statistical Organization's Annual Survey of Industries collated in EPW Research Foundation (2007).

As Chart 4 shows labour productivity rose more than two-and-a-half times between the years 1981-82 and 1996-97, stagnated and even slightly declined during the years of the industrial slowdown that set in thereafter, and has once again been rising sharply in the early years of this decade.

There are two factors that would have contributed to this sharp increase in labour productivity. First, an increase in capital-intensity in individual industries, that has associated with it an increase in labour productivity. And, second, a faster rate of increase in the demand for and production of capital intensive commodities, resulting in an increase in the share of capital intensive production in the total. Our concern here is with the latter set of changes, as a result of

**Table 8.** Top 25 Industrial Categories in Terms of Rate of Growth of Labour Productivity

| Industry | Code | RoG |
|---|---|---|
| Manufacture of railway and tramway locomotives and rolling stock | 352 | 76.6 |
| Manufacture of coke oven products | 231 | 48.3 |
| Manufacture of watches and clocks | 333 | 41.2 |
| Dressing and dyeing of fur; manufacture of articles of fur | 182 | 21.7 |
| Manufacture of television and radio transmitters and apparatus for line telephony and line telegraphy | 322 | 21.4 |
| Manufacture of glass and glass products | 261 | 20.9 |
| Publishing | 221 | 17.3 |
| Manufacture of motor vehicles | 341 | 15.1 |
| Manufacture of domestic appliances, n.e.c. | 293 | 13.3 |
| Manufacture of other electrical equipment n.e.c. | 319 | 13.0 |
| Manufacture of structural metal products, tanks, reservoirs and steam generators | 281 | 8.8 |
| Manufacture of non-metallic mineral products n.e.c. | 269 | 6.8 |
| Manufacture of refined petroleum products | 232 | 6.4 |
| Manufacture of electric motors, generators and transformers | 311 | 6.4 |
| Manufacture of office, accounting and computing machinery | 300 | 6.1 |
| Manufacture of rubber products | 251 | 6.0 |
| Manufacture of tobacco products | 160 | 5.4 |
| Spinning, weaving and finishing of textiles | 171 | 4.6 |
| Saw milling and planing of wood | 201 | 4.3 |
| Manufacture of paper and paper product | 210 | 4.2 |
| Manufacture of television and radio receivers, sound or video recording or reproducing apparatus, and associated goods | 323 | 4.0 |
| Manufacture of accumulators, primary cells and primary batteries | 314 | 4.0 |
| Manufacture of dairy products | 152 | 3.5 |
| Manufacture of man-made fibres | 243 | 3.4 |
| Production, processing and preservation of meat, fish, fruit vegetables, oils and fats | 151 | 3.1 |

*Source*: Computed from data available from the Central Statistical Organization's Annual Survey of Industries collated in EPW Research Foundation (2007).

shifts in the pattern of demand.

Therefore, Table 7 attempts to relate changes in product mix directly to labour productivity. This it does by relating the ranks of individual three-digit industries in terms of the rates of growth of net valued added with their ranks in terms of Average productivity at the beginning of the period, Productivity growth during 1993-94 and 2003-04 and Average capital intensity at the end of the period (Capital intensity has been calculated using capital estimates based

on the perpetual inventory accumulation method).

The figures do point to a significant, even if not overwhelmingly strong, relationship between value added growth on the one hand and productivity growth on the other, and a reasonable association between the output/value added variables and average productivity and average capital intensity. Thus the faster growing sectors substantially include those that are characterised by higher rates of growth of productivity and higher capital intensity.

Table 8 provides information on the top 25 3-digit sectors in terms of trend rates of increase in labour productivity among those for which data is available. It should be clear that they cover all of the sectors associated with the credit-financed and inequality-driven household demand boom, suggesting that the pattern of growth associated with the more open and liberalised regime of the 1990s has been significantly responsible for the extremely poor showing in terms of employment growth of an otherwise buoyant organized manufacturing sector.

It is indeed true that conclusively establishing a direct link between the process of growth, the pattern of demand and the stagnation in organized employment is difficult. But the elements of evidence pieced together above do suggest that the initial level of income and expenditure inequality, the increase in that inequality, and the shift in the stimulus for growth from public expenditure and investment to debt-financed private consumption and exports during the liberalisation period has delivered a pattern of demand for manufactures and a process of industrial growth that is biased in favour of capital intensive sectors and technologies. Together with the factors encouraging increases in capital intensity in individual sectors discussed elsewhere (Chandrasekhar, 2008), this is bound to have contributed to the tendency for organised sector employment to stagnate even as production growth in the sector accelerates, or to the phenomenon of "jobless growth."

This pattern of growth was accompanied by a significant shift in the distribution of income in the organized sector that intensified the tendencies described above. This was because the benefits of the labour productivity increase went largely to those deriving rent, interest and profit incomes, rather than workers. The share of wages in value added which was stable through much of the 1980s (Chart 5) has been declining almost consistently since the late 1980s till 1996-97 and then after a period of stability fell sharply to touch less than half its mid 1990s level.

This was the result of two developments. The restructuring of the public sector has meant that public sector manufacturing employment which was rising during the 1980s (Chart 6), was on the decline during the years of liberalisa-

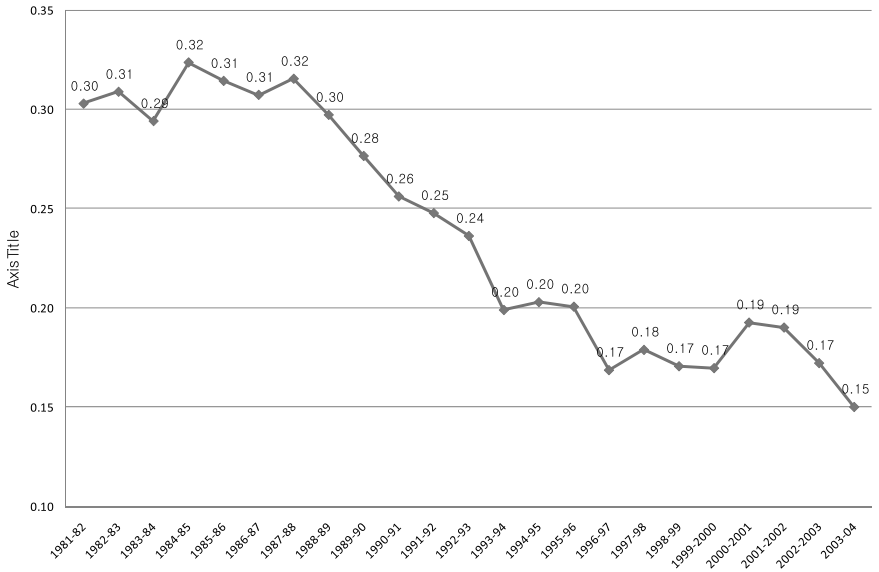


**Chart 5.** Ratio of Wages to Net Value Added in Organised Manufacturing

*Source*: Computed from data available from the Central Statistical Organization's Annual Survey of Industries collated in EPW Research Foundation (2007).

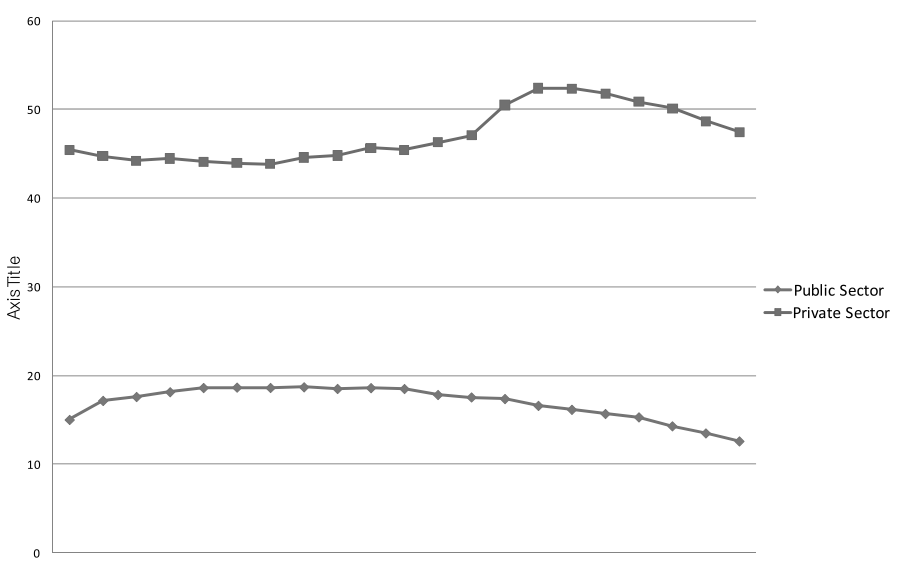


**Chart 6.** Organised Sector Employment (Hundreds of thousands)

*Source*: Government of India, Ministry of Finance (1985; 1991; 2001; 2005).

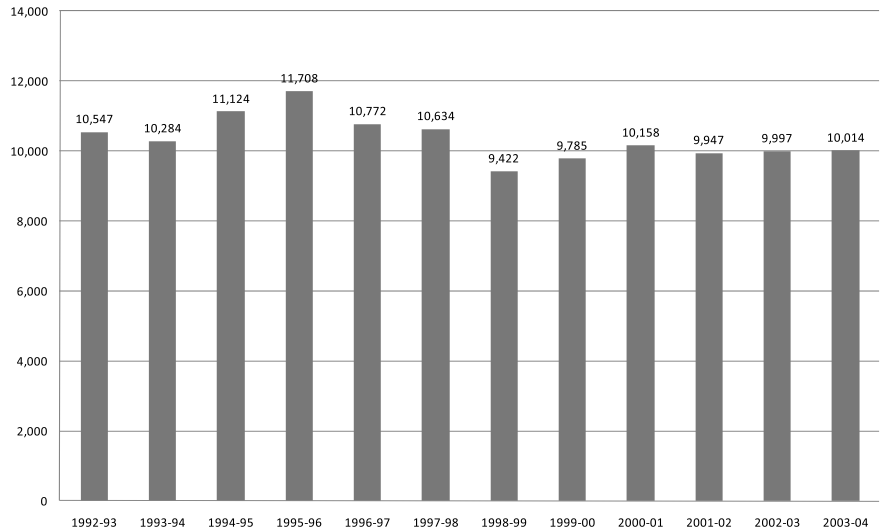


**Chart 7.** Average Annual Real Wage Per Worker: Organised Manufacturing

*Source*: Computed from data available from the Central Statistical Organization's Annual Survey of Industries collated in EPW Research Foundation (2007); EPWRF and Reserve Bank of India (2009).

tion and fell particularly sharply after 1997. Private organised manufacturing employment which was stagnant during the 1980s, rose marginally during the early 1990s and particularly sharply during 1995-97, after which it has declined to return to its mid-1990s level by 2003. In the event, aggregate (public and private) organised manufacturing employment rose from 6.1 million in 1981 to 6.4 million in 1994 and 6.9 million in 1997, and then declined sharply to 6 million in 2003.

The second development of significance is that the average real wage of workers in the organised manufacturing sector has been more or less constant right through the 1990s (Chart 7). That is, the relative price of capital with respect to labour has shifted in favour of capital not because workers are being paid high and rising *real* wages, but because the prices of capital goods have been reduced and kept cheap as part of the policy of facilitating private investment.

Together, the above two developments have ensured that the benefits of the rise in labour productivity have largely gone to the surplus earners in the organised manufacturing sector, who have been the main beneficiaries of the policies of liberalisation in general and trade liberalisation in particular.

Thus, the recent boom was fundamentally dependent upon greater global integration, which also made the growth process more uneven and more vulnerable to internally and externally generated crises. It is commonly perceived that this reflected the impact of trade liberalisation, but in fact changes in finance were probably more significant, in ways elaborated above. Essentially, recent growth was related to financial deregulation that sparked a retail credit boom and combined with fiscal concessions to spur consumption among the richest quintile of the population. This led to rapid increases in aggregate GDP growth, even as deflationary fiscal policies, poor employment generation and persistent agrarian crisis kept mass consumption demand low. The substantial rise in profit shares in the economy and the proliferation of financial activities (which together with real estate accounted for nearly 15 per cent of GDP in 2007-08) combined with rising asset values to enable a credit-financed consumption splurge among the rich and the middle classes especially in urban areas, which in turn generated higher rates of investment and output over the upswing. The earlier emphasis on public spending as the principal stimulus for growth was thus substituted in the 1990s with debt-financed housing investment and private consumption of the elite and burgeoning middle classes. The recent Indian growth story in its essentials was therefore not unlike the story of speculative bubble-led expansion that marked the experience of several other developed and developing countries in the same period.

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