Rapid growth since 1990 has transformed India from the world’s 50th ranked economy in nominal U.S. dollars to the 10th largest in 2005. The growth of per capita income has helped reduce poverty. At the same time, evidence suggests that income inequality is rising and that the gap in average per capita income between the rich and poor states is growing. This paper reviews India’s long-term growth experience with a view to understanding the determinants of growth and the underlying political economy. The paper looks specifically at the political economy of India’s growth transformation from a low-growth environment (pre-1980s) to a rapid-growth environment (post 1980s) and asks how sustainable is this transformation in view of concerns about regional disparity and income inequality. The paper concludes that the pledge that India’s post-independence leadership had undertaken to abolish mass poverty remains only partially redeemed. Half the battle still lies ahead. Many more would like the fruits of the economic boom to come to them. The greatest challenge for India’s policy makers today is to balance the growth momentum with inclusionary policies.

Sadiq Ahmed, Senior Manager for Regional Programs, South Asia Region, World Bank
Ashutosh Varshney, Professor of Political Science, University of Michigan, Ann Arbor

The mandate of the Commission on Growth and Development is to gather the best understanding there is about the policies and strategies that underlie rapid economic growth and poverty reduction.

The Commission’s audience is the leaders of developing countries. The Commission is supported by the governments of Australia, Sweden, the Netherlands, and United Kingdom, The William and Flora Hewlett Foundation, and The World Bank Group.

Battles Half Won: The Political Economy of India’s Growth and Economic Policy since Independence

Sadiq Ahmed
Ashutosh Varshney
Battles Half Won: The Political Economy of India’s Growth and Economic Policy since Independence

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About the Series

The Commission on Growth and Development led by Nobel Laureate Mike Spence was established in April 2006 as a response to two insights. First, poverty cannot be reduced in isolation from economic growth—an observation that has been overlooked in the thinking and strategies of many practitioners. Second, there is growing awareness that knowledge about economic growth is much less definitive than commonly thought. Consequently, the Commission’s mandate is to “take stock of the state of theoretical and empirical knowledge on economic growth with a view to drawing implications for policy for the current and next generation of policy makers.”

To help explore the state of knowledge, the Commission invited leading academics and policy makers from developing and industrialized countries to explore and discuss economic issues it thought relevant for growth and development, including controversial ideas. Thematic papers assessed knowledge in areas such as monetary and fiscal policies, climate change, and equity and growth and highlighted ongoing debates. Additionally, 25 country case studies were commissioned to explore the dynamics of growth and change in the context of specific countries.

Working papers in this series were presented and reviewed at Commission workshops, which were held in 2007–08 in Washington, D.C., New York City, and New Haven, Connecticut. Each paper benefited from comments by workshop participants, including academics, policy makers, development practitioners, representatives of bilateral and multilateral institutions, and Commission members.

The working papers, and all thematic papers and case studies written as contributions to the work of the Commission, were made possible by support from the Australian Agency for International Development (AusAID), the Dutch Ministry of Foreign Affairs, the Swedish International Development Cooperation Agency (SIDA), the U.K. Department of International Development (DFID), the William and Flora Hewlett Foundation, and the World Bank Group.

The working paper series was produced under the general guidance of Mike Spence and Danny Leipziger, Chair and Vice Chair of the Commission, and the Commission’s Secretariat, which is based in the Poverty Reduction and Economic Management Network of the World Bank. Papers in this series represent the independent view of the authors.
Acknowledgments

We would like to thank Roberto Zagha for comments on an earlier draft of this paper and Sana Jaffrey for research assistance.
Abstract

Rapid growth since 1980 has transformed India from the world’s 50th ranked economy in nominal U.S. dollars to the 10th largest in 2005. The growth of per capita income has helped reduce poverty. At the same time, evidence suggests that income inequality is rising and that the gap in average per capita income between the rich and poor states is growing. This paper reviews India’s long-term growth experience with a view to understanding the determinants of growth and the underlying political economy. The paper looks specifically at the political economy of India’s growth transformation from a low-growth environment (pre-1980s) to a rapid-growth environment (post 1980s) and asks how sustainable is this transformation in view of concerns about regional disparity and income inequality. The paper concludes that the pledge that India’s post-independence leadership had undertaken to abolish mass poverty remains only partially redeemed. Half the battle still lies ahead. Many more would like the fruits of the economic boom to come to them. The greatest challenge for India’s policy makers today is to balance the growth momentum with inclusionary policies.
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When economists propose their favored economic policy agendas and fret that they are not immediately adopted, or get aborted after adoption, because of social instability, one reason for policy failure and economists’ frustration is the lack of understanding of the social and political context in which the policy was implemented…. Hence the focus on the politico-cultural underbelly of an economy does not have to be founded in skepticism of economic policy, but in recognition of the fact that this is a complement of it and so should assist in the design of better and more appropriate economic policy.”

Kaushik Basu (2004: 5)

1. Introduction

Rapid growth since 1980 has transformed India from the world’s 50th ranked economy in nominal U.S. dollars to the 10th largest in 2005. When income is measured with regard to purchasing power parity, the Indian economy occupies fourth place, after the United States, Japan, and China. Along with growing incomes, India’s increasingly outward orientation makes it an important player in the global economy and the growing optimism about India’s economy has led to a surge in international investors’ interest. Further growth acceleration since 2003 has shifted the debate from a concern about the ability to sustain an annual growth rate of 6 percent to the prospects for increasing this growth rate to 8 percent (Ahmed 2007).
At the same time questions have been raised about the distribution of the benefits of growth between income groups, especially the poor. A key concern is the perception of two Indias, one shining and the other bleak, referring to the large gap in the standard of living between the rich and the poor (World Bank 2006a, Kohli 2006). Evidence suggests that income inequality is rising and that the gap in average per capita income between the rich and poor states is growing. There is substantial disparity in social indicators between rich and poor states, suggesting that not only income is low in the poorer states but also the quality of life is worse. The persistence of lagging regions, with substantial concentration of the poor, is raising concerns about social and political stability of these regions, with possible fallout for the country as a whole. Election results at the national and state level also suggest that unless the issue of the large income inequality and disparity in standard of living is tackled upfront, there is a risk that the economic reform momentum might slow down. If this happens, growth will suffer.

The objective of this paper is to review India’s long-term growth experience with a view to understanding the determinants of growth and the underlying political economy. The paper looks specifically at the political economy of India’s growth transformation from a low growth environment (pre-1980s) to a rapid growth environment (post 1980s) and asks how sustainable is this transformation. Following the introduction, Section 2 looks at the evolution of India’s growth while Section 3 reviews this growth experience in terms of its impact on employment and poverty. Section 4 briefly reviews the policy framework underlying this growth. Section 5 develops a political framework to understand the process and politics of policy making in India. This framework is then applied in Section 6 to explain India’s growth transformation. In Section 7, the paper looks at inclusiveness, which is arguably at the heart of the sustainability of economic reforms and long-term growth. Finally, some concluding remarks are provided in Section 8.

2. Evolution of India’s Growth

This section reviews India’s long-term growth in relation to total and per capita GDP growth; the changing composition of growth by the three broad sectors of agriculture, industry, and services; and the growth experience by states. Sectoral composition provides useful information about the relative dynamism of these components and helps explain the link between growth and employment. Similarly, because states have important flexibility in their policies, their growth experience enables a better understanding of the determinants of growth.

These sections draw heavily from an earlier research (Ahmed 2007).

Figure 1 shows the pattern of India’s long-term growth. There are two distinct growth periods: a first phase from 1950 to 1980 (phase I) and a second phase from 1980 to 2006 (phase II). The first phase is characterized by slow growth in both absolute and per capita terms when compared with growth in phase II. In this period, India grew at an average pace of only 3.6 percent per year in absolute terms and 1.2 percent in per capita terms. In the second phase, growth accelerated to 6.0 percent in absolute terms and 4.0 percent in per capita terms. Within these two broad phases there are some interesting variations. During phase I, the decades of 1950–60 and 1960–70 experienced almost identical growth rates (4.0 percent per year). But growth dipped substantially during the 1970–80 decade (3.0 percent per year), causing per capita annual income to virtually stagnate at below 1 percent. Indeed, this decade saw the slowest pace of economic expansion since independence. In phase II, the decades of 1980–90 and 1990–2000 both experienced fairly rapid growth (5.8 and 5.5 percent per year, respectively), but importantly, growth accelerated further during the 2000–06 period (7.3 percent per year). In addition, if the growth in more recent years is examined, the acceleration becomes quite prominent (figure 2). Thus, the average annual rate of growth during 2002–06 is estimated at 8.6 percent and 9.2 percent in 2006.

Fast growth since 1980 has placed India among the top nine rapidly growing economies of the world. Table 1 shows a list of countries that have grown by 5 percent or more per year during 1980–2003. Interestingly, while India grew quite similarly between 1980–90 and 1990–2003, in a relative sense it consolidated its gains during 1990–2003, rising from its ranking as the eighth fastest growing economy during 1980–90 to the third fastest in 1990–2003.

Figure 1: India’s Long-Term Growth, 1950–2006


For a more nuanced and detailed review of India’s long-term growth experience and phases of growth, see Virmani 2004a.
The growth surge of the recent years (2002–06), if sustained, will further strengthen India’s position. This could make India the world’s second fastest-growing economy after China. However, despite the rapid growth of the past 26 years, in per capita terms India is still a very low-income economy given the very late start of its development. Thus, measured in nominal dollars, India’s per capita GNP in 2005 was a mere 2 percent of that of the United States. In purchasing power parity terms, the share rises to 8 percent, still a small proportion of the U.S. per capita income. Clearly, there is a huge amount of catching up still to be done.

**Sectoral Composition of Growth**

The broad sectoral composition of growth by decades is shown in table 2. Agriculture grew the slowest, at only 2.6 percent per year during 1950–2006. In contrast to that, both industry and services grew more than twice as fast at about 5.8 and 6.0 percent respectively per year. When compared by growth phases, all sectors show better growth performance in phase II than in phase I.
Table 2: India’s Sectoral Composition of Growth, 1950–2006 (percent per year)

<table>
<thead>
<tr>
<th></th>
<th>Agriculture</th>
<th>Industry</th>
<th>Services</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1950–60</td>
<td>3.0</td>
<td>6.2</td>
<td>4.3</td>
<td>3.9</td>
</tr>
<tr>
<td>1960–70</td>
<td>2.3</td>
<td>5.5</td>
<td>4.8</td>
<td>3.7</td>
</tr>
<tr>
<td>1970–80</td>
<td>1.5</td>
<td>4.0</td>
<td>4.4</td>
<td>3.1</td>
</tr>
<tr>
<td>1980–90</td>
<td>3.4</td>
<td>7.1</td>
<td>6.7</td>
<td>5.6</td>
</tr>
<tr>
<td>1990–2000</td>
<td>2.5</td>
<td>5.6</td>
<td>7.6</td>
<td>5.6</td>
</tr>
<tr>
<td>2000–06</td>
<td>2.8</td>
<td>7.7</td>
<td>8.9</td>
<td>7.3</td>
</tr>
<tr>
<td>1950–80</td>
<td>2.3</td>
<td>5.2</td>
<td>4.5</td>
<td>3.6</td>
</tr>
<tr>
<td>1980–2000</td>
<td>2.9</td>
<td>6.4</td>
<td>7.7</td>
<td>6.0</td>
</tr>
<tr>
<td>1950–2006</td>
<td>2.6</td>
<td>5.8</td>
<td>6.0</td>
<td>4.7</td>
</tr>
</tbody>
</table>


Within phase I, the decade of 1970–80 was generally a difficult period for growth, especially for agriculture. Industrial growth also slowed in this period. Together, they pulled down GDP growth to only 3.1 percent per year, the slowest pace of expansion in any decade since 1950. More generally, except for 1980–90, agriculture grew at 3.0 percent or less, mainly at 2.5 percent or below. This growth is considerably weaker than in China or even Pakistan. The industrial sector maintained a steady pace of growth, at 5.5 percent or more per year, for most of the 56-year period except for the deceleration during 1970–80. Acceleration in the expansion of the services sector provided the main impetus to the GDP growth surge after 1980. Thus, the annual average services growth climbed from 4.5 percent during the 1950–80 to 7.0 percent during 1980–2000.

These differential sectoral growth rates have brought about a major structural transformation in the Indian economy. That is illustrated in figure 3. The agricultural sector’s share of GDP shrank dramatically throughout the period, falling from 56.9 percent in 1950 to only 17.5 percent in 2006. The industry sector’s share of GDP rose from 14.3 percent to 27.7 percent during the same period. Most notably, the services sector’s share surged from a low of 29.8 percent in 1950 to more than 54.7 percent in 2004. Interestingly, industry’s share of GDP has increased only marginally during the 1990s, from 27 percent in 1990 to 28 percent in 2006, while services’ share moved up from 41 percent to 55 percent, showing its dynamism.

Regional Pattern of Growth: State-Specific GDP

In India’s decentralized political environment where policies, resources, and institutions differ substantially by states, understanding the pattern of growth by states is important. Detailed reviews of state-level growth performance are available in Ahluwalia (2002a), Bhattacharya and Sakthivel (2004), and Krishna (2004).
Unfortunately, reliable state-specific GDP data are available from only 1960 onward. The rates of growth by decade since 1960 are shown in table 3. Not surprisingly, growth has varied significantly by states and by decades. During the low-growth phase (1960–80), most states grew slowly and close to the Indian national average. The exceptions were Haryana, Punjab, and Orissa. The higher growth in these three states was largely due to strong growth in agriculture. During the second phase of rapid national growth (1980–2004), a number of states took the lead in contributing to the growth acceleration: Gujarat, Karnataka, Maharashtra, Rajasthan. The average growth in these states exceeded the national average.

Table 3: Regional Pattern of India’s Growth, 1960–2004 (percent per year)

<table>
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<tr>
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<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Andhra Pradesh</td>
<td>3.0</td>
<td>3.1</td>
<td>6.3</td>
<td>5.6</td>
<td>4.9</td>
<td>3.1</td>
<td>5.9</td>
</tr>
<tr>
<td>Bihar</td>
<td>2.3</td>
<td>3.1</td>
<td>4.8</td>
<td>3.6</td>
<td>0.2</td>
<td>2.7</td>
<td>3.7</td>
</tr>
<tr>
<td>Gujarat</td>
<td>4.6</td>
<td>3.5</td>
<td>5.3</td>
<td>6.2</td>
<td>11.0</td>
<td>4.1</td>
<td>6.3</td>
</tr>
<tr>
<td>Haryana</td>
<td>5.9</td>
<td>4.5</td>
<td>6.4</td>
<td>4.9</td>
<td>6.3</td>
<td>5.2</td>
<td>5.9</td>
</tr>
<tr>
<td>Karnataka</td>
<td>4.2</td>
<td>3.1</td>
<td>5.1</td>
<td>7.8</td>
<td>3.9</td>
<td>3.7</td>
<td>6.2</td>
</tr>
<tr>
<td>Kerala</td>
<td>4.0</td>
<td>2.2</td>
<td>3.6</td>
<td>5.5</td>
<td>4.8</td>
<td>3.1</td>
<td>5.1</td>
</tr>
<tr>
<td>Maharashtra</td>
<td>2.9</td>
<td>4.6</td>
<td>6.0</td>
<td>5.8</td>
<td>6.7</td>
<td>3.8</td>
<td>6.2</td>
</tr>
<tr>
<td>Madhya Pradesh</td>
<td>2.1</td>
<td>3.0</td>
<td>5.1</td>
<td>3.8</td>
<td>6.7</td>
<td>2.6</td>
<td>4.8</td>
</tr>
<tr>
<td>Orissa</td>
<td>9.8</td>
<td>2.9</td>
<td>2.8</td>
<td>4.4</td>
<td>6.7</td>
<td>6.4</td>
<td>4.2</td>
</tr>
<tr>
<td>Punjab</td>
<td>4.6</td>
<td>4.8</td>
<td>5.2</td>
<td>4.7</td>
<td>2.8</td>
<td>4.7</td>
<td>4.8</td>
</tr>
<tr>
<td>Rajasthan</td>
<td>4.7</td>
<td>1.0</td>
<td>7.4</td>
<td>4.7</td>
<td>5.2</td>
<td>2.9</td>
<td>6.1</td>
</tr>
<tr>
<td>Tamil Nadu</td>
<td>2.8</td>
<td>1.7</td>
<td>5.6</td>
<td>6.4</td>
<td>1.4</td>
<td>2.3</td>
<td>5.6</td>
</tr>
<tr>
<td>Uttar Pradesh</td>
<td>2.5</td>
<td>3.0</td>
<td>5.0</td>
<td>3.5</td>
<td>1.7</td>
<td>2.8</td>
<td>3.9</td>
</tr>
<tr>
<td>West Bengal</td>
<td>2.2</td>
<td>3.1</td>
<td>4.3</td>
<td>6.7</td>
<td>7.1</td>
<td>2.7</td>
<td>5.8</td>
</tr>
<tr>
<td>India Average</td>
<td>3.7</td>
<td>3.1</td>
<td>5.6</td>
<td>5.6</td>
<td>6.0</td>
<td>3.4</td>
<td>5.8</td>
</tr>
</tbody>
</table>

A few states grew at about the national average, especially Haryana, Andhra Pradesh, West Bengal, and Tamil Nadu. But a number of states significantly lagged behind the national average, especially Bihar, Orissa, and Uttar Pradesh. The faster-growing states on average registered significantly higher rates of expansion in industrial and service sectors as compared with the lagging states.

Given the initial differences in the states’ incomes, the differential growth rates along with variable progress in tackling population growth have brought about substantial differences in the per capita income of the states (figure 4). The gap between the rich and poor states has widened particularly rapidly since the 1990s. The widening income gap between states has generated a substantial debate about liberalization policies and the convergence of growth (Ahluwalia 2002a; Bajpai and Sachs 1996; Purfield 2006). This divergence in per capita state incomes has also led to large differences in the standard of living across states and progress with poverty reduction. Not surprisingly, the incidence of poverty is among the highest in the poorest states of Bihar, Orissa, and Uttar Pradesh. The state-level income inequalities have contributed to both a growth pessimism based on the fear of a social backlash and a populist view that India’s rapid growth has not benefited the poor.

**Figure 4: India States Per Capita Income Trends, 1960–2002**

<table>
<thead>
<tr>
<th>States</th>
<th>1960</th>
<th>1980</th>
<th>2002</th>
</tr>
</thead>
<tbody>
<tr>
<td>India Average</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>West Bengal</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Uttar Pradesh</td>
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<td></td>
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<tr>
<td>Tamil Nadu</td>
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<tr>
<td>Rajasthan</td>
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<tr>
<td>Punjab</td>
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<tr>
<td>Orissa</td>
<td></td>
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<td></td>
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<tr>
<td>Maharashtra</td>
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<td></td>
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<tr>
<td>Madhya Pradesh</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Kerala</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Karnataka</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Haryana</td>
<td></td>
<td></td>
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<tr>
<td>Gujarat</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Bihar</td>
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<tr>
<td>Andhra Pradesh</td>
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</tbody>
</table>

*Source: World Bank South Asia Regional Database, 2005.*
3. The Quality of Growth: Poverty and Human Development

It is now well recognized that the long-term sustainability of growth depends significantly upon proper distribution of the benefits of growth. How has growth affected the poor and what is the progress with improving human development? We now look at these quality dimensions of India’s growth.

Poverty and Human Development

As we have already indicated, there is a growing concern that higher growth in India is not benefiting the poor adequately. What is the evidence and what are the key issues? Table 4 summarizes the average poverty and selected human development outcomes for India during the two growth phases. The results are quite striking, although not surprising. Both rural and urban poverty increased during 1951–78, even though income distribution improved, reflecting the stagnation of growth during phase I.4

Table 4. India’s Development Indicators by Growth Phases

<table>
<thead>
<tr>
<th></th>
<th></th>
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</tr>
</thead>
<tbody>
<tr>
<td>GDP growth (% p.a.)</td>
<td>3.6</td>
<td>5.7</td>
</tr>
<tr>
<td>Per capita GDP growth (% p.a.)</td>
<td>1.2</td>
<td>3.8</td>
</tr>
<tr>
<td>National poverty incidence (%)</td>
<td>45.3 (1951–52); 48.4 (1977–78)</td>
<td>43.0 (1983–84); 27.9 (2004–05)</td>
</tr>
<tr>
<td>Urban poverty (%)</td>
<td>35.5 (1951–52); 40.5 (1977–78)</td>
<td>35.7 (1983–84); 25.9 (2004–05)</td>
</tr>
<tr>
<td>Rural poverty (%)</td>
<td>47.4 (1951–52); 50.6 (1977–78)</td>
<td>45.3 (1983–84); 28.7 (2004–05)</td>
</tr>
<tr>
<td>Income distribution b</td>
<td>Gini urban: 0.40 (1951); 0.35 (1977–78)</td>
<td>Gini urban: 0.34 (1983–84); 0.38 (2004–05)</td>
</tr>
<tr>
<td>Infant mortality rate (per ‘000)</td>
<td>146 (1960); 115 (1980)</td>
<td>115 (1980); 60 (2003)</td>
</tr>
<tr>
<td>Adult literacy rate</td>
<td>Male: 18.3 (1951); 43.6 (1981)</td>
<td>Male: 43.6 (1981); 73 (2002)</td>
</tr>
</tbody>
</table>

Notes:
a. Poverty and inequality estimates for 2004–05 are preliminary and as reported in Himanshu 2007, and Dev and Ravi 2007.
b. Inequality data for 1951 and from Datt 1997.

4 This result is not dependent on the choice of starting and end years or any reflection of special factors. On a long-term basis, for some 30 years after independence poverty reduction did not happen in India (Datt 1997).
The pace of poverty reduction picked up substantially in phase II, supported by the acceleration in growth. Progress with human development was similarly better in phase II. So, it is reassuring that higher growth did allow India to make faster progress in improving the well-being of its citizens. State-level analysis shows not only that poverty was reduced in all states but that human development was similarly better in phase II. There is also a positive correlation between growth and poverty. The incidence of poverty tends to be lowest in rapidly growing states and highest in the slow-growing, low-income states (Datt 1997; World Bank 1997, 2000; Deaton and Dreze 2002). So, a part of the development challenge is to find ways to accelerate growth in the lagging regions rather than abandon the growth effort. Nevertheless, there is also evidence that income inequality increased (Deaton and Dreze 2002; Himanshu 2007; Dev and Ravi 2007) and human development indicators remain weak by international standards, including the quality of health and education outcomes. Income inequality increased fairly rapidly in urban areas between 1993 and 2005 (Himanshu 2007; Dev and Ravi 2007). These facts suggest that along with more rapid growth India needs to pay stronger attention to improving equity.5

**Labor Force, Employment, and Real Wages**

One key link between growth and poverty reduction is through the creation of productive employment. The somewhat unusual pattern of services-led growth has fed some concerns about the sustainability of growth as well as a worry about labor absorption (Kohli 2006). How unusual is India’s growth experience in regard to sectoral composition? This issue has been studied in some detail by Kochar et al. (2006). The study concludes that although the share of manufacturing in output and employment in 1981 was at a normal level when compared with countries at a similar level of development and size, this share lagged behind during the 1980–2002 period. In contrast the share of services in output and employment was below the norm in 1981, but although the output share of services surged ahead during the 1980–2002 period, the employment share lagged behind. The study also finds evidence that India’s services and manufacturing sectors tend to exhibit skill-intensive growth that is more typical of advanced industrial countries as opposed to East Asian countries.

Do these findings verify the pessimism expressed by Kohli? Kochar et al. explain this pattern of growth as reflecting partly the policy bias in India’s education policies since the early days in favor of higher and scientific education as opposed to basic education and training, and partly the effect of labor market policies that reduce employment flexibility and discriminate against labor-intensive enterprises. Clearly, therefore, this slower than expected growth of

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5 For a good review of growth and equity issues, see World Bank 2005c.
manufacturing is in part the result of a policy-induced constraint (inflexibility of the labor market) that has lowered the expansion of labor-intensive manufacturing, rather than an inherent weakness of the growth process in phase II. Similarly, as we shall see later in more detail, the services sector’s surge in growth in phase II is the result of reforms, including greater openness to global markets. The downside risks to its sustainability are linked to global downturn and the absence of further reforms, factors that will also hurt manufacturing growth. So, the sustainability of overall growth is not dependent on the relative balance between growths in services and manufacturing.

The issue of low employment creation is a substantial one. What is the evidence? Unfortunately comparable long-term labor force and employment data are not available. We have more recent data pieced together from various sources in a study done by the World Bank (2006b). On the supply side, labor force grew by 1.7 percent during 1983–2000 (table 5). The labor force is becoming better educated although the average level remains very low when compared with the East Asian economies (World Bank 2006b). Also, the education gap between rural and urban workers on the one hand and between female and male workers on the other is quite striking. On the demand side, employment actually grew faster than the supply of labor, although the overall elasticity of employment to GDP growth is low (only 0.3 percent). The faster aggregate growth of employment relative to the labor supply is also reflected in rising real wages (table 6).


<table>
<thead>
<tr>
<th></th>
<th>1983/84</th>
<th>1999/2000</th>
<th>Growth rate (% per year)</th>
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<tbody>
<tr>
<td>Labor force (million)</td>
<td>312.9</td>
<td>408.8</td>
<td>1.7</td>
</tr>
<tr>
<td>Of which:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Urban</td>
<td>63.1</td>
<td>100.0</td>
<td>2.9</td>
</tr>
<tr>
<td>Rural</td>
<td>249.8</td>
<td>308.8</td>
<td>1.3</td>
</tr>
<tr>
<td>Employment</td>
<td>265.1</td>
<td>360.9</td>
<td>2.0</td>
</tr>
<tr>
<td>Of which:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Regular</td>
<td>39.0</td>
<td>57.4</td>
<td>2.4</td>
</tr>
<tr>
<td>Casual</td>
<td>79.3</td>
<td>120.6</td>
<td>2.7</td>
</tr>
<tr>
<td>Self-employed</td>
<td>146.8</td>
<td>182.9</td>
<td>1.4</td>
</tr>
<tr>
<td>Employment share:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Agriculture</td>
<td>66.7</td>
<td>58.7</td>
<td></td>
</tr>
<tr>
<td>Industry</td>
<td>12.0</td>
<td>12.1</td>
<td></td>
</tr>
<tr>
<td>Services</td>
<td>21.3</td>
<td>29.2</td>
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</thead>
<tbody>
<tr>
<td>Salaried worker/casual worker (ratio)</td>
<td>Male</td>
<td>Female</td>
<td>Male</td>
<td>Female</td>
</tr>
<tr>
<td>Agriculture</td>
<td>1.0</td>
<td>2.0</td>
<td>1.5</td>
<td>2.0</td>
</tr>
<tr>
<td>Nonagriculture</td>
<td>1.9</td>
<td>2.3</td>
<td>2.1</td>
<td>3.3</td>
</tr>
<tr>
<td>Agriculture</td>
<td>16.4</td>
<td>11.0</td>
<td>26.0</td>
<td></td>
</tr>
<tr>
<td>Nonagriculture</td>
<td>23.8</td>
<td>11.7</td>
<td>38.3</td>
<td></td>
</tr>
<tr>
<td>All activities</td>
<td>18.0</td>
<td>11.1</td>
<td>29.3</td>
<td></td>
</tr>
<tr>
<td>Public work</td>
<td>19.5</td>
<td>11.9</td>
<td>31.5</td>
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What then is the employment concern? The employment and real wage concerns are actually driven by low overall employment elasticity of growth, differential sectoral impact of employment, and the differential rates of wage increases between sectors and by gender. First, although real wages grew economy-wide, the growth was slower than the expansion of per capita income for low-skilled workers. This is a reflection of the overall low employment elasticity of GDP growth. Second, real wages grew much slower in agriculture as compared with nonagriculture. That is due to the slow growth in average labor productivity in agriculture, the very low levels of educational attainment of agriculture workers, and the relatively slow growth in demand for labor in low-skill, labor-intensive, nonagriculture activities. As a result, there is continued strong reliance on agriculture for employment. Thus, although the output share of agriculture has fallen from 40 percent in 1980 to only 25 percent in 2004, the employment share declined only marginally from 66 percent in 1983/84 to 59 percent in 1999/2000 (World Bank 2006b). The much slower growth of employment in industry and services relative to their contribution to growth in output has constrained the overall employment elasticity of output and the growth of real wages economy-wide. This poses the challenge for creating “good jobs” that provide higher productivity and higher real wages. Third, there are substantial wage differentials between male and female workers. Finally, the wage differential between skilled and unskilled workers has widened (World Bank 2006b).

For the near future, these findings suggest the need to address two key policy challenges. First, there is a need to redress the dualistic pattern of skills by focusing on ways to upgrade the skill profile of the large bulk of the uneducated or low-skill work force through appropriate reforms in education and training policies. Second, there is need to remove the constraints on labor market flexibility to allow a more labor-intensive pattern of growth in the formal manufacturing and services sector.
4. The Economics of Growth

Following the seminal work on growth by Solow (1956), the growth accounting analysis shows that growth per unit of labor depends on capital accumulation and factor productivity. Increase in one or both can raise the rate of growth. Capital accumulation in turn depends on the rate of investment. In a market economy, investment depends on profitability. The profitability of investment depends in part on the price of capital, which is affected by the national savings rate and external capital flows. External capital flows also have an effect on the ability to acquire new technology and thereby affect total factor productivity. How have these elements played out in India?

Savings and Investment

Figure 5 shows the trend in saving and investment. Over the longer term, India’s saving and investment rates have increased substantially. Both saving and investment rates have grown steadily throughout all decades, rising from the low levels of 10 to 12 percent, respectively, during the 1950s to the 23 percent range in the 1990s. The national savings rate surged further to 27 percent during 2000–04, buoyed by inflow of remittances. Overall, the average investment rate in phase II (23 percent of GDP) was much higher than in phase I (15 percent of GDP). It is clear therefore that the higher growth rate since the 1980s has indeed been supported by a more rapid pace of investment.

Figure 5: Trend in Saving and Investment, 1950–2004

Total Factor Productivity

The emphasis on total factor productivity (TFP) results from the theory that the sustainability of growth over the longer term will depend on the ability to make continuous TFP improvements. Without improvements in TFP, diminishing returns to factor accumulation will drive down the growth rate over the longer term. Several studies have analyzed developments in India’s TFP. The more recent ones include Rodrick and Subramanian (2004), Virmani (2004b), Acharya et al. (2003), and Bosworth and Collins (2003). The results of these studies are summarized in table 7. Despite differences in assumptions and methodology, there is a remarkable degree of consistency in the studies’ results. The stylized facts appear to be as follows: First, TFP has played an important role in pushing long-term growth in India. Second, there has been a significant increase in TFP and its contribution to growth in phase II. Indeed, international comparison of TFP contribution to growth done by Bosworth and Collins (2003) suggests that India scored very low during the 1960–80 period (at only 10 percent) compared with other countries. However, the contribution of TFP surged to 57 percent during 1980–99, which is among the top performer category.

Table 7: India Total Factor Productivity Estimates (percentage annual average growth rates)

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<tbody>
<tr>
<td>GDP</td>
<td>3.8</td>
<td>3.4</td>
<td>5.3</td>
<td>6.5</td>
</tr>
<tr>
<td>TFP</td>
<td>1.4</td>
<td>0.7</td>
<td>2.0</td>
<td>2.6</td>
</tr>
<tr>
<td>Proportion of GDP growth explained by TFP (%)</td>
<td>38</td>
<td>21</td>
<td>38</td>
<td>40</td>
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<tbody>
<tr>
<td>Net domestic product (NDP) per worker</td>
<td>1.3</td>
<td>2.4</td>
</tr>
<tr>
<td>TFP</td>
<td>0.7</td>
<td>2.4</td>
</tr>
<tr>
<td>Proportion of per worker NDP growth explained by TFP (%)</td>
<td>54</td>
<td>69</td>
</tr>
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<th></th>
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</thead>
<tbody>
<tr>
<td>GDP per worker</td>
<td>1.9</td>
<td>0.7</td>
<td>3.9</td>
<td>3.3</td>
</tr>
<tr>
<td>TFP growth</td>
<td>0.7</td>
<td>–0.5</td>
<td>2.5</td>
<td>1.6</td>
</tr>
<tr>
<td>Proportion of per worker GDP growth explained by TFP (%)</td>
<td>40</td>
<td>negative</td>
<td>64</td>
<td>48</td>
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</tr>
</thead>
<tbody>
<tr>
<td>GDP per worker</td>
<td>1.8</td>
<td>0.9</td>
<td>3.7</td>
<td>3.3</td>
</tr>
<tr>
<td>TFP</td>
<td>1.2</td>
<td>0.5</td>
<td>2.9</td>
<td>2.4</td>
</tr>
<tr>
<td>Proportion of per worker GDP growth explained by TFP (%)</td>
<td>67</td>
<td>56</td>
<td>78</td>
<td>73</td>
</tr>
</tbody>
</table>

The evidence summarized above suggests that the acceleration in India’s rate of growth in phase II over phase I occurred as a result of both a sharp increase in capital accumulation and a strong improvement in productivity. The surge in the national saving rate observed during the 2000–04 period and evidence of increasing foreign capital inflows suggest that financing does not appear to be a constraint to further increases in the investment rate. The better prospects for foreign investment also suggest stronger opportunities for accumulation of better technology, which is a positive factor for total factor productivity and growth.

**Policies Underlying Growth Outcomes**

From an accounting perspective, there is no disagreement that the per worker growth rate depends on the investment effort and the pace of productivity growth. The debate has centered on what determines the investment rate and productivity growth. This has translated into a debate about the role of specific policies in supporting growth. A summary of this debate is contained in Ahmed (2006). In regard to India, the controversy is about the role of deregulation policies versus “attitudinal changes.” The implications of liberalization policies for supporting growth in India have been studied extensively (Acharya 2006; Ahluwalia 2002b; Krueger and Chinoy 2002; Panagariya 2005; Virmani 2005; World Bank 2000, 2003; Ahmed 2007). These studies have provided evidence that the growth momentum since the 1980s has much to do with pro-market reforms. The reforms started in the 1980s but accelerated in the 1990s. This received wisdom has been challenged by a study that concludes that “growth was triggered by an attitudinal shift on the part of the national government towards a pro-business (as opposed to pro-liberalization) approach” (Rodrik and Subramanian 2004).

A careful review of the debate suggests that this has less to do with the substance and more with the choice of time period and the interpretation of associated reforms. In regard to the time period, the distinction between the two subperiods of phase II, 1980–90 and 1991 onward, is overdrawn. The facts are clear: the upward shift in the growth path occurred after 1980 and not 1991. But to argue that growth in the 1980–90 decade occurred as a result of attitudinal changes rather than pro-market reforms is misleading. The government’s shift from an inward-looking, command-and-control economy to an outward-oriented, incentive-based, private sector–led economy is indeed at the heart of the reforms during phase II. Calling them “pro-business” rather than “pro-market” does not change the substance that these reforms were directed at improving the incentives for the private sector. As Ahmed (2007), Panagariya (2005), Virmani (2005), and Joshi and Little (1998) have shown, some significant pro-market reforms took place during the 1980–90 period. Many others happened after the crisis of 1991. Reforms in both periods were geared to improving incentives for the private sector. During 1980–90, the government
signaled its change in development strategy through reforms that were easy. A large share of the growth impact came from better use of existing capacities reflected in TFP improvement. From 1991 to 2006, more fundamental market-oriented reforms took place. A larger share of the growth response in this period came from capital accumulation, although TFP contribution remained substantial. Importantly, most researchers agree that without the reforms of the 1990s, the growth spurt of the 1980s could not have been sustained.

A detailed analysis of policy outturn done by Ahmed (2007) shows that the low investment effort and low productivity improvements of phase I were the result of weak incentives and low efficiency resulting from a highly controlled and inward-looking economy. The exchange rate was overvalued and inflexible, trade and capital flows were highly restrictive, the financial sector was heavily controlled under public ownership, and investment regulations were overwhelming. In phase II, the exchange rate was made flexible, exchange controls were removed, the financial sector was reformed, trade restrictions were progressively removed, and investment was deregulated. So, essentially, in the first phase, the Indian economy was inward looking and managed by state-led command-and-control interventions. In the second phase, the economy was more outward oriented and driven by the private sector through market-based incentives. These are two different development strategies and policy regimes with markedly different growth outcomes.

Along with the flexibility of the exchange rate, the impact of trade, investment, and financial deregulation on private investment has been remarkable. The private investment rate as a share of GDP surged from an average of 10.8 percent of GDP in the 1970–80 period to 18.2 percent in the 2000–05 period. Much of the response until the late 1990s came from the domestic private sector. Foreign direct investment was sluggish, partly because the deregulation drive was a bit conservative initially. Thus, in 1990/91 net foreign investment was only $103 million, and it grew to $2.3 billion in 1998/99. This pattern, however, is now changing in response to stronger efforts to deregulate and improve the business environment for foreign private investment. Thus, foreign investment increased to $13.7 billion (2 percent of GDP) in 2003/4.

India’s experience also brings out several interesting points about the relationship between macroeconomic policies and growth. For more than 50 years, India on average has maintained a fairly stable macroeconomic environment. In regard to internal balance, the average long-term inflation rate has been about 6.6 percent per year, below the world average of 8.8 percent and substantially below the average for low-income economies (12.5 percent). Concerning external balance, India kept its average current account deficit at about 1.3 percent of GNI per year, thereby restricting its external debt to only 19 percent of GNI as of 2004. Exports have surged from less than 8 percent of GDP

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6 Foreign investment data were obtained from Economic Survey 2005–2006, Ministry of Finance (Government of India 2005).
in 1950 to 19 percent in 2004, reserves have increased from less than 17 percent of annual imports in the 1960s to 134 percent of 2004 imports, and the external debt service burden in 2004 was below 20 percent of exports. However, while India maintained macroeconomic stability in both growth phases, the policies that allowed macroeconomic stability during phase I were fundamentally different from policies that supported macroeconomic stability during phase II. In the first phase, macroeconomic stability was maintained through monetary tightening, control over the exchange rate, trade barriers, and exchange controls. The policies were not aimed at supporting private investment. Not surprisingly, they adversely affected private investment and growth. They, along with other regulatory restrictions, were an important reason for relatively low private investment and low factor productivity during this period. In the second phase, monetary policy was somewhat less tight than in the first phase but remained within prudent limits, thereby keeping the inflation rate significantly below average rates for the world and for developing countries. Most important, the exchange rate was made flexible sequentially, until this became market determined. Exchange controls were progressively eliminated, and trade policies were liberalized. These policies spurred private investment and exports, which in turn were an important factor for rapid growth. Another noteworthy dimension is the conduct of fiscal policy, which has been controversial and yielded mixed results. In an effort to break out of the low-growth syndrome of phase I, India adopted an expansionary fiscal policy stance in phase II. This policy had some initial success, and public investment increased, contributing to higher growth. However, the momentum could not be sustained. Much of the deficit was financed domestically. As a result, the domestic debt and interest burden surged, reducing the availability of resources for public spending in infrastructure. Also, there is some evidence of the crowding out of private investment. So, even though the long-term adverse effects of large fiscal deficits on macroeconomic stability were offset by monetary, exchange rate, and trade policies, the efficacy of expansionary fiscal policy for sustained growth has proven limited owing to the growing fiscal debt service burden and the crowding out of private investment.

5. The Political Underpinnings of Economic Policy

If economic policies, partly since the 1980s and especially since 1991, are responsible for India’s recent economic successes and the upward growth trajectory, some questions naturally follow the account provided above. How exactly does the policy process operate in India? How did the transformation in policies begin to come about in the 1980s and pick up momentum in 1991? Why was the economic strategy not changed earlier despite a long period of low growth? What role did leaders play in ushering change? How did they learn
what was wrong and, more importantly, how to set things right? Why did they change some policies (investment, trade, exchange rate), but not others (especially labor laws)? Why has growth rates of different states diverged so much in the second period? Finally, moving forward, inclusiveness is a critical issue, especially as urban-rural, interpersonal, and regional inequalities have grown. Are the decision makers thinking about inclusiveness?

These questions inevitably lead towards a discussion of the politics of economic reforms. Economic policies emerge and evolve in a political context. It is a political economy truism that governments, unlike firms, are not economic agents. Governments are, first and foremost, political constructs. For governments, economic objectives are often a part of the larger play of politics.

In the remainder of this section, we start with a framework for thinking about the politics of India’s economic policy. We present first some key institutional features of Indian polity that have a strong bearing on economic policy. We then turn to some highly distinctive features of Indian politics, which give us a perspective on how economic policy is viewed by politicians in India and why. Having presented this larger perspective, we outline the policy process and identify the main actors involved in policy.

Politics and Policy: A Framework

Institutional Features

Two features of India’s formal institutions should be especially kept in mind when we analyze policy: India is a federal polity; and it has a parliamentary democracy. Both have implications for economic policy.

Federalism is inscribed in the constitution. Some economic policy arenas are reserved for the central government: currency, foreign trade, telecommunications, investment, and so forth. But some other key economic matters are concurrent, meaning the center and states have to formulate policy in consultation. Education, health, labor laws, and power, among other things, belong to the concurrent list in India’s constitution. It is harder to develop consensus on concurrent policy arenas, especially if the central and state governments are not ruled by the same political party. In India, the latter has been true since 1967. Until 1967, the Congress party formed the central as well as state governments. In this respect, China is dramatically different.

The policy implications of Indian democracy should also be noted. We discuss them in detail in Section 7. To summarize our arguments, universal-franchise democracy historically followed the industrial revolution in the West. Britain, the oldest democracy in the world, had only 19 percent franchise in the 1830s, by which time it had gone through an industrial revolution. East Asia has also followed the Western model in sequencing industrialization and democracy. In contrast, in 1947, an independent India was born poor and overwhelmingly agrarian, but with no restrictions on franchise. As a consequence, inclusiveness
has played a more significant role in Indian policy making than was generally true at a comparable level of development elsewhere.\(^7\)

It is, of course, well known that the institutional features of a polity influence politics and the policy process. It is normally less recognized in economic policy circles that historical experiences that shape political ideologies may in turn have an effect on the policies that politicians pursue. We need to ask: What is truly distinctive about India’s politics? And how does it influence policy?

**Distinctive Historical Legacies**

Surprising as it may seem, economic issues and policies have generally not made, or unmade, governments in India. On the whole, economics does not determine India’s election results. The sole exception is inflation. Why this is so will become clear later on. Let us first look at what normally tends to determine the electoral fortunes in India.

The concept of “master narratives” is the best way to answer this question. Master narratives are stories about a society that make its fault lines intelligible to the masses. Master narratives are grounded in historical experience; they form the institutionalized common sense of politics. They mobilize the energies of the masses, and put together winning coalitions in politics. Freedom, equality, and race are often viewed as the master narratives of U.S. politics (Huntington 1981; Smith 1997). In India, the key issues are different for historical reasons.

Indian politics has witnessed three master narratives in the twentieth century: secular nationalism, Hindu nationalism, and caste-based social justice (Varshney 2002). Religion and caste, and their relationship to the state and citizenship, are central to all three narratives, but each arranges these building blocks differently. On the whole, economics is subservient to the master categories of religion and caste. The struggle over religion and caste is basically about how some social groups, and by implication, individuals belonging to such groups, are treated in society—with dignity and equality, or with prejudice and discrimination. To use contemporary language, it is a struggle over how formal citizenship rights, available in the constitution, can be made effective and real. Economics is part of this struggle, but not necessarily the most important part.

Let us take a brief look at each of the three master narratives. Secular nationalism is India’s constitutionally endorsed official ideology. It says that equal rights of citizenship are available to all Indians regardless of their religion or caste. India as a nation is owned by all of its citizens. This view is a legacy of the freedom movement led by Mahatma Gandhi and Jawaharlal Nehru.

Hindu nationalism has a fundamentally different view. For Hindu nationalists, the Hindus, India’s majority religious group constituting 82 percent

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\(^7\) That close to a fourth of the population is still below the poverty line and India’s human development record is mediocre constitute a different kind of analytic problem. Under certain conditions, it can be demonstrated that a gap is possible between inclusiveness as a political principle and the economic outcomes of that principle (Varshney 2005).
of the population, are the primary owners of the nation. Other religions, especially the Muslims, 12.8 percent of total Indian population in 2001, and the Christians, 1.9 percent of the population, must accept the primacy of Hindus and accept Hindu culture, if not religion, as national culture. In effect, this view, when privileged by elections, tends to make Muslims and Christians second-class citizens of India, generating a lot of anxiety and passion.

The third narrative, caste-based social justice, concentrates on the contradictions within the majority Hindu community. It argues that the elite upper Hindu castes, numbering somewhere between a fourth to a third of the Hindu society today, have historically enjoyed superior status and also subjected the lower castes, constituting a majority of Hindu society, to various forms of subjugation and discrimination. Only an egalitarian restructuring of the Hindu social order, with affirmative action seen as its linchpin, and democracy viewed as the key weapon of change, can bring social justice about.

In the first two decades of independence, the secular nationalist narrative, and its prime representative, the Congress party, enjoyed a nearly uncontested hegemony. Since then, the last two narratives have become a force, first at the state level, then at the central level. Today, none of three narratives enjoys a clear dominance. Coalitions between them settle who wins elections and forms government.

What do these structural features mean for economic policy? Two implications are of special significance: one about poverty specifically, and another about economic policy generally.

**The Politics of Poverty**

Given how many of India’s citizens have been poor—from over a majority of the electorate in the early years to roughly a third till the late 1990s—it is worth asking why a winning coalition of the poor was never constructed in Indian

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8 A caste census has not been taken since 1931. Exact caste numbers, therefore, are virtually impossible to derive for any castes other than the Scheduled Castes, whose numbers the census does collect.

9 The Muslims, according to this narrative, are not oppressed by the Hindus but by the upper Hindu castes; Muslims, thus, can join the lower-caste alliance in a struggle to overturn the political, social, and economic hegemony of the upper castes.

10 On several occasions, politicians have sought to displace these narratives with various other constructions of the fault lines of Indian society and of the goals the nation ought to pursue. But no alternative attempt has succeeded more than briefly. In the 1950s, linguistic divisions drove politics for some time; by giving each major language group a state in the Indian federation, Delhi successfully dislodged the salience of linguistic issues. “Banish poverty” was Indira Gandhi’s electoral slogan in the late 1960s; it disappeared in the political background in the 1970s. An anti-corruption platform brought V.P. Singh to power in 1989, but once in power, he chose the third narrative—caste injustice—to build a winning coalition. In the 1980s, the urban-rural cleavage was also defined as India’s principal cleavage, but it lost to politics based on religion and caste in the 1990s. Of these constructions, two were economic: banish poverty, and urban-rural contradictions. Neither survived as a major platform in politics.
politics. Such a construction could, in principle, have married two different objectives: the economic objective of attacking poverty and the political objective of putting together an electoral majority. While such an arrangement might still have left the question of what anti-poverty strategy to follow—an indirect market-oriented approach, or a direct asset-transfer approach—it would have at least generated a huge pro-poor political pressure in the system.

That such a coalition never came about has a great deal to do with how poverty is experienced by most poor people in India. The largest proportion of the poor in India has historically come from three social categories: the ex-untouchable Dalits (the Scheduled Castes, or SCs); the so-called middle castes (the “other backward classes” or OBCs); and the traditionally nomadic or forest-based Scheduled Tribes (STs). The SCs are about 16 percent of India’s population, the STs 7.5 percent, and the OBCs anywhere between 40 to 52 percent. These are also groups that have historically suffered humiliation and discrimination at the hands of the upper castes in a vertical Hindu social order. For centuries, they were looked down upon; they were not allowed access to the upper-caste temples, wells, schools, and village commons; the styles of their dress and the architectural patterns of their homes had to be in keeping with their “station in life”; their children were seen to be fit only for the menial jobs, not worthy of education; and their women were also treated with disrespect (Rudolph and Rudolph 1967; Weiner 1991; Varshney 2000b).

Poverty, in other words, is not just a low-income category in India, but something much more comprehensive. For most poor people, it came with the denial of human dignity. Being treated badly is not the same as being poor; in India, the two were traditionally conjoined. Moreover, the pain of the denial of dignity often lasted longer, for even when lower groups climbed up the economic ladder, there were denied better treatment for long.

As a result, when democracy came and the numerically larger lower castes began to realize how voting could be used as a weapon to counter the traditionally instituted status inequalities, their focus was on dignity and justice (Weiner 2001). Poverty was viewed as a subset of the larger problem of degradation, discrimination, and deprivation. To be treated as a human being became the political battle cry. Lower-caste parties now have emerged in most parts of India, and they are being steadily incorporated in the power structures (Jaffrelot 2003; Varshney 2000b). At the same time, it is also widely recognized that while lower-caste assertion is on the rise and older forms of discrimination

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11 For example, in the state of Kerala, where a coalition of the poor was put together, land reforms became the principal method of poverty alleviation. For a whole variety of historical reasons, Kerala did not go for a market-oriented approach to poverty reduction. For an understanding of Kerala’s strategy, see Heller (2000) and Herring (1983).
12 Greater precision on OBC percentages is not possible because, as already reported, India’s census does not publish statistics on any castes other than the SCs.
13 For a study of the Nadars of Tamil Nadu on these lines, see Hardgrave (1970).
are declining, the outcomes on the ground have lagged behind lower-caste gains in political representation.

Why have the lower-caste parties not produced a politically united class of the poor? The resolution of this paradox is well known in politics and sociology. While almost all lower castes, compared to upper castes, were huddled at the lower end of the social scale, they were not equally deprived of dignity. The middle castes, for example, were historically not as badly treated as the untouchables. Being higher on the ritual scale, the middle castes were most unlikely to group themselves with the untouchables, and they, on the whole, did not. A subjectively united class of the poor, thus, never became a politically reality in India. To make matters even more complex, Muslims, 12–13 percent of the population, were the largest non-Hindu group to be among the poor. Religiously different from the lower Hindu castes, they felt a split between their identity as Muslims and their interest as poor people.

To summarize, ethnicity became the category through which the full extent of deprivation was experienced by the poor in India. Class, or poverty per se, could not become the driver of politics. The poor were always talked about in Indian policy circles, but the polity has felt the greatest pressure to attack discrimination and denials of dignity, not poverty. A desire for effective, as opposed to formal, citizenship has been one of the principal determinants of lower-caste politics.14 Poverty is simply one aspect of this larger problem.

The Politics of Economic Policy

The concept of master narratives of politics also makes clear where economic policy belongs in India’s political space. Religion and caste have dominated mass politics in India; economic policy has basically been a contentious matter in elite politics (Varshney 2000a and 2007).

What are the key differences between mass politics and elite politics? The primary arena of mass politics is the street and the ballot box. The major theaters of elite politics are the English language press, the Internet, university seminars, corporate conferences, and the corridors of power, where corporate executives, officials of the international financial institutions, foreign government representatives, and lobbies meet with the bureaucrats and politicians. Negotiations, discussions, and bargaining are the typical forms of elite politics. Voting, agitations, protests, and demonstrations are the principal forms for mass politics; riots are also sometimes a key element. Only occasionally disrupted by mass agitations and protests, authoritarian polities are normally driven by elite politics. Democracies witness both forms of politics more or less as a routine matter.

What, analytically speaking, allows a policy to enter mass politics? Three factors are typically critical: (a) how many people are affected by the policy, (b)

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14 For an account of how the search for equal citizenship in a highly unequal society can generate unusual democratic forms, see Mehta 2003.
how organized they are, and (c) whether the effect is direct and short-run, or indirect and long-run. The more direct the effect of a policy, the more people are affected by it and the more organized they are, the greater the potential for mass politics. Underlying, long-run, and indirect links do not flourish in mass politics where the basic message has to be simple, intuitive, clearly demonstrable, and capable of arousing mass action.

Within economic policy, following this reasoning, some issues are more likely to arouse mass contestation than others. For example, inflation, by affecting more or less everybody except those whose salaries are inflation-indexed, quickly becomes part of mass politics. Privatization, a change in labor laws, withdrawal of agricultural subsidies, and reforming the reservation policy for small-scale industry also have similar properties. Either a large number of people are negatively affected in the short run (agriculture and small-scale industry), or those so affected, even when not in large numbers, are well organized in unions (privatization and labor laws). It should now be clear why India’s decision makers have not restructured agricultural subsidies, not reformed labor laws, not radically dereversed the small industry sector, and achieved limited privatization.

Contrariwise, stock markets directly affect the shareholders, whose numbers are not likely to be large, and who are also not likely to be organized, in a poor country. As a result, short of a financial collapse, stock market fluctuations and the developments in the capital markets rarely, if ever, arouse mass politics in less developed countries. Similarly, overhauling industrial investment rules—delicensing—concern primarily the investor, foreign and indigenous. Their numbers are also typically small. Since 1991, India’s reformers have achieved their greatest success in reforming capital markets and investment regimes.

What of trade liberalization and currency devaluation? If a country’s economy is heavily dependent on foreign trade, a lowering of tariff walls, a reduction in quantitative trade restrictions, and a devaluation of the currency will indeed be of great concern to the masses, for it will directly affect mass welfare. In 2004, trade constituted more than 50 percent of the GDP of Singapore, China, Malaysia, Thailand, the Philippines, Mexico, Hungary, the Republic of Korea, Poland, and Venezuela, among some others. Changes, especially dramatic changes, in the trade and exchange rate regimes of these countries have a clear potential for mass politics. However, if trade is a small part of the economy, as has been true of India and Brazil historically, changes in trade and exchange rate regimes remain peripheral to the mass concerns. In 1991, India’s trade/GDP

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15 The overall size of the economy complicates the meaning of low trade/GDP ratios. Smaller economies tend generally to have a high trade/GDP ratio, making trade very important to their political economies. With the striking exception of China, however, the largest economies of the world—the United States, Japan, and Germany—are less trade dependent. Still, trade politics, as we know, has aroused a great deal of passion in the United States and Japan. The meaning of the
ratio was a mere 15 percent. Of late, this ratio has been rising rapidly, nearing 35–38 percent. Trade is likely to be a matter of mass contestation before long.\textsuperscript{16}

Another point about delicensing and import tariffs ought to be noted. Those hurt in the short run by such reforms included, primarily, the industrialists of the sectors protected from foreign and internal competition.\textsuperscript{17} But the expected long-term benefits of such liberalization were substantial, even enormous. As a result, India’s politicians invested a lot of energy in reforming the investment and trade regimes. A similar argument can be made about capital markets. In other words, these reforms made political as well as economic sense.\textsuperscript{18}

It is intuitively plausible to suggest that the distinction between mass politics and elite politics would be more relevant to democracies, given that periodic renewals of mass mandates are not necessary in authoritarian countries. Compared to China, India’s privatization plans remain slow and halting—the welfare of workers who might lose their jobs continues to be an important political concern and questions about transparency in sales touch off substantial political storms. To be sure, China was also cautious about privatization to begin with, embarking on it only in the late 1990s, nearly two decades after the market-oriented turn in economic policy came about. But once Chinese political leaders decided to go for privatization, they did not retrace steps regardless of what consequences it had for those laid off. A treason or subversion trial against labor leaders protesting job losses is virtually impossible in India’s democracy. But in China, this is what a \textit{Washington Post} correspondent observed:

Under tight security and with an angry crowd holding a vigil in sub-zero temperatures outside, a court in this Northeastern Chinese city (Liaoyang) tried two prominent labor leaders on subversion charges today…. Yao Fuxin, 52, and Xiao Yunlinag, 56, were arrested last March for helping organize large-scale protests in Liaoyang demanding aid for workers left jobless by economic reforms and punishment for officials unfairly profiting from the privatization of state industries. The protests,

\begin{footnotesize}
\textsuperscript{16} It should also be noted that compared to economic policy, ethnic disputes tend quickly to enter mass politics because they isolate a whole group, or several groups, on an ascriptive basis. They also directly hit political parties—both ethnically-based parties (which may defend, or repel attacks on, their ethnic group) and multiethnic parties (which may fiercely fight attempts to pull some ethnic groups away from their rainbow coalitions). Because they invoke \textit{ascriptive}, not \textit{voluntary}, considerations, the effects of ethnic cleavages and ethnically based policies are obvious to most people and, more often than not, ethnic groups are either organized, or tend to organize quickly. On why ethnic groups find it easier to develop group action, see Hardin (1995).
\textsuperscript{17} The workers in these sectors were basically protected against layoffs, given India’s labor laws.
\textsuperscript{18} It can be hypothesized that by focusing so much on privatization and contraction of public sector, policy makers in Latin America and Africa ended up investing their political energies on matters where the cost-benefit calculus was not as straightforward.
\end{footnotesize}
which drew as many as 30,000 people from factories across the city, were among the biggest labor demonstrations in China in years…19

The analysis above should explain why India’s reforms have followed a very clear pattern: radical or substantial reform of capital markets, investment regimes, and trade and exchange rate regimes; no, or very, little reform of agricultural subsidies and labor laws; and no great push towards privatization. The distinction between mass and elite politics is critical to explaining these patterns.

The Policy Process

The policy process in India can be conceptualized as consisting of three kinds of circles. At the core are the so-called policy actors: the politicians heading ministries and the bureaucrats serving under them. On policy matters constitutionally defined as “central”—for example, exchange rates, foreign trade, and telecommunications—the core policy actors are entirely concentrated in Delhi. This core expands to include state governments, if the policy at issue is constitutionally categorized as “concurrent.” For instance, power, education, and health are, among others, concurrent subjects. Within this core, there can be differences of opinion between ministries: Finance and Agriculture have historically wrestled over agricultural prices and subsidies (Varshney 1995). Such differences are typically resolved by the prime minister. There can also be differences between Delhi and state governments. On power, for example, state governments and Delhi have on several occasions been at odds (Mukherji 2004). These differences are harder to resolve than those between different ministries in the Cabinet, especially if the central and state governments are ruled by different parties. A lot of give and take often becomes necessary.

The second circle in the policy process consists of factions in the ruling party or in the ruling coalition. In the days of one-party dominance (1947–91), the Congress party typically had a right-of-center and a left-of-center faction within the ruling party (Frankel 1978 and 2005). The BJP, when it came to rule, was also split between an ideologically correct, swadeshi (self reliance), right wing and a more pragmatic right-of-center faction (Sinha 2007). Sometimes these factions are not ideological. A few of the factions are driven purely by personality rivalries or patronage concerns. Small regional parties, important in ruling coalitions since 1996, are often especially tied to some important organization or interests in their own states. They may not be ideologically driven in their policy choices.

The third circle in the policy process consists of lobbies and interest groups. Both corporate interests and labor unions are well-organized in India, though over time the power of business groups has risen and that of labor unions has gone down. Historically, neither is known to have exerted pressure for a change

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in the overall economic policy. Rather, they mostly reacted to the policies announced, and when they did lobby, they did so for very particularistic benefits, such as tariff reduction or excise tax concession for a particular commodity (Kochanek 1974). The 1990s witnessed a change, as industrial associations, especially the relatively new Confederation of Indian Industries (CII), started sponsoring, and participating in, debates about policies in general (Kochanek 1995-96). General policy advocacy has thus been added to particularistic lobbying.

Two more sources of policy inputs need to be recognized. In times of economic crisis, the international financial institutions (IFIs) can become key policy actors, but in normal times, their power is limited.20 The economics profession is quite developed in India, and the top echelons of India’s bureaucracy, whether running central plans, or encouraging market-oriented economic policies, have displayed considerable economic competence. The exceptions would appear to be states, where economic bureaucracies are less developed. Often, these also happen to be poorer states, which require resources over and above their central allocations and tax collections. The IFIs can play a bigger role in such states.

A final source of policy input is the press. It does not formally participate as an organization in the policy process, but it vigorously debates policy ideas relevant to the larger public sphere, brings in experts who may not be involved in the policy process, and seeks to exert its weight by shaping opinion. Some of what the press does, or says, feeds back into the policy process. Parliament debates are sometimes triggered by what appears in the press.

The picture of the policy process sketched above is thus quite complex. The complexity, however, can be reduced to two cardinal rules of economic policy making: (a) the greatest power undoubtedly rests with politicians and bureaucrats; and (b) politicians are relatively risk-averse on issues that can bring large numbers of people agitating on the streets, and are normally more resolute if the masses are not adversely and negatively affected in a big way in the short run. India’s democracy is incapable of administering shock therapies, even if one argues that such therapies will improve the long-run welfare prospects.

6. The Political Economy of India’s Growth Transformation

If this is how the policy process operates, how did policy change come about, partly in the 1980s and especially in 1991? And what explains why India’s leaders, while keeping institutions of a capitalist economy such as stock markets, banks, and private firms, were at the same time wary of more fully embracing

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markets until the 1980s, with one exception (agricultural policy)? In normal policy discourse, a great deal of emphasis is placed on the role of leadership in policy change. Was India’s leadership exceptionally economically adroit after the 1980s and remarkably incapable before? For chronological reasons, we begin with phase one (1950–80).

**Phase I (1950–80)**

Proposed almost a century back, Max Weber’s threefold typology of leadership—traditional, legal-rational, and charismatic—remains the starting point of discussions of leadership in the social sciences even today (Weber and Eisenstadt 1968). Traditional leaders derive power from long-held conventions and norms of succession. Charismatic leaders inspire mass loyalty by their personality and personal record. Legal-rational leaders acquire authority from institutions, not from the force of personality or tradition.

Indian politics has witnessed all three types of leaders since independence. By now, however, traditional modes of leadership are disappearing in vast swaths of the country. Gone are the days of upper-caste leaders commanding votes purely on grounds of traditional caste structures. The political arena has become increasingly competitive, and an array of lower-caste leaders has burst on the scene, challenging the hold of upper-caste leaders and making bargaining quite central to government formation and survival. Increasingly, leaders fall into the charismatic or rational-legal category.

It is often believed that inspiring charismatic leaders bring about fundamental change in policy directions. The period 1950–80 was dominated by two of the most charismatic leaders post-independence India has seen: Jawaharlal Nehru (1950–64), and Indira Gandhi (1966–84, except for 1977–80; Mrs. Gandhi hereafter). With the exception of the transformation of agricultural policy in the mid-1960s, India’s fundamental economic strategy, based on a distrust of markets, trade pessimism, and a belief in *dirigisme* (state control and guidance of industry), did not change for three decades. While Nehru’s charismatic authority was clearly associated with the birth of Indian *dirigisme*, Mrs. Gandhi’s charisma is not linked to any great departures in economic policy. The decisive change in agricultural policy took place after Nehru died and before Mrs. Gandhi took power. This “interregnum” (1964–66) was not led by charismatic politicians. The oft-heard belief in policy circles that policy change may require charismatic leadership is belied by at least what happened in India in the mid-1960s, as also during the decisive shifts in the 1990s, as we shall argue later.

The first phase of India’s economic history raises three important political economy questions. Why did Nehru opt for *dirigisme* and not embrace markets more fully as a way to develop India? Why did Mrs. Gandhi not change the overall economic policy, even though India’s growth rate failed to pick up
during 1966–80, a period when she was at the helm for the most part? And how was agricultural policy transformed in the mid-1960s?

The *dirigisme* of the Nehru period was partly based on his own beliefs, and partly on the economic theories of the time, supportive as they were of central planning as the best way to industrialize poor societies. The Soviet Union’s rapid industrialization had convinced most postcolonial leaders that central planning was necessary for rapid industrialization (Hirschman 1981).21 India’s economic bureaucracy worked with the prevalent theories of industrialization. In addition, Nehru’s own position on markets and the profit motive is noteworthy:

> It would be absurd to say that the profit motive does not appeal to the average Indian, but it is nevertheless true that there is no such admiration for it in India as there is in the West. The possessor of money may be envied but he is not particularly respected or admired. Respect and admiration still go to the man or woman who is considered good and wise, and especially to those who sacrifice themselves … for the public good. (Nehru 1946: 554)

Nehru’s continuing electoral popularity despite serious stagnation in agriculture was one of the interesting paradoxes to emerge in the first half of the 1960s. Consistent with the view above, Nehru’s agricultural policy was not based on price incentives to farmers: rather, it was based on land reforms, which were supposed to raise production, and on food price controls, considered necessary for transferring savings from agriculture for financing industrial development (Varshney 1995). This policy had run into trouble by the early 1960s, but Nehru won a massive election victory for his party in the 1962 elections. Low economic performance did not electorally matter. Nehru’s identification with the master narrative of secular nationalism, a narrative he had in part created during the freedom struggle, triumphed over the rising economic malaise. That narrative continued to provide assurance to some key social groups in India, especially the upper castes, who had led the freedom movement, the Dalits, the scheduled tribes, and the religious minorities. Given (i) a first-past-the-post parliamentary system, which does not require a majority of votes for parliamentary majorities, and (ii) the presence of multiple opposition parties that were not united, the combination of upper castes, Dalits, and religious minorities was enough to elect the Congress to power.

In retrospect, given the economic zeitgeist of the time, it is not surprising that the Nehru era saw the birth and institutionalization of central planning in India. What is surprising is the lack of change in industrial policy under Mrs. Gandhi after the mid-1960s. Not only had problems in plan implementation

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21 Two more points should be noted. First, the 1930s experience of market-based economies was quite disastrous. And second, the USSR, not the United States, placed the first satellite in space. In retrospect, we can see what was wrong in Soviet economic planning. But until the late 1960s, the impression in many political as well as economic quarters was that the Soviet economic model was quite viable.
started appearing as early as the second half of the 1960s (Bhagwati and Desai 1970), but the economic growth rate in the 1970s, as we saw earlier, was the lowest since independence. On at least two occasions, Mrs. Gandhi had a remarkable opportunity to change policy—after a victorious war with Pakistan (1971–72), which immeasurably added to her status, and during the 18 months of the “emergency,” when she suspended democracy and had very few constraints on her power. No change came about.

On why policy paralysis nonetheless persisted, Bardhan (1984) has provided the most widely read explanation. His explanation relies on power of interest groups. India’s dominant coalition, Bardhan argues, consists of the industrialists, the farmers, and the public sector bureaucracy. All three benefited from **dirigisme**: industrialists because they were protected from external competition; farmers because they got price and input subsidies; and the public bureaucracy because it was well paid, protected, and wielded enormous powers. No important interest group had an incentive to push the government for a change in policy.

This popular explanation underestimates the role of the state and political leadership. If Bardhan could show that Mrs. Gandhi was interested in changing India’s economic strategy but she failed because of the interest group gridlock, his argument would stand. But there is no evidence at all that Mrs. Gandhi had an alternative economic strategy in mind. She had the charisma to make a decisive break, but she did not use her charisma in the economic realm.22 An overwhelming proportion of her rule, especially 1966–77, coincided with a very low economic growth, but she only lost one election during her stewardship. Suspension of democracy and some draconian family planning policies were the reason for her 1977 election defeat (Weiner 1978). Low economic growth did not matter. So long as the ideology of secular nationalism was not given up, Mrs. Gandhi and her party continued to be viewed with favor by the upper castes, Dalits, scheduled tribes, and most religious minorities. This was the electoral formula that lasted from Nehru through Mrs. Gandhi (Weiner 1987).

In contrast, a noncharismatic Prime Minister during 1964–66 and his equally noncharismatic Agriculture Minister altered India’s agricultural policy.23 In 1964, Lal Bahadur Shastri became Prime Minister by coincidence after Nehru’s death. Shastri emerged as a compromise candidate because he was nonthreatening to the two major factions in the party. C. Subramanian was his Food and Agriculture Minister. Subramanian, like Shastri, had not led any fiery election campaigns. He was basically a technocratically capable politician (Frankel 1978).

Supported by well-chosen economic bureaucrats and the right-of-center faction of the Congress party, the two together brought about a fundamental restructuring of agricultural policy. Unlike Nehru’s arguments, the new policy

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22 The charisma instead was used in the political realm. See Rudolph and Rudolph (1987) and Weiner (1989).

23 This account of policy change in the mid-1960s below is a summary of the argument developed in Varshney (1995). For details, see Chapter 3.
was based on price incentives for farmers, supported by incentives for adoption of new farm technologies. A green revolution occurred. India, precariously dependent on American shipments of wheat in the mid-1960s, became food self-sufficient.

In summary, charismatic leadership does not explain India’s agricultural shift in the 1960s. More or less the same story, as we will show next, would be repeated in 1991. Both policy shifts show how institutions work in the Indian polity in moments of economic crisis. Change came about more because of how personalities derived power from institutions, less on account of how institutions derived power from charismatic personalities. Moreover, there was a great deal of learning in the policy process, which in moments of crisis was capitalized upon. We explain later what the sources of learning were.

Phase Two (1980–2006)

Unlike popular perception, policy movement towards markets did not begin in 1991; rather, 1991 was the culmination of a process that commenced systematically during the term of Rajiv Gandhi (1985–89). Indeed some pro-market reforms had happened even earlier, firstly during the rule of the Janata government (1977–79) and then during the return of Indira Gandhi (1980–84), but these were very partial and hesitant (Joshi and Little 1998). Rajiv’s regime initiated a more concerted effort toward economic liberalization and reliance on the private sector. A “reform team” in the economic bureaucracy was put in place by Rajiv Gandhi (Shastri 1995). Unlike previous bureaucratic constellations, this team preferred markets over central planning and was more exposed in its professional life to East Asia and international financial institutions. Rajiv Gandhi delicensed some industries, lowered corporate tax rates, and gave incentives for the development of high technology in several sectors. Exchange rate reform and reduction of quantitative restrictions on imports also happened. The reform team kept working on new policy ideas. By 1991, the blueprint of a larger market-oriented shift in policy was already in place.

In 1991, P.V. Narasimha Rao became Prime Minister entirely by accident—Rajiv Gandhi, leader of the Congress party, had been assassinated by LTTE militants during the 1991 election campaign. Rao was well known in India’s uppermost political circles for overall competence, but not for charismatic leadership. Moreover, Rao appointed a technocrat, not a charismatic, politician as Finance Minister. Manmohan Singh was not a professional politician; he was a highly respected economic bureaucrat who had served in a whole variety of appointed, not elected, positions, including the head of the Reserve Bank of India. The economic capabilities of Manmohan Singh and his economic team are beyond doubt. But we will misunderstand the sources of change if we do not put the reform team in the larger institutional perspective.

A balance of payments crisis became an opportunity for this team, along with Finance Minister Manmohan Singh, to bring about a fundamental shift in
India’s economic strategy. “The current level of foreign exchange reserves,” announced Singh, “would suffice to finance imports for a mere fortnight.”\textsuperscript{24} But instead of addressing only the macroeconomic crisis through an IMF-style stabilization program, which would have been the conventional way to go, Singh sought to change the entire economic strategy. “Macroeconomic stabilization and fiscal adjustment alone cannot suffice; they must be supported by essential reforms in economic policy … (facilitating) a transition from a regime of quantitative restrictions to a price-based mechanism…. Overcentralization and excessive bureaucratization have proved to be counter-productive.”\textsuperscript{25} Thus began a whole series of economic reforms, introduced incrementally in the political process.

A basic restructuring of economic policies goes through a well-defined political process in India. Specifically, the annual government budget becomes the key indicator of changes in economic policies, but it is an instrument over which the executive does not have final authority. The government can only present a budget; the legislature must approve it. In many countries, the budget simply sums up the health of government finances. In India, given the historically entrenched and highly interventionist role of the state in the economy, most big changes in economic policy, especially those that reduce the role of government and, therefore, alter taxes, public expenditures, and economic laws, show up prominently in the budgetary instrument. If India’s parliament had not passed the first few budgets after 1991, the new economic policies would have been stillborn, not because of a faulty economic logic but due to the institutional constraints of a parliamentary system. We must, therefore, not only ask why the government introduced reforms, but why India’s parliaments repeatedly endorsed them by approving the budget.

It is hard to recall how gloomy the reform prospects were in July 1991. Lacking a clear majority in parliament, the Rao government did not even seem stable. The country was going through a massive Hindu-Muslim upheaval on the one hand and a serious dispute over caste-based affirmative action on the other. To make matters worse, two insurgencies—one in Punjab, another in Kashmir—were showing no signs of abatement. The nation’s former head of government, Rajiv Gandhi, had just been brutally assassinated. Instead of reform optimism, many commentators were concerned whether India would survive as a nation in the 1990s.

As it turned out, in spite of lacking a clear majority in parliament, the Rao government was able to push reforms, whereas only a few years back Rajiv Gandhi’s government, even with a three-fourths majority, had to pull back after initiating market-oriented policy moves.\textsuperscript{26} Opposition politicians vigorously criticized the budgets during 1991–95, but did not vote against them.

\textsuperscript{24} Lok Sabha Debates, Series 10, 24 July 1991, p. 272.
\textsuperscript{25} Lok Sabha Debates, ibid, p. 276, emphasis added.
\textsuperscript{26} For a detailed political analysis of how Rajiv Gandhi’s reform program stalled, see Kohli (1987).
They did not because by 1990, India’s politics had become triangular. Between 1950-90, the principal battlelines of politics were bipolar. The Congress was the party of government, and all other parties were opposed to it. Between 1990-97, a triangular contest developed between the left (the Marxists and lower-caste parties), the Hindu nationalists, and the Congress party. Coalitions were increasingly formed against the Hindu nationalists, not against the Congress. To begin with, the left disliked the reforms, but they disliked Hindu nationalism even more. Having risen from 2 seats in 1984 to 120 seats in 1991, the Hindu nationalist BJP was the rising force in Indian politics. Once the Hindu nationalists demolished the Baburi mosque in December 1992, the left became even more convinced that the Hindu nationalists had to be contained. Collaboration between the various opposition parties was required to defeat budgets, but the Hindu nationalists and the Communist left simply could not come together. That would have unseated the Congress party from power, which in turn implied the clear possibility that the BJP would march further in the elections that would ensue.27

Thus, India’s economic reforms kept progressing because the political context had made Hindu-Muslim relations (and caste animosities) the prime determinant of political coalitions. It was not charismatic leadership, but the workings of India’s institutions that led to a transformation in policy, once a decision to change was made at the top, and a skillful team of technocrats was put together. The project of policy transformation was immensely helped by the religious and caste-related storms of Indian mass politics.

Another economic development we noted above requires explanation. Why have the growth rates of various states diverged so much in the second period (1980–2006)? On the whole, the Western and Southern states have done much better; and the Northern and Eastern states have lagged behind.

Four reasons for such divergence can be advanced. First, as is well known, greater reliance on market forces tends to generate inequalities to begin with. States better endowed with infrastructure benefit more when markets are freed up. This was true even when the green revolution technologies and farm price incentives were introduced in the mid-1960s. Punjab, Haryana, and Western Uttar Pradesh were the first to have the green revolution. The other states benefited later. By now, of course, Punjab and Uttar Pradesh have declined, showing that the initial advantages do not last for ever and other states may eventually catch up. The early beneficiaries of the new reforms in India are all states with a better infrastructure.28

Second, especially after 1991, India’s states have been allowed to negotiate directly with foreign investors and international financial institutions. Before

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27 Since 1998, a substantial section of the non-Marxist, lower-caste, left and the BJP have come together. However, by the time this happened, the reforms were firmly in place.

28 One should add that the Western states of Gujarat and Maharashtra have historically been also more business-oriented.
1991, all state-level negotiations of this kind were routed through Delhi. Moreover, during 1950–80, central planning ensured some equity in investment and resource flows. The better endowed states are now able to attract greater investment.

Third, a strictly political argument, not systematically made yet, is worthy of consideration as a hypothesis. The Southern states were the first to go through a democratic social revolution, as lower castes displaced the dominance of upper castes in politics by the late 1960s or early 1970s. As a consequence, the entrepreneurial energies of the Southern states were released in a way that the North, still going through a caste churning, has not experienced. In sociological circles, it is often noted that businesses from all sorts of castes, including both upper and lower, have burst on the scene in South India, whereas in the North, entrepreneurs continue to come predominantly from the traditional Vaishya or Marwari castes. Data on the caste origins of entrepreneurs have not been systematically collected on an all-India basis, but as a hypothesis, this factor is worth seriously keeping in mind.

Finally, once the new hegemony of lower castes was institutionalized in Southern India, a most contentious issue in politics declined in significance, and better governance came about. Caste churning in Northern politics began several decades later, and is still an ongoing phenomenon. Good governance and social churning do not normally go together.

Learning

In the 1980s and 1990s, we find evidence of two kinds of learning—external and internal—in India’s policy-making circles. To be sure, external influences were also present at the birth of India’s economic policy in the 1950s. At that time, as we have seen, the Soviet experience of plan-led industrialization was highly influential. However, by the 1980s, serious cracks appeared in that model, and by the late 1980s, the Soviet model collapsed in its homeland, which had a profound influence on India’s policy makers. After taking over as Finance Minister, Manmohan Singh argued: “The overall thinking of the economic profession of this country was greatly influenced by the Soviet model. With the collapse of the command economy of the Eastern European type, everybody is convinced that it is time for fresh thinking.”

As mentioned above, fresh thinking had already started emerging in the mid-1980s, when several policy makers began to pay attention to East Asia. Moreover, Western experiences, especially those in the IFIs, became transformative for some existing and future bureaucrats. Two factors were especially important: new reflection on the part of several senior economic

bureaucrats, and lateral introduction of “new blood” in high echelons of economic bureaucracy.\(^{30}\)

Korea was the first East Asian country to catch attention. By the mid-1980s, it had clearly emerged as one of the most successful industrializers in the developing world. Manmohan Singh argued: “There must be a deep examination of what has gone wrong. Why is it that South Korea is talked about? In 1960, South Korea had the same per-capita income as India. Today, South Korea’s income is 10 times India’s.”\(^{31}\) Korea’s success highlighted the significance of foreign trade and global markets.

It should, however, be noted that the change in bureaucratic thinking alone could not have been an inspiration for policy change. On their own, bureaucrats can at best make small changes in India’s policy; without political patronage, they cannot introduce fundamental changes in policy. In Prime Ministers Rajiv Gandhi (1985–89) and Narasimha Rao (1991–96), the new economic thinking found political patrons at the topmost rungs of the polity. Even Manmohan Singh as Finance Minister needed such support, for he was not a professional politician.

By the late 1990s, as Chinese economic achievements became better known, China replaced Korea in India’s policy discourse. Korea’s success might have been recognized in the highest circles in the 1980s, but it did not enthuse too many politicians in general. Skeptics noted Korea’s smaller size and its alliance with the United States. China’s size, complexity, and monumental economic rise have made it a more acceptable reference point. In the 11th and 12th Lok Sabha (1996–99), India’s elected lower house, China was cited 9 times in parliamentary debates; in the 13th Lok Sabha (1999–2004), 14 times; and in the three years of the 14th Lok Sabha, currently in existence, (2004–), a whopping 113 times.\(^{32}\) On the legislation on special economic zones (SEZ) introduced by the Commerce Minister in parliament in October 2005, the debate was full of references to China, some calling China a model.\(^{33}\) In the 2006 annual budget speech by Finance Minister P. Chidambaram, China’s success in attracting FDI was mentioned as a model to follow and as a counsel for pragmatism.\(^{34}\)

In the highly nationalistic setting of Indian politics, arguments about Indian exceptionalism have traditionally thrived and comparisons have normally been

\(^{30}\) Shastri (1995) gives the most systematic account of the influences on top economic bureaucrats in the 1980s, covering senior career bureaucrats such as Abid Hussain, Venkitraman, N.K. Singh, and A.N. Verma, whose experiences at ESCAP, Bangkok, or at the World Bank suggested that India’s economic strategy had to change, and lateral entries such as Montek Singh Ahluwalia, Shankar Acharya, and Rakesh Mohan, brought in from the World Bank, who were more market-oriented than their predecessors in the economic bureaucracy.

\(^{31}\) Weintraub (1991). Repeated references were also made to Korea in interviews given to The Economist (May 23, 1991) and India Today (July 31, 1991).

\(^{32}\) Some of these citations for security and defense issues, however.

\(^{33}\) Lok Sabha Debates, October 5, 2005.

\(^{34}\) Lok Sabha Debates, February 28, 2006.
resisted. After the heydays of Soviet-influenced planning in the 1950s, explicit references to foreign models were entirely rare. The current burst of India-China comparisons partly reflects a new confidence in the political circles, and is partly a genuine desire by policy makers to learn from an economic giant of our times, a giant that was as poor as India only a few decades back.

Internal learning in policy circles is also important, though it has never shaped fundamental changes in the overall policy design. Internal experiences have basically influenced specific policies. Given that some of the policies are assigned by the constitution primarily to states, different states in India have experimented with different models in rural development, education, health, and power sectors. Great successes and failures at the state level send signals to the entire polity. For instance, the Rural Employment Guarantee Law (REGL), passed by the current parliament in 2005, has its origins in the Employment Guarantee Scheme of Maharashtra. Mistakes have also been a source of learning.

There is also evidence of policy learning via experimentation, or “learning by doing.” Privatization of the power sector in Orissa in the mid- to late 1990s became a negative example for most policy makers. It emphasized how important it was to have independent regulatory structures, not regulatory authorities beholden to the government, when public utilities are privatized. A roughly similar realization marked India’s Telecom sector in the late 1990s. Fumbling for much of the 1990s, it became a runaway success in the late 1990s after regulatory structures were reformed.

7. Sustaining Reforms:
The Challenge of Inclusiveness

As India moves forward, inclusion has become its greatest policy challenge.\(^{35}\) India’s democracy has given the underprivileged a great deal of voice, a voice that can create political instability, if ignored. As we have already reported, three kinds of inequalities have grown since reforms were introduced: interpersonal, interstate, and rural-urban. The policy makers are showing signs that they are aware of the magnitude of the problem.

The inclusionary pressures in India are best viewed in a larger and comparative perspective. It is a standard proposition of political economy that there are some built-in tensions between markets and democracy.\(^{36}\) Such tensions arise due to the well-known difference in the organizing principles of the two systems. For democracies, the masses are citizens; individually, they have the same weight in franchise as those privileged or part of the elite. But markets deal with commodities, not citizens. By and large, the masses appear in the markets as

\(^{35}\) For a fuller development of ideas contained in this section, see Varshney (2007).

\(^{36}\) See for example Lindblom (1977), Polanyi (2001), and Przeworski (2003).
consumers of goods, as suppliers of labor, or as small producers of low value-added goods. As consumers, the masses matter if they have the purchasing power, and as suppliers of labor and products, the value of their work is determined by the forces of supply and demand. In a market-based economy, no assumption of equality of all is made, which is intrinsic to elections, a vital principle of democracy.

In the West, the tensions between democracy and markets remained manageable for at least three reasons: universal franchise came to the West only after the industrial revolution had been completed, which effectively meant that the poor got the right to vote after Western societies had become quite rich; a welfare state, attending to the low-income segments of the population, has been in operation for much of the twentieth century; and finally, those more educated and earning higher incomes tend to vote more than the poorer sections of society.

The Indian experience constitutes a departure on all three counts. First, as already noted, India adopted universal franchise at birth, much before the prospects of an industrial revolution could be visualized. India’s development experience was thus bound to be different from the West. It is also remarkably distinct from East Asia. Korea and Taiwan, China embraced universal-franchise democracy only between the late 1980s and mid 1990s, two to three decades after their economic upturn began. China and Singapore are not yet democratic. One might argue that in countries such as China, too, policy makers have to anticipate what policies might cause serious explosions of discontent and try to deal with them before they arise. But collective action is simply much easier in India: protest is constitutionally protected and opposition parties exist to lead protest. Mass protest, thus, is more normal in Indian politics, and can often be quite consequential. Second, India does not have an extensive welfare state, though it is trying to create one of late. The poor have very few safety nets. Third, and this is critical, defying democratic theory, a great “participatory upsurge” has marked Indian politics of late. Compared to the upper tiers of society, the so-called plebian orders have participated noticeably more in elections. Indeed, the new conventional wisdom of Indian elections turns standard democratic theory on its head: the lower the caste, the lower the income, and the lower the education, the greater the odds that an Indian will vote (Yadav 2004).

How do markets deal with the poor? The standard market-based economic perspective is quite straightforward: expansion of markets will conquer poverty better than any other method. Markets release remarkable entrepreneurial energies, which can be harnessed for the larger good of society, including that of the poor. No society, the neoliberal economists argue, has ever banished mass poverty without embracing markets.37

37 This point may be generally true, but the obvious exception of Cuba exists. Moreover, significant pockets of poverty remain in a heavily market-oriented United States.
All of these statements are true, but only in the long run, not in the short to medium run. Authoritarian politicians may concentrate entirely on the long run, but faced with the requirement that election mandates must be periodically renewed, democratic politicians are, of necessity, concerned more about the short and medium run than about the long run. Moreover, how the masses view the markets in the short to medium run also depends on whether the markets are gainfully employing them, thereby increasing their purchasing power and welfare.

As we reported earlier, India’s growth over the last three decades has not been employment-intensive. For all practical purposes, at 20–25 percent of the population, the numbers of those who are the prime beneficiaries of reforms and those who continue to hover below the poverty line roughly match, and the latter have a much higher voting turnout. If one adds to this calculus the fortunes and dispositions of those not much above the poverty line (let us say those below $2 a day, instead of $1 a day), who also tend to vote more than the middle classes do, one can see why any reforming government in India will have to think about inclusion, if reforms begin to affect mass consciousness.

Have reforms begun to affect mass consciousness, or are they still a factor primarily in elite politics? In a survey of mass political attitudes in India conducted in 1996, only 19 percent of the electorate reported any knowledge of economic reforms, even though reforms had been in existence since July 1991. In the countryside, where more than 70 percent of Indians lived, only about 14 percent had heard of reforms, whereas the comparable proportion in the cities was 32 percent. Further, nearly 66 percent of the graduates were aware of the dramatic changes in economic policy, compared to only 7 percent of the mostly illiterate poor. In contrast, close to three fourths of the electorate, urban and rural, literate and illiterate, rich and poor, were aware of the 1992 mosque demolition in Ayodhya; 80 percent expressed clear opinions of whether the country should have a uniform civil code or religiously prescribed and separate laws for marriage, divorce, and property inheritance; and 87 percent took a stand on the caste-based affirmative action.

Further, economic reforms were also a nonissue in the 1996 and 1998 elections. In fact, Manmohan Singh, India’s star reformer, lost his election in 1996. And in the 1999 elections, the biggest reformers either lost or did not campaign on reforms.

Did the 2004 elections end the relative nonsignificance of economic reforms in electoral politics? The question is relevant because the BJP-centered National Democratic Alliance (NDA) ran an “India Shining” campaign. Further, two of the biggest reformers at the state level, Chandrababu Naidu in Andhra Pradesh and

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38 The survey was conducted by the Center for the Study of Developing Societies (CSDS) under the leadership of Yogendra Yadav and V.B. Singh. For the larger audiences, the findings are summarized in India Today, August 15, 1996. All figures cited below are from the CSDS survey.

S.M. Krishna in Karnataka, lost power in 2004 elections. The former was, in fact, routed.

Studies are unclear as to whether reforms single-handedly accounted for the NDA’s election defeat (Yadav 2004), but it is unmistakably clear that the political pressure on politicians to make reforms relevant to the masses is rising. Based on the largest-ever sample drawn for election studies in India, the statistics collected by the National Election Study (NES) 2004 give us the materials to understand how the masses are beginning to view economic reforms.

Table 8 summarizes some key results. More people believed that reforms benefited only the rich, not the whole nation, and the more we climb down the social ladder, the greater is that belief. Upper castes are nearly even split on whether the reforms helped the whole nation or only the rich. But among those segments placed lower on the socioeconomic scale—the “Other Backward Castes” (OBCs), the Dalits (the Scheduled Castes), Adivasis (the Scheduled Tribes), and the Muslims—the belief that reforms have mainly benefited the rich is held by a huge margin. One should also add that the upper castes constitute an overwhelming proportion of India’s middle class. The fit between the two categories—upper castes and middle class—is not perfect, but it is very substantial.

Further, in a dramatic contrast to 1996, when a mere 19 percent of the citizens had any opinion on reforms, a little over 85 percent expressed clear judgments in 2004. It should be obvious that in 1996 there was no understanding of reforms beyond elite levels, but the reforms are now becoming part of mass consciousness.

The current government has some of the ace reformers of post-1991 India, including Prime Minister Manmohan Singh, Finance Minister P. Chidambaram, and Planning Chief Montek S. Ahluwalia, but two of the biggest initiatives of this government have been distinctly antimarket: the National Rural Employment Guarantee Program (NREGP) and the extension of affirmative action to the so-called “Other Backward Castes” (OBCs) in higher education. The first, already passed by parliament and on the legal statutes, gives a guarantee to every rural household that 100 days of annual work will be given to at least one member of the household, a scheme currently in operation in 200 districts and to be extended to the entire country over the next two years.

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40 For why reforms cannot be held accountable for the NDA’s defeat, see Varshney (2007).
41 The sample size was over 22,500, which allows not only national-level, but also state-level generalizations. The NES studies have been led by Lokniti, a project headquartered at the Centre for the Study of Developing Societies (CSDS), Delhi, with Yogendra Yadav at the intellectual helm.
42 Only 3,263 people out of a sample of 22,500 had no opinions.
Table 8: Perceptions of Economic Reforms According to Community, 2004 (percent of row totals)

<table>
<thead>
<tr>
<th>Economic Reforms Benefited</th>
<th>Upper Caste</th>
<th>OBC</th>
<th>Dalit</th>
<th>Adivasi</th>
<th>Muslim</th>
<th>Other</th>
<th>N</th>
</tr>
</thead>
<tbody>
<tr>
<td>The whole country</td>
<td>38</td>
<td>29</td>
<td>19</td>
<td>20</td>
<td>16</td>
<td>27</td>
<td>6,387</td>
</tr>
<tr>
<td>Only the rich</td>
<td>36</td>
<td>42</td>
<td>51</td>
<td>44</td>
<td>53</td>
<td>42</td>
<td>9,755</td>
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<tr>
<td>No one</td>
<td>13</td>
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<td>14</td>
<td>16</td>
<td>17</td>
<td>13</td>
<td>3,143</td>
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<tr>
<td>No opinion</td>
<td>12</td>
<td>16</td>
<td>16</td>
<td>20</td>
<td>13</td>
<td>19</td>
<td>3,263</td>
</tr>
</tbody>
</table>


The second seeks to reserve 27 percent of seats in government-aided higher education institutions, including the Indian Institutes of Technology (IITs) and Indian Institutes of Management (IIMs), for the OBCs. Whether these are the right ways to bring benefits to the masses may be debatable, but it should be obvious why the government has undertaken these measures.43

The middle classes, no more than 25–30 percent of India’s population, are electorally not very attractive to political parties. The number of votes in the two other categories—the middle castes (OBCs) and the lower segments (SCs, STs and Muslims)—is much higher44; and these strata, all below the middle classes, also tend to have higher turnout rates. Thus, in the pure arithmetic of vote, unless they begin to participate in elections more and/or become roughly 50 percent of the electorate, India’s middle classes, the principal beneficiaries of economic reforms, will be less than fully consequential in electoral politics. The middle classes control the press, especially the English-language press, and have a preponderant presence in the corporate sector. As a result, they can still generate a vigorous debate in the country, strengthening the public sphere of democracy. But their electoral significance does not match their power over the instruments of public criticism.45

8. Conclusion

India has come a long way since independence in 1947. To be sure, India’s independence was a moment of joy, “a tryst with destiny,” as Nehru, India’s first and longest-serving Prime Minister, memorably put it. But it was also a moment of pain and agony. Partition violence killed a large number of people; India’s

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43 A third big anti-market initiative was announced in March 2008, Loans for small farmers have been waived by the current government. The total cost is estimated to be over $15 billion. 

44 For details, see Deshpande and Yadav (2006).

45 It should also be noted that the BJP, should it return to power after the next elections, cannot entirely escape these inclusionary pressures. If the BJP has to expand further, it must move resolutely downward for support. That is where the biggest numbers of votes exist. Unsurprisingly, the BJP did not oppose the national rural employment guarantee legislation, nor did it resist the new affirmative action plan. All parties participating in India’s electoral politics today can testify to the rise of inclusionary pressures.
literacy rate was a mere 16–17 percent; and though exact estimates are hard to come by, most analysts would concede that anywhere between a half to two thirds of the population was below what we have come to call the poverty line. Beyond the princes and the maharajas, the middle class was very small, and the manufacturing sector miniscule. A half century of virtual economic stagnation had preceded independence.

Today, with savings/GDP and investment/GDP ratios in excess of 30 percent, India is undoubtedly going through an economic boom, building up further on an annual growth rate of roughly 6 percent since 1980 and touching on late annual growth rates of 9 percent. Mass poverty has come down, especially in the last 25 years; the literacy rate has crossed 65 percent; the middle class numbers anywhere between 200 to 300 million people, the exact magnitude depending on the indicator chosen; more than six million cell phones are being sold every month; foreign investors are rushing in; and internationally competitive firms are fast emerging—not only in the information technology industry, but also in several other skills- and knowledge-intensive product lines, such as pharmaceuticals. Finally, India’s corporate leaders are acquiring major firms abroad, creating new international synergies in their supply chains.

But a lot of Indians, and certainly most of India’s political leaders, including those who champion market-oriented economic reforms, believe that poverty and deprivation have not come down rapidly enough. What is an acceptable rate of decline in poverty is not, fundamentally, an economic question. A nation’s politics decides what is acceptable. The impression that India’s boom has mainly benefited the upper Hindu castes, the cities, and the Southern and Western states is inescapable. On the whole, the lower Hindu castes, the scheduled tribes, the large Muslim minority, the villages, and the Northern and Eastern states have lagged considerably behind. India’s post-independence leadership had promised to abolish mass poverty. That pledge remains only partially redeemed. Half the battle still lies ahead.

Under such circumstances, a universal-franchise democracy—where the deprived, defying standard democratic theory, have come to vote as much as the privileged—is bound to feel inclusionary pressures. Many more would like the fruits of the economic boom to come to them. The greatest challenge for India’s policy makers today is to balance the growth momentum with inclusionary policies.
References


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<td>2,247</td>
<td>17,500</td>
<td>4,216</td>
<td>33 mil.</td>
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*40 inches in height and 6-8 inches in diameter

Pounds | Gallons | Pounds CO₂ Equivalent | BTUs
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