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A short history of India's economy

A chapter in the Asian drama

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Abstract: This paper is a short history of the Indian economy since 1968. India today is a changed country from what it was half a century ago, when Myrdal published his *Asian Drama*. The stranglehold of low growth has been broken, its population below the poverty line has fallen markedly, and India has joined the pantheon of major players globally. This paper analyses the economic policies and the politics behind this transformation; and uses that as a backdrop to take stock of the huge challenges that lie ahead.

Keywords: India, growth history, political economy, corruption, technological change
JEL classification: A12, B10, B31, N14, O10

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1 Gunnar Myrdal and India

My first encounter with Gunnar Myrdal's *Asian Drama* was soon after its publication. I joined Delhi University's St. Stephen's College as an undergraduate in 1969. One of our professors, Kalyanjit Roy Choudhury, a voracious reader, told us with excitement about this new, mammoth publication. Soon the book became the ultimate fashion statement for students on our campus. To be seen crossing the college yard with one of the volumes of the book in hand raised one's status. To be seen talking about what was in it raised it even more. It was a case of good competition, which helped raise the level of erudition of my generation of students.

The publication, half a century ago, of this three-volume magnum opus, focused on South Asia, predominantly India, and more tangentially on several Southeast Asian nations, marked a turning point not just for the economics students of Delhi University, but for all those engaged in the study of economic history, political economy, and development. Treating the region as focus, Myrdal ranged over economics, history, and politics. His work would leave its mark on the region and on economics itself. Its mark on economics occurred because what Myrdal was attempting, admittedly in an inchoate way, amounted to an early precursor of both New Institutional Economics and Behavioural Economics. This was his insistence that to understand the performance of economies as complex as those of India and its neighbours, we have to view economics as a discipline embedded in sociology, psychology, and politics.

Because Myrdal was charting such a new course, *Asian Drama* was both pioneering and flawed, as we now know with the hindsight of recent research in behavioural and institutional economics. We can see these twin traits in his analysis of India's economy. In looking at India's sluggish growth and the vast numbers living in extreme poverty, Myrdal often allowed his pessimism to show through. As he wrote,

> If in a country like India the government were really determined to change the prevailing attitudes and institutions, and had the courage to take the necessary steps and accept the consequences, then these would include the effective abolition of caste, prescribed by the constitution, […] land reform and tenancy legislation, […] the eradication of corruption at all levels [,] forceful attack on the problem of the educated unemployed and their refusal to do manual work, and so on. (Myrdal 1968: 368[1]).

One senses in this a pessimism that is deep. It is a concerned pessimism, one that stems almost from a frustration with a test case of a nation—in this case India—breaking out of the stranglehold of colonialism, and one he wishes would succeed and become a prototype for others. This commitment deserves appreciation, but the remark also suggests an inadequate understanding of the complexity of interaction between economics and politics and the troublesome idea of the endogeneity of institutions. His questioning 'If […] the government were really determined' and suggestion that the 'abolition of caste' and 'eradication of corruption' are matters of choice by an agent called government or by individuals that constitute the government reveals a rather simplistic view of government as an exogenous institution. This is a common presumption in economics.

We would not, for instance, say that the market's failure shows that consumers are not determined. It is arguable that the level of determination a government exhibits is not an exogenous variable,

[1] All page references to *Asian Drama* are to the widely used version edited by Seth King (Allen Lane 1972).

and, even if it were, it is not clear that governments have within their wherewithal the ability to control many of the social ills like discrimination and corruption. The persistence of these ills is not necessarily evidence of political leaders condoning them, even though it often is. We have to use more sophisticated analysis to separate out the cases where the corruption is being condoned or even encouraged, and where it is being haplessly suffered because its mitigation is beyond the leader's reach—or any individual's reach, for that matter. Many of our worst social ills are *collective* traps.

Fortunately, economics has moved on since then and even taken some small steps to reach out to the neighbouring disciplines of politics, psychology, and sociology by trying to conceptualize institutions as endogenous structures. While Myrdal deserves credit for venturing out to some of these, rather treacherous, multi-disciplinary terrains so early, the social sciences at that time did not have the tools and theoretical constructs to do justice to such inter-disciplinary trespassing. As a consequence, we can now share the concern that Myrdal had for the theatre of Asia and at the same time bring some of the more contemporary, multi-disciplinary social science methods to bear on the project. That is what I shall attempt to do in this paper, whose focus is India and, in particular, India's economy. But in keeping with the above observation I look at some of economics' neighbouring disciplines insofar as they have a bearing on the subject matter of this paper.

India is today a changed country from what it was half a century ago. It still has huge challenges staring it in the face but, at the same time, the country has long since broken with the 'Hindu rate of growth', its population below the poverty line has fallen steadily since the late 1960s, and sharply over the last decade, and it has joined the pantheon of major players globally. One way of celebrating *Asian Drama* is to take stock of what India has done since the time of its publication in 1968 and peer into the future to assess the challenges that lie ahead, and that is what I propose to do in this paper. In the spirit of Myrdal's work, my aim here is to analyse and not provide a comprehensive description. The description is done selectively, with an eye to providing material for the analysis. Myrdal himself noted: 'As our main concern is analytical rather than merely descriptive, we have not felt obligated to produce exhaustive factual details.' (Myrdal 1968: 17).

The paper continues with a brief analysis of the political backdrop of the Indian economy. This is followed, in Section 3, by a short and selective description of India's growth experience since Independence but with special attention to what happened in the 1970s onward. Thereafter, in Section 4, I turn to some contemporary challenges for India. It should be pointed out at the outset that the challenges are numerous; so I select areas within my expertise and where I have some ideas to offer. The final section of the paper consists of a peering into the future.

2 Politics first

From the vantage point of hindsight, it seems quite remarkable that India did what no other newly independent developing country did. It invested in politics first—establishing democracy, free speech, independent media, and equal rights for all citizens. At one level all progressive leaders around the world tried this. After the end of World War II, as nations broke from the yoke of imperialism and became independent, we had not just Jawaharlal Nehru in India, but Bung Karno Sukarno in Indonesia, Mohammad Ali Jinnah in Pakistan, Kwame Nkrumah in Ghana, Julius Nyerere in Tanzania, and several other leaders trying to put their nation on an even keel politically, and build political institutions to promote inclusive economic development. But in most cases it did not last. Coups, chaotic responses, and the lust for power caused democracy to collapse in one nation after another, bringing in military rule and conflict. A map of democracy around the world in 1985 would show a bleak landscape in virtually all developing and emerging nations. India was the exception.

While a large part of the credit for this does go to the early political leaders, Mahatma Gandhi, Nehru, and Ambedkar, and to progressive writers and intellectuals like Rabindranath Tagore, Periyar E.V. Ramaswamy, and Sarojini Naidu, as in all matters of history, luck also plays a role. And India had it in ample measure. In any case, the upshot was that in terms of political design and structure, with regular elections, a progressive constitution, secularism, free media, and an empowered supreme court, India resembled an advanced nation, and in this respect had very few peers in the developing world.[2]

India's downside turned out to be its economy. With growth sluggish, large swathes of population living in abject poverty, and widespread illiteracy, the country trudged along decade after decade, while several other nations, like South Korea, Taiwan, Singapore, and Hong Kong, starting from roughly the same level of economic prosperity in the 1950s, took off in spectacular ways. Some would argue that this sluggishness was in part *caused* by India's democracy and progressive politics, and that, if there had been a dictator, he or she would have pulled the economy out of the vicious circle of poverty. I will comment on this later. But the fact remains that whether or not this causal explanation from politics to economics has any merit, two things do stand out: early India's remarkable political achievements and the persistent economic stagnation for at least three decades after its independence.

Two caveats to the above claim ought to be made. First, the description should not convey the impression of nothing happening during these first decades. Despite overall growth remaining subdued at around 3.5 per cent per annum, much was happening beneath that. Taking a page out of the Soviet model, India tried to institute five-year planning, with an effort to set up heavy industries, large-scale steel production, and dam-building to generate electricity on a large scale. Second, somewhere in the mid-1960s India had a successful 'green revolution' and broke out of the trap of low agricultural productivity and frequent famines. Though this was most visible in Punjab, Haryana, and western Uttar Pradesh, its benefits were felt across the nation.

The second caveat is that the slow growth of the early years should not be taken as an indicator of the nation's independence not having an impact on the economy. Independence was good for India, even in terms of the yardstick of pure economic growth. Sivasubramonian's (2000) comprehensive statistical study shows that annual growth, from being negligible during the first 50 years of the 20th century, moved up to somewhere between 3 and 3.5 per cent in the decades immediately after the country's independence in 1947. Nayyar (2006) in his Kingsley Martin lecture at Cambridge University in fact identifies 1951 and 1980 as the two turning points in India's growth in the 20th century. I will have occasion to dispute his second turning point but that will come later.

There would be a short interruption in democracy in 1975, when the Prime Minister, Indira Gandhi, declared an Emergency and took dictatorial control over the nation. For those who believe dictatorship helps economic growth, the Emergency seemed like a godsend because, in 1975/76, India's GDP growth rate hit 9 per cent, an unimaginable figure at that time and, it is also believed, the trains ran on time. However, if these hardliners studied the growth trend thereafter, they would be deflated. Growth thereafter began to decline and, by 1979/80, it had plummeted to

[2] For discussion, see Sen (2005) and Basu (2009). For one of the most authoritative studies of the interface between politics and economics in India, see Bardhan (1998).

-5.2 per cent, the worst year in India's history from 1947 to now.[3] In fact, after that year, India has not had a single year of negative GDP growth.

Luckily, the Emergency lasted just under two years and, unlike most dictatorships, it was brought to an end by an election, called by Indira Gandhi herself, in 1977, when she was roundly defeated. It remains a mystery why she behaved so differently from other dictators—namely, calling an election and then not rigging it. One theory, to which I subscribe, is that she was troubled by the fact of having destroyed her father's legacy of a vibrant democracy, wanted the legitimacy of an election, and was prepared to (and some have argued that she even expected to) lose. The other hypothesis is hubris, namely, that she was confident that, though the opposition and much of the media cried foul, she would win and then she would consolidate her power. In any case, fortunately for all supporters of democracy, she was defeated.

When Indira Gandhi returned to power in the 1980s, India's policies began to change. I would argue that unlike her father, Jawaharlal Nehru, she did not have an innate economic ideology. While she had strong political convictions, which she backed up with an enormous strength of personality, on matters of economics, she had few deep convictions. When it came to economic policy, her career can be broken into two parts—the first when she was her father's daughter, driven largely by Nehru's ideology, and the second when she was her sons' mother, steered largely by her sons' convictions.

In her early years as leader, and all the way up to the mid-1970s, Indira Gandhi was largely her father's daughter and she did what Nehru would have done. Nehru's own ideology was broadly Fabian socialist, with an instinctive internationalism. As he wrote to Amiya Chakravarty in a letter dated 29 November 1935, 'I have far more in common with English and other non-Indian socialists than I have with non-socialists in India.' And later, when he was Prime Minister of the country, he had joked with the US ambassador to India, John Kenneth Galbraith, that, to understand India, Galbraith ought to realize that Nehru was 'the last Englishman to be ruling over India'. His socialist instinct—the belief that there should be vastly greater equality of income and wealth—was genuine. Commenting on what differentiates Western and Indian political thinking, Myrdal had written, 'Another fact is South Asia's commitment to egalitarianism, which is an integral part of their ideology of planning.' (Myrdal 1968: 120). Despite this, Nehru balked at the centralization of power that he saw in China and the Soviet Union.

Questions remain about whether these two instincts are compatible. In the end, the form of socialism India followed is best described as state capitalism. A few large public sector firms and banks were established, there were lots of private firms and enterprises, with some polarization between the very large and very small (with a missing middle), the state tried to command and direct from the top, and, finally, all this was wrapped up in a profuse rhetoric of socialism. It is interesting to note that Myrdal (1968) himself had toiled to make sense of India's 'socialism' and observed how this effort involved a certain amount of 'verbal jugglery'. The evidence that much of it was verbal jugglery comes from the fact that enormous income and wealth inequality prevails in India (see, for instance, Bardhan 2007). Some observers of India's political economy have argued that, despite this rhetoric, in practice, India drifted to 'neo-liberalism' (Kohli 2012).

This is an important observation. India never practised socialism in the sense of having a centralized ownership of the means of production in the hands of the state, though using the term

[3] As this topic has been so much in the news since the demonetization of 8 November 2016, I should point out that the only other time demonetization was tried in independent India was in 1978, when Morarji Desai was Prime Minister. This was before the year when growth tanked in a way not seen since India's independence.

socialism had become mandatory in all government documents and declarations pertaining to the economy, well into the 1990s. What India meant by the term socialism (and pursued—that too without much success) was a kind of welfare state, in which there would be support for the poor in terms of healthcare, education, and basic food. But even this was more often present in writings emerging from the government than in actual action. In terms of the government owning the means of production, India was nowhere near a socialist state: India had roughly 14 per cent of GDP coming from state-owned enterprises, whereas for China this was 40 per cent. These data are not easy to compute and there is indeed a big margin for error (see Basu 2009) but the large difference is significant.

In her early years, Indira Gandhi pursued a policy similar to that of Nehru, the nationalization of banks in 1969 being the most aggressive move along those lines. By the time she returned to power in the 1980s, three years after her electoral defeat in 1977, her strategy had shifted, this time under the influence of, primarily, her younger son, Sanjay Gandhi, and later of Rajiv Gandhi, which would have large implications for India's economic trajectory, the story of the next section.

Indira Gandhi was also a deep influence on India's politics and the nature of the state. Even leaving aside the Emergency, she had centralized power, often in her own hands, much more than Nehru. As Kothari (1977) argued, this in turn tended to take away power and initiative from the grassroots level, and resulted in a centralization of power that Nehru had resisted. According to Kothari (though there is scope to contest his view), this had a negative effect on economic growth.

Similar issues arise in evaluating India's democracy. Thanks to the adoption of the principle of 'one person, one vote', independent India established representative government right from the start, but questions remain about how 'responsive' India's 'representative' state is. In a compelling essay, Mehta (2012) examines these questions. Echoing Myrdal's view that distant histories can have deep influences on the nature of contemporary politics and institutions, Mehta points to the social inequalities that go far back into Indian history, having legacy effects on the nature of democracy.

One of the principal historical sources of social inequality in India is its caste system. While in itself caste is a deplorable inheritance—and, at least in speech, most founding political leaders of India spoke out against it—it has been argued by some that the castes have played a role in nurturing India's democracy by providing focal points of coalition and political mobilization for disadvantaged groups (see Varshney 2013). What complicates the story is that many of these caste identities are local and regional, which has thwarted mobilization across the nation—an outcome that has both plusses and minuses.

It must also be recorded that the nature of India's politics has changed much since the mid-1970s. The domination of a few big parties and in particular the Congress has diminished vastly. Regional parties have sprung up all over the nation and India has seen the rise of coalition politics also on the national stage, as parties have had to reach out to others to make sure they have the majority necessary to form a government. This has put a new set of brakes and challenges on policy experimentation, and, at the same time, brought a certain agility to politics, as all parties that matter have had to master the art of accommodation and compromise.

Despite all these caveats, despite the two-year retreat from 1975 to 1977 caused by the Emergency, and despite its complicated and many-splendored manifestation, democracy is a remarkable achievement for India. While research and activism must persist in analysing and correcting the weaknesses of India's democracy, it needs to be appreciated that this, like good infrastructure, is an institutional and political investment that modern India has inherited and it would be folly to damage it just when the nation has reached a stage where it is able to take advantage of and build on it to power its economy, promote development, and even step up the GDP growth rate.

While this is not the central concern of this paper, the political story that I have laid out in this section is of considerable relevance. There is a small but undeniable build-up of opinion in India that is questioning the value of India's early commitment to cultural and political openness, secularism, and commitment to freedom of speech, for the media and also for individuals—from university campuses to the street-corner coffee house. It is regrettable that there are now forces that would like to reverse this. I believe that democracy, cultural openness, and secularism are traits that make for a better society and also more growth, at least of a sustainable kind. Whether or not India's early investment in this kind of politics was the right choice at that time (I believe it was but am aware that this is not beyond contestation), to squander this social and political capital just as the economy is taking off would be a mistake of enormous proportions, akin to making early investment in large ports, roadways, and railways, and then deciding not to use them.

3 India's economic trajectory since independence

Before getting into a discussion of India's trajectory, let us begin with a quick overview of where India stands among the Asian economies. This is captured in Table 1. In the cluster of 10 Asian countries on display, India is the eighth poorest in terms of per capita GDP, ahead of Pakistan and Bangladesh. At least two nations in this group, South Korea and Singapore, are actually high-income nations. Given that all the countries in this cluster were roughly in the same per capita income band in the 1950s, this shows what persistent good growth and the magic of compounding can do.

Table 1: The Asian landscape, 2017

Country	Population (million)	GDP (billion current US$)	GDP per capita (current US$)	GDP per capita PPP (US$)	GDP growth rate 2016–17 (%)
Singapore	6	324	57,714	93,905	3.6
Korea, Rep.	51	1,531	29,743	38,260	3.1
China	1,386	12,238	8,827	16,807	6.9
Thailand	69	455	6,594	17,871	3.9
Indonesia	264	1,016	3,847	12,284	5.1
Philippines	105	314	2,989	8,343	6.7
Vietnam	96	224	2,343	6,776	6.8
India	***1,339***	***2,598***	***1,940***	***7,056***	***6.6***
Pakistan	197	305	1,548	5,527	5.7
Bangladesh	165	250	1,517	3,869	7.3

Source: World Bank World Development Indicators, 2017.

It is heartening to see that there is some catching-up taking place now, because the poorer nations seem to have the higher growth. The economies growing at the fastest rates in 2016–17 are Bangladesh, with a growth rate of 7.3 per cent, followed by China (6.9 per cent), Viet Nam (6.8 per cent), Philippines (6.7), and India (6.6) (Table 2). Singapore and South Korea now have the slowest growth rates in this cluster, as is only to be expected of countries that have become rich.

Table 2: India's annual GDP growth rate and investment rate, 1950–2018

Year	Annual GDP growth rate	Investment rate	Savings rate	Year	Annual GDP growth rate	Investment rate	Savings rate
1950–51		9.3		1984–85	4	19.1	16.0
1951–52	2.3	11.4		1985–86	4.2	20.6	15.2
1952–53	2.8	8.5		1986–87	4.3	20.1	16.5
1953–54	6.1	7.9		1987–88	3.5	21.9	18.2
1954–55	4.2	10		1988–89	10.2	22.8	20.1
1955–56	2.6	12.8		1989–90	6.1	23.7	21.5
1956–57	5.7	15.2		1990–91	5.3	26	21.8
1957–58	-1.2	14		1991–92	1.4	21.8	23.2
1958–59	7.6	11.7		1992–93	5.4	23	23.4
1959–60	2.2	12.4		1993–94	5.7	22.2	24.6
1960–61	7.1	14.3		1994–95	6.4	24.7	25.6
1961–62	3.1	13.4		1995–96	7.3	25.3	25.0
1962–63	2.1	14.9		1996–97	8	23.7	24.9
1963–64	5.1	14.3		1997–98	4.3	25.6	24.1
1964–65	7.6	14.5		1998–99	6.7	24.2	23.7
1965–66	-3.7	16.2		1999–00	8	26.6	24.2
1966–67	1	16.7		2000–01	4.1	24.3	23.9
1967–68	8.1	14.3	10.0	2001–02	5.4	24.2	25.5
1968–69	2.6	13.1	11.2	2002–03	3.9	24.8	27.5
1969–70	6.5	14.6	11.4	2003–04	8	26.8	31.1
1970–71	5	15.1	10.0	2004–05	7.1	32.8	32.0
1971–72	1	16	10.4	2005–06	9.5	34.7	33.2
1972–73	-0.3	14.7	12.1	2006–07	9.6	35.7	33.9
1973–74	4.6	17.3	9.8	2007–08	9.3	38.1	32.5
1974–75	1.2	17.5	12.8	2008–09	6.7	34.3	32.0
1975–76	9	17.2	15.2	2009–10	8.6	36.5	33.7
1976–77	1.2	17.4	14.5	2010–11	8.9	36.5	32.7
1977–78	7.5	17.8	14.0	2011–12	6.7	35.5	32.9
1978–79	5.5	21.1	14.3	2012–13	5.4	39	32.1
1979–80	-5.2	20.4	12.5	2013–14	6.1	38.7	31.4
1980–81	7.2	19.2	14.2	2014–15	7.2	33.8	30.8
1981–82	5.6	18.9	14.6	2015–16	7.9	34.4	30.1
1982–83	2.9	19.1	14.3	2016–17	6.6	33.3	29.8
1983–84	7.9	18.2	15.0	2017–18	6.7		

Notes: The GDP growth before 2011 shown is at factor cost, at constant prices, with 2004–05 as base. The GDP growth after 2011 shown is at factor cost, at constant prices, with 2011–12 as base; and Investment Rate refers to gross capital formation as a percentage of GDP.

Source: Economic Survey 2017–18, Government of India, 2018.

Good growth is the outcome of various factors, from the nature of institutions in the nation, the prevalent social norms, the positioning of the nation in the global polity, and the nature of economic policy pursued by the respective governments, to the size of the nation's population. It may not be entirely coincidental that the richest country, Singapore, is the smallest, and the second richest country, South Korea, is the second smallest. It is arguable that none of these factors driving growth is binding in itself; and so there is always hope that a lack in one particular dimension can be compensated for by good performance on some other dimension that may be more under the control of policymakers.

Some of the drivers of growth are beyond the control of any individual or organization. But there are also some that can be shaped by the government and individuals in the nation. The purpose of economic analysis is to identify the latter and help nations achieve higher growth and all-round development. And in a project commemorating Myrdal's *Asian Drama* there should be no need to remind the reader that economic growth does not occur solely because of good economics, but is due to many other factors that lie beyond mainstream economics (see Khan 2018; Stewart 2018).

What is only hinted at by the above data and marks India's economic history since the nation's independence in 1947 is the lack of drama it has experienced in comparison with other Asian countries. The data shown in Table 1 (see also Figure 1 below) make this evident.

Barring the growth spike in 1975 mentioned above, the nation chugged along at a fairly steady low-growth rate, of around 3.5 per cent per annum, for the first three decades. Given that India's population was initially growing at over 2 per cent per annum, this meant a snail's pace growth of barely over 1 per cent for per capita income. Table 3, based on the data in Table 2, summarizes some of the essential numbers. The annual GDP growth rate, averaged over decades, shows India growing at 3.91 per cent, 3.68 per cent, and 3.09 per cent over the 1950s, 1960s, and 1970s, respectively. In decadal terms, the big break was in the 1980s, when the growth breached the 5 per cent mark for the first time.

Table 3: India's decadal GDP growth and investment rates

Year	Annual GDP growth rate	Investment rate	Savings rate
1951–61	3.91	11.82	-
1961–71	3.68	14.71	9.03
1971–81	3.09	17.86	12.96
1981–91	5.38	21.04	17.32
1991–2001	5.71	24.14	24.27
2001–11	7.68	32.44	31.42
2011–18	6.61	35.78	31.17

Notes: The GDP growth rate before 2011 is shown at factor cost, at constant prices, with 2004–05 as base; the GDP growth rate after 2011 is shown at factor cost, at constant prices, with 2011–12 as base; and Investment rate refers to gross capital formation as a percentage of GDP.

Source: Economic Survey 2017–18, Government of India, 2018.

I believe this initial sluggishness was, in part, a consequence of the nature of Indian politics. Democracy with a vibrant media and regular elections makes governments wary of policy experiments, because the politicians are likely to be out of office if the policies backfire. So what

Park Chung Hi could do in South Korea, or Mao Zedong could in China, or Lee Kuan Yew in Singapore was not feasible for leaders in India's democratic setting.[4]

All this is well reflected in the anecdotes of history and comparative statistics. In the 1950s, South Korea and India were almost equally poor and, in fact, most advanced nations treated South Korea as the basket case that would need support and aid to prevent major suffering but there was not much hope of a growth surge, whereas India was treated as ready to take off.

However, Park Chung Hi took commanding control of the economy and made some daring policy decisions, some of which backfired massively and had to be retracted (see Krueger 1998). Maybe because of this policy agility, the economy stumbled a few times but also grew at a remarkable clip. As Table 1 shows, South Koreans are now a little more than 17 times as rich as Indians, in per capita income terms, which shows what a combination of good policies and institutions can do.

Turning to China, in contrast to India, we find it, all the way up to 1976, experiencing fluctuations in growth that would have been unimaginable, and also intolerable, in India. The broad picture of India's growth captured in Table 2 reflects this relative tranquillity, which is in sharp contrast to the situation in China. In 1961, following the Great Leap Forward and the famine it unleashed—arguably the biggest famine in world history—China had a negative growth of 27 per cent. That is, more than a quarter of its GDP disappeared.

The Cultural Revolution would again result in a drop in growth much greater than India ever saw. On the other hand, China had several years of double-digit growth during the 1960s and 1970s. Until the arrival of Deng Xiaoping, the most notable feature of China's economy was not how high or how low growth was, but the fluctuations in growth. This would change in the early 1980s, when China moved to a sustained high-growth path over a 30-year period.

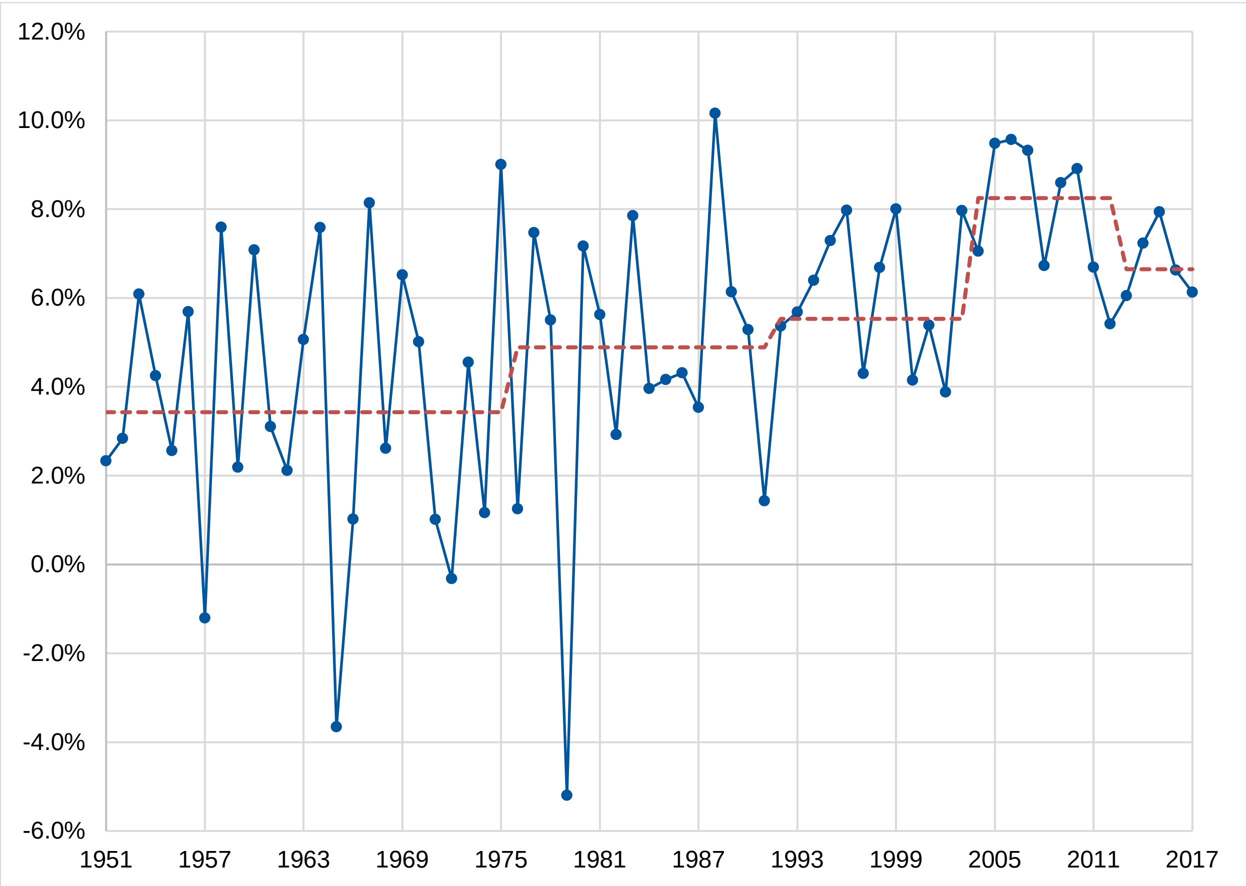
China did poorly in growth in the mid-1970s but that was a time of global slowdown. The oil price shock of 1973 affected the whole world; and this was also, for many countries, the time to jettison the old exchange rate regime in favour of a more flexible one. All this affected China but, after the policy reforms of the late 1970s and early 1980s, there was no looking back for the country. In fact, when the Latin American crisis of 1982 happened, caused by the huge international debt build-up, it had a negligible effect on China, which was by then on a fairly steady 10 per cent per annum growth path. China's growth is gradually slowing down now, currently just below 7 per cent per annum, but that is probably a reflection of the economy's maturity. It is beginning to look like a proper upper-middle-income nation.

For India, in contrast to China—barring relatively small dips in 1957–58 and 1965–66, and a very occasional 8 per cent growth and one year of 9 per cent growth (in 1975–76)—the trajectory remained quite uneventful for the first three decades after Independence. Growth picked up through the 1980s as a changed Indira Gandhi tried to free up markets and ease controls, which were beginning to smother the country's growth. But by the end of the 1980s, more than anything else, it was fiscal laxity that helped India grow faster and also set the stage for the big crisis of 1990–91, when the first Gulf War precipitated a massive slowdown and a balance of payments crisis for India.

[4] Lest this misleads the reader, I should add that just as China, Singapore, and South Korea are examples of authoritarian control and high growth coinciding, there are many more examples of nations with totalitarian control at the helm and low growth and devastated economies.

This is where there is scope for some debate on whether the growth pick-up that India saw in the early 1980s can be described as a turning point, as Nayyar (2006) has called it. Rodrik and Subramaniam (2004b) take a similar view, pointing to an 'attitudinal shift' in the government in the 1980s that boosted growth. At one level this is a semantic controversy. It is indeed true that while in a pure comparison of numbers in terms of decadal growth, as captured in Table 2, and also Figure 1, the broad direction of India's growth is upward, there is indeed a sharp rise in growth between the 1970s and 1980s. There were indeed some important policy drivers behind the growth pick-up, including Indira Gandhi's greater reliance on markets and less on the state, but there was, at least from the mid-1980s, also some short-termism, in terms of fiscal fuelling, which contributed to the growth but also to the economic crisis of 1990–91. The proximate cause of the crisis was the first Gulf War, which put a sudden stop to the inflow of foreign exchange to India. At that time, the main inflow of foreign exchange was from remittances sent by Indian workers in the Gulf countries. The Iraqi invasion of Kuwait and the subsequent crisis put a virtual stop to this. One reason why this spun into an even bigger crisis than need have been the case was the growing fiscal burden of the previous years.

Figure 1: Growth rate of India's real gross value-added at factor cost,1951–2017, with four period averages



Source: Author's compilation from data in Table 2.

The crisis of the 1990s enabled India to do what China had been able to do in the 1960s and 1970s, and South Korea in the 1970s—experiment with policy shifts and reforms, and the rewards were visible. The economic reforms of 1991–93 in India have been analysed extensively (see Nayyar 1996; Ahluwalia 2002; Mohan 2002). They caused many changes, most notably in India's international sector, best captured by India's foreign exchange reserves, which increased exponentially after 1993, as depicted in Figure 1. There was also the removal of India's notorious licensing system; this drew attention to the larger subject of the costs of doing business, which in India were (and still are) very high. I shall return to this later.

Some parts of the reform were commonsensical but we do know that in democracies, with the complicated dynamics of group decision-making, even the commonsensical is often hard to implement, the current gun-control challenge in the United States being a good example. In the case of India, since foreign exchange reserves used to be so low, it had become standard wisdom that people and corporations should not be allowed to take foreign currency out of the country.

Table 4: India's foreign exchange reserves

Year	Total reserves	
	₹ billion	US$ million
1954–55	9	1,873
1959–60	4	762
1964–65	3	524
1969–70	8	1,094
1974–75	10	1,379
1979–80	59	7,361
1984–85	72	5,952
1989–90	63	3,962
1994–95	798	25,186
1999–00	1,659	38,036
2004–05	6,191	141,514
2009–10	12,597	279,057
2014–15	21,376	341,638
2017–18	27,930	405,810

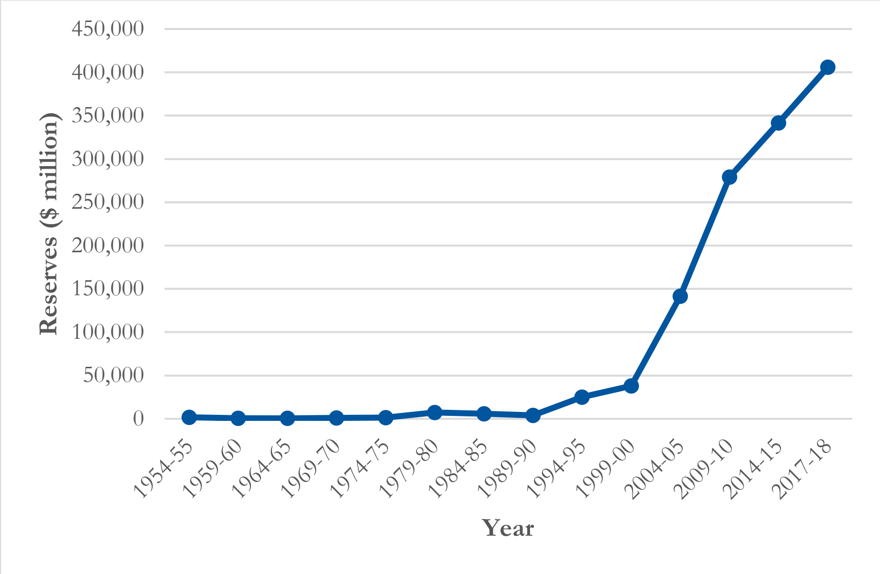
Note: 2017–18 as at 6 July 2018. Other years as at end of March.

Source: Reserve Bank of India & Centre for Industrial & Economic Research (CIER); Economic Survey 2013–14.

What this wisdom missed out on was the fact that if you do not allow people to take their foreign currency out of the country, they will not bring their foreign currency into the country in the first place. Hence, it is likely that one reason India had so little foreign reserve is that there were such severe restrictions on taking foreign money out of the country. This was changed during the reforms of 1991–93 and the results were visible within three or four years.

Of course, at the time of such a policy shift there is a risk of crisis, because once the restrictions to take foreign exchange out are lifted, the first instinct of people will be to take their foreign reserves out and this can cause a sudden balance of payments crisis. India reached out to the IMF for support at the time of the reforms, to ensure that there would be a back-up in the event of a sudden currency haemorrhage. Once that immediate risk of crisis was overcome, the benefits were visible. The country's foreign exchange reserves began to rise exponentially from the mid-1990s (see Table 4 and Figure 2) and the level, which used to hold steady roughly at $5 billion, now stands at over $400 billion.

Figure 2: India's foreign exchange reserves



Source: Author's creation using data from Table 4.

The nation's growth rate also picked up from 1994, and hovered between annual rates of 6 per cent and 8 per cent, with a small drop in and after 1997, almost certainly caused by the East Asian crisis. The growth rate picked up once again in 2003 and from 2005 it was at a level of over 9 per cent for three consecutive years, for the first time drawing comparisons with China's.

Such major shifts have many precursors and I would be remiss not to mention some less dramatic but important changes that began in the late 1960s and played an important role in preparing the ground for India's later high growth. I do believe that the early political investments of Nehru that I have already referred to played an important role in the long-run strength of the Indian economy. Turning to economic policy, the most important story was that of savings and investment. On these dimensions India today resembles East Asian economies, with savings and investment rates somewhere between 30 and 40 per cent.[5] But this was not always the case, as is evident from Table 2.

What arguably gave a boost to savings and therefore investment was Indira Gandhi's controversial decision to nationalize all banks in 1969. It may have had other, negative, effects, but one consequence of this was that there was a sudden rise in the number of bank branches in relatively remote rural areas (a consequence of a directive from the government to the state-owned banks). This made it easier for people to save money, and through the 1970s there was a steep and unprecedented rise in India's savings rate (Basu and Maertens 2008). A comprehensive study by Athukorala and Sen (2004) also found that the 'spread of banking facilities' in India played a positive role in promoting savings. They also showed that public savings tend to boost overall savings because, although public savings displace private savings, this displacement effect is muted.

What India saw subsequently was a most unusual growth pattern for a developing country. It was not the manufacturing sector that led India's growth but the services sector (Murthy 2005; Nayyar

[5] Both pure economic theory, from the Harrod–Domar model to the work of Solow and Swan, and the experience of East Asian economies, from Japan, Hong Kong, Taiwan, and Singapore to, more recently, China, suggest that a rise in savings and investment rates boosts long-run growth, at least during the initial phases, when there is a lot of slack labour, as was (and, for that matter, is) the case in India.

2012; Basu 2015). Over the next 15 years India topped the chart of nations in terms of services sector growth and this was primarily because of the information technology sector, in which the country excelled, but there is more to the story.

The growth story of India's services sector is an outlier in terms of the experience of developing countries across the world. It has been argued that the services sector growth tends to occur in two waves: one which takes an economy from the low- to middle-income category, and a second one which occurs in middle-income economies, giving them a further boost (Eichengreen and Gupta 2009). The first consists of various informal sectors growing rapidly, whereas the second gets its boost from more sophisticated sectors, such as information technology and finance, triggering the overall services sector growth.

It is this second-stage services sector growth that happened in India, rather early and with a vigour rarely seen anywhere else. As Nayyar's (2012) estimation shows, between 1980 and 2009, India's services sector growth was so large that it picked up 85 per cent of the decline in share of agriculture. That the share of agriculture will decline in the process of development is normal. What this statistic shows is both the remarkably good performance of India's services sector and the remarkably poor performance of India's manufacturing sector.

The factors that drove India's success in the services sector are several and make for interesting economic analysis. First, there was an early policy shift that was rooted in politics but had an unintended, beneficial effect. This had to do with the computing sector. Following a spat with IBM in 1977, India asked the company to leave the country. This caused big disruptions to the computing sector in India, but it also became an inadvertent application of the infant industry argument, whereby India was forced to make its own innovations and advances in this sector (Murthy 2005). This prepared the initial ground and then, when the economic reform of 1991–93 happened, India's information technology sector was ready for take-off. As has been emphasized by Narayana Murthy (2004), the reforms were critically important because they cut down government bureaucracy and enabled speed in a sector that depends on that.

I have argued elsewhere (Basu 2015) that two of India's big stumbling blocks, a cumbersome bureaucracy and poor infrastructure, explain a significant part of both its success in the services sector and stagnation in the manufacturing sector. The manufacturing sector, which needs to transport its products over roads and use the nation's ports to ship goods out for global sales, and has to negotiate the bureaucracy to pay taxes and get permits, was naturally stunted. The services sector, and in particular IT products, on the other hand, was initially largely tax exempted and so did not have to interact much with the bureaucracy. Further, its outputs did not, for the most part, have to be carted across roads or negotiate ports since they could be digitally sent to the user. Hence, this sector could bypass the nation's two big stumbling blocks.

Another interesting connection, which fits so well with the kinds of concern that Gunnar Myrdal had, is between democracy and services sector growth. Eichengreen and Gupta (2009) argue that the second wave of services sector growth has a connection with democracy, with more vibrant democracies having an advantage. They create an ethos of openness and connectivity that are crucial to this sector. One obvious factor is internet connectivity. Many nations with severe top-down state control place restrictions on digital connectivity to thwart dissent and the amassing of popular opinion. Fortunately, India had the advantage of a democratic system, and it is arguable that this played a significant role in the success of its services sector and, hence, in its overall economic development.

This pattern of growth, coupled with India's over-production of engineers through the 1960s, 1970s, and 1980s, had an interesting political fall-out. As Silicon Valley took off and there was growing need of expertise in the USA, India became its main partner in this segment of the economy. This caused a warming of relations between the USA and India, which had hit rock bottom at the time of Bangladesh's independence in 1971 when Indira Gandhi refused to toe Nixon's line. This political development has been of great help to both the United States and India, with FDI flowing in both directions between the two countries and greater geo-political cooperation between them. With Indians getting more than 50 per cent of the H1B visas (the category meant for professionals) that the USA issues, these links have continued to grow.

All these drivers had fallen into place by the early years of this millennium and, by 2003, India seemed to have moved another step up the growth ladder. In 2003–04, India's GDP grew by 8 per cent and then from 2005 to 2008 it grew at over 9 per cent for three consecutive years. It is likely that India has moved up to a higher growth path, even though there have been some trying years since. Immediately after 2008, the great global recession had its effect on India. After 2010, major corruption scandals rocked the entire economy and in 2016 a totally ill conceived demonetization put the brakes on the economy. It is, however, arguable that India is now on a higher growth path overall and, unless it becomes a serial blunderer, the economy will be able to maintain a growth of over 8 per cent per annum.

To complete the picture of how India has developed overall, it is important to look at other primary indicators of progress: literacy, poverty, inequality, and health. The story here has been less encouraging. For a nation committed to equality and socialism, as discussed above, India did surprisingly poorly on these important indicators of overall development. Literacy is a striking example. In higher education, India did remarkably well for a developing economy (though it has, of late, been losing rank), as could be seen from the large presence of Indians in international gatherings of science, engineering, and other areas of higher learning and research. Yet, in terms of basic literacy, it trailed behind much poorer nations. Table 5 shows the basic numbers for adult literacy since Independence, as per census data.

Table 5: Adult literacy

Year	Adult literacy (%)
1951	18.33
1961	28.30
1971	34.45
1981	43.57
1991	52.21
2001	64.87
2011	74.04

Source: Census of India.

Given that it is easier to make progress on a low base, the performance was very disappointing up to 1991. It has been moving up more substantially since then. It is also worth noting that there is a great deal of variance across the country, with two states—Kerala and Mizoram—having over 90 per cent adult literacy, whereas in several states it is barely above 60 per cent. These figures hide large gender differences in most parts of India. There is only one state where female literacy is over 90 per cent. This is Kerala. At the other end, there are states with abysmally low female literacy, such as Rajasthan (52.7 per cent) and Bihar (53.3 per cent).

The above numbers are symptomatic of other social indicators, like poverty, health, and malnutrition. Table 6 gives India's poverty rates, using the simple head-count ratio. Poverty has been declining, with an especially sharp fall after 2009, but with over 20 per cent of the population living on less than $1.90 a day and 60 per cent living on $3.20 a day or less, there is still a great distance to go.

Table 6: Poverty: Percentages of population consuming less than $1.90 and $3.20 (PPP adjusted) per day

	Poverty head count (% of population)	
Year	< $1.90 / day	< $3.20 / day
1977	60.00	87.35
1983	53.90	84.90
1987	44.80	80.40
1993	45.90	81.10
2004	38.20	75.20
2009	31.10	70.00
2011	21.20	60.40

Source: World Bank Development Research Group.

For a nation growing as well as India has in recent years, these indicators provide little comfort and the nation cannot be unmindful of the fact that they can become a drag on overall development and even GDP growth.

Finally, let me briefly turn to inequality. The numbers here are dismaying and reveal what was discussed earlier in this paper, namely, that socialism in India was mainly a rhetorical exercise. The measurement of inequality is of course a vexing problem, the classic work being that of Sen (1977).[6] The Gini coefficient of income or consumption inequality is high but there are other measures, based on wealth and the tracking of the difference between the super-rich and the median person. This shows very high and worsening inequality (Bardhan 2007; Mishra 2012), which is likely to have negative spillovers in the long-run, and maybe not that long. In a nation that now has several individuals listed among the world's wealthiest individuals, the numbers on poverty quoted above tell us that India does have work to do in reversing some of these inequality trends.

4 Contemporary challenges

Having described the Indian economy's history and trajectory thus far, I want to now discuss some contemporary challenges that the nation faces. While India's growth has picked up in the last few decades, and especially since 2005, as just discussed, India still faces formidable challenges—of deep-seated poverty, endemic corruption, growing inequality, and other anxieties of early growth. How should the nation deal with these challenges? How should India turn the march of technology that is happening around the world and creating turmoil in so many places to its advantage? Is that at all possible? How should it attend to the disquiet of the disenfranchised class, a necessary concomitant of high inequality?

As noted above, India did poorly in terms of basic literacy, which resulted in large segments of the population being left behind, causing inequality to rise beyond what would have happened

[6] For an excellent short summary of the numbers and also the challenge of measurement in the context of India, see Mishra (2012).

otherwise. As the data cited in the previous section show, basic literacy is beginning to catch up now but there is a tendency towards a slide in terms of higher education and research. The country has to bring new, innovative ideas for spreading basic and higher education without breaking the back of fiscal expenditure.[7] The aim in this section is not to be even-handed but to comment on four particular areas where India has work to do and on which I have comments on offer.

4.1 Bureaucratic costs

Let me begin with a matter that I have not commented on in this paper but is, I believe, a major restraint on India's development. It is also something that underlies the problems of inefficiency and corruption that were so germane to Gunnar Myrdal's analysis of India. This is the subject of bureaucratic transaction costs. In India, the cost of transactions with the bureaucracy is too high. This curbs enterprise and especially handicaps small businesses, which cannot afford to operate large legal departments to deal with government sanctions and permits and navigate other bureaucratic hurdles. India's disadvantage in this is caught well by the World Bank's *Doing Business* indicator, which is explicitly designed to capture how hard it is for small businesses to do their essential transactions with the government. Among the 190 countries studied by the World Bank, India currently has a rank of 100 in terms of the 'ease of doing business', where rank 1, currently occupied by New Zealand, indicates the country where there are the fewest bureaucratic inefficiencies.

In Table 7, I provide a snapshot of how India performs in comparison with a group of Asian economies in terms of specific indicators that are particularly important in facilitating business and enterprise. Consider, for instance, the number of days it takes to get the basic permits to start a small enterprise. In Singapore it takes 3 days, in South Korea 4 days, in Bangladesh 20 days, and in India a full month.

Table 7: Bureaucratic efficiency, 2017

Country	No. of days to start business	No. of days to enforce a contract	No. of years to resolve insolvency	Border compliance for exports (hours)	Border compliance for imports (hours)
India	30	1,445	4.3	106.1	264.5
China	23	496	1.7	25.9	92.3
Vietnam	22	400	5	55	56
Bangladesh	20	1,442	4	99.7	183
Malaysia	18	425	1	45	69
Pakistan	18	1,071	2.6	75	129.3
Thailand	5	420	1.5	51	50
South Korea	4	290	1.5	13	6
Singapore	3	164	0.8	10	33

Source: Author's construction, using World Bank data (World Bank 2018).

As I pointed out earlier, a person will hesitate to bring foreign exchange into a country that does not allow foreign exchange to be taken out of the country; similarly, an enterprise pondering whether to start a new business will consider how difficult it is to close it and exit, should the business fail. For this reason, one of the 10 indicators that make up the overall ease of doing business is the time it takes to resolve insolvency and close down a firm. The data on this are quite remarkable. Resolving insolvency in Singapore takes 9 months, in Malaysia 1 year, in South Korea

[7] For a comprehensive stocktaking and novel ideas, see Agarwal (2009) and Patra et al. (2017).

1.5 years; in India it takes 4 years and 3 months. The story is similar for the time required to enforce a contract and the time needed to obtain export clearance and customs clearance for imports.

In the light of all this, it is not hard to understand why India's manufacturing sector has failed to take off. As was hinted at earlier, removing cumbersome and unnecessary bureaucratic hurdles is one of the cheapest ways to give the manufacturing sector a boost.

In moving on I should make three warnings. First, in reality there are thousands of dimensions to measuring a business environment. The aim must not be to target the World Bank's indicators and work specifically on them. Yet there is a tendency in contemporary India to do just that, because the *Doing Business* ranking has suddenly become a visible and much-talked about indicator. That can move a nation up the World Bank's chart and yet miss the substantive improvements the indicators are supposed to approximate. Second, it is important to remember that ease of doing business is not the same as overall welfare. It would be foolhardy to concentrate on ease of doing business to the exclusion of other measures of a nation's welfare. One important dimension of human life is how difficult or easy it is for ordinary people to interact with the government. How easy is it to get a driving licence, to pay one's electricity bills, or to file an income tax return? *Doing Business* measures the ease of business groups' interaction with the state, but there is also a need for a measure that captures ordinary people's ease of interaction with the state. Such a 'living life' index would capture an important dimension of economic life alongside what is measured by the *Doing Business* index.

Finally, the need to eliminate unnecessary hurdles must not be equated with a call for doing away with regulation. No modern economy can run well and for the well-being of its overall population if it is left entirely to the dictates of profit making. We need regulation to direct the economy, and we certainly need laws and controls to curb environmental damage. We cannot allow enterprises to choke our rivers, lakes, and oceans with plastic and chemicals on the grounds of free-market efficiency. But what has happened in India is a stacking-up of old and new rules, many of which serve no purpose other than to slow down decision making and fuel corruption as people are forced to cajole and bribe those in authority to get the necessary permissions.

4.2 Corruption control

The above topic naturally leads us to the problem of endemic corruption, which was a major concern of Myrdal. However, his emphasis was on the determination of leaders as a potential remedy. While this may be of some importance, it may not address the crux of the problem. At the same time, it would not be not right to treat corruption as inevitable, as some take it to be. Corruption can be curbed and vastly diminished. But to do this needs analysis and careful reasoning, as much as determination and grit on the part of leaders. The world has had leaders who were deeply troubled by corruption and determined to end it in their nation, and were themselves incorruptible, and yet failed. To understand this, we need to dissect the problem carefully.

First, many observers make the mistake, looking at the corruption all around them, of treating corruption as an inherent part of society. There are some passages in Kautilya's *Arthashasthra* that have nurtured this belief. Consider this: 'Just as it is impossible not to taste honey or the poison on the tip of the tongue, so it is impossible for a Government servant not to eat up at least a part of the King's revenue.' This beautiful imagery, characteristic of Kautilya, expresses a rather pessimistic view, and nurtures a sense of helplessness in the face of corruption.

Fortunately, there is enough evidence now that corruption can be controlled. There are developed countries in the world that had a high level of corruption in the early 19th century. In Myrdal's own country, Sweden, for example, there was the ubiquitous institution of the '*sportler*', which was something between a tip and a bribe, given to a bureaucrat to get some 'job' done. It is gone now. Today, the Scandinavian and Nordic nations are among the least corrupt countries in the world. There are examples of economies where corruption has gone down over an even shorter period—a couple of decades. Singapore and Hong Kong are good examples. According to Transparency International's data, Singapore has less corruption than the UK and USA; Hong Kong less than the USA.[8]

Much of the challenge of corruption control arises from unrealistic assumptions about the behaviour of the agents of the state. Once we recognize that they are human, with their own motivations and aims, we can attempt to draft appropriate laws. This is essentially a problem of mechanism design. I shall stay away from such micro issues here; I have discussed these at some length elsewhere, in the context of controlling bribery (Basu 2015, 2018). I want instead to address here one widespread challenge that arises in countries where corruption is endemic, such as Brazil, India, and China. To put the problem in perspective, it may be pointed out that these three countries have ranks of 96 (Brazil), 81 (India), and 77 (China) in terms of the perceived level of corruption among the 180 countries analysed by Transparency International, the least corrupt country (New Zealand) having a rank of 1 and the most corrupt (Somalia) a rank of 180.

The problem I am referring to here is the fact that a determined leader has a surfeit of options when it comes to deciding where to start cleaning up corruption. This leads to a special political challenge of selecting a path and once again forces the economist to trespass from markets into matters of politics. To understand this, consider a nation where corruption is endemic. This can be because there is a natural self-reinforcing element to corruption: if lots of people are corrupt, it seems fine for you to be corrupt. And this logic can lead to a corruption trap (World Bank 2015).

There is also the problem of nations with a complex history of law-making, such as India[9], where there has been such a build-up of layers of law and custom that it is now virtually impossible to avoid violating the law. Debroy's (2000) estimate is that, between central government and the (29) state governments, India has over 30,000 laws, a disproportionate number gathering dust and, worse, occasionally invoked to harass opponents. Therein lies the problem.

Consider now a leader in some such nation who is genuinely keen to put an end to corruption. With corruption everywhere, the leader faces a choice of where to start. She can pick anybody and find him guilty of some violation of the law. Now, every political leader knows that if she wishes to survive politically it is best to arrest not allies but those in opposition. But once she begins to go after her enemies it becomes clear that the anti-corruption policy itself is a handy instrument to silence the opposition and to go after a press that is critical of her policies. In other words, what begins as an anti-corruption policy becomes an instrument of disciplining the opposition and the media. This is the danger that is faced by Xi Jinping, by Narendra Modi, by Michel Temer. It is an important reason why corruption persists and why the persistence of corruption is not necessarily a sign of the leader not being serious about removing corruption but simply a manifestation of a political-economic trap in which nations tend to get caught. And India is no exception.

One way for a leader serious about crime control to handle this is to set up some broad parameters and hand over corruption control to an autonomous authority, with the explicit commitment that, once this authority begins to function, it will have full autonomy, in the way a nation's supreme

[8] https://www.transparency.org/news/feature/corruption_perceptions_index_2017#table

[9] For an elegant commentary on this history, see Roy and Swamy (2016).

court is supposed to have. In Asia, Indonesia is the only country that has had some experience of this kind of institution, though even it has run into problems recently.

4.3 Norms and institutions

Turing to broader issues, the challenge of mitigating corruption entails thinking of the state as an endogenous institution consisting of individuals with their own objectives and motivations, as assumed in the literature on new institutional economics, of which Myrdal's work was clearly a precursor (see Evans 1995; Stiglitz 2017; Basu 2018). Such a perspective opens up new ways of thinking about the law and how to control corruption.[10] I want to discuss one that relates to social norms and, more generally, sociology.[11]

In controlling corruption, the design of incentives with which economists have been concerned matter, but the social and political setting is just as important. This is often missed by neoclassical economists, who treat social and cultural variables as exogenous and redundant for the economy. Stressing the malleability of cultural mores and their connection to economic development, Geertz (1963: 2) observed:

> [It] has become more and more apparent that Tokugawa Japan, pre-1917 Russia, and the England of 1750 were not merely periods of quiet, unchanging stability before a sudden cataclysm of economic revolution, but rather periods of widespread intellectual and social ferment, in which *crucial social relationships and cultural values were being altered in such a way as to allow an eventual large-scale reorganization of productive activities*' (my italics).

In short, we can try to eliminate or modify cultural traits that have harmful consequences on the economy and encourage the ones that aid efficiency and progress. And even though it is true that, at this stage, we do not fully understand *what causes* culture and social norms to change, the mere recognition that they do change and can potentially respond to policy is important and can help set up a useful research agenda exploring the link between various policies and what they do to our mores. Second, even when our norms and culture are fixed, knowing how they intertwine with economic variables enables us to think of new policy interventions and assess more accurately the costs and benefits of interventions.

As illustration, consider the problem of teacher absenteeism in government-run schools, which has reached epidemic proportions and is representative of much that is wrong with the bureaucracy. Several studies show that, when it comes to playing truant from school, Indian teachers are a very good match for their students (Rana et al. 2002). A multi-country study in which researchers made surprise visits to government-run primary schools shows that in terms of teacher truancy, India is second only to Uganda (Kremer et al. 2004)—and by a short head. At any time, 25 per cent of teachers are found missing from government-run schools in India; the figure for Uganda is 27 per cent. Further, the authors found that only 45 per cent of teachers in India were actually teaching at the time of the surprise visits.

What should be done? In answering this, economists have typically looked to *economic* variables. This can indeed be useful. We now know what effect sudden inspections have. We have some idea of the role of salaries on such behaviour. Analysts have rightly stressed the role of incentives and

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[10] See Basu (2011), Abbink et al. (2014), Berlin et al. (2017), and Mishra (2017).

[11] For an innovative scheme of corruption control which does not involve the government but entails self-enforcing contracts among private sector firms and corporations, see Dixit (2015).

sanctions—both carrots and sticks—in creating greater work discipline among teachers. However, I believe that much of the problem is rooted in culture and social norms. Economists assume that, once we cite culture, we are planning to do a disappearing act in a welter of words and vague generalities. That is not true. There is now an increasing body of knowledge that is beginning to give shape and structure to these topics. For one thing, we know that our behaviour is affected by group think and notions of social stigma. It is otherwise hard to explain why, though teachers are paid the same salary and subjected to the same rules of economic incentives and punishments across the nation, teacher truancy is Jharkhand is about three times as high as that in Maharashtra, as the Kremer et al. (2004) study shows. Our behaviour is often guided not by monetary considerations but by notions of dignity, pride, and self-respect. And these can be shaped and guided.

In reality, unlike in the neoclassical model, people, including those indulging in corruption, are aware of the moral dimensions of corruption. However, when corruption is widespread, it may seem a more tolerable form of behaviour. It can then be like an equilibrium-selection norm. As is pointed out in the *World Development Report: Mind, Society, and Behavior* (World Bank 2015: 60), through much of history and in many contemporary societies, corruption is 'a shared belief that using public office to benefit oneself and one's family and friends is widespread, expected and tolerated. In other words, corruption can be a social norm.'

An interesting recent study (Abbink et al. 2014) checks this out by artificially *creating* the social norm in a laboratory setting, and measuring people's behavioural response.[12] The study sorts people according to their corruption propensities and then pairs participants—some with more corrupt and some with more honest partners, letting them know what kind of people they are paired with. It is found that the probability of offering a bribe doubles when the subject is paired with a more corrupt partner rather than a more honest partner. The social setting influences individual behaviour. The moral quality of leadership in society can make a difference. And there is now a large body of literature which outlines social and institutional interventions that can be as powerful as economic incentives in changing some of these adverse behaviour patterns in society.

4.4 Technology and labour

Turning finally to the challenge of technology and labour, for India this is as yet a problem in its early stages, but it may come to be the dominant problem in the medium to long term. Worldwide and in high- and upper-middle-income countries the problem is acute. Thanks to the rise of two kinds of technology—the 'labour-saving' kind, which is leading to machines and robots replacing labour, and the 'labour-linking' kind, which is allowing workers in low-wage nations to do some of the work for rich economies without having to leave their shores—there is a clear trend of wage shares falling and inequality rising.

The problem is affecting India (Kotwal 2017). Since the reforms to India's economy during 1991–93, growth has been higher but job creation has lagged behind growth quite significantly (Ghose 2016; Nayyar 2017). During the real-high growth period for India, from 2005 to 2008, for instance, when GDP was growing at roughly 9.5 per cent per annum, annual job creation was barely 2 per cent.

I believe that this will become an inevitable problem once India becomes a high-income or even an upper-middle-income economy, since it is a global problem. However, such a time has not yet come and there is no reason why India should not be able to take advantage of labour-linking

[12] See also Bicchieri and Xiao (2009) and Banerjee (2016).

technologies and create more jobs as it grows. Greater success in this will entail some intelligent geo-political policies and interventions. It is possible that Trump's United States will become more and more protectionist and also put brakes on H1-B immigration, which will affect India, since it is the biggest beneficiary of this category of immigration. India's aim should be to create links with other nations, such as Germany, the UK, Japan, and even China, so that these countries can use India's skills via labour-linking technologies, and out-compete the United States in the global goods market.

However, to continue to be competitive in this dimension, India will have to build skills and continue to improve and modernize its education system. As Ghose's (2016) recent study shows, not only is India's labour force very poorly educated, the distribution of education is also abysmal. This will cause a large problem because the demand for unskilled work is bound to go down. Mechanical work will soon not need labour because machines will out-compete labour, but when it comes to creative work and research, human skills will continue to be critical, at least in the foreseeable future. This is what takes us back to what was stressed above—the importance of education, especially the development of creative skills.

To absorb labour, it is also important to grow and nurture both the agricultural and manufacturing sectors. India's services sector, the engine of India's good performance, is virtually on auto-pilot now. Attention needs to be directed to the other sectors, which also happen to be more labour-intensive. For this, work is needed in two areas that have already been mentioned: namely, creating better infrastructure and cutting down bureaucracy.[13] Since India has the natural advantage of cheap labour—and that will not be lost soon—the government does not have to do much more than remove the stumbling blocks and these sectors will grow and create jobs.

There will be a challenge later when wages rise and India becomes part of the global story. My belief is that India will need radical reforms such as some form of profit sharing across the population. But that is not a problem special to India, and so of no direct concern to this paper.

5 The next 25 years

Peering into the distant future is not easy for any discipline, and economics is no exception. The discipline has reached a maturity whereby short-term forecasts—predicting the effects of today's interventions over the next weeks, months, or even a year—have gained some credibility and this is what provides the foundation for modern monetary and fiscal policy. With the arrival of big data analysis and improved techniques for mathematical modelling, there should be improvements in the power of forecasting over longer horizons. But we are not there yet. Moreover, the intertwining of economics with politics and societal norms and habits makes long-term forecasting hazardous. With these caveats in place, it is time, in these closing pages, to indulge in some of the joys of speculation about what the next 25 years may look like for India.

It has been a remarkable half century since 1968, when Myrdal's seminal work drew global attention to this newly independent nation, the size of a continent. All the portents are that India will continue to grow rapidly and will take on the mantle of a growth leader in the world.[14] At this moment, this sounds overly optimistic since, politically and socially, India is going through a bleak

[13] Some more specific, and exciting, new ideas, such as the development of coastal economic zones, have been discussed in recent times (see Singh 2018).

[14] See discussion in Basu (2015). See also Rodrik and Subramaniam (2004a).

patch. Especially alarming are the rise in grassroots violence, heightened communalism, and the clampdown on press freedom. In addition, there was the disastrous policy mistake of demonetization in November 2016, which slowed growth, hurt the poor and the informal sector, and damaged jobs. But the reason for my optimism is that I expect all this to pass. I expect the recent regressive tendencies to be contained. This can happen either through introspection and policy change at the level of top political leadership in the nation or via a future election. Over the last year or so, there has been visible disquiet in the common person about the nation's state of affairs. This is a reason to expect a change of course, and is the basis of my optimism for where India will be a quarter-century from now. This is the point forecast. A run of 9 per cent annual growth, which began in 2005 but has slackened off since then, maintained over a 20-year period is not a pipe dream; and if India can get back onto such a growth path in five years from now, it will be a transformed country by 2043. Given that it is a nation that made some sophisticated choices in terms of its politics earlier than almost any other nation achieving independence, with a substantial economic growth to back this up, India could be a global leader in several senses (and hopefully a force for the good).

But, even if we put aside the political risks that I mentioned above, there are other dangers. And in peering into the future, one would be remiss not to point to some of these potential pitfalls. Despite India's remarkable growth performance over the last decade and a half, there are still many vulnerabilities. First, agriculture as a share of value-added in GDP has over the last 50 years become quite small but it is still a vital sector that employs around half of the nation's labour force. Even a small decline in its production can cause food inflation, large welfare losses among the poor, and even political instability. Therefore, agriculture as a sector will continue to need nurture.

Second, as pointed out above, while technology will eventually create a global challenge that will affect India as well, for some time still to come India will be able to take advantage of its cheap labour and boost its manufacturing sector, which is a powerful absorber of labour. But to nurture this sector more investment is needed in infrastructure, the reduction of bureaucratic costs, and also good macroeconomic policy, because a wrong exchange rate policy can blight the nation's scope for greater manufacturing exports. This opportunity to occupy the space abandoned by high- and upper-middle-income countries because of rising labour costs and greater automation (including the arrival of robotics) will be with India for another 10 or 15 years. But thereafter, as India's own labour costs rise and artificial intelligence and robotics arrive in a big way, the country's (along with the whole world's) growth strategy will have to change. For this it will need major upgradation in the quality of education. Clearly, all drudge work will be taken by new-generation machines, and human beings will have to find work in research, innovation, and creative fields like art and philosophy. India had a head start in higher education soon after Independence, but it has since lost ground. The nation will need new investments in this.

Third, and a closely related problem, is the matter of inequality. If the working classes are not endowed with more creative skills, there is the danger that, even if India continues to grow, all its growth will be concentrated at the top end. As Ghatak (2017) points out, India does have a growing inequality problem, and unless it invests in health and education, and also taxes the rich and curtails dynastic inter-generational transfers in a more comprehensive way, it may have growth but at the cost of true development. This will be a problem for India for some time to come. While the growth story has been exemplary, various indicators show that growth has not been distributed well across society (see Subramanian 2016). This shows up clearly if we compare two countries that have had similar growth, Viet Nam and India. In terms of child malnutrition, for example, India has performed markedly less well than Viet Nam (Ray 2008), showing that the spoils of growth may not have been shared well at all. Yet, as Viet Nam's experience also shows, this is not inevitable.

Some of these prospects and problems are not exclusive to India, but global. Since the fates of nations are so deeply intertwined in today's globalized world, it may not be amiss to make a brief observation about global prospects. It seems reasonable to anticipate two future courses for the world. One is a low-probability event that we will not be able to adapt ourselves to in terms of governance and regulation of the rapid technological change we are witnessing today. If that happens, all our economies, including that of India, will founder. It is not impossible that civilization as we know it will not survive. This has happened before. Large civilizations have perished because they had grown beyond their own capacity to manage and control unanticipated problems. Environmental damage that the inhabitants were wreaking unwittingly contributed to the fall of some great societies, prominently the Indus Valley civilization. There is no reason why failure to regulate and manage the march of technology cannot cause another such downfall.

My expectation is that this dismal scenario has a low probability. The more likely outcome is that we will rise to the occasion with novel regulations and laws, as we did in the early 19th century in response to the Industrial Revolution. One concomitant of this—a natural fall-out of improving technology—is much more rapid growth. World GDP is currently growing at roughly 3 per cent per annum. For this to rise to an annual rate of 10 to 12 per cent may seem impossible at first thought, but on reflection that is a plausible scenario. Again, such changes have occurred in history. From 1500 to 1820, according to data collected by Maddison (2007), the world's annual growth rate was just 0.32 per cent, with large sections of the world experiencing no growth at all. In China, annual per capita income stood at $600 (1990 international dollars) throughout this period. For someone living at that time, it would have been difficult to anticipate that the Industrial Revolution, and international policy response to it, would lift average annual global growth to 2.25 per cent—seven times as fast as growth before the Industrial Revolution—as happened after 1820.

The world can get there and India can play a leadership role in ushering in such an age. With its early investment in the political institutions of democracy, secularism, and openness to ideas, as well as in good universities and institutes of higher learning, including science and engineering, and in its more recent improvements in savings and investment rates, India, with its enormous size, has the potential to be in the frontline. There are policy corrections to be made, there are pitfalls to be avoided, as discussed in this paper, but, with all those caveats, the prospects look good for what lies ahead.

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