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**THESIS**

**THE POLITICAL ECONOMY OF INDIA'S ECONOMIC  
REFORMS: THREE PERIODS FROM 1947-2016**

by

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June 2016

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PERIODS FROM 1947-2016**

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## **ABSTRACT**

India's economic policies have evolved significantly since its independence in 1947. The evolution of the policies can be assessed by the unique domestic and international environment that existed during the most pivotal parts of India's economic history. This research explores some of the most notable parts of India's political economy and analyzes the domestic and international factors during that time. The research concludes that India's political economy is undoubtedly influenced by both types of factors. More surprisingly, the relative weight of domestic versus international factors has been gradually shifting in the past six decades.

The changing dynamic of how India's economic policies are made is useful in understanding what shapes public policy in the world's largest democracy, and how both Indian and international actors can best seek to impact the country's economic policies.

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## **LIST OF ACRONYMS AND ABBREVIATIONS**

BJP	Bharitya Janata Party
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
IFI	International Financial Institutions
IMF	International Monetary Fund
INC	Indian National Congress
ISI	Import Substitution Industrialization
IT	Information Technology
NAS	New Agricultural Strategy
SEZ	Special Economic Zone
SOE	State Owned Enterprise
WTO	World Trade Organization
WWII	World War II

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## I. INTRODUCTION

### A. MAJOR RESEARCH QUESTIONS

Since gaining independence in 1947, Indian economic growth has been slow and sporadic. Economic growth averaged between 2–3 percent annually before rising to an average of 6–8 percent growth after 1991.<sup>1</sup> Initially, Indian policy makers adopted a socialism-inspired economic plan that remained in place until the mid-1980s. Then, in the 1980s, Indian economic policy began transitioning toward market liberalism, leading to an eventual adoption of free-market principles in 1991 under Narsimha Rao’s leadership. What drove Indian economic policy decisions from independence to 1980, 1980 to 1991, and 1992 onward? In particular, how did domestic and international influences interact to affect Indian economic policy-making? And how did the influence of domestic and international factors shift over the different time periods in influencing India’s economic policy?

### B. IMPORTANCE

This thesis builds on a large variety of scholarship on India’s economic policy and performance. Much of the existing literature focuses on one of the three aforementioned economic periods and ascribes causal factors that are unique to that time. Studies of the post-independence time period typically focus on Indian colonial history as a “deep determinant”<sup>2</sup> of the policies that were adopted. The second time period, which involved the first shift of economic policy toward market liberalization, is typically described in terms of either internal political pressures or exogenous forces that forced the hand of Indian politicians. Finally, the third and most recent era of India finally embracing free-market economics is generally described as an eventuality in line with the predictions of

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<sup>1</sup> Bipan Chandra, Mridula Mukherjee, and Aditya Mukherjee, *India After Independence: 1947–2000* (New Delhi: Penguin Books, 2000).

<sup>2</sup> Dani Rodrik, “Institutions, Integration, and Geography: In Search of the Deep Determinants of Economic Growth,” Weatherhead Center for International Affairs, 2002, 1, <http://wcfia.harvard.edu/publications/institutions-integration-and-geography-search-deep-determinants-economic-growth>.

modernization theory.<sup>3</sup> Each of these periods is unique and demarcated by a significant event. However, it is not often a single causal factor, but a confluence of unique circumstances that shapes a government's decision making.

The significance of this study is threefold. First, this thesis studies the domestic and international political situations that existed during the three economic time periods. It aims to determine the undercurrents in the domestic and international environments, how the forces interacted at different times, and how the international and domestic environments influenced Indian politicians' approach toward economic development. Second, Indian economic development is forecasted to exhibit economic growth at a rate and length that could surpass China's meteoric ascent.<sup>4</sup> With a quickly industrializing economy and a population expected to become the largest in the world by 2025, Indian modernization is a near certainty.<sup>5</sup> An assessment of how Indian politics has responded to various influences and events in the past may help predict future policy decisions. Third, international institutions' consensus on the correct policies for economic growth can have a large influence on policies adopted by developing countries. Historically, these institutions have evolved their policy recommendations depending on current events at the time. The Washington Consensus was dominant in the 1980s and 1990s, and is now overshadowed by the Beijing Consensus; waiting in the wings for its moment is the Mumbai Consensus.<sup>6</sup> Each of these consensuses was a package of policies tailored to the economic challenges of its time. Understanding the influences to India's economic policy will be essential to understanding the scope and impact of the forthcoming Mumbai Consensus.

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<sup>3</sup> Alexander Gerschenkron, "Economic Backwardness in Historical Perspective," in *Economic Backwardness in Historical Perspective: A Book of Essays* (Cambridge, MA: Belknap Press, 1979), 5–30.

<sup>4</sup> Christine Lagarde, "Seizing India's Moment" (Speech, Lady Shri Ram College, New Delhi, India, March 16, 2015), <https://agenda.weforum.org/2015/11/india-economy-will-roar-viraj-mehta/>.

<sup>5</sup> Ibid.

<sup>6</sup> Chrystia Freeland, "The Mumbai Consensus," *Reuters*, October 22, 2010, <http://blogs.reuters.com/chrystia-freeland/2010/10/22/the-mumbai-consensus/>.



### **C. HYPOTHESIS**

This thesis evaluates the various domestic and international influences on Indian politicians as they charted the country's economic course. The unique set of environmental circumstances present during India's independence led it toward a socialist-inclined economic policy. As that particular set of circumstances ebbed, a new set of domestic and international factors began to exert influence on India in the late 1970s to early 1980s, leading politicians to revisit their assumptions about economic growth. Finally, the most recent era of Indian economic history has had its own unique characteristics, which have been shaped by endogenous domestic and exogenous international factors, and the interactions between them.

The hypothesis of this thesis is that India's economy policy-making has been influenced by a combination of domestic and international factors. In each period, one has been more prominent in shaping India's political economy. This thesis proposes that India's economic trajectory is most accurately explained through an analysis that combines our understanding of domestic and international factors, especially emphasizing how they have interacted over time in shaping periods of political economic policy-making. These periods, after being defined by either endogenous or exogenous factors, can change by shifting influence from one factor to the other (i.e., endogenous to exogenous), or by a change in the direction within the factor (i.e., endogenous populism to endogenous market-liberalism).

### **D. LITERATURE REVIEW**

Due to the scope of this research question, a large selection of literature is applicable in understanding the weight of domestic and international factors on economic policy-making. Section 1, which follows, reviews existing literature on economic growth theories. This literature is not specific to India, but lays the groundwork for understanding various approaches to economic growth. All the theories covered generally apply to various phases in India's economic history. Section 2 surveys the literature on the three different periods of India's economic history. While this portion of the literature review introduces the relevance of different economic theories into Indian economic

history, the purpose of this section is to holistically document the global and domestic environments in India during each of the periods.

## **1. Economic Growth Theory**

Competing theories of economic growth offer different perspectives through which to understand India's adoption of specific economic policies at different points in its history. This section focuses on the competing economic prescriptions for fostering growth from different schools of economic thought, ranging from neoclassical economics, to convergence theory, institutional legacy and path dependency, the developmental state, and socialism.

### ***a. Neoclassical Economics***

Neoclassical economic growth theory prescribes minimal intervention by the government in the economy. The requirement for neoclassical free-market economic growth theory is based on the existence of an unencumbered price signal, a concept first explained by Adam Smith in *The Wealth of Nations* and further developed by 20th century economists such as Friedrich Hayek and Milton Friedman.<sup>7</sup> The neoclassical interpretation of free-market economics leaves few responsibilities for the state aside from providing public goods, administering rule of law, and national security. Though nearly impossible to implement and sustain in its pure theoretical form, neoclassical economics provides the principles that govern a free-market economy. In practice, free-market economies and countries that are transitioning to the free-market model balance an ebb and flow in the level of involvement that society either needs or demands from the government.<sup>8</sup> Reviewing neoclassical economic theory is useful for understanding what Indian politicians believed economic reforms would accomplish. The next three

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<sup>7</sup> Adam Smith, "An Inquiry into the Nature and Causes of the Wealth of Nations," in *The Political Economy Reader: Markets as Institutions*, ed. Naazneen Barma and Steven Kent Vogel (New York, NY: Routledge, 2008), 27–40; Friedrich Hayek, "The Road to Serfdom," in *The Political Economy Reader: Markets as Institutions*, ed. Naazneen Barma and Steven Kent Vogel (New York, NY: Routledge, 2008), 91–106; Milton Friedman, "Capitalism and Freedom," in *The Political Economy Reader: Markets as Institutions*, ed. Steven Kent Vogel and Naazneen Barma (New York, NY: Routledge, 2008), 107–16.

<sup>8</sup> Karl Polanyi, "The Great Transformation," in *The Political Economy Reader: Markets as Institutions*, ed. Naazneen Barma and Steven Kent Vogel (New York, NY: Routledge, 2008), 121–52.

established schools of thought use neoclassical principles as a foundation upon which to develop more specific theories of growth.

***b. Convergence through Modernization Theory***

Contemporary literature in convergence theory builds on the ability of free-market economics to build wealth and adds the dimension that some countries or regions will modernize or experience economic growth before others due to a variety of factors such as technological, geological, cultural, or resource-based advantages. Regardless of the motivator of the initial economic growth, convergence theory assumes that the country's leading economic development will face lower rates of growth as they explore new technologies and incur large investment costs in their quest for growth.

On the other hand, developing countries have the advantage of mimicking the leading countries, and will therefore be able to implement technologies and policies that are most effective at generating economic growth, modernize at a faster rate, and economically converge with the leading countries at the top of the "ladder of development."<sup>9</sup> Convergence theorists simplify modernization into a singular path that will necessarily lead to economic growth eventually. Applied to cases such as India, this argument would imply that the evolutions of India's economic policies were due to gradual modernization as part of the natural order of a state's economic development. This argument is dissected by several authors who argue that there are several factors that contribute to if a country is able to economically modernize or not. Factors such as social capability, political institutions, and the country's economic starting point play a role in shaping future economic modernization.<sup>10</sup> Furthermore, authors such as Samuel Huntington and Richard Florida argue that there is actually very little convergence occurring at a global scale. Instead, convergence is happening to a smaller extent at various different points in the economic spectrum across the globe, leading to a collection

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<sup>9</sup> Gerschenkron, "Economic Backwardness in Historical Perspective," 729.

<sup>10</sup> Lant Pritchett, "Divergence, Big Time," *The Journal of Economic Perspectives* 11, no. 3 (1997): 3–17; Moses Abramovitz, "Catching Up, Forging Ahead, and Falling Behind," *The Journal of Economic History* 46, no. 2 (1986): 385–406.

of very rich, moderately rich, and poor cities and countries around the world.<sup>11</sup> Applying modernization theory and its opposing viewpoints to Indian economic development does not yield a satisfying answer to its economic trajectory. India is modernizing, but in fits and starts. It is developing “hills and valleys”<sup>12</sup> of economic growth, but not in ways that can be explained by existing theory.

**c. Institutional Legacy and Path Dependency**

“Deep Determinants” is a phrase coined by Dani Rodrik to explain the lasting impacts of geography, culture, historical trajectories, and previous institutions on the development of a country.<sup>13</sup> The search for explanatory differentiators emerged as a response to the assertions of convergence theory: If convergence was empirically not happening, why not?<sup>14</sup> Here, I focus on the arguments for historical trajectories and institutional legacies in India as an influence in future economic policy decisions.

Historical trajectories are often manifested through the lasting impacts of a former colonial power. The manner in which they impact their colonies’ future development varies. The current schools of thought give significance to the governmental institutions established in the colonies, educational systems, length of colonization, the colonizer’s domestic governing institutions, degrees of mercantilism, and approach to free trade.<sup>15</sup> Granted, the impact of a colonial history can be significant and lasting. However, given

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<sup>11</sup> Samuel P. Huntington, “Political Order and Political Decay,” in *Political Order in Changing Societies* (New Haven, CT: Yale Univ. Press, 2006), 32–92; Richard Florida, “The World Is Spiky: Globalization Has Changed the Economic Playing Field, But Hasn’t Leveled It,” in *Essential Readings in Comparative Politics*, ed. Patrick H. O’Neil and Ronald Rogowski, 4th ed. (New York, NY: W.W. Norton & Company, 2010), 590–95.

<sup>12</sup> Florida, “The World Is Spiky,” 591.

<sup>13</sup> Rodrik, “In Search of Deep Determinants.”

<sup>14</sup> Gregory Clark, “Why Isn’t the Whole World Developed? Lessons from the Cotton Mills,” *The Journal of Economic History* 47, no. 1 (1987): 141–73.

<sup>15</sup> Abhijit Banerjee and Lakshmi Iyer, “History, Institutions, and Economic Performance: The Legacy of Colonial Land Tenure Systems in India,” *American Economic Review* 95, no. 4 (2005): 1190–1213, doi:10.1257/0002828054825574; Daron Acemoglu, Simon Johnson, and James A. Robinson, “The Colonial Origins of Comparative Development: An Empirical Investigation,” *National Bureau of Economic Research Working Paper Series No. 7771* (2000), doi:10.3386/w7771; Kevin B. Grier and Gordon Tullock, “An Empirical Analysis of Cross-National Economic Growth, 1951–1980,” *Journal of Monetary Economics* 24, no. 2 (September 1989): 259–76, doi:10.1016/0304-3932(89)90006-8; Robin M. Grier, “Colonial Legacies and Economic Growth,” *Public Choice* 98, no. 3/4 (1999): 317–35.

that a single colonial power controlled multiple colonies, and these myriad colonies experienced significantly different economic outcomes after gaining independence, the colonial deep determinant theory leaves gaps in the explanation.

Institutional legacy serves as a deep determinant in that an initial set of circumstances drive economic growth in a particular direction.<sup>16</sup> The institutional order then begins to gain momentum and begets future institutions and policies, which then increase the costs of changing course. The related argument to institutions shaping economic policy is that a well-designed institutional system serves as a catalyst for economic policy decisions, regardless of what motivated them.<sup>17</sup> Specific to India is the argument that the institutional legacies of British colonialism and early Indian administrations laid the support structures for a robust economy, left only to be triggered by a major policy decision; various authors argue whether that triggering decision occurred in the 1980s or 1990s.<sup>18</sup>

While each of these arguments has their merits, they give little credence to human agency, which has overcome the bindings of deep determinants in various cases around the world. Specifically, for India, the study of colonial and institutional deep determinants provides a foundation upon which to base further study.

#### ***d. The Developmental State***

A large body of work exists on the concept of the “developmental state,” first coined by Chalmers Johnson.<sup>19</sup> The developmental state is a market-based approach to governing that hinges on strong cooperation between the public and private sectors of a

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<sup>16</sup> Douglass C. North, *Institutions, Institutional Change and Economic Performance* (New York, NY: Cambridge University Press, 1990), 3.

<sup>17</sup> Rodrik, “In Search of Deep Determinants,” 19.

<sup>18</sup> J. Bradford DeLong, “India Since Independence: An Analytic Growth Narrative,” in *In Search of Prosperity: Analytic Narratives on Economic Growth*, ed. Dani Rodrik (Princeton, NJ: Princeton University Press, 2003), 190.

<sup>19</sup> Chalmers Johnson, “Political Institutions and Economic Performance: The Government-Business Relationship in Japan, South Korea, and Taiwan,” in *The Political Economy of the New Asian Industrialism*, ed. Frederic C. Deyo, Cornell Studies in Political Economy (Ithaca, NY: Cornell University Press, 1987), 136–64.

country.<sup>20</sup> Johnson's concept is based on four pillars: a stable bureaucratic elite, public-private cooperation in forming and executing industrial policy, government investment in education, and a free-market price mechanism (using the free market to determine where government investment would be best utilized). Although India has historically underperformed on the pillars of a developmental state as outlined by Johnson, studying the successful cases of the developmental state is valuable for identifying how the relationships between the public and private sectors of a country can impact its future development.<sup>21</sup> In the Korean example, the relationship between the public and private sectors was based on the government providing direction for where the country's industrial investments should go, and then having the large private sector corporations follow that direction in exchange for trade protection and other benefits from the government. The somewhat subordinate relationship of the corporations to the government, combined with steady government direction can be accredited with driving economic growth in South Korea.

Comparatively, as Atul Kohli observes, India had stable governing regimes in its early history, but could not foster the same relationship with its private sector.<sup>22</sup> Instead, the private sector was able to secure import protection from the government without providing concessions in exchange. The differences between the Korean and Indian cases can be useful in explaining why Indian leaders either chose to, or were forced to, adopt certain economic policies. For instance, the relationship between the public and private sector in India was very different from their relationship in South Korea. Whereas the Korean private sector was relatively deferential to the state for developing and implementing economic policies, the Indian private sector lobbied to eliminate economic policies that imposed rules or competition while keeping or expanding policies that provided subsidies or protected them from competition.<sup>23</sup> Understanding why the Korean

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<sup>20</sup> Richard F. Doner, Bryan K. Ritchie, and Dan Slater, "Systemic Vulnerability and the Origins of Developmental States: Northeast and Southeast Asia in Comparative Perspective," *International Organization* 59, no. 02 (2005): 327–61, doi:10.1017/S0020818305050113.

<sup>21</sup> Atul Kohli, *State-Directed Development: Political Power and Industrialization in the Global Periphery*, Kindle Edition (New York, NY: Cambridge University Press, 2004), 228.

<sup>22</sup> Ibid.

<sup>23</sup> Ibid.

state was able to limit private-sector influence in economic policy-making, and the Indian state was not, is useful in characterizing the strength of domestic influences in economic policy making.

*e. Socialism*

Concluding this review of the theoretical models of economic growth is socialism. Socialism, as advocated by Karl Marx, is a political and economic theory based on control of the means of production. Socialism prescribes a strong central government with the warrant to direct economic production throughout the country based on centrally decided goals. It emerged as a school of thought in the early 20th century as a reaction to growing wealth disparities and the economic exploitation of the working-class by societal elites.<sup>24</sup> This parallels the way Indian leaders would later view the British exploitation of India.<sup>25</sup> Following its independence in 1947, India's decision to follow a socialist-inclined economic policy was largely influenced by its first Prime Minister, Jawaharlal Nehru.<sup>26</sup> Having been witness to British colonial exploitation, Nehru believed in the promises of the socialist agenda. As the premiere statesman for the Indian independence movement, Nehru was exposed to various international influences, the mix of which led him to believe socialism and a state-directed economy would be most beneficial for India.<sup>27</sup> Reviewing literature on the socialist ideology will be useful for framing the perceived benefits of its policy prescriptions. Combined with the domestic economic situation in India at the time, this literature can help answer why Nehru advocated for a socialist economy.

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<sup>24</sup> Karl Marx and Friedrich Engels, "The Communist Manifesto," in *The Political Economy Reader: Markets as Institutions*, ed. Naazneen Barma and Steven Kent Vogel (New York, NY: Routledge, 2008), 41–62.

<sup>25</sup> Chandra, Mukherjee, and Mukherjee, *India after Independence*, chap. 25.

<sup>26</sup> Kohli, *State-Directed Development*, 228.

<sup>27</sup> DeLong, "India Since Independence"; Kohli, *State-Directed Development*; Atul Kohli, *Poverty Amid Plenty in the New India* (New York, NY: Cambridge University Press, 2012); Lloyd I. Rudolph and Susanne Hoeber Rudolph, *In Pursuit of Lakshmi: The Political Economy of the Indian State* (Chicago, IL: University of Chicago Press, 1987).

## 2. Indian Political–Economic History

India’s political–economic history can be broken out into three distinct segments. First, the Nehruvian period, which lasted from India’s independence in 1947 to 1980. Though Nehru died in 1964, his economic legacy dominated policy until the late 1970s. The second period, from 1980–1991, is best characterized as an economically transitional period, and is bookended by one subtle and one momentous event. Finally, the third economic period begins in 1992 and is ongoing.

### a. *The Indian Economy: Independence to 1980*

An ample number of studies have identified the endogenous and exogenous factors that influenced India’s economic policies following its independence in 1947. Existing literature on the era immediately after independence focuses on the Indian political recoil from decades of colonialism. Since British colonialism specifically is credited with establishing many Indian political and economic institutions, the Indian political economy is often characterized as a recoil from its colonial past.

On the economic front in particular, being exploited by a foreign capitalist power tilted Indian politics toward sovereignty and socialism.<sup>28</sup> Since Indian foreign policy was an implementation of its economic perspective, it is worth considering how India’s foreign policy was also shaped by her colonial legacy. Did a self-reliant foreign policy, chosen by Indian politicians still reeling from colonization, lead India to adopt an economic policy that focused more on organic economic growth than a globalized economic policy? The literature on Indian international relations immediately after independence describes the emergence of a “non-aligned” foreign policy as a reaction to the same foreign exploitation that drove India’s socialist economic policies.<sup>29</sup> Also

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<sup>28</sup> Chandra, Mukherjee, and Mukherjee, *India after Independence*, 9, 47; B. R. Tomlinson, *The Political Economy of the Raj, 1914–1947: The Economics of Decolonization in India*, Cambridge Commonwealth Series (London: Macmillan Press, 1979).

<sup>29</sup> Itty Abraham, “From Bandung to NAM: Non-Alignment and Indian Foreign Policy, 1947–65,” *Commonwealth & Comparative Politics* 46, no. 2 (April 1, 2008): 10; Chandra, Mukherjee, and Mukherjee, *India after Independence*, 36; “History and Evolution of Non-Aligned Movement,” *Government of India: Ministry of External Affairs*, August 22, 2012, <http://mea.gov.in/in-focus-article.htm?20349/History+and+Evolution+of+NonAligned+Movement>; Rajen Harshe, “India’s Non-Alignment: An Attempt at Conceptual Reconstruction,” *Economic and Political Weekly* 25, no. 7 (February 24, 1990): 399.



contributing to India's socialist tilt were Nehru's personal inclinations. He was initially attracted to the idea because of its nationalist underpinnings. Reacting to British oppression and exploitation, Nehru sought an independent Indian government that could provide economic security and liberty, ideals he believed attainable only through central planning.<sup>30</sup>

The socialist path that India set out on shaped the next four decades of Indian economic history. The Nehru/Gandhi ruling coalition advocated for an inclusive, but self-reliant, culture with villages as the driving force for growth and development.<sup>31</sup> In the 1950s, possibly reacting to China's communist model, India tried to balance a mixed capitalist and economist model, combining state-led planning with a small role for the market. Over the next 30 years, the attempt to cohabitate these two economic models led to an era where a "complex bureaucratic process had stifled entrepreneurship and resulted in decades of slow economic growth,"<sup>32</sup> while at the same time not delivering the social justice promises of the socialist ideology.

Despite there being substantial literature on the economic and foreign policies of India, they are often portrayed as the end results. After India adopted certain policies, the iterative feedback loop of how their implementation impacted the future political economy is overlooked. In other words, questions such as how the implementation of India's initial economic policies altered its domestic and international contexts and how those contexts then impacted future economic decisions are typically left unaddressed. Furthermore, since India's domestic political economy and foreign policy are large enough areas of study in their own rights, very little of the literature focuses on the areas where they interacted with each other in informing Indian economic policies during her socialism inclined period.

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<sup>30</sup> K. V. Viswanathaiah, "Jawaharlal Nehru's Concept of Democratic Socialism," *The Indian Journal of Political Science* 26, no. 4 (1965): 91–99.

<sup>31</sup> Kohli, *State-Directed Development*, 290; Lydia Powell, "India's Modern Economic History: A Brief Review," *The Globalist*, September 3, 2012, <http://www.theglobalist.com/indias-modern-economic-history-a-brief-review/>.

<sup>32</sup> Powell, "India's Modern Economic History."

**b. *The Indian Economy: 1980–1991***

When considering the three different eras of Indian economic policy, this one is characterized by a gradual shift toward free-market principles. Economic reforms, which were a response to a macroeconomic balance of payments crisis, included tax reforms, removal of tariffs and barriers to foreign capital investment, and prudent management of currency exchange rates. Since the reforms were implemented gradually, and not bookended by singular events, the literature varies on what years this time period comprises. Some authors propose it began as early as 1965,<sup>33</sup> whereas others claim it began as late as 1991.<sup>34</sup> This literature review will use the issuance of India's 6th Five-Year Plan in 1980 and 8th Five-Year Plan in 1992 to demarcate India's economic transition period as between 1980 and 1991.

The causal factors affecting economic policy choices in this intermediate era are characterized in the literature in one of two ways. The transition to liberalization is either explained on the basis of influence from external actors<sup>35</sup> or due to a gradual realization that the “authoritarianism cum growth model”<sup>36</sup> was not comprehensive enough for growth in developing countries, capturing the influence of domestic politics.

(1) External Influence: 1980–1991

Even among the category of external influences to India's economic policies, experts cite several different factors with varying degrees of significance assigned to each. In his book, *State Directed Development*, Atul Kohli argues for the significance of shifting global perceptions on growth; one toward neo-liberal economic policies.<sup>37</sup> Liberalizing economic policy typically engenders significant opposition from those who stand to lose their privileges. Therefore, having the support of the international

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<sup>33</sup> Chandra, Mukherjee, and Mukherjee, *India after Independence*, 351.

<sup>34</sup> Kohli, *Poverty Amid Plenty*; Stephen P. Cohen, *India: Emerging Power* (Washington, DC: Brookings Institution Press, 2001), 98.

<sup>35</sup> Kohli, *Poverty Amid Plenty*, 95.

<sup>36</sup> Rudolph and Rudolph, *In Pursuit of Lakshmi*, 222.

<sup>37</sup> Kohli, *State-Directed Development*, 349.

community to undertake reform is “deemed crucial” by economic reformists.<sup>38</sup> This argument would suggest that political leaders are already motivated to pursue reforms, and international consensus makes it easier for them. However, it does not address how a shifting global perception on economic reforms can itself incite leaders to pursue reform.

An argument for what drove politicians to pursue reform can be pulled straight from Kenneth Waltz’ “Balance of Power” theory.<sup>39</sup> As suggested by Jeff Smith and others, India’s military loss to China in the 1962 war was attributed to China’s superior military, which was financed by an industrialization boom in China. Leaving aside the negative societal consequences of the concurrent Great Leap Forward, China’s military was well funded during this era.<sup>40</sup> This argument suggests that Indian politicians were at least partly motivated to pursue economic reforms because of a need to strengthen the military; gains from shifting to a free-market economy could be used to help fund the military.<sup>41</sup> While this is a compelling argument, it puts a lot of weight on a single causal factor; economic reforms are not typically the first logical step toward modernizing a military.

A third international influence, as argued by Shyam Kamath, and supported by declassified CIA reports, is that the United States and Soviet Union were both funneling billions of dollars in economic aid to India in an effort to keep India from aligning with the other side.<sup>42</sup> The argument suggests that as international aid from both blocs began to wane when the Soviet Union weakened, the Indian economy began to face fiscal troubles, further altering the political calculus that led to economic reforms.

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<sup>38</sup> Kohli, *Poverty Amid Plenty*, 95.

<sup>39</sup> Kenneth N. Waltz, “Reductionist and Systemic Theories,” in *Theory of International Politics*, 1st ed (Boston, MA: McGraw-Hill, 1979), 60–128.

<sup>40</sup> Henry Kissinger, *On China*, Kindle Edition (New York, NY: Penguin Books, 2012), chap. 4.

<sup>41</sup> Jeff Smith, *Cold Peace: China-India Rivalry in the Twenty-First Century* (Lanham, MD: Lexington Books, 2015); John W. Garver, *Protracted Contest: Sino-Indian Rivalry in the Twentieth Century* (Seattle, WA: University of Washington Press, 2001); Peter B. Evans, *Embedded Autonomy: States & Industrial Transformation* (Princeton, NJ: Princeton University Press, 1995), 5.

<sup>42</sup> Shyam J. Kamath, *Foreign Aid and India: Financing the Leviathan State* (Washington, DC: CATO Institute, 1992); “Warsaw Pact Economic Aid Programs in Non-Communist LDCs: Holding Their Own in 1986,” Intelligence Assessment, (1988), [http://www.foia.cia.gov/sites/default/files/document\\_conversions/89801/DOC\\_0000498651.pdf](http://www.foia.cia.gov/sites/default/files/document_conversions/89801/DOC_0000498651.pdf).

(2) Domestic Influence: 1980–1991

Various experts cite domestic influence as a driver for Indian economic reform. One such argument by Atul Kohli suggests that as the shifting composition of the Indian economy from agriculture toward industry and the service-sector played a large part in developing political support reform.<sup>43</sup> Another argument suggests that the domestic politics tilt toward reform was a product of overly populist policies in the late 1970s.<sup>44</sup> After years of economic stagnation brought about by populism, a lack of public investment led to the realization by the business classes that relying on the government for capital investment was not sustainable.<sup>45</sup> Therefore, when the government implemented private sector reforms in the early 1980s, “big businesses welcomed them effusively.”<sup>46</sup> Other arguments suggest the significance of a balance of payments crisis, growing influence of regional versus national politics,<sup>47</sup> and the maturing of small/medium size businesses and their commensurate middle-class populations as other domestic imperatives that drove economic reforms.<sup>48</sup>

(3) A Holistic Assessment: 1980–1991

1980 to 1991 was an important part of Indian economy history; many disparate events leading up to, and during, this period has been cited as factors that eventually led to economic reforms. However, as mentioned earlier, both the international and domestic factors are so expansive that attempts to understand them have to approach one as

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<sup>43</sup> Kohli, *Poverty Amid Plenty*, 100.

<sup>44</sup> *Ibid.*, 89.

<sup>45</sup> The largest source of industrial investment in India at the time was the government. As populist policies shifted expenditure of government resources toward subsidies, it resulted in a shortage of industrial investment, which then resulted in economic stagnation in the following years as industrialization stagnated.

<sup>46</sup> Kohli, *Poverty Amid Plenty*, 102; Rudolph and Rudolph, *In Pursuit of Lakshmi*, 241.

<sup>47</sup> Chandra, Mukherjee, and Mukherjee, *India after Independence*, 362; Rudolph and Rudolph, *In Pursuit of Lakshmi*, 205, 242.

<sup>48</sup> Evans, *Embedded Autonomy*, 168–73.

primary and the other as secondary. A holistic look at all the various factors and their interplay throughout this time period is missing from the existing literature.

**c. Indian Economy: 1992–2015**

The 1991 liberal economic reforms enacted by then Prime Minister Narasimha Rao and his finance minister, Manmohan Singh, produced very quick results. Indian GDP growth was catapulted from a historical average of 2–3 percent, and 1991’s paltry 0.8 percent, to 7.5 percent in the following four years, and an average of 6.8 percent from 1992–2014.<sup>49</sup> The end result of this has been a concentration of wealth along regional, urban, and class lines, causing domestic pressures to ensure equal growth.<sup>50</sup> Internationally, India has seen a large influx of foreign direct investment, but this also has been only toward certain regions and cities. The era after the 1991 economic reforms has been characterized by a globalized approach to economic development, a growing domestic economy, but also increased economic inequality within the population.

(1) External Influence: 1992–2015

The 1990s ended with two significant events that impacted India’s economic policy. First was India’s test of a nuclear bomb in 1998. Internationally, the nuclear tests were unexpected and drew various economic sanctions, but the sanctions were inconsequential and short-lived.<sup>51</sup> Furthermore, the Kargil War with Pakistan in 1999 also had only temporary impacts on the Indian economy. As suggested by Teresita Schaffer, by the end of the 1990s, the economic reforms from earlier in the decade had already enriched India to where the influence of international pressure was reduced.<sup>52</sup> Furthermore, India had begun evolving its initial non-aligned policy into one of “multi-alignment,” as defined in a report by the influential Indian think-tank, the Centre for

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<sup>49</sup> Chandra, Mukherjee, and Mukherjee, *India after Independence*, 367; “World Development Indicators,” *The World Bank*, n.d., <http://databank.worldbank.org>.

<sup>50</sup> Kohli, *Poverty Amid Plenty*, 142.

<sup>51</sup> Daniel Morrow and Michael Carriere, “The Economic Impacts of the 1998 Sanctions on India and Pakistan,” *The Nonproliferation Review* 6, no. 4 (1999): 1–16.

<sup>52</sup> Teresita C. Schaffer, *Rising India and U.S. Policy Options in Asia* (Washington, DC: Center for Strategic and International Studies, 2002), 29.

Policy Research. While this report does not represent an official Indian position, its contributors are immensely influential in the policy-making process. Whereas non-alignment sought to minimize foreign influence in Indian policy-making, multi-alignment accepts the constant exogenous pressures. Therefore, as the report argues, a multi-aligned foreign policy of engaging all economic and political partners would strengthen India to a point where it could resist international influence.<sup>53</sup>

The global economic environment during this era was also leaning toward economic liberalization. The Chinese example of transitioning to a market-based economic model had demonstrated sustained unprecedented economic growth.<sup>54</sup> The United States and Western Europe were just finishing a decade of economic liberalization and continuing to reduce market regulation, leading to the longest economic expansion in U.S. history.<sup>55</sup> The global economy was clearly rewarding countries with market-liberal economic policies, an international trend that India could not ignore as it sought international political, economic, and military credibility.

## (2) Domestic Influence: 1992–2015

Since 1991, India's domestic politics have been enormously influential in shaping economic policy-making. The economic growth as a result of the 1991 economic reforms and the continued liberalization of the Indian economy and licensing apparatus has created a large, relatively wealthy, and vocal middle class. As argued by Rahul Mukherji, economic reforms have produced winners in the corporate sector and middle class. Pro-reform groups and small to medium size business owners united a large portion of the population in support for continued economic reforms. On the other side, leftist parties, trade unions, and left-wing economists sought to undo the market reforms, but they were

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<sup>53</sup> Sunil Khilnani et al., "NonAlignment 2.0: A Foreign and Strategic Policy for India in the Twenty First Century" (New Delhi: Centre for Policy Research, February 29, 2012), <http://www.cprindia.org/research/reports/nonalignment-20-foreign-and-strategic-policy-india-twenty-first-century>.

<sup>54</sup> Kissinger, *On China*.

<sup>55</sup> Christian E. Weller, "Learning Lessons From the 1990s," *Economic Policy Institute*, April 10, 2002, [http://www.epi.org/publication/webfeatures\\_viewpoints\\_l-t\\_growth\\_lessons/](http://www.epi.org/publication/webfeatures_viewpoints_l-t_growth_lessons/).

too splintered to mount an effective opposition.<sup>56</sup> As the middle class amassed wealth and power under the new economic system, it became increasingly vocal about continuing economic liberalization at almost any cost.<sup>57</sup> The result of the emergence of the Indian middle class has been a shift in economic decision making from the national to the state levels. Kohli argues that this has concentrated economic growth to certain sectors of the population: mostly educated English-speaking Indians in the engineering, transportation, tech, and banking industries. These and other emerging industries are concentrated in a handful of states, capturing a large part of the country's total economic growth.<sup>58</sup> As a result, "some Indian states are growing rapidly, while others are not," due to the comparative advantages and individual political economies of each state.<sup>59</sup> Recent literature suggests that the biggest influences to Indian economic policy-making are the growing middle class and growing income inequality.<sup>60</sup>

### (3) A Holistic Assessment: 1992–2015

The era after India's economic liberalization dramatically shifted the importance and influence of both international and domestic factors. With its newfound wealth, India appears to have been able to insulate itself from international economic headwinds. Internally, a newly enriched and vocal middle-class continues to push for continued liberalization. However, as with the previous era, existing literature typically explores either India's newly empowered international presence or emerging middle class due to the scope of each topic. This leaves unanswered what the impact of globalization was on the Indian middle class, why it was able to so quickly transition away from decades of

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<sup>56</sup> Ashutosh Varshney, "Mass Politics or Elite Politics? India's Economic Reforms in Comparative Perspective," *The Journal of Policy Reform* 2, no. 4 (November 1998): 242, doi:10.1080/13841289808523388.

<sup>57</sup> Rahul Mukherji, "The Political Economy of India's Economic Reforms," *Asian Economic Policy Review* 3, no. 2 (December 2008): 315–31, doi:10.1111/j.1748-3131.2008.00118.x.

<sup>58</sup> Kohli, *Poverty Amid Plenty*, chap. 3.

<sup>59</sup> *Ibid.*, 216.

<sup>60</sup> Swaminathan S. Ankelsaria Aiyar, "Capitalism's Assault on the Indian Caste System," Policy Analysis (Washington, DC: CATO Institute, n.d.); Kohli, *Poverty Amid Plenty*; Chandra, Mukherjee, and Mukherjee, *India after Independence*; Mukherji, "The Political Economy of India's Economic Reforms."

state-led economic policy-making, and how it was able to the knowledge and organize itself to continue influencing the country's political economy.

## **E. THESIS OVERVIEW**

This thesis focuses specifically on how domestic and international pressures shaped Indian politicians and the population in deciding what economic policies would be most advantageous for them. This chapter has reviewed the economic theories that apply to India's development. With a broad brush, this chapter also assessed the major trends in each of India's economic periods. Chapter II narrows the focus to India's first economic period and considers the major domestic and international factors that shaped its socialist economic policy. Chapter III does the same for India's transitional economic period, and Chapter IV provides an in-depth look at India's current globalized economic period. Finally, Chapter V draws conclusions about the domestic and international events that shaped India's past and reflects on how their relevance has ebbed and flowed.



## II. INDIAN POLITICAL ECONOMY: 1947–1979

Long years ago we made a tryst with destiny, and now the time comes when we shall redeem our pledge... To bring freedom and opportunity to the common man, to the peasants and workers of India; to fight and end poverty and ignorance and disease; to build up a prosperous, democratic and progressive nation, and to create social, economic and political institutions which will ensure justice and fullness of life to every man and woman.

—Jawaharlal Nehru<sup>61</sup>

### A. 1947–1979 AT A GLANCE

When India gained independence in 1947, the economic situation was dire. Almost half its population was living under the poverty line, the infant mortality rate was nearly 20 percent, agricultural productivity was low, incomes were stagnant, and industrial development was stunted.<sup>62</sup> Indian politicians, headed by the first Prime Minister, Jawaharlal Nehru, were faced with the challenge of strengthening the nascent nation.

The time period from 1947–1979 was one with many significant domestic and international trends and events. This chapter looks at two of the most consequential events for the Indian economy during this period—industrial policies adopted after independence, shaped by import substitution industrialization, and the green revolution—and review the domestic and international trends that shaped them.

### B. INDIA’S INDUSTRIAL POLICIES

In 1947, India adopted an industrial policy of import substitution industrialization (ISI). This strategy for rapid industrialization and economic development strategy was utilized by developing countries around the world, especially South America, based on the belief that it would accelerate countries’ industrialization efforts. ISI policy prescriptions are based on Keynesian economic principles that advocate a role for the

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<sup>61</sup> Jawaharlal Nehru, “Tryst with Destiny” (Speech, New Delhi, August 15, 1947), <http://www.svc.ac.in/files/TRYST%20WITH%20DESTINY.pdf>.

<sup>62</sup> Chandra, Mukherjee, and Mukherjee, *India after Independence*, 15–16.

government in managing the development of a country's economic sectors. The standard application of these policies during the post-WWII time period was in the heavy industries: steel, mining, shipbuilding, and other such sectors.

India adopted policies relatively in line with the usual ISI prescriptions. Under political pressure to pursue a self-reliant economy, India's leaders enacted policies that "emphasized the growth and long-term development of heavy capital goods industries run by the state with largely indigenous technology."<sup>63</sup> As early as 1931, politicians envisioning the future of India had resolved that, among other things, "the State shall own or control key industries and services, mineral resources, railways, waterways, shipping and other means of public transport."<sup>64</sup> According to Atul Kohli, Nehru believed that private firms could not be trusted with every sector of the Indian economy. Therefore, the private sector had significant restrictions on investment and production limits imposed on it. This was borne out of a desire to achieve rapid economic growth with equity for all sectors of the population; as stated by Kohli, "the nationalist commitments of India's leaders translated into a suspicion of an open economy and a preference for heavy industry."<sup>65</sup>

Nehru and other politicians chose heavy industrialization and ISI-based trade policies in large part because of how easily they were influenced by political decrees, more so than agriculture or land reform that were parts of ISI strategies in other developing countries.<sup>66</sup> Additionally, the selection of these particular policies was influenced by a number of domestic and international trends. Chapter II analyzes a few of the more prominent trends that led Indian leaders to adopt their particular industrialization policies.

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<sup>63</sup> Sarosh Kuruvilla, "Linkages between Industrialization Strategies and Industrial Relations/Human Resource Policies: Singapore, Malaysia, the Philippines, and India," *ILR Review* 49, no. 4 (July 1, 1996): 649, doi:10.1177/001979399604900404.

<sup>64</sup> Viswanathaiah, "Nehru's Concept of Democratic Socialism"; Chandra, Mukherjee, and Mukherjee, *India after Independence*, 341.

<sup>65</sup> Kohli, *State-Directed Development*, 237.

<sup>66</sup> Kohli, *Poverty Amid Plenty*, 83.

## 1. Domestic Influences

Indian independence leaders entered office with their own visions of what the country's economy should look like, who it should benefit, and how to accomplish those two goals. However, domestic pressures prompted shifts in which economic policies were applied and how they were structured. This section will discuss some of the more significant domestic influences on India's political economy: self-reliance, the Nehruvian vision, industrialization, trade policies, and the rise of industrial conglomerates.

### a. *Indian Self-Reliance*

As evidenced by the quote from Nehru's *Tryst with Destiny* speech, Indian leaders recognized that they were faced with the daunting task of both modernizing the country and lifting millions of Indians out of poverty. The revolution, which brought about Indian independence, had to encompass social and economic change, not just political. Furthermore, British colonization had left Indians with a bad taste for foreign involvement, equating any foreign political or economic influence with imperialism. As Nehru envisioned it, the objective was to "unleash forces from below among our people,... to build up the community and the individual,... [and to] aim at progressively producing a measure of equality in opportunity and other things."<sup>67</sup> Chandra and Mukherjee best describe the sentiment, noting that after independence, "the vision of a self-reliant independent economy was developed and popularized. Self-reliance was defined... as avoidance of a subordinate position in the world economy."<sup>68</sup> This vision of a "self-reliant independent economy" did not bar India from participation in a global economy, but focused on rapid industrialization through the creation of indigenous industries.

### b. *Nehru's Vision for India*

The concept of a free India, as envisioned by the Indian National Congress (INC), was to be a democratic country that could also pursue rapid industrialization and

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<sup>67</sup> Chandra, Mukherjee, and Mukherjee, *India after Independence*, 146.

<sup>68</sup> *Ibid.*, 23.

economic growth. Nehru and other leaders in the independence movement, Gandhians, socialists, capitalists, as well as communists, were united in that goal. This coalition also recognized that pursuing rapid industrialization under a democratic banner was unprecedented.<sup>69</sup> Around the world, every other country that was pursuing rapid industrialization was doing so under an authoritarian regime. As was demonstrated in countries such as South Korea and Japan, an authoritarian regime was able to insulate itself from popular recourse when enacting systemic changes to a country's economy. Discontented segments of the population could complain, but were less likely to be able to affect significant change in economic policy. India, however, was attempting the same industrialization policies as a democracy. While having a popular mandate from the electorate did give Nehru and other politicians credibility, they were not as immune to political lobbying as their authoritarian counterparts. As Nehru tried to enact his vision of a socialistic industrial state, he found himself conceding to various interests in the industrial sectors.

Nehru's version of socialism was democratic socialism. Viewing capitalism as inherently anti-social, Nehru's philosophy conceded that a private sector was necessary to technology-driven industrialization.<sup>70</sup> With that concession, Nehru still favored a role for the government in shaping economic structures and the rules that would govern it, while allowing private enterprise to operate within those limitations. Furthermore, he advocated for economic sectors where public and private companies operated in an effort to "counteract the anti-social side of capitalism."<sup>71</sup> For politicians in the Indian National Congress party, counteracting the anti-social side of capitalism meant ending poverty, inequality of opportunity, and maintaining human rights and quality of life. The goal was for this to be achieved by making families and towns the binding factor for India's vast

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<sup>69</sup> Ibid., 340.

<sup>70</sup> Viswanathaiah, "Nehru's Concept of Democratic Socialism," 95.

<sup>71</sup> Ibid., 96, 98.

population. By fostering an idyllic relationship between various peoples, towns, and religions, the Indian population could attain unity as a nation.<sup>72</sup>

Nehru also realized that the implementation of this ideology could not be rushed. For nearly 20 years after independence, he shaped policy setting up what he believed were the critical points of his vision for India. In 1964, Nehru's Indian National Congress party posited four points in the Bhubaneswar Resolution to describe his vision for Indian socialism:

1. that the essential requirements of food, clothing, housing, education and health of every man, woman and child in the country are satisfied;
2. that, as a means to the above end as well as because of the intrinsic value that should be attached to social justice in a viable democracy, large disparities that exist in the economic and social status of different sections of the community should be narrowed down;
3. that necessary changes in the ways of thinking and in the ways of living of the people be brought about democratically so as to facilitate the full growth of human personality which alone would make it possible for the full utilization [sic] of the enormous human resources which the country is endowed with; and
4. that the Nation should set before itself the task of realizing these objectives substantially by the end of the Fifth Plan.<sup>73</sup>

Nehru was an immensely influential figure in shaping India's policies following independence. Being one of India's founding leaders, his close association with Gandhi, and the sheer fact that he was the head of the Indian National Congress party afforded him a significant mandate in shaping India's politics and economy in accordance with his interpretation of democratic socialism. Congress dominated India's political system in the early years. Political opposition, where it did exist, was weak, uncoordinated, and active mostly at a regional level.<sup>74</sup> Though Nehru's vision of a self-reliant socialist-inclined

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<sup>72</sup> Md. Ayub Mallick, "Ideology of the Indian National Congress: Political Economy of Socialism and Socialistic Pattern of Society," *IOSR Journal of Humanities and Social Science* 12, no. 2 (2013): 97–99, doi:10.9790/0837-12296112.

<sup>73</sup> Viswanathaiah, "Nehru's Concept of Democratic Socialism," 98; The Fifth Plan is a reference to the fifth Five-Year economic plan which was set to end in 1978.

<sup>74</sup> Chandra, Mukherjee, and Mukherjee, *India after Independence*, chap. 14.

democracy still influences India's political economy, modern politicians have been adapting his concept in the globalized economic environment.

**c. *Rapid Industrialization***

At independence in 1947, the large industrial firms that provided the Indian economy with essential goods were mostly British and were withdrawing from the country along with the British government. In response, Indian politicians moved to quickly replace those companies with new ones that could provide the same goods and services. Influenced by the domestic pressures for self-reliance, India shunned foreign influence and sought to build its own industrial base. Politicians carved out economic sectors, gave each sector to a domestic firm in near-monopolistic conditions, restricted or taxed the import of competing foreign goods, and provided subsidies to domestic firms for various goods or materials related to manufacturing.<sup>75</sup>

In order to protect the oppressed and “Other Backward Castes,”<sup>76</sup> the state had to control the production process. The desire to be self-reliant and also to rapidly industrialize shaped industrial policies in the form of import-substitution based industrialization.

**d. *Industrial Conglomerates***

The British colonization of India had focused on developing institutions that extracted resources from the sub-continent, which could then be manufactured into goods and sold back to India. During World War II (WWII), much of Britain's industrial base was damaged by German aerial bombardment. This led to the British investing in a concentrated industrial base in India to help with the war effort. As described by Kohli, “many of these industries did rather well during the second World War, so much so that

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<sup>75</sup> Kohli, *State-Directed Development*, 196.

<sup>76</sup> Yogendra Yadav, “Understanding the Second Democratic Upsurge,” in *Transforming India: Social and Political Dynamics of Democracy*, ed. Francine R. Frankel (New Delhi: Oxford University Press, 2006), 121.

‘at the time of independence... India possessed a large and fairly sophisticated modern industrial complex.’”<sup>77</sup>

While Nehru and the Indian National Congress had noble intentions for industrializing India, maintaining social and economic equity, and gaining international credibility for the country, the democratic approach to accomplishing these goals ended up undercutting their efforts. Though the main actors were unified in their methods before and during the independence effort, there were substantially more actors influencing the political system post-independence, notably the Indian business class.

As India began its industrialization process during World War II, a powerful group of conglomerates consolidated India’s industrial capacity among themselves. Groups such as the Tatas, Birlas, and Singhanias emerged from World War II with a significant amount of economic and political capital, which they used in shaping economic policy during and after India’s independence.<sup>78</sup> As argued by Kohli, “the Achilles heel of Indian political economy [was] the mismatch between the statist model [of government] and the limited capacity of the state to guide social and economic change.”<sup>79</sup> In other words, India’s insistence on remaining a democratic governing body made it challenging for politicians to enact policies that drove rapid and equitable industrialization partly due to the influence of industrial conglomerates in shaping protectionist governing policies.

Once established, Indian conglomerates’ impact on India’s political economy was significant. They challenged the regulatory abilities of the Indian government, helping cement protectionist trade policies. Indian economist Rakesh Mohan captures the problem inherent in powerful conglomerates:

It is seen in recent years that even relatively strong regulatory actions taken by regulators against such global [conglomerates] has had negligible market or reputational impact on them in terms of their stock price or similar metrics. Thus, there is a loss of regulatory effectiveness as a result

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<sup>77</sup> Kohli, *State-Directed Development*, 226.

<sup>78</sup> *Ibid.*, 228.

<sup>79</sup> *Ibid.*, 232.

of the presence of such conglomerates. Hence there is inevitable tension between the benefits that such global banks bring and some regulatory and market structure and competition issues that may arise.<sup>80</sup>

Though this quote references modern financial conglomerates, the challenges with industrial conglomerates in post-independence India were similar. When British corporations vacated the Indian marketplace, there were few sectors where indigenous companies could step in to supply the marketplace. The industries that weren't reserved for the state sector were licensed out through the Industrial Policy Resolutions of 1948 and 1956.<sup>81</sup> As a result, Indian businesses scrambled for licenses to operate in any industry tangentially related to their core competencies. In this scramble, the companies best connected to the License Raj system thrived. By the late 1960s, a handful of conglomerates emerged. Among them were the Tatas and Birlas, who controlled 70 and 203 various companies respectively.<sup>82</sup> Since licenses were required to enter into a these various sectors, the companies that did manage to secure licenses prospered in the naturally monopolistic conditions.

The largest threat to the conglomerates was the Indian government itself, which as described earlier, was envisioned by Nehru to “counteract the anti-social side of capitalism.”<sup>83</sup> To manage this risk, the conglomerates were able to influence government officials to further restrict licensing programs and continue protectionist policies that provided the conglomerates subsidized raw materials as well as preventing foreign competition in the Indian marketplace. Furthermore, since India's population was large enough to provide future growth potential, exporting into the global economy could be ignored. The result of this policy combination is captured succinctly by S. Manikutty,

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<sup>80</sup> Rakesh Mohan, “Financial Sector Reforms and Monetary Policy: The Indian Experience,” in *India's Economic Development Since 1947*, ed. Uma Kapila, Fourth Edition (New Delhi: Academic Foundation, 2009), 848.

<sup>81</sup> S. Manikutty, “Family Business Groups in India: A Resource-Based View of the Emerging Trends,” *Family Business Review* 13, no. 4 (December 2000): 279.

<sup>82</sup> Ibid.

<sup>83</sup> Viswanathaiah, “Nehru's Concept of Democratic Socialism,” 96.



“the system made the Indian enterprises (private as well as the state sectors) inefficient and globally uncompetitive.”<sup>84</sup>

## **2. International Influences**

As significant as domestic influences were in shaping India’s industrial policies, they were only part of the story. Despite its leaders’ attempts to insulate the country from global influences, India’s policies were reflective of the international trends going on at the time. The development of contemporary economic thought, a non-aligned foreign policy, and the Cold War all exerted their influence in shaping India’ industrial strategy

### *a. Post–WWII Theories of Economic Growth*

Japan emerged from devastation after World War II with a model for rapid industrialization, the developmental state, which set the example for developing countries around the world. As described earlier, the ISI system advocated for protectionist economic policy to help develop indigenous industrial capabilities; India’s economic policies at the time did not significantly depart from the conventional wisdoms. Later in the 20th century, the conventional wisdoms evolved, advocating for market-liberal economic policies, fiscal discipline of government subsidies, tax reforms, and trade liberalization.

Though it sought a non-aligned economic and political path, India was not immune to global economic currents. Both schools of thought, protectionist and market-liberal, influenced Indian politicians and shaped their approaches toward India’s political economy.

### *b. Non-Alignment*

The non-aligned foreign policy emerged from centuries of European colonial rule. In 1947, Indian leaders were especially sensitive to the idea of having other world powers decide what was in their best interests and were increasingly focused on self-reliance. Arguably, the roots of the non-aligned ideology were already existent for several years

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<sup>84</sup> Manikutty, “Family Business Groups in India,” 279–80.

prior to India gaining independence on August 15, 1947. Frustration with years of economic exploitation by the British and a desire to prove economic parity with other countries formed the basis of a self-reliant ideology, which then evolved into an economic policy approach where Indians were in control of India's future.<sup>85</sup>

Some Indian schools of thought perceive their freedom as entirely of their own making, independent of global power shifts. Yet India's ability to shake British colonial influence was not entirely its own doing. In the aftermath of World War II, Britain lost its status as a global superpower, ceding its position to the United States, and later also to the Soviet Union. Distracted with problems closer to home and maturing governments in its colonies, the British chose to relinquish control in the colonies instead of reasserting their power.<sup>86</sup> The point is that India emerged from the control of a waning global hegemon into a world where two other rising hegemons were battling for global preeminence.<sup>87</sup>

The American and Soviet Cold War mentality of enlisting states into their political and economic ideological camps had a large part of the world committed to one of the two camps. Seeing the effects of this global dyad, India was not inclined to side with either power. As stated by Rajen Harshe, "India, like a typical newly liberated state, wanted to protect its hard won freedom and sovereignty."<sup>88</sup> Indian leaders realized that the nature of 20th century colonialism was economic, no longer requiring the holding of territory by force. Nehru envisioned India different from other post-colonial nations who he believed were being "pushed into a neo-colonial situation where, while formal political independence was achieved, the erstwhile colony's economy continued to be essentially dominated by metropolitan interests."<sup>89</sup> By committing to either the American or the Soviet ideology, Indian leaders feared they would be constrained to operating in

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<sup>85</sup> Sanjaya Baru, "Self-Reliance to Dependence in Indian Economic Development," *Social Scientist* 11, no. 11 (1983): 33, doi:10.2307/3517074; Chandra, Mukherjee, and Mukherjee, *India after Independence*, 10.

<sup>86</sup> Chandra, Mukherjee, and Mukherjee, *India after Independence*, 36.

<sup>87</sup> "History and Evolution of Non-Aligned Movement."

<sup>88</sup> Harshe, "India's Non-Alignment," 399.

<sup>89</sup> Chandra, Mukherjee, and Mukherjee, *India after Independence*, 339.

accordance with American or Soviet desires, effectively turning the newly independent country back into a reliant colony.

*c. The Cold War*

For better or worse, during this time period India found itself geographically right in the middle of a major friction point in the Cold War. Sitting to India's west, the Soviet reach into Asia was stalled in nearby Afghanistan, balanced by the American presence in Pakistan. Moreover, China went from being a Soviet ally to acting on its own accord, adding geo-political pressure on India from the east. Though India declared itself non-aligned, she was inevitably swayed by the influences of the three more-powerful nations at her doorstep. Soviet industrialist policies shaped Nehru's ideologies and the Indian economy at independence but, since it was already a democracy, American leaders sought to bring India under the capitalist mantle as well. While the Soviet Union was providing Indian over one billion dollars in economic aid through the Warsaw Pact, Western governments and institutions were pressuring India to liberalize its economy.<sup>90</sup> While India never acknowledged it as a motivating factor, non-alignment allowed India to court both the American and Soviet blocs for economic aid. Declassified CIA reports estimate that India was receiving half of the two billion in foreign aid disbursed annually by the Soviet Union through the Warsaw Pact.<sup>91</sup> Coupled with aid from the United States, India received nearly \$55 billion in aid between 1951 and 1991.<sup>92</sup>

**C. THE GREEN REVOLUTION**

In the aftermath of a war with China in 1962, India found itself in a financial crisis as a result of droughts and food shortages. A dependence on Western powers, mostly the United States, made the need for agricultural reform evident to the Indian government. Furthermore, the human toll of the food shortages provided politicians the political capital required to disturb the protectionist status quo and enact some of the

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<sup>90</sup> "Warsaw Pact Economic Aid Programs in Non-Communist LDCs: Holding Their Own in 1986."

<sup>91</sup> Ibid.

<sup>92</sup> Kamath, *Foreign Aid and India: Financing the Leviathan State*.

liberalizing reforms being called for by foreign aid donors.<sup>93</sup> In response, India modernized its agriculture industry by adopting new technologies such as high-yield variety seeds, chemical fertilizers, pesticides, modern machinery, and agricultural education programs. The cost of these modernizations was heavily subsidized by the Indian government, which now saw food self-sufficiency as fundamental to its goals of economic self-reliance. These significant levels of investment in the agricultural sector led to over 30 percent increases in crop yields, enough to feed the nation as well as drive industries that served the agricultural sector.<sup>94</sup>

The green revolution of the 1960s was significant for India in three ways. First, it established India as a leading global agricultural producer, leading to a better financial situation for the country by providing it with a marketable export.<sup>95</sup> Second, it demonstrated that politicians keen on driving economic reforms could leverage moments of crisis to enact change, a theme that returns in shaping the economic reforms of 1991.<sup>96</sup> Lastly, the economic successes of the green revolution enriched a new class of the Indian population, lower caste farmers. In doing so, it set the stage for an emergence of a middle class, another theme that rises to prominence after 1991.<sup>97</sup> The green revolution is understood as changing the course of India's political economy by several scholars as it changed the foundations of Indian political system. While it is often seen as driven by domestic food security concerns, it was molded by a mix of domestic and international influences.

## **1. Domestic Influences**

The green revolution was, at its heart, a change in domestic economic policies that, in turn, came in reaction to a domestic food crisis. The sweeping changes that

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<sup>93</sup> Mukherji, "The Political Economy of India's Economic Reforms," 320.

<sup>94</sup> Chandra, Mukherjee, and Mukherjee, *India after Independence*, 412.

<sup>95</sup> Mukherji, "The Political Economy of India's Economic Reforms," 328; David M. Malone and Rajeev Chaturvedy, "Impact of India's Economy on Its Foreign Policy Since Independence" (Asia Pacific Foundation of Canada, November 10, 2009), 5, <https://www.asiapacific.ca/research-report/impact-indias-economy-its-foreign-policy-independence>.

<sup>96</sup> Mukherji, "The Political Economy of India's Economic Reforms," 320.

<sup>97</sup> *Ibid.*; Chandra, Mukherjee, and Mukherjee, *India after Independence*, 415.

resulted from the green revolution were rooted in the reforms that were part of the New Agricultural Strategy (NAS) policies enacted in the early 1960s. Though the groundwork was laid by the domestic influences of the NAS, the green revolution was triggered in part by agricultural stagnation and food shortages.

*a. New Agricultural Strategy*

A prevailing sentiment among some scholars is that Nehru's early vision of socialism ignored agriculture in his goal of rapidly industrializing India.<sup>98</sup> This view suggests that grain was imported and subsidized in an effort to keep prices low and encourage industrialization, and it was not until Nehru's death and the Prime-Ministership of Lal Bahadur Shastri that economic policies toward agriculture were revamped. However, the policies enacted by Prime Ministers Shastri and Indira Gandhi were founded on the incremental reforms enacted under Nehru's New Agricultural Strategy. The NAS was a part of India's 3rd Five-Year Plan, an economic plan for the country from 1961–1966. It increased the government's focus on agriculture and wheat production, which were beginning to emerge as weak-points in India's goals of industrializing and self-reliance. Contrasted with the 1st Five-Year Plan, NAS policies began investing in irrigation, fertilizer, power facilities, and educational infrastructure such as agriculture-focused universities and research laboratories. As described by Chandra et al., India began to “place great emphasis on creating the physical and scientific infrastructure necessary for modern agriculture... [agricultural industries] took their place along with steel plants as the ‘temples of modern India’ in the Nehruvian vision.”<sup>99</sup>

Nehru, in the late 1950s, realized that India could not continue to produce grains simply by cultivating more land. Following in the footsteps of Japan and China, he realized that advanced technologies were necessary to increase the productive capacity of

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<sup>98</sup> John H. Perkins, *Geopolitics and the Green Revolution: Wheat, Genes, and the Cold War* (New York: Oxford University Press, 1997), 175; Chandra, Mukherjee, and Mukherjee, *India after Independence*, 411.

<sup>99</sup> Chandra, Mukherjee, and Mukherjee, *India after Independence*, 411.

existing land.<sup>100</sup> Furthermore, the NAS identified parts of the country with geographic advantages to receive government assistance in modernizing their agricultural production. However, the interest in modernizing the agricultural sector did not last long. As discussed in the next section, the impact of two wars identified more immediate weaknesses that needed to be addressed.

***b. Agricultural Stagnation and Food Shortages***

The New Agricultural Strategy laid the groundwork for reform in that sector but was overshadowed by wars with China and Pakistan. After the wars, in one of which the Indian army suffered an embarrassing loss to China, the priority suddenly became modernizing the military. Money was redirected from the agricultural sector to the military, and the timing could not have been worse. In 1965 and 1966, India faced two consecutive years of drought. The marginal gains in productivity that had come out of the NAS were wiped out as farmlands dried up. During this period, agricultural output dropped by 17 percent, and food output fell nearly 20 percent.<sup>101</sup>

The domestic pressures of the droughts were intense. The government had to increase food purchases from other countries, especially the United States, challenging the Indian ideal of self-reliance. Prime Ministers Shastri and Indira Gandhi realized that the famine was largely a result of India's own protectionist economic policies. The country was reliant on buying grain and other commodities on the global market, but had no viable products for sale. The trade imbalance left India with a shortage of foreign exchange.<sup>102</sup> The solution for this was two-fold. First, India would have to modernize its agriculture sector quickly. Second, it would have to open itself up to foreign trade. Although there was plenty of public support for modernizing agriculture, domestic pressure against economic liberalization was more intense. The concern was that if foreign goods were allowed to be sold in India without tariffs, it would drain the country's foreign currency reserves. Initially, the solution to these domestic influences

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<sup>100</sup> Ibid.

<sup>101</sup> Mukherji, "The Political Economy of India's Economic Reforms," 320.

<sup>102</sup> Vivek Chibber, *Locked in Place*, Kindle Edition (Princeton, NJ: Princeton University Press, 2003), 218.

was to balance against this with foreign economic aid. However, modernizing the agricultural sector ended up providing India with an answer to this problem as well.

Realizing the problems with its agricultural sector, India sought help from the west in acquiring and developing high-yield varieties of seeds. Coupled with the infrastructural modernizations that had begun development under Nehru in the early 1960s, the results of the high-yield crops were staggering. Total irrigated areas increased from one million hectares to 2.5 million in the early 1970s. Use of electric and diesel tools in farming increased five-fold, wells multiplied by a factor of four, and tractor usage increased nearly 450 percent. Between 1967 and 1972, this led to increased food production by 35 percent from 89 to 112 million tonnes.<sup>103</sup> More importantly, food imports decreased nearly 70 percent by 1970. The trend continued well into the 1970s and eventually converted India into a net food exporter, adding to the foreign currency reserves that domestic leaders has earlier been concerned about depleting.<sup>104</sup>

## **2. International Influences**

The green revolution resulted from a remarkable confluence of factors that, when combined, changed India's economic trajectory. In analyzing the domestic factors of the green revolution, this paper briefly touched on two international factors. The wars with China and Pakistan and the food imports from the United States were both largely influential in shaping the conditions that allowed the green revolution to take place.

### ***a. Wars with China and Pakistan***

In 1962 and 1965, India fought wars with China and Pakistan, respectively. India decisively lost the first, and barely won the second. These wars revealed two important facts to Indian leaders. First, the Chinese military was far ahead of the Indian military in size, technology, and ability. Secondly, it underscored the reality that India was bordered on both sides by hostile nations. The northeast states of India could be invaded and claimed by China at any time, as had been the Aksai Chin border area in 1962. On the

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<sup>103</sup> Chandra, Mukherjee, and Mukherjee, *India after Independence*, 413.

<sup>104</sup> *Ibid.*, 414; Chibber, *Locked in Place*, 218; Kamath, *Foreign Aid and India: Financing the Leviathan State*.

west, India was contending with Pakistan over control of the Jammu and Kashmir region. Though Indian forces had beaten back a Pakistani invasion and captured some Pakistani territory, it exposed a potential future weakness.

Both these wars occurred as India was in the process of modernizing its agricultural sector. Faced with more immediate existential threats, Indian politicians diverted economic resources away from continued agricultural modernization. The net effect of these conflicts was to delay India's agricultural investment. The delay came at an inopportune time; as soon as the conflicts were over, the country was hit with two years of droughts. What was previously a poor but manageable situation degraded into a serious problem for Indian leaders, leading them to seek assistance from the United States.

***b. Food Imports from the United States***

The second significant international influence on the green revolution was India's need for economic and food aid from countries it had specifically sought not to rely on. India found itself embroiled in a relationship with the United States without equal footing. It was reliant on American foreign aid to feed its population, importing over ten million tons of grain in 1966.<sup>105</sup> In exchange, India found itself having to make concessions to American leaders.

Turning to America for food aid was not a spontaneous occurrence. In the 1950s, Nehru and other Indian leaders started receiving pressure from domestic industrialists to pursue limited economic liberalization. Between them, the industrialists could not come to a consensus which, according to Sanjaya Baru,

prevented any large scale influx of foreign capital into India... The absence of business avenues to enter India forced the Americans to look for new avenues and typically it was food which became now an important vehicle for penetration. The food imports of 1956 which were paid for in rupees gave the Americans extensive control over the economy.<sup>106</sup>

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<sup>105</sup> Chandra, Mukherjee, and Mukherjee, *India after Independence*, 412.

<sup>106</sup> Baru, "Self-Reliance to Dependence in Indian Economic Development," 37.



Thus, the United States established an economic beachhead from which it could influence India. With an existing relationship and logistics chain with the United States for food purchases, India could really only look to the U.S. for food aid. The American President at the time, Lyndon B. Johnson, realized that this was an opportunity to both pursue geopolitical initiatives and also make India adopt the economic liberalization reforms that the United States had also been pushing for. Right as famine conditions were peaking in India, the United States threatened to cancel pending aid shipments until India softened its stance on America's involvement in the Vietnam War. Additionally, Johnson had a desire to "twist India into accepting an economic policy package favoured [sic] by the U.S.," and that, "India should be put 'on a short leash' and what better way to do it than to use India's dependence on the U.S. for food."<sup>107</sup>

Indian leaders recognized this attempt by the United States to influence India's economy and realized they had to act. Resisting pressures from the American and Soviet blocs required food self-sufficiency. Whereas the 1962 and 1965 wars led to a deferring of investment in the agricultural sector, the need to seek food aid from the United States renewed a sense of focus on agricultural modernization.

#### **D. CONCLUSION**

The first 32 years of India's independent history included vast amounts of change. The nation was born as democratic-socialist country and faced all the problems of industrialization that came along with that. Just as Indian leaders began recognizing some fundamental problems with their industrial policies, they were faced with wars, drought, and famine. At the end of the 1970s, India was on the verge of a major shift; it was about to take the first steps toward a liberalized economy. India's path from democratic socialism to the first hints of liberalization was shaped by various domestic and international influences. The specific position that India found itself in in 1979 was a result of the unique confluence of domestic and international events that, in turn, shaped how India's initial industrial policies and the green revolution unfolded.

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<sup>107</sup> Chandra, Mukherjee, and Mukherjee, *India after Independence*, 412.

Both international and domestic factors appear to be equally important in shaping India's political economy during this period. India's industrial policies were affected by Nehru's political beliefs on self-reliance, industrialization, and the relationship between the public and private sectors of the economy. As one of India's founding fathers and first prime minister, Nehru and his legacy played an outsize role in domestic politics, and therefore on India's industrial policies. The domestic response to the green revolution was a continuation of Nehru's legacy. As discussed earlier in this chapter, Nehru's New Agricultural Strategy began investing in modernizing India's agricultural infrastructure, an investment that proved critical to India emerging from the droughts and famine as a net food exporter.

International influences factored heavily in both India's industrial policies and its response to the green revolution. India's ISI-based economic policies were informed by international norms that suggested this as the most effective method for developing countries. Furthermore, India's non-aligned geopolitical posture precluded export-led development to a patron country as enjoyed by the South Korean developmental state. The impact of India's wars with China and Pakistan, international food aid, and agricultural technologies from the United States demonstrate the international community's influence on India's green revolution.

Overall, India's political economy seems to have been relatively equally affected by domestic and international factors from 1947–1979. Domestic influences seem to have been marginally more significant than international factors, but the balance is not as lopsided as could have been expected. Despite globalization's minimal impacts during this period and India's efforts to isolate itself from international currents, international factors were more consequential to the Indian political economy than expected.

### **III. INDIAN POLITICAL ECONOMY: 1980–1991**

#### **A. 1980-1991 AT A GLANCE**

To an outside observer, the 1980–1991 time-period began unremarkably in terms of Indian economic policy. Policy-makers were still grasping the economic and political implications of the green revolution that reshaped the Indian economy. The decade began unexceptionally but ended with a dramatic balance of payments crisis in 1991. India's reaction to the crisis is often marked in history as India's entrance into the global economy. Yet, as consequential as the 1991 crisis was in redefining India's political economy, it would not have been possible without the slow transition of the preceding decade. This chapter analyzes two significant events in India's political economy during this time period: the 6th Five-Year economic plan that guided India's economy from 1980–1985, and the economic crises of 1991. Both events were shaped by different domestic and international exigencies and both played a role in the trajectory of India's economic liberalization.

#### **B. THE 6TH FIVE-YEAR PLAN (1980–1985)**

The green revolution had a remarkable economic impact on India; it undermined the previously held notions that the government should act as a central planner. This does not suggest that the Indian economy was entirely decentralized after the green revolution. Instead, it demonstrated that the strict licensing regime was not necessary for a functional economy; licenses were still required, but industries could increase production without government approval based on their own business case.<sup>108</sup> The successes of lower and middle-class farmers combined with both global and domestic political pressure, shifted the political calculus of populist and socialist policy-making. The most important document to capture this marginally liberalized approach to policy making is the 6th Five-Year Plan, referred to from here on as the 6th Plan. The 6th Plan laid the foundations for India's eventual economic liberalization in 1991. As stated by Atul Kohli,

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<sup>108</sup> Atul Kohli, "Politics of Economic Growth in India, 1980–2005: Part I: The 1980s," *Economic and Political Weekly* 41, no. 13 (2006): 1251.

“economic growth in India started accelerating a full decade prior to liberalization [sic] of 1991.”<sup>109</sup>

The goals of the 6th Plan were broad, ranging from economic development to family planning. For the purposes of this study, the economic goals can be condensed down to a continued emphasis on self-reliance and overall social welfare, with the additional element, as observed by the Planning Commission, of “taking into account the failures of the past three decades of planning, recent developments,... as well as the vision of the future.”<sup>110</sup> This caveat is an important one. The plan acknowledges the impact of various recent policies and events in its formulation, such as the role that decentralized planning and technological investments played in enabling the green revolution. The following section highlights the impact of the domestic and international pressures.

## **1. Domestic Influences**

The green revolution enriched many segments of the population that were previously considered outside elite social circles. Farmers, packagers, transporters, and others in the agricultural industries all benefited from the boom in production and the new policy of exporting food.<sup>111</sup> This section will discuss the domestic influences and the emerging realization of an unsuccessful central-planning policy, which led to a more pro-business approach to state-intervention.

### ***a. Toppling the Commanding Heights***

The commanding heights, Lenin’s term used to describe the power held over the economy by the state, were a large part of India’s political economy in its early years. In 1955, Nehru’s economic advisor, P.C. Mahalanobis, created a single formula to administer the entire Indian economy. The prevailing sentiment was that an

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<sup>109</sup> Planning Commission, “6th Five Year Plan,” Government Archives, *Planning Commission*, (n.d.), chap. 3, <http://planningcommission.gov.in/plans/planrel/fiveyr/index6.html>.

<sup>110</sup> Ibid.

<sup>111</sup> Leela Fernandes, *India’s New Middle Class: Democratic Politics in an Era of Economic Reform*, Kindle Edition (Minneapolis, MN: University of Minnesota Press, 2006), chap. 1.

industrialization-focused command-economy could deliver economic growth and social benefit.<sup>112</sup> According to political economist Francine Frankel, the green revolution in the late 1960s deflated the credibility of that model.<sup>113</sup> This realization was not isolated to India's political elite. The public was also realizing the limitations of a state-run economy and starting to vote to that effect.<sup>114</sup> Kohli points out that as early as 1981, around the same time as the launch of the 6th Five-Year Plan, the *Times of India* editorialized, "A change of considerable significance is taking place in India... the emphasis has shifted from distributive justice to [economic] growth."<sup>115</sup>

Indira Gandhi returned as the Prime Minister in 1980 after a three-year Emergency-induced hiatus. At that time, India was in the midst of an economic recession coupled with rampant inflation of over 18- percent annually.<sup>116</sup> The lesson of the green revolution was that the Indian economy did not need to be as protected as industrialists had argued in the past and export pessimism need not be feared. Economist R. Nagaraj describes 1980 as a time where there was "considerable gloom about the immediate prospects for industrial growth, despite having a surplus of food and foreign exchange stocks... [Industrial growth] was widely regarded as a long-term constraint on India's economic growth... [The green revolution] had provided an argument that the controls on output, investment, and trade—popularly called the 'permit license raj'—were stifling private initiative and wasting meagre public resources."<sup>117</sup> The message was not lost on Indira Gandhi. Her return to leadership "downplayed redistributive concerns and prioritized growth."<sup>118</sup> She also adopted a more anti-labor stance to expand her alliance

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<sup>112</sup> Malone and Chaturvedy, "Impact of India's Economy on Its Foreign Policy," 581; Francine R. Frankel, *India's Political Economy 1947–2004: The Gradual Revolution*, 2nd edition (New Delhi: Oxford University Press, 2005), 581.

<sup>113</sup> Frankel, *India's Political Economy 1947–2004*, 155.

<sup>114</sup> *Ibid.*, 158.

<sup>115</sup> Kohli, "Politics of Economic Growth in India, Part I," 1255.

<sup>116</sup> "World Bank: World Development Indicators."

<sup>117</sup> R. Nagaraj, "Industrial Policy and Performance since 1980: Which Way Now?," in *India's Economic Development Since 1947*, ed. Uma Kapila, Fourth Edition (New Delhi: Academic Foundation, 2009), 3707.

<sup>118</sup> Kohli, "Politics of Economic Growth in India, Part I," 1255.

with big business, halted public sector growth, and “demoted the significance of economic planning.”<sup>119</sup>

Upon coming back into office, Indira Gandhi’s approach reflects a changed stance that is visible in the way the 6th Five-Year Plan was developed. The previous government was nearing completion of a draft economic plan when Gandhi took office in January 1980. One of her first actions was to annul the Indian Planning Commission’s plan, and redirect the commission to pursue relatively liberal economic policies. Gandhi’s directive to the Planning Commission to break from their existing guidance marks the only time in Indian history that such a drastic policy redirection occurred.<sup>120</sup> The 6th Five-Year Plan was released in August 1980. It marked a significant departure from policies such as land reforms and anti-poverty initiatives such as “Garibi Hatao,”<sup>121</sup> policies Indira Gandhi had advocated for in the past.<sup>122</sup> Her shift can be attributed to the changing political realities in India. A newly expanded middle class wanted more economic opportunities, which often came at the expense of distributive policies.<sup>123</sup> State organizations were coming to the same conclusion; in 1981 the Indian Planning Commission conceded that, “trends in capacity utilization up to 1979/80 in major industries have been a source of considerable concern [because] the poor use of capacity represents a waste of resources and thus adds to the resource constraint.”<sup>124</sup>

Clearly, the domestic political climate was moving from central planning toward market liberalization. Indira Gandhi felt she had enough political capital with the lower economic quintiles to implement policies advocated by the upper quintiles. As described by Kohli, “Gandhi and her advisors might have calculated that a realignment with big

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<sup>119</sup> Ibid.

<sup>120</sup> Jørn Rattso, “The Macroeconomics of India’s 6th Five Year Plan,” *Economic Modelling* 3, no. 4 (October 1986): 273, doi:10.1016/0264-9993(86)90028-3.

<sup>121</sup> “Garibi Hatao” translates to “eradicate poverty” was part of the Congress Party’s platform during the 1971 elections. The premise was to prioritize anti-poverty initiatives as part of an appeal to poor and rural portions of the Indian electorate.

<sup>122</sup> Banerjee and Iyer, “History, Institutions, and Economic Performance: The Legacy of Colonial Land Tenure Systems in India,” 23.

<sup>123</sup> Fernandes, *India’s New Middle Class*, chap. 1.

<sup>124</sup> Matthew McCartney, *India - The Political Economy of Growth, Stagnation and the State, 1951–2007* (London: Routledge, 2009), 163.

capital may not be too costly, in part because the poor were already loyal to her.”<sup>125</sup> More importantly, Gandhi recognized that if the new approach generated economic growth, she could claim ownership of that in future appeals to the poorer parts of the electorate.

To summarize, India’s 6th Five-Year economic plan was starkly different from the plans that preceded it. The plan was not notable for any particular policy, but for being the first official economic plan with hints of economic liberalization. Its muted arrival was not unintentional. The domestic political environment had begun shifting toward less government control. The electorate, with the wealth acquired during the green revolution, was able to vocalize its new prerogatives and make it politically feasible for the prime minister to depart from India’s previous economic trajectory. As consequential as the domestic imperatives were, international influences also helped shape the 6th Five-Year Plan.

## **2. International Influences**

A 2011 CATO Institute paper noted, “There was no Ronald Reagan or Margaret Thatcher in India: reform was a very pragmatic process.”<sup>126</sup> There were no leaders in India who championed free-market economic principles. However, the international consensus on economics was shifting in the 1980s. South Korea had demonstrated the potential benefits of transitioning to a capitalist economy in the 1960s under the leadership of Park Chung Hee. In China, Deng Xiaoping was proving the validity of that model for larger countries.<sup>127</sup> Meanwhile, India’s foreign trade was hamstringed by tariffs and stringent caps on foreign investment. The impact of foreign trade is enmeshed with the domestic influences of the increasingly wealthy Indian population. With its gained wealth, the Indian population voiced their opinions on economic policy to political leaders, creating the phenomenon described in the previous section on the shifting

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<sup>125</sup> Kohli, “Politics of Economic Growth in India, Part I,” 1255.

<sup>126</sup> Swaminathan S. Ankelsaria Aiyar, “The Elephant That Became a Tiger: 20 Years of Economic Reform in India,” Policy Analysis (Washington, DC: CATO Institute, July 20, 2011), 3, <http://www.cato.org/publications/development-policy-analysis/elephant-became-tiger-20-years-economic-reform-india>.

<sup>127</sup> Ibid.

political landscape around economic policy. The purpose of this section is to analyze the foreign sources of India's economic growth during this timeframe, and its impact in shaping domestic economic opinions.

**a. Foreign Sources of Increasing Wealth**

As mentioned earlier, India had a relatively closed economy before and during the green revolution. According to Koichi Fujita, though the initial impacts of the green revolution were noteworthy enough,

it was the second wave that contributed significantly to increased rural incomes and consequently to the economic development of the country overall. During the 1980s, this second wave washed over the whole of India, buoying a large number of individual crops, including rice. The improvement it brought in rural incomes led to an expansion of the market for non-agricultural products and services, bringing in turn rapid development of the non-agricultural sector.<sup>128</sup>

The growth in both agricultural and non-agricultural sectors came from both domestic consumption, which was growing 7.5 percent annually,<sup>129</sup> as well as foreign capital in the form of trade surpluses and foreign direct investment. Foreign trade was highlighted in various parts of the economic plan as key to helping India pursue its economic goals. After a muted start to the plan, foreign exports grew beginning in 1981. More importantly, the variety of exports was increasing, and domestic production of foods and industrial goods were growing fast enough that foreign imports could be reduced.<sup>130</sup> In this case, the narrative of the effects is more illustrative than the percentages. The export/import balances across the economy were being tilted in India's favor as it began exporting agricultural and basic industrial products.<sup>131</sup>

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<sup>128</sup> Koichi Fujita, "The Green Revolution and Its Significance for Economic Development," Working Paper (Tokyo: Japan International Cooperation Agency Research Institute, 2010), 1, [https://jica-ri.jica.go.jp/publication/assets/JICA-RI\\_WP\\_No.17\\_2010.pdf](https://jica-ri.jica.go.jp/publication/assets/JICA-RI_WP_No.17_2010.pdf).

<sup>129</sup> Rattsø, "The Macroeconomics of India's 6th Five Year Plan," 274.

<sup>130</sup> Minoo R. Masani, "India: Problems with the Sixth Five-Year Plan," *Asian Affairs* 6, no. 2 (1978): 97–107.

<sup>131</sup> Planning Commission, "Sixth Five Year Plan 1980–1985: Mid-Term Appraisal" (New Delhi: Government of India, August 1983), 7, [http://planningcommission.gov.in/reports/publications/mta\\_6fyp.pdf](http://planningcommission.gov.in/reports/publications/mta_6fyp.pdf).



Foreign direct investment (FDI) also contributed to India's newfound wealth. FDI in 1976 and 1977 was effectively non-existent and did not begin to rise until the latter half of the green revolution in 1978. At this point, FDI kept increasing from nearly zero to almost \$100M USD in 1981.<sup>132</sup> Prior to 1980, foreign investment in many economic sectors was limited to 40 percent, and often these sectors were only ones that involved sophisticated technology. As a corollary to the 6th Plan, the Industrial Policy Statements of 1980 and 1982 took the position that FDI restrictions discouraged investment, and should be scaled back.<sup>133</sup> The green revolution played an exemplary role; the high-yield variety seeds and crops that Indian institutions had unsuccessfully been trying to develop, were provided by foreign countries and helped save India from famine. FDI, it was argued, "could enhance efficiency by bringing superior technologies and better work practices."<sup>134</sup> Only with a more economically liberal governing regime, could India leverage other countries' comparative advantages to maximize its own.

Unlike the international influencers in the past chapter, the international influences to the 6th Five-Year Plan were much less overt. The correlation between the growing wealth of the Indian population and increased foreign economic entanglement was becoming obvious to politicians and the electorate alike. The domestic influence on shaping the economic policies manifested in the 6th Plan was a channel through which the growing influences of foreign capital made its mark.

### **C. THE 1991 ECONOMIC CRISIS**

The 1980–1991 decade of reforms began with a whimper. A series of policy prescriptions published in the 6th Five-Year Plan laid the unglamorous foundation for the event that closed the decade. The 1991 fiscal crisis in India was, at its heart, a balance of payments crisis. While the 1980s had been an era of relatively higher growth, it was, as described by Chandra, "not a result of any step-up of savings and investment; in many ways it was a result of over-borrowing and over-spending. The growth was both debt led

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<sup>132</sup> "World Bank: World Development Indicators."

<sup>133</sup> Kishor Sharma, "Export Growth in India: Has FDI Played a Role?," Discussion Paper (New Haven, CT: Yale, July 2000), 4, [http://www.econ.yale.edu/growth\\_pdf/cdp816.pdf](http://www.econ.yale.edu/growth_pdf/cdp816.pdf).

<sup>134</sup> *Ibid.*, 5.

and the result of an explosion of domestic budgetary spending.”<sup>135</sup> Though the incremental reforms in the past decade had helped provide the Indian economy a taste of globalization’s benefits, the reforms had not done enough to make India’s import/export balances sustainable. Due to a confluence of various domestic and international factors, India’s foreign debt ballooned in the late 1980s, topping \$80 billion. Servicing the country’s debt began to occupy an pluralistic share of the annual budget, peaking at 35-percent in 1990.<sup>136</sup> Finally, in mid-1991, India found itself without enough currency reserves for its next purchase of essential imports. Fortunately for India, the Prime Minister at the time, Narasimha Rao, and his economic minister, Manmohan Singh, recognized the gravity of the situation and were able to implement expansive reforms to help make the Indian economy more competitive on a global scale.

Before delving into the domestic and international factors that shaped the environment around the 1991 economic crisis, it will be useful to review the policies enacted by Rao and Singh. These policies were tailored to address the factors that played a part in causing the crisis. While the reforms pursued by the minority government of Rao and Singh (under the Indian Congress Party) were dramatic for India, they were modest when compared globally. Nevertheless, they were necessary for the country to adapt to the global economic dynamic. The reforms consisted of a freer moving exchange rate for the Rupee, further liberalizing trade and industrial regulations, curbing the pervasive License Raj, encouraging privatization of state enterprises, further encouraging FDI, and reforming the financial sector to make it less insular. In short, the economic reforms were “an attempt to free the economy from stifling internal controls as well as equip it to participate in the worldwide globalization process to its advantage.”<sup>137</sup>

The Indian economy responded quickly and positively to these changes. Within one year of the reforms, growth of the Gross Domestic Product (GDP) increased from 0.8 percent to 5.3 percent, eventually climbing to 7.5 percent in the following years. Virtually all economic metrics such as FDI, domestic savings, and industrial production

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<sup>135</sup> Chandra, Mukherjee, and Mukherjee, *India after Independence*, 363.

<sup>136</sup> *Ibid.*

<sup>137</sup> *Ibid.*, 366.

simultaneously ticked upward.<sup>138</sup> Again, the narrative that emerges is more telling than the numbers. The Indian economy was becoming more sustainable and self-reliant. It was self-reliant not in the inward looking way as originally envisaged by Nehru, but in that it could generate enough economic growth and demand domestically to sustainably participate in the global market.

Looking back at the crisis, India's response successfully addressed the root cause of the crisis and set up the country to outperform its historical economic growth rates. The specific policies of India's response were a product of the domestic and international environmental factors at the time.

## **1. Domestic Influences**

Domestic politics played an enormous role in the 1991 economic crisis. Crises have the potential to bring opposing political parties together, as was the case in India. Their coalescing typically allows for a united response to the problems at hand. India's response to the 1991 economic crises played out very differently. This section will analyze the domestic political environment as it led up to the 1991 economic crisis, and the unique political environment in 1991 that allowed the sweeping reform package to be enacted.

### ***a. Preceding the Economic Crisis***

The 6th Five-Year Plan was in effect from 1980–1985. As this paper suggested earlier, the plan was driven in part by Indira Gandhi's force of personality. After Indira Gandhi was assassinated in 1984, her son Rajiv Gandhi rode a wave of popular support to an electoral victory in 1985, capturing 76 percent of Parliament's lower house.<sup>139</sup> He continued his mother's reform agenda by delicensing industries, reforming corporate investment regulations, easing tariffs and trade barriers, and restructuring tax laws. More importantly, he penned several critiques of his mother's and grandfather's ISI based

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<sup>138</sup> "World Bank: World Development Indicators."

<sup>139</sup> Varshney, "Mass Politics or Elite Politics?," 239.

economic strategy.<sup>140</sup> Rajiv Gandhi's economic reforms were lauded by the international press but criticized in India's left-leaning domestic newspapers. Despite the domestic pressure, Gandhi was able to use the political capital he earned in the 1984 election to press reforms forward.<sup>141</sup>

Gandhi's political capital did not last indefinitely. His 1986 effort to cut food and fertilizer subsidies galvanized the populist political opposition and even gave dissenting voices in Gandhi's own Congress Party the opportunity to speak out. He gradually lost the political support to continue enacting economic reforms in the wake of events such as the Bofors scandal in 1986 which implicated him of receiving kick-backs from a Swedish arms manufacturer, Gandhi lost the political support to continue enacting economic reforms.<sup>142</sup> Gandhi realized that pushing through the extensive reforms early in his administration had been too abrupt and had undercut his ability to enact reforms later.<sup>143</sup> As described by Chandra, "the major issue of the emerging macroeconomic imbalance, [the] stabilization of the fiscal and balance of payments deficits, was however left unattended, despite the expressed intentions to the contrary."<sup>144</sup> Gandhi was not able to address the country's fiscal imbalances during his tenure due to mounting political opposition. Gandhi and his Congress Party were voted out of power in 1989. Inevitably, an unbalanced fiscal policy, caused the economic crisis a few years later.

1989 to 1990 was a tumultuous period in Indian domestic politics. The defeat of the Congress Party led to the second non-Congress led government in Indian history. The National Front was formed by opposing parties to counter the Congress Party. Despite their unity in opposition to the Congress Party, this period was marked by discontent between the political parties in the National Front; little attention was paid to continuing the economic reforms.

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<sup>140</sup> Ibid., 241.

<sup>141</sup> Ibid., 242.

<sup>142</sup> Chandra, Mukherjee, and Mukherjee, *India after Independence*, 365.

<sup>143</sup> Varshney, "Mass Politics or Elite Politics?," 244.

<sup>144</sup> Chandra, Mukherjee, and Mukherjee, *India after Independence*, 365.

Rajiv Gandhi's early years built on the policy foundations laid by the 6th Five-Year Plan, but they were implemented too fast for their own political sustainability. The second half of his tenure had fewer economic accomplishments. The lull in economic reforms continued during the fraught domestic political environment from 1989 to 1990. Rajiv Gandhi was empowered to enact his reforms by his overwhelming political victory that undercut his political opposition. He was later undone by his own missteps, which helped create a consolidated political opposition. However, the opposition did not stay consolidated for long. The fractious domestic political environment led to Congress returning to power in a multi-polar political landscape.

***b. Domestic Politics During the Crisis***

Rajiv Gandhi was campaigning to reestablish support for the Congress party in the 1991 elections when he was assassinated by Tamil rebels. Congress won the most seats during that election due in part to frustration with the previous National Front government as well as sympathy over Rajiv Gandhi's assassination.<sup>145</sup> This time the political landscape was very different from what the Congress Party encountered in 1985. Instead of the 75 percent majority it held in 1985, the Congress Party only held a plurality of seats in the 1991 government. What Congress had in its favor was an unorganized opposition. As described by Varshney, "by 1990, India's politics had become triangular. Between 1950 and 1990, the principle battle-lines of politics were bipolar. The Congress was the party of government and all other parties were opposed to it. [After 1990], a triangular contest developed between the left, the Hindu nationalists, and the Congress party. Coalitions were increasingly formed against the Hindu nationalists, not against the Congress."<sup>146</sup>

The political opposition was consumed with infighting when the Congress party returned to power in 1991. Under the leadership of Narasimha Rao, Congress formed a minority government and later expanded it to a majority government.<sup>147</sup> This coincided

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<sup>145</sup> Ibid., 291.

<sup>146</sup> Varshney, "Mass Politics or Elite Politics?," 247.

<sup>147</sup> Chandra, Mukherjee, and Mukherjee, *India after Independence*, 291.

with the emerging economic crisis. In mid-1991 India found itself with only 2 weeks' worth of capital to cover the country's imports.<sup>148</sup> Without the economic reforms enacted by Prime Minister Rao and Manmohan Singh, India would have had to default on obligations. Part of the rescue efforts included a loan from the International Monetary Fund (IMF).

The IMF required India to continue the economic reforms that had stagnated since Rajiv Gandhi's administration. A large part of that was cutting the budget deficit, which meant cutting subsidies.<sup>149</sup> The post-crisis reforms continued liberalizing the economy through the country's annual budgets. Whereas the Congress party's political opponents had collaborated to stop the economic reforms in the late 1980s, the situation in the early 1990s was different. Domestic social issues were in the national press; Hindu nationalists in 1992 had destroyed India's oldest and largest mosque, Babri Masjid.<sup>150</sup> Babri Masjid and other instances of domestic violence incited by Hindu nationalists caused other minority political parties to coalesce in opposition to the Bharitya Janata Party (BJP), which was seen as a Hindu nationalist party. For instance, BJP members voted against the 1993 budget proposed by the Congress party, but ended up being the only political party to vote against it. Most other minority parties voted to pass the budget in opposition to the BJP, not necessarily in support of the budget's contents.<sup>151</sup>

Political opposition continued in this vein for the next three years, allowing a Congress-led government to further liberalize the Indian economy. The economic policies were marginally more popular in the 1990s than they were in the 1980s, but the political opposition was distracted by and united against a different threat at the home front. Whereas Rajiv Gandhi enacted his reforms using his political capital, Narasimha Rao and Manmohan Singh enacted their reforms by capitalizing on the fragmentation of opposing domestic influences.

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<sup>148</sup> Ibid.

<sup>149</sup> Atul Kohli, "Politics of Economic Growth in India, 1980–2005: Part II: The 1990s and Beyond," *Economic and Political Weekly* 41, no. 14 (2006): 1363.

<sup>150</sup> Chandra, Mukherjee, and Mukherjee, *India after Independence*, 441.

<sup>151</sup> Varshney, "Mass Politics or Elite Politics?," 248.

## 2. International Influences

International influences were as influential as domestic politics in shaping India's economic reforms. At the peak of the 1991 crisis, India turned to emergency loans from international financial institutions (IFIs) to pay for its trade imbalance. The international influences on India's economic reform came in the form of IFIs demanding structural adjustments to India's economic policies in exchange for assistance.

### a. *Influence of International Financial Institutions*

Economic models for growth in the early to mid-20th century were very different from the ones in the latter half of the 20th century. The policies advocated by IFIs, such as the World Bank, IMF, and World Trade Organization (WTO), are hugely influential around the world. As stated by Nobel prize winning economist Angus Deaton, "There may not be a world government, but there are global institutions... whose policies affect the incomes of people in many countries and whose activities are perhaps sufficiently state-like in their potential to do good and harm."<sup>152</sup> The IFI's conventional wisdom used to dictate that debt crises and balance of payments crises could be resolved by import substitution and other interventionist economic policies.<sup>153</sup> In the post-World War II era, the conventional wisdom began to shift toward a more market-liberal approach to recovering from economic crises.

After World War II, IFIs began to suggest that "opportunities for import substitution were limited, and ties to the world economy had become more varied, complex, and difficult to sever."<sup>154</sup> The IMF in the 1980s started realizing that the causes of economic crises in most developing countries were structural and began requiring a "quid-pro-quo" of economic policy changes in exchange for financial assistance.<sup>155</sup> New policies at the IMF and WTO were driven in part by the countries that funded their

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<sup>152</sup> Angus Deaton, *The Great Escape: Health, Wealth, and the Origins of Inequality*, Kindle Edition (Princeton, NJ: Princeton Univ. Press, 2015), 263.

<sup>153</sup> Stephan Haggard, *Developing Nations and the Politics of Global Integration* (Washington, DC: Brookings Institution, 1995), 19.

<sup>154</sup> *Ibid.*

<sup>155</sup> *Ibid.*, 21.

operations. For instance, the United States' contributions to the IMF currently allots it 16.7 percent of organization's votes.<sup>156</sup> The United States and other European powers began to "strongly champion the IFIs as guardians of conditionality" in the 1980s, thereby defining the conditions India encountered when it approached the IMF for assistance in 1991.<sup>157</sup>

When India sought emergency loans from the IMF it had to immediately transport several tons of gold to Europe to secure the loan.<sup>158</sup> The IMF in return insisted on continued structural economic reforms. The Narasimha Rao-led Congress government leaned on IMF support to help implement the reforms. The IMF and other IFIs demanded rapid privatization of state-run enterprises, reform of regulatory structures, and most importantly, a drastic shift in India's approach toward FDI.<sup>159</sup>

Absent the economic crisis in 1991, Indian politicians would have had to contend with domestic politics to slowly implement reforms. The largest opposition came from the Indian industrialists who felt they would be disadvantaged by having to compete with international companies.<sup>160</sup> While their domestic opposition could have impeded the process of economic reform in the past, the crises transformed the political economy of the country. India's slow path from the 1980s toward liberalizing the economy was accelerated by the exigency of the economic crisis and the structural adjustments demanded by international institutions.

#### **D. CONCLUSION**

The 1980–1991 period was a short portion of India's history, but one that has had a major impact on its economic trajectory. This decade began with a slow departure from the protectionist economic dogma of the past. The process began with a set of domestic factors influencing a change in India's 6th Five-Year Plan, and ended with a series of

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<sup>156</sup> "IMF Members' Quotas and Voting Power, and IMF Board of Governors," *International Monetary Fund*, April 16, 2016, <https://www.imf.org/external/np/sec/memdir/members.aspx#1>.

<sup>157</sup> Haggard, *Developing Nations and the Politics of Global Integration*, 22–24.

<sup>158</sup> Chandra, Mukherjee, and Mukherjee, *India after Independence*, 364.

<sup>159</sup> Haggard, *Developing Nations and the Politics of Global Integration*, 105.

<sup>160</sup> Mukherji, "The Political Economy of India's Economic Reforms," 321.



rapid economic liberalizing actions impelled by a combination of domestic and international pressures.

Domestically, changing perceptions about the effectiveness of the government's license raj and the limits of a state-run economy led to hints of economic liberalization in India's 6th Five-Year Plan. Domestic party politics created an environment that first stifled Rajiv Gandhi's economic reforms, and then enabled his successor to accelerate the pace of reforms. The international influences were borne out of domestic causal factors. Economic reforms from the green revolution increased India's agricultural exports and encouraged investment, leading to an inflow of foreign capital. International factors played a larger role after the 1991 economic crisis. Global financial institutions provided India a fiscal lifeline but required India to resume its economic liberalization.

Overall, this decade demonstrated that India's domestic factors are as effective in shaping the country's political economy as international factors. The inflow of foreign investment and capital was a result of domestic politics and reforms. After the World Bank provided India with liquid capital during the economic crisis, the reforms were still handled through domestic politics, and only informed by the international financial institutions. Though international institutions saved India from defaulting on its payments, the subsequent domestic politics were more directly responsible for shaping India's political economy after the economic crisis.

At the start of this study, the author expected that international norms and institutions would play a larger role in India's political economy as the country joined the global community. Instead, this chapter suggests that India is either equally affected by both domestic and international factors, or that domestic factors are slightly more influential in India's political economy.

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## IV. INDIAN POLITICAL ECONOMY: 1992–2016

### A. 1992–2016 AT A GLANCE

The previous period ended with a dramatic shift in India's political economy and change in the institutional norms on how to manage the Indian economy. The result was an influx of investment from international companies through manufacturing in India or outsourced labor.<sup>161</sup> Indian citizens and the Indian government became wealthier as money flowed into the country. This period saw an acceleration in the growth of the Indian middle class and a change in the occupations that composed it, but also led to an increase in the country's income inequality. India's political economy since 1991 has been largely shaped by these two trends.

### B. GROWTH OF THE INDIAN MIDDLE CLASS

India's middle class has grown at a frenetic pace since the economic crisis of 1991. Defined as the combination of the third and fourth quintiles of India's population based on household income, India's middle class is projected to grow to 520 million people and account for 40 percent of the global middle class by the end of the 21st century.<sup>162</sup> The socio-economic benefits of a robust middle class are well documented; economic scholars such as John Maynard Keynes, Friedrich Hayek, William Easterly, and Gurucharan Das have written about the middle class' role in perpetuating economic growth. A stable middle class spurs increased investment in productive capabilities, leads to higher levels of growth, and compels more effective governance than in societies without a prominent middle class.<sup>163</sup>

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<sup>161</sup> Fernandes, *India's New Middle Class*, chap. 4.

<sup>162</sup> Homi Kharas, "The Emerging Middle Class in Developing Countries," Slideshow (Brookings Institution, June 2011), <http://siteresources.worldbank.org/EXTABCDE/Resources/7455676-1292528456380/7626791-1303141641402/7878676-1306699356046/Parallel-Session-6-Homi-Kharas.pdf>; Eric Beinhocker, Diana Farrell, and Adil Zainulbhai, "Tracking the Growth of India's Middle Class," *McKinsey Quarterly* 3 (2007): 55.

<sup>163</sup> William Easterly, "The Middle Class Consensus and Economic Development," *Journal of Economic Growth* 6, no. 4 (December 2001): 317–35; Nicholas Wapshott, *Keynes Hayek: The Clash That Defined Modern Economics*, Kindle Edition (New York: Norton, 2011); Gurcharan Das, "The India Model," *Foreign Affairs* 85, no. 4 (2006): 2–16.

India's middle class is no different. After being catalyzed by the 1991 economic reforms, the middle class quadrupled in size to 250 million people and enjoyed a nearly three-fold increase in per capita income.<sup>164</sup> Another effect of the 1991 economic reforms was a renewed corporate interest in India with the rise of a massive new potential consumer base. The flow of FDI entering the economy outpaced the existing economic drivers of the civil-service bureaucracy and agricultural sector. As a result, the middle class also shifted its composition from bureaucratic and agriculture based professions to include entrepreneurs and service-sector workers.<sup>165</sup> As the middle class grew, it accumulated wealth and began a transformation into a consumption-based economy. In 2006, over two-thirds of India's GDP was driven by consumption compared to only 30 percent in 1950.<sup>166</sup> This section reviews the domestic and international factors that helped rapidly enrich the Indian population and push them into middle-class status.

India's middle class has also had an impact on the country's politics. India's middle class has politicized religion and ethnicity leading to a growing nationalist sentiment throughout the country.<sup>167</sup> Simultaneously, regional political parties and caste-based politics have become prevalent. Leela Fernandes describes the context of these changes as a "reconstitution of the meaning and boundaries of citizenship" and increased involvement by previously politically disenfranchised groups.<sup>168</sup> Overall, India's political landscape is gaining new players while also seeing influence concentrating along various sub-national causes.

## 1. Domestic Influences

The Indian middle class is largely a product of the domestic political dynamics that resulted from the 1991 economic reforms. The economic reforms impacted the domestic Indian market in two ways. First, regulations on domestic companies were

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<sup>164</sup> Das, "The India Model," 2.

<sup>165</sup> Eswaran Sridharan, "The Growth and Sectoral Composition of India's Middle Class: Its Impact on the Politics of Economic Liberalization.," *India Review* 3, no. 4 (October 2004): 406.

<sup>166</sup> Das, "The India Model," 6.

<sup>167</sup> Fernandes, *India's New Middle Class*, chap. 5.

<sup>168</sup> *Ibid.*

reduced, leading to wealth accumulating within the middle and upper economic classes.<sup>169</sup> Second, increasing levels of wealth changed the consumption patterns of the Indian consumer, providing opportunities for Indians to provide goods and services to their compatriots. Combined, these two domestic factors played a substantial role in the growth of the Indian middle class.

*a. Unburdened Domestic Companies*

The two primary effects of the 1991 economic reforms were the privatization of state owned enterprises and alleviating of licensing requirements. Both these domestic changes had outside impacts on the Indian middle class.

For most of India's history, privately-run companies were seen as potentially harmful to society based on perceptions that they would make the rich richer and poor poorer.<sup>170</sup> The global wave of privatization in the 1990s demonstrated this was not necessarily true. In a 2003 article, economists Nancy Birdsall and John Nellis described the benefits of corporate privatization as "an important element in an overall reform program that leads to higher growth and general job expansion... previously unemployed or poorly paid workers might gain jobs, or better jobs."<sup>171</sup> Privatization of state-owned firms had this same effect in India and thus contributed to the growth of the middle class.

The Indian government divested itself of majority shares in several of its state-owned enterprises (SOEs).<sup>172</sup> The divestments were part of the stipulations from international financial institutions for monetary assistance during the economic crisis. As these firms shifted from public to private ownership, the benefits of privatization were increasingly tangible. Privatized firms experienced 3 percent higher sales, 4 percent higher profit, and a 17 percent higher valuation than comparable firms that remained

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<sup>169</sup> Ibid., 88.

<sup>170</sup> Kohli, *State-Directed Development*, 237.

<sup>171</sup> Nancy Birdsall and John Nellis, "Winners and Losers: Assessing the Distributional Impact of Privatization," *World Development* 31, no. 10 (October 2003): 1622, doi:10.1016/S0305-750X(03)00141-4.

<sup>172</sup> Nandini Gupta, "Selling the Family Silver to Pay the Grocer's Bill?: The Case of Privatization in India," in *Reforms and Economic Transformation in India*, ed. Jagdish N. Bhagwati and Arvind Panagariya, Kindle Edition, Studies in Indian Economic Policies (New York, NY: Oxford University Press, 2013), 2125.

state-owned.<sup>173</sup> More importantly, privatization was not empirically connected to a decline in employment and instead demonstrated a significant increase in employment. According to political economist Nandini Gupta, SOEs eliminated redundant positions as they privatized. However, as the firms became more efficient and grew, new domestic positions were created to enable the firm's growth offsetting earlier job losses and collectively leading to a 38 percent increase in wages paid to employees.<sup>174</sup> Not all SOEs were privatized in the 1990s. Nearly a quarter of previously established SOEs were partially privatized between 1991 and 2009. Regardless of how much equity was transferred to the private sector, the impact of partial privatization compared similarly to the ratios and percentages of SOEs that shifted majority control to private investors.<sup>175</sup> Partly due to this phenomenon, the average income per capita in India has tripled from \$340 USD to \$1,056 USD since 1991.<sup>176</sup> As Indian citizens grow richer, the number of people who qualify as middle-class is projected to increase from 20 percent in 1995 to 41 percent by 2025.<sup>177</sup>

The economic reform package also included reduced licensing requirements for domestic firms. Data from the Centre for Monitoring the Indian Economy shows that the reforms reduced the extensive tariff regime from an average of 350 percent to 150 percent, removed quantitative restrictions on imports and exports, and fully eliminated the public-sector monopoly for imports between 1991 and 1992.<sup>178</sup> Indian businesses flourished under the less restrictive regulatory environment. In the following decade, the number of domestic companies nearly tripled from 3,031 to 8,864.<sup>179</sup> The growth of domestic corporations was not limited to certain sectors, it spanned across the major industries of agriculture, textiles, chemicals, metals, and manufacturing. Furthermore, the

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<sup>173</sup> Ibid., 2146.

<sup>174</sup> Ibid., 2158, 2268.

<sup>175</sup> Birdsall and Nellis, "Winners and Losers"; Gupta, "The Case of Privatization in India."

<sup>176</sup> Values in constant 2005 US\$; "World Bank: World Development Indicators."

<sup>177</sup> Beinhocker, Farrell, and Zainulbhai, "Tracking the Growth of India's Middle Class," 55.

<sup>178</sup> Laura Alfaro and Anusha Chari, "Reforms and the Competitive Environment," in *Reforms and Economic Transformation in India*, ed. Jagdish N. Bhagwati and Arvind Panagariya, Kindle Edition, Studies in Indian Economic Policies (New York, NY: Oxford University Press, 2013), 3151.

<sup>179</sup> Ibid., 3215.

newly established companies were largely successful, indicating sufficient demand in the Indian economy for goods and services. As stated by economists Alfaro and Chari, the firms' "average assets grew in the following two decades... [and] new private firms stand out in terms of the growth rate of their average profits."<sup>180</sup>

***b. Organic Demand in the Indian Economy***

India's liberalized regulations and tariff regime led to an increase in the number and profitability of domestic companies. As the firms expanded, their demand for domestic labor and expertise also grew, leading to increased hiring of domestic labor, specifically in the service sector. From the 1990s to mid-2000s, the service sector grew to account for over 50 percent of India's GDP.<sup>181</sup> More importantly, the increased revenues in the service sector did not increase the size of the middle class as much as they changed its composition. Fernandes describes this phenomenon:

At a structural level, the new middle class is... defined by a change in the status of jobs, which now signify the upper tiers of middle class employment. The socioeconomic boundaries of the new middle class are shaped by this shift in the direction of new middle class employment aspirations. In symbolic terms, the cultural and economic standard for the "old" middle class would have been represented by a job in a state bank or the Indian civil service. Members of the new middle class aspire to jobs in [the service sector].<sup>182</sup>

The 1991 economic reforms were a catalyst for economic growth in India. Domestic firms took advantage of their newfound freedoms and expanded to cater to the expanding Indian market. The growing national economy and increased national wealth spurred domestic consumer demand. Sensing an opportunity, Indians rose to provide goods and services that international companies could not quickly respond to. By spending their accumulated capital, members of the middle class spurred demand

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<sup>180</sup> Ibid., 3238.

<sup>181</sup> Fernandes, *India's New Middle Class*, 1274.

<sup>182</sup> Ibid.

throughout the country.<sup>183</sup> Industries that once only provided goods and services to Indian elites began to serve the increasingly affluent middle class as well. Sufficient domestic demand for goods and services created opportunities for a new group of people who provided goods and services to eventually become part of the statistical middle class as well.<sup>184</sup>

## **2. International Influences**

The 1991 economic reforms made the Indian market more lucrative for foreign firms as well as domestic companies. Chapter III discussed India's first foray into raising FDI limits in the 1980s and the impacts it had on the Indian economy. This section analyzes the effects of FDI on the Indian middle class in the 1990s and 2000s.

### ***a. FDI's Contribution to India's Middle Class***

Historically, India had an industrial licensing system that effectively prevented any private investment in certain sectors of the economy. This system was first relaxed in the 1980s but was not significantly deregulated until the 1990s with "every [subsequent] year seeing further relaxation of restrictions."<sup>185</sup> Multinational corporations quickly recognized the value propositions in India; an English-speaking population with significantly lower labor costs could provide services to the Western world for a low cost. Within ten years, the number of foreign companies in India grew nearly 50 percent from 533 to 748 across every economic sector that saw FDI limits relaxed.<sup>186</sup>

Most multinational companies that came to India were part of the Information Technology (IT) industry. Between 1994 and 2000, the number of foreign IT companies grew at an annual rate of 50 percent and accounted for 2 percent of India's GDP, and 18

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<sup>183</sup> Rajiv Dehejia and Arvind Panagariya, "Services Growth in India: A Look Inside the Black Box," in *Reforms and Economic Transformation in India*, ed. Jagdish N. Bhagwati and Arvind Panagariya, Kindle Edition, Studies in Indian Economic Policies (New York, NY: Oxford University Press, 2013), 1294–1762.

<sup>184</sup> Fernandes, *India's New Middle Class*, 1183.

<sup>185</sup> Baldev Raj Nayar, "Opening up and Openness of Indian Economy," *Economic and Political Weekly* 36, no. 37 (2001): 3534.

<sup>186</sup> Alfaro and Chari, "Reforms and the Competitive Environment," 3215.



percent of its total exports.<sup>187</sup> More importantly, the burgeoning IT sector employed over 650,000 Indians at a median salary 17 percent higher than the second highest paid industry.<sup>188</sup>

Various other industries also benefited from an FDI boom and grew relative to their historical size, leading to a small subset of the Indian population getting wealthier and joining the middle class. However, their impact on the middle class ended up being less significant than initially expected. Atul Kohli describes the post-1991 FDI environment:

The role of [FDI] in India has increased since 1991, though not dramatically. [FDI] has averaged some \$3 billion per annum [from 1991–2015]; it was as high as \$35 billion in 2009, though it declined quite sharply—by as much as a third, to some \$24 billion—in 2010... [These numbers] are small when compared to foreign investment inflows into China during the same period (nearly \$100 billion in 2010). Investment has grown rapidly in India... [but] within this changing economy, indigenous big business houses continue to be the most significant.<sup>189</sup>

Kohli suggests that while FDI-induced economic growth is helpful in driving growth of the middle class, it is not as potent as homegrown investment. Frankel takes a similar approach, saying “the new knowledge-based industries in which India is set to excel—and for which the [1991] reforms vastly multiply our comparative advantage— will not create that [number] of jobs we require.”<sup>190</sup> The narrative of FDI playing a consequential role in the growth of India’s middle class is an easy one to believe. However, the data suggests that while FDI was useful in expanding the middle class in some economic sectors, its impacts were relatively isolated.<sup>191</sup> Instead, domestic demand and investment proved to be more effective in expanding India’s middle class.

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<sup>187</sup> Frankel, *India’s Political Economy 1947–2004*, 785.

<sup>188</sup> Kohli, *Poverty Amid Plenty*, 119.

<sup>189</sup> *Ibid.*, 46.

<sup>190</sup> Frankel, *India’s Political Economy 1947–2004*, 785.

<sup>191</sup> Kohli, *Poverty Amid Plenty*, 118.

### C. INCREASING INCOME INEQUALITY

Collectively, Indian citizens have undoubtedly grown richer since 1991; the country's GDP and per-capita income have grown by over 6 percent annually in the last three decades.<sup>192</sup> As discussed in Chapter III and earlier in this chapter, much of that growth can be attributed to the 1991 economic reforms. However, there are also negative impacts to the country's growing wealth. Kohli describes the situation in India:

Unfortunately, this 'new' India remains a country of numerous poor, illiterate, and unhealthy people... The pro-business tilt of the Indian state [after 1991] is responsible both for the progressive dynamism at the apex and for the failure to include India's numerous excluded groups in the polity and the economy.<sup>193</sup>

Leela Fernandes also applies the growing inequality to its impact on the middle class, saying that the economic success since the 1990s has "reinforced sociocultural distinctions that separate the middle class from the poor and working classes."<sup>194</sup>

Literature on India is full of both data and anecdotal accounts that demonstrate the severe disparities. A 2010 New York Times article highlighted this disproportion when profiling the world's most expensive private residence, a 27-story building in Mumbai that cost \$1 billion to build. The building stands amidst one of Asia's largest slums, housing over one million people, in a city where over 60 percent of the population lives in poverty.<sup>195</sup> The economic disparities span multiple dimensions. Inequality has manifested itself across India's geographic regions, urban versus rural divide, and class lines.<sup>196</sup>

Economic inequality across India's regions and states is evident when comparing their annualized GDP growth over the past 20 years. India's five poorest states (Assam, Bihar, Madhya Pradesh, Orissa, and Uttar Pradesh) grew at an average annual rate of 4.7

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<sup>192</sup> Ibid., 79.

<sup>193</sup> Ibid., 1.

<sup>194</sup> Fernandes, *India's New Middle Class*, 2584.

<sup>195</sup> Jim Yardley, "Soaring Above India's Poverty, a 27-Story Home," *The New York Times*, October 28, 2010, <http://www.nytimes.com/2010/10/29/world/asia/29mumbai.html>.

<sup>196</sup> Kohli, *Poverty Amid Plenty*, 121.

percent, but the five richest states (Gujarat, Haryana, Maharashtra, Punjab, and Tamil Nadu) grew 1.5 times faster.<sup>197</sup> Furthermore, the population of poorer Indian states tends to be higher. Per India's 2011 census, the population of India's five richest states has grown 84 percent in the preceding decade, and accounts for 25 percent of India's total population. However, the population of the five poorest states has nearly doubled in the same period and now accounts for 38 percent of India's total population.<sup>198</sup> Overlaying the economic and population metrics reveals that rich states are getting wealthier, but the population growth is occurring in the poor states.<sup>199</sup> This is captured in the per capita incomes of the states. In 1991, the per capita income of India's poorest state, Bihar, was one-third of the per capita income in India's richest state, Maharashtra. Since 1991, Bihar's per capita income has fallen to 25 percent of Maharashtra's.<sup>200</sup>

The existence of severe levels of income inequality in India is difficult to refute. It has been an unexpected by-product of the same economic reforms that enriched different subsets of the Indian population. This section will analyze domestic and international dynamics which factor into the India's increasing economic inequality.

## **1. Domestic Influences**

India's growing income inequalities can be attributed to two predominant causal factors. First, there is significant regional diversity across India on approaches toward economic growth. Second, the poorer electorate's preference for alleviating the symptoms of economic inequalities instead of the root causes.

### ***a. Regional Diversity***

India's national elections in 2014 were dominated by economic concerns. At the root of Narendra Modi's overwhelming win was his record of achieving economic

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<sup>197</sup> "Regional Economic Indicators," *IndiaStat*, n.d., <http://indiastat.com/economy>.

<sup>198</sup> "2011 Census," *Census of India*, 2011, <http://censusindia.gov.in>.

<sup>199</sup> Kohli, *Poverty Amid Plenty*, 123.

<sup>200</sup> *Ibid.*

successes in his home state of Gujarat.<sup>201</sup> Underlying the economic policies were somewhat market-liberal policies that enabled easy access to permits and licenses, quick environmental clearances for incoming investments, and more efficient governance by government agencies and their civil servants.<sup>202</sup> The business-friendly approach led Gujarat to the nation's fastest GDP and job growth and earned his economic policies the colloquial nickname, "Modinomics."<sup>203</sup> Similar economic policies can be found in all of India's fastest growing states and are critical to understanding the growing regional inequality throughout India.<sup>204</sup>

In contrast to Gujarat's Modinomics, India's poorest states tend to have less efficient governing institutions and their policies have a decidedly neo-patrimonial tilt. Politics in these states are driven by personalities and often result in a poor investment climate.<sup>205</sup> In these states, such as Bihar, Orissa, and Madhya Pradesh, the poorest parts of the electorate have far fewer economic opportunities available but their numbers afford them recognition by politicians. Instead of pursuing policies that would spur economic growth, politicians readily appeal to class, caste, and regional nationalism.<sup>206</sup> Political leaders in India's lesser performing states aim government resources at redistributive efforts such as food and fuel subsidies, welfare programs, and anti-capitalist/elitist sentiments. Kohli describes the net result of this approach to governance as:

With the state's political class focused on everything but the state's development, a variety of socioeconomic problems continue to accumulate: poor infrastructure; the decay of major public institutions, including universities; the deterioration of law and order; and widespread corruption. This is not a context conducive to attracting private investment.<sup>207</sup>

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<sup>201</sup> Eswaran Sridharan, "Behind Modi's Victory," *Journal of Democracy* 25, no. 4 (2014): 20–33, doi:10.1353/jod.2014.0068.

<sup>202</sup> "The Gujarat Model," *The Economist*, January 10, 2015, <http://www.economist.com/news/finance-and-economics/21638147-how-modi-nomics-was-forged-one-indias-most-business-friendly-states>.

<sup>203</sup> Ibid.

<sup>204</sup> Kohli, *Poverty Amid Plenty*, pt. 3.

<sup>205</sup> Ibid., 154.

<sup>206</sup> Rudolph and Rudolph, *In Pursuit of Lakshmi*, 219; Kohli, *Poverty Amid Plenty*, 158.

<sup>207</sup> Kohli, *Poverty Amid Plenty*, 178.

The implication, as suggested by patterns in the demographic and economic data, is that rich states grow their economies faster than poor states due to more comprehensive pro-business policies. For instance, politicians in Gujarat have prioritized industrialization and pro-industry policies, leading to a developmental-state type atmosphere that has enriched its population.<sup>208</sup>

On the other hand, poorer states with weaker governing institutions focus on state-led economic growth, a model richer states have moved away from. Furthermore, their policies are less cohesive. West Bengal, for example, has publicized its goals to be an “investor-friendly climate”<sup>209</sup> while simultaneously pursuing policies that deter private investment such as land reform, which returned parcels of land to peasant farmers for agricultural use; faltering investment in educational and medical infrastructure; and adopting government policies based on the preferences of rent-seeking political elites.<sup>210</sup>

Corruption and rent-seeking practices are another measure of regional diversity in economic policies. The same business-friendly approaches that are credited for catapulting economic growth in states such as Gujarat and Maharashtra are also potential threats to the region’s political elites. Jennifer Bussell suggests that economic reform poses a risk to corrupt elites by threatening the “corrupt income derived from manipulation of state institutions.”<sup>211</sup> Reducing corruption is a corollary to economic reforms in India. The states that benefit most from pro-business policies and economic reforms are the same ones that can overcome opposition from local and regional elites.

***b. Focus on Direct Poverty Alleviation***

The politics in India’s poorer states accentuate the growing income inequality through policies that are geared toward placating the electorate and “direct” versus

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<sup>208</sup> Ibid., 185–190.

<sup>209</sup> Ibid., 206.

<sup>210</sup> Ashutosh Varshney, *Battles Half Won: India’s Improbable Democracy* (New Delhi: Penguin Books, 2013), chap. 9.

<sup>211</sup> Jennifer Bussell, *Corruption and Reform in India: Public Services in the Digital Age* (Cambridge: Cambridge University Press, 2012), 3.

“indirect” measures for poverty alleviation.<sup>212</sup> Direct measures are government initiatives that aim to directly reduce the symptoms of poverty and are characterized by “income transfers” to poorer electorates.<sup>213</sup> Direct measures can include programs such as government-sponsored employment programs, subsidies on consumer staples, and land reforms that transfer ownership to the poor. Indirect measures are aimed towards changing the economic environment to foster private investment and perpetuating economic growth. India has a long history of applying direct measures in efforts to reduce poverty across the nation. Direct measures had mixed results and the conventional wisdom has evolved toward market liberalization to achieve economic growth. Poorer states in India apply direct measures to lower their economic inequalities with higher frequency than India’s richer states; direct measures are less effective in resolving the causal factors of economic inequality.<sup>214</sup>

Politicians in India’s poorer states are partly forced to adopt direct measures due to their electorates. As explained by Varshney, “direct methods have clearly comprehensible and demonstrable short-run linkages with the well-being of the poor... [whereas] the impact of indirect methods on poverty is not so immediate.”<sup>215</sup> Democratically elected politicians in poor areas are limited by their electorate’s affinity for welfare programs. The poor electorate is often comprised of multiple ethnic, religious, or caste-based subgroups. These “demand groups” regularly spawn their own political leaders who rise to power by dividing the poor electorate into groups.<sup>216</sup> Upon gaining power, their largest political threats come from leaders of other minority groups. Therefore, the incentive of political leaders is to mollify their own electorate in the short-term, ensuring their continued electoral loyalty. Direct measures to address poverty

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<sup>212</sup> Ibid., 269.

<sup>213</sup> Ibid.

<sup>214</sup> Frankel, *India’s Political Economy 1947–2004*, chap. 14.

<sup>215</sup> Varshney, *Battles Half Won*, 270.

<sup>216</sup> Rudolph and Rudolph, *In Pursuit of Lakshmi*, chap. 9.

accomplish this task far more effectively than indirect measures that may take years to produce economic benefits.<sup>217</sup>

The combination of regional diversity in terms of economic policies and short-term measures aimed at reducing poverty are the two strongest domestic factors in India's growing income inequality. However, international trends also play a role in shaping India's economic disparities.

## **2. International Influences**

Richard Florida's "The World is Spiky" challenges the paradigm that globalization has made innovation and economic growth accessible to everyone throughout the world.<sup>218</sup> Instead, Florida suggests that the effects of globalization are compartmentalized in parts of the world due to the country's demographic dispositions and comparative advantages. The effects of globalization are similarly concentrated within countries like India.

### ***a. Localized Globalization***

This thesis has catalogued the historically restrictive trade and economic policies that impacted India's political economy. Many of these policies have been rolled back or repealed in the past three decades and the impacts have been profound for the Indian economy. One of India's recent progression toward a market-liberal economy is the creation of special economic zones (SEZ) which draw in dozens of multi-national companies due to more liberal economic laws than the rest of India.

India's SEZ policy was created in the 1960s but gained momentum in 2000 when India partly reformed its legal framework. The result was a program similar to one that is credited for sparking China's economic boom in the 1980s and 1990s.<sup>219</sup> The SEZ policy is credited with bringing nearly \$15 billion USD of investment into India, and creating

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<sup>217</sup> Varshney, *Battles Half Won*, chap. 9; Rudolph and Rudolph, *In Pursuit of Lakshmi*, chap. 10.

<sup>218</sup> Florida, "The World Is Spiky."

<sup>219</sup> Aradhna Aggarwal, "Special Economic Zones: Revisiting the Policy Debate," *Economic and Political Weekly* 41, no. 43/44 (2006): 4533.

over 500,000 jobs between 2000 and 2007.<sup>220</sup> Despite the large numbers, the quantitative benefit of the zone was minor at the national aggregate level. More importantly, SEZs launched a wave of international companies establishing a corporate presence in India. There were 212 SEZs established in India from the 1960s to 2006, the bulk of which formed after 2000. In the decade since 2006, the number of unique SEZs has grown to nearly 1,000 across 13 Indian states.<sup>221</sup>

International companies established in India and hired large numbers of Indian workers, effectively creating a constituency that directly benefited from an expanding SEZ policy. International companies have used their footholds in India's SEZs to lobby politicians such as Sonia Gandhi for similarly relaxed economic policies and additional SEZs.<sup>222</sup> Opposing parties argue that any new SEZ will have to be built on farmland, weakening India's food security and displacing large numbers of farmers and local villages. Furthermore, critics argue that international companies will be best positioned to capitalize on the opportunity, resulting in unpredictable and uneven growth for Indian companies.

The impact of the SEZs has been very localized benefits to India's political economy. The residents and employees in SEZs, such as Cyber City outside New Delhi, are largely in favor of the program, but there is less appreciation for the program in parts of the country not working with an SEZ. The local economies of SEZs throughout India have displayed symptoms reminiscent of the resource curse, leading to high valuations of labor in industries represented by the SEZ but low wages and employment opportunities for those in other professions.<sup>223</sup> Farmers are usually the most disadvantaged by SEZs and have launched many successful efforts to resist new SEZs throughout India, arguing that India is not legally allowed to seize private property to advantage international

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<sup>220</sup> Ibid.

<sup>221</sup> "Fact Sheet on Special Economic Zones," *SEZ India*, accessed May 24, 2016, <http://www.sezindia.nic.in/writereaddata/pdf/factsheet.pdf>.

<sup>222</sup> Aggarwal, "Special Economic Zones: Revisiting the Policy Debate," 4535.

<sup>223</sup> Michael Levien, "Special Economic Zones and Accumulation by Dispossession in India," *Journal of Agrarian Change* 11, no. 4 (2011): 454–83.



companies. The result has been a series of legal battles challenging the efforts of international companies to globalize small portions of India.<sup>224</sup>

#### **D. CONCLUSION**

The post economic reform period in India's history is marked by a series of steps toward continued economic liberalization and an increasingly wealth population. However, the growing wealth has been limited to certain sectors of the population and is spread disproportionately around the country. Both hallmarks of this period's political economy, increasing wealth and inequality, have been shaped by domestic and international factors. The growing wealth and size of India's middle class has been impacted by the growth of domestic companies just as much as it has by foreign investment in India, if not more so. The indigenous demand for goods and services within India has allowed Indian companies and entrepreneurs to leverage the country's massive internal market to both enrich themselves and bring new products and technologies to their compatriots. The wealth generated by Indian and international companies within India has disproportionately benefited the people and regions who were best suited to capitalize on the new economic dynamics. Regional diversity, an electorate focused on the symptoms of poverty instead of causes, and localized globalization driven by India's special economic zones have contributed to the country's increasing income inequality.

Interestingly, India's political economy has become more reliant on domestic factors than international as the country has become more globalized and politically and economically interconnected. Chapter III of this thesis assessed that even the most notable international influences to India's economy can be traced back to domestic causal factors. FDI played a role in growing India's middle class, but a relatively minor one compared to the domestic demand for goods and services or the growth of Indian companies. Localized globalization through the Special Economic Zones has a noticeable impact, but is derived from variations in domestic economic policy.

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<sup>224</sup> Ibid., 455.

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## V. CONCLUSION

The political economy of any country is constantly in flux. As is the case in India, domestic and international factors sway the economic policies the country's government undertakes. While researching how domestic and international factors affected India's political economy, the author expected that international factors would be increasingly important to India's economic posture. This was based on an assumption that as India's economy globalized, international market forces would force India to quickly liberalize its economy to the same levels as Western markets in Europe or the United States. Instead, India has retained control over its economic policies while also joining the global market economy. As mentioned in the conclusions for Chapters III and IV, even the most impactful international influences to India's economy can be directly traced back to causal factors borne out of domestic pressures.

The strength of India's domestic factors in shaping its economic policies was not apparent immediately after independence. Chapter II discussed India's economy policies from 1947 to 1979, a period where the two major events were both seemingly ripe for domestic factors to hold sway. Instead, India's industrial policies seem to have been equally motivated by domestic leaders' ideologies as well as international norms that suggested protectionist policies such as ISI. The green revolution was also equally impacted by domestic and international factors. India's domestic agriculture policies were important, but appear to have been vulnerable to international factors such as wars, food aid, and agricultural imports controlled by other countries.

Perhaps India's leaders realized they were susceptible to international forces, a concept that Jawaharlal Nehru was staunchly opposed to. The two following economic periods, discussed in Chapters III and IV, demonstrated that no matter the nature of major events in India's economic history, domestic factors played a noticeably larger role in shaping their outcomes. The 6th Five-Year Plan, 1991 economic crisis, growth of India's middle class, and increasing income inequality were all shaped by domestic politics and causal factors more heavily than international ones. Despite its increasing exposure to

global markets, trade, and politics, India retained much more autonomy over its economy than the author expected.

One answer seems most persuasive when exploring why India was able to maintain economic sovereignty to the degree it did. As discussed in Chapter I, India is currently the world's second most populous country, and expected to be the most populous country within a decade.<sup>225</sup> Additionally, the country's growing GDP gives it the leverage to attract foreign capital and investment due to its large domestic market and dictate economic policies on its own terms.<sup>226</sup> Global trends and norms might tilt India, but the country has the population and economic potential to move in whichever direction it chooses; a power that India exercises with increasing frequency. In retrospect, this is not the first historical example of a country leveraging its size to dictate its own economic trajectory. China's exponential economic growth followed the same basic formula and invalidated countless predictions that it would have to fully liberalize its economy in order to sustain economic growth.<sup>227</sup> The question that remains is whether having a massive population and lucrative economic potential is a useful tool or an economic crutch for India's economy. Unfortunately, China's example has not yet provided a clear answer to this question, but India's example provides arguments for it being both a tool and a crutch.

India's current prime minister, Narendra Modi, launched his flagship economic development program "Make in India" upon taking office in 2014.<sup>228</sup> The program was designed to recruit foreign companies to manufacture their products in India through a carrot-and-stick based approach. Companies were enticed to manufacture their products in India through the increase of SEZs, potential tax and tariff benefits, and by easier access to hundreds of millions of Indian consumers.<sup>229</sup> If that were not enough, international companies are coerced into manufacturing in India through import tariffs as

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<sup>225</sup> Lagarde, "Seizing India's Moment."

<sup>226</sup> Beinhocker, Farrell, and Zainulbhai, "Tracking the Growth of India's Middle Class."

<sup>227</sup> Kissinger, *On China*, chap. 4.

<sup>228</sup> Sridharan, "Behind Modi's Victory."

<sup>229</sup> Aggarwal, "Special Economic Zones: Revisiting the Policy Debate"; "The Gujarat Model."

high as 300 percent.<sup>230</sup> The policy appears to be working: the electronics giant, Apple, is supplementing production of its iPhones with a factory in India largely for easier access to the lucrative Indian consumer market.<sup>231</sup>

There are also potential risks to leveraging India's population in order to dictate economic policies. The Indian consumer's purchasing power is high in the aggregate but relatively low on a per-capita basis when compared globally.<sup>232</sup> Companies with more expensive products may be dis-incentivized to manufacturing in India if the potential for lower tariffs and lower prices will not be help it appeal to enough Indian consumers. In situations such as this, Indian consumers who do seek out these products will be forced to higher prices than consumers around the world. Furthermore, there is the normative debate about if fully liberalized economies are better for economic growth than market economies that also have government intervention; this revisits the neo-classical economics arguments between Adam Smith and Friedrich Hayek, which is discussed in Chapter I.

Looking at the history of India's political economy reveals a country that is increasingly shaping its economic policies on its own terms, and leaving less room for international influence. India's economy will be the country's most effective tool for projecting power in the 21st century. Economics impels India's ability to modernize its military, support human rights around the world, ease tensions between India and its rival neighbors, and lift millions of its citizens out of poverty. India's economic growth is becoming a defining aspect of the global economy in the 21st century with implications for companies and governments throughout the world.

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<sup>230</sup> "Make In India: Foreign Direct Investment," *Make In India*, accessed February 19, 2016, <http://www.makeinindia.com/policy/foreign-direct-investment>.

<sup>231</sup> Rajesh Roy and Newley Purnell, "Why It Could Be a While Before Apple Can Open Stores in India," *Wall Street Journal*, May 27, 2016, sec. World, <http://wsj.com/indiarealtime/2016/05/27/why-it-could-be-a-while-before-apple-can-open-stores-in-india/>.

<sup>232</sup> Beinhocker, Farrell, and Zainulbhai, "Tracking the Growth of India's Middle Class."

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