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India's economic development since independence

An interpretative survey

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Abstract: When India became a republic in 1950, the economy was primarily agrarian, with three-fifths of output originating from agriculture. In the sixty years since independence, there has been a significant transformation of economic activity away from agriculture, with less than one-fifth of output now originating from agriculture and the rest from manufacturing and services. Since the 1980s, along with structural change, there has been strong economic growth, till 2010, followed by a period of declining growth. In this paper, we describe India's economic foundation, paying particular interest to the processes of economic growth and structural change. We begin with a brief discussion of the patterns of growth and structural change since independence. We then discuss the economic policies that have underpinned India's economic development. Next, we discuss the evolution of the three main economic sectors—agriculture, industry, and services. We then provide a summary of India's regional performance. We end with a discussion of India's economic performance in the post-2014 period.

Key words: economic growth, structural change, economic policy, India

JEL classification: O10, O53, P27

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1 Introduction

India went through two very different growth phases in the first half of the twentieth century, prior to independence. In the first period, up to 1914, global trade increased to unprecedented levels due to dramatically decreasing transport costs and the ‘common currency’ effect of the gold standard (Findlay and O’Rourke 2007). During this period, India had a liberal trade regime imposed on it by its colonial master, the British. In this period, India benefited from increased integration with a Europe-centred world economy (Roy 2011). In the second period, 1914–47, following the outbreak of the First World War and leading up to the Great Depression, transport costs started rising, the gold standard was on the demise and protectionism was on the increase. This led to a phase that the economic historians Findlay and O’Rourke describe as ‘deglobalization’ as world trade volumes collapsed. India, with its dependence on the world economy for its growth impulse in the colonial period, suffered a protracted stagnation in standards of living.

By the end of the colonial period, there had been a marked intensification of poverty, as agricultural production stagnated and there was a collapse of artisanal industry (Roy 2011). There were pockets of growth, however, in trade and large-scale industry, especially textiles. Much of the growth in the economy occurred in regions favoured by colonial investments in irrigation and infrastructure, and the economy was unbalanced, both spatially and sectorally, at the time of independence.

2 Growth and structural change in the Indian economy

In this section, we set out the ‘stylised facts’ of India’s economic development. We begin with an overview of India’s record in economic growth, and then move on to a description of the process of structural change in the economy.

2.1 Economic growth

After a long period of stagnation, especially from the mid-1960s to the late 1970s, GDP (gross domestic product) per capita started rising in the late 1970s, and has kept on steadily increasing over the last two decades of the twentieth century and in to the first decade of the twenty-first century. This is a remarkable achievement in terms of increases in average standards of living, and one paralleled by few other countries in the same period, except for China. However, the process of economic growth has not been balanced, at least across the major sectors of the economy—agriculture, manufacturing and services. The average annual rate of economic growth accelerated from 2.9 per cent in 1965–79 to 5.8 per cent in 1980–90. This was mostly due to an increase in the rates of growth of the service sector (which rose from an annual average of 4.3 per cent in 1965–79 to 6.5 per cent in 1980–90), and the manufacturing sector (which grew from an annual average of 4.1 per cent in 1965–79 to 6.9 per cent in 1980–90). In the post 2000 period, the annual average rate of economic growth was 6.9 per cent in 2000–01 to 2010–11 and 5.4 per cent in 2011–12 to 2021–22, in large measure due to very strong growth in the service sector (7.0 per cent annually over this period). By contrast, the annual average rate of growth of the agricultural sector has been around 3 per cent over 1991–2021. Since the early 1980s agriculture has been the laggard in economic growth in India.

2.2 Structural change

There has been significant change in the structure of the Indian economy in the six decades since independence. Whereas in 1955, agriculture comprised 57 per cent of output, in 2021, it comprised

a mere 15 per cent. While in 1955, manufacturing comprised 9.9 per cent of output, in 2021, it was 18 per cent. This was mostly due to the growth in the output of the organised or formal manufacturing sector, from 4.9 per cent in 1955 to 11.2 per cent in 2012. Perhaps the most remarkable feature of the Indian economy's structural change has been the increase in the share of the service sector—from 19 per cent of GDP in 1955 to 54 per cent in 2021. It is well known that India's pattern of economic development has been atypical, in that the service sector has comprised a far higher share of economic activity than should have been the case, given India's level of per capita income (Sen 2008).

3 Economic policies

The economic policy of a nation is crucial in understanding its economic foundation. This is particularly true for a country like India where a highly interventionist government has followed a complex set of economic policies in a wide variety of areas and sectors since independence. In this section, we provide an introduction to the macroeconomic, trade, industrial and financial sector policies prevailing in India since independence.

3.1 Macroeconomic policy

One of the key features of India's post-independence economic policy until the mid-seventies was the strong emphasis on maintaining a conservative stance with respect to monetary and fiscal policy. Unlike many other developing countries, the Indian government kept a tight rein on the budget deficit and its monetization during this period. From the mid-1970s, there was, however, a gradual erosion of fiscal conservatism resulting in a steady increase in the fiscal deficit. This remarkable shift in fiscal policy stance can be traced to the changing political economy of the country, as socio-economic groups (such as public sector workers, small-scale industrialists and medium and large farmers) that were dormant in the past began to be increasingly assertive and asked for a greater share of government subsidies. At the same time, with the weakening of political power at the centre, the Indian state became increasingly populist as it resorted to settle the claims of various 'pressure-groups' through the budgetary process. The increasing fiscal deficits of the central government were an important contributing factor behind the severe balance-of-payment crisis of 1991. Since 1991, the Indian government has attempted to keep the fiscal deficit under control, with varying degree of success.

The expansionary fiscal policies coupled with the limited measures to liberalise the economy in the mid-1980s contributed to a discernible increase in output (GDP) growth in the economy from the early 1980s. This growth momentum, however, turned out to be unsustainable as the widening budget deficit and rapid increase in imports unmatched by export growth soon began to be reflected in a widening current account deficit. Despite rapid increase in inward remittances by expatriate Indians, the widening current account deficit began to reflect a rapid erosion in the nation's external reserve position. The situation was aggravated by the abrupt fall in remittance inflows and oil price increases caused by the Gulf War leading to the mid-1991 balance-of-payments crisis. The crisis proved to be the harbinger of a significant structural adjustment-cum-liberalization reform implemented under the supervision of the IMF.

The crisis led to a temporary decline in GDP growth in 1991 and 1992. Since then there has been a rebound of the economy, with annual growth rates comparable to or ever higher than those of the 1980s. The average annual growth rate during 1993–99 was 6 per cent compared to 5.5 per cent for the 1980s.

As a consequence of expansionary macroeconomic policy the rate of inflation witnessed an upsurge in the 1980s. The annual rate of inflation (measured by the GDP deflator) in the 1980s was 6 per cent, up from less than 3 per cent in the 1970s. Inflation peaked at over 10 per cent during the 1991 crisis, but has subsequently come down, falling below 8 per cent since 1995. This was primarily the result of monetary tightening but also of a freeze on all administered prices including food and fuel. Despite declared policy commitments, the government has not been able to achieve the fiscal consolidation required for successfully combining sustained rapid growth with low inflation. The very small improvement in the fiscal deficit since 1991 has been achieved by a fall in public investment, rather than through broadening the revenue base or pruning current expenditure. Continued reliance on tight monetary policy on inflationary consideration at a time when the budget deficit is running high continues to thwart long-run growth through continuing high interest rates. Moreover the reliance on cuts in public investment expenditure for want of reducing the budget deficit has not led to the provision of infrastructure needed for rapid growth under the market-oriented policy reforms (Joshi and Little 1997).

3.2 Trade policy

From the mid-1950s till the late 1970s, India had a highly restrictive trade regime. Nearly all imports were subject to discretionary import licensing or were channelled by government monopoly trading organizations. The only exceptions were commodities listed in the Open General Licence (OGL) category. Capital goods were divided into a restricted category and the OGL category. While import licences were required for restricted capital goods, those in the OGL could be imported without a licence subject to several conditions. The most important of these were that the importing firm had to be the 'actual user' of the equipment and could not sell the latter for five years without the permission of the licensing authorities and that the resulting change in capacity must be compatible with the capacity approved by the industrial licensing authorities. Intermediate goods were divided into the banned, restricted and limited permissible categories plus an OGL category. As these names suggest, the first three lists were in order of import licensing stringency. OGL imports of intermediate goods were also governed by the 'actual user' condition. The import of consumer goods was, however, banned (except those which were considered 'essential' and could only be imported by the designated government canalising agencies).

Beginning with the export–import policy of 1977, there was a slow but sustained relaxation of import controls. Several capital goods, which until then remained under stringent import licensing, were steadily shifted to the OGL category. These changes were made with the intention of allowing domestic industries to modernize and OGL status was usually accompanied by reduced customs tariff rates. Moreover, during the 1980s the import licensing of capital goods in the restricted list was administered with less stringency. In the case of intermediate goods too, there was a steady shift of items from the restricted and limited permissible categories to the OGL category. However, in the case of both capital and intermediate goods, in most cases these goods were placed in the OGL list if they were not being domestically produced. Thus, import liberalization during this period may not have led to immediate direct competition to established producers of intermediate and capital goods in India (though in several instances, the goods that were allowed to be imported were imperfect substitutes of domestically produced goods). Furthermore, the average effective tariff rate for capital goods increased from 37 per cent in 1973 to 63 per cent in 1988. Also, consumer goods remained on the banned list for the entire duration of the 1970s and 1980s. Like imports, exports were also subject to an elaborate licensing regime. There were goods whose export was 'not allowed', goods whose exports were considered on a case-by-case basis, goods whose export was allowed within an export quota announced and allocated each year, goods whose export was canalised, and goods on the OGL list that could be exported subject to prescribed conditions.

The pace of the trade reforms—in particular, the shift from quantitative import controls to a protective system based on tariffs—initiated in the mid-1970s was considerably quickened by the new government (led by Rajiv Gandhi) that came into power in November 1985. Also, beginning in the mid-1980s, there was a renewed emphasis by the new administration on export promotion. The number and value of incentives offered to exporters were increased and their administration streamlined. Export licensing was also not generally implemented in a manner that became a significant deterrent to exports.

In 1991, as a part of the structural adjustment programme, quotas on the imports of most machinery and equipment and manufactured intermediate goods were removed. Furthermore, the ‘actual user’ criterion for the imports of capital and intermediate goods was removed. There was also a significant cut in tariff rates, with the peak tariff rate reduced from 300 per cent to 150 per cent and the peak duty on capital goods cut to 80 per cent. There was, however, little change in trade policy with respect to consumer goods, which remained on the ‘negative’ (banned) list. After the 1990s, consumer goods industries, which continued to benefit from these continuing import bans, accounted for over 40 per cent of domestic manufacturing value added (Joshi and Little 1997).

3.3 Industrial policy

The two key components of the regulatory framework were the Industries (Development and Regulation) Act of 1951 and the Industrial Policy Resolution of 1956. The first piece of legislation introduced the system of licensing for private industry. The licensing system governed almost all aspects of firm behaviour in the industrial sector, controlling not only entry into an industry and expansion of capacity, but also technology, output mix, capacity location and import content. The principal aim of this Act was to channel investments in the industrial sector in ‘socially desirable directions’. The Industrial Policy Resolution classified industries into three categories, based on the role the state was expected to play in each category. The divisions were: a) industries in Schedule A, mostly public utilities, basic and strategic industries, which were exclusively reserved for the state to develop; b) industries listed in Schedule B, mostly heavy industries that were to be progressively owned by the state but private firms were also allowed to enter; and c) industries outside the Schedules A and B which were open to private firms.

The system of controls was reinforced in the 1970s with the introduction of the Monopolies and Restrictive Trade Practices (MRTP) Act in 1970 and the Foreign Exchange Regulation Act (FERA) in 1973. The MRTP Act stipulated that all large firms (those with a capital base of over Rs.200 lakhs) were permitted to enter only selected industries and that too on a case-by-case basis. In addition to industrial licensing, all investment proposals by these firms required separate approvals from the government. The FERA provided the regulatory framework for commercial and manufacturing activities of branches of foreign companies in India and Indian joint-stock companies with a foreign equity holding of over 40 per cent. The act specified a list of industries where such firms would be allowed to operate and all new investments and substantial expansions required separate approval from the government.

The industrial licensing system in conjunction with the import licensing regime led to the elimination of the possibility of competition, both foreign and domestic, ‘in any meaningful sense of the term’ (Bhagwati and Desai 1970: 272). As it became increasingly complex over time, it led to ‘a wasteful misallocation of investible resources among alternative industries and also accentuated the under-utilization of resources within these industries’ (Bhagwati and Srinivasan 1975: 191) thus, contributing to high levels of inefficiency in the industrial sector. As Bhagwati (1993: 50) pointed out, ‘the industrial-cum-licensing system ... had degenerated into a series of arbitrary, indeed inherently arbitrary, decisions where, for instance, one activity would be chosen

over another simply because the administering bureaucrats were so empowered, and indeed obligated, to choose’.

In the mid-1980s, there were some half-hearted liberalization measures such as the dilution of licensing requirements as regards entry and expansion of capacity. The list of industries open to large firms was also extended and the asset threshold above which firms were subject to monopoly regulation raised. Substantial deregulation occurred in 1991 with the industrial licensing system abolished altogether, except for a select list of environmentally sensitive industries (Mookherjee 1995). Sections of the MRTP Act that restricted growth or merger of large business houses were eliminated. The list of industries reserved for the public sector was reduced from seventeen to six and private investment actively solicited in the infrastructural sector. Foreign ownership up to a certain limit was ‘automatically’ approved for a wide range of industries deemed to be of national importance. Therefore, the policy regime since 1991 provided a far more conducive environment for private-sector firms to diversify and grow (Panagariya 2008). However, certain aspects of the old regulatory framework remained in place, in particular, labour laws that prohibit firms over a certain size from firing workers who have been in employment with the firm for more than one year, and bankruptcy procedures that do not allow firms to liquidate their assets easily.

3.4 Financial sector policy

In the 1950s and 1960s, the Indian financial sector operated in a fairly liberal environment. This period saw the consolidation of the Reserve Bank of India (RBI) in its role as the agency in charge of the supervision and control of banks. An important feature of the banking sector during the period 1951–68 was that a large proportion of bank credit went to the industrial sector and, within it, to the large borrowers, with the agricultural sector getting a little over 2 per cent of bank credit. Thus, there was a growing realization among Indian policy-makers that there was a need for extensive social control of the Indian banking system. In July 1969, as a consequence, fourteen of the largest commercial banks were nationalised.

Evolution of the Indian financial sector beginning in 1969 can be divided into three distinct sub-periods: first, a period of increasing financial repression from the early 1970s to the mid-1980s; second, a period of mild reforms until 1991; and finally, from 1991, a period of an increasingly liberalised financial sector. In the first period, the bank nationalization of 1969 was followed by the nationalization of six more Indian commercial banks in 1980. Banks were increasingly pressurised to lend to the ‘priority sector’, comprising agriculture and allied activities, small-scale industry, retail trade, transport operators, professionals and craftsmen. While this meant that more credit was available to small-scale firms, medium and large firms may have received a decreasing share of bank credit in the process. At the same time, there was an increasing recourse to the banking sector via the statutory liquidity ratio to finance the ever-widening budget deficits of the central government in the 1970s and the 1980s, possibly crowding out bank financing of private investment. While the commercial banks essentially provided short-term credit to the manufacturing sector, long-term loans were provided by All India Development Banks like the Industrial Development Bank of India and Industrial Credit and Investment Corporation of India. These term-lending institutions depended a lot on the government for resources (usually subsidised heavily) and their allocation of long-term loans to firms was strictly monitored by the government according to plan priorities. The government with respect to pricing, quantum and timing of new issues controlled the stock markets.

While social control of the banking sector might have led to increasing inefficiency in the financial intermediation process, there was significant growth in the commercial banking system in the country both in geographical coverage and amount of resources mobilised (Sen and Vaidya 1997). This was in great part due to a strictly enforced branch licensing policy followed by the RBI. Under

this policy, the RBI restricted banks from opening branches in urban and metropolitan areas. Instead, the thrust of branch expansion was mostly to the ‘under-banked’ districts in rural and semi-urban areas. This led to an increase in bank deposits as a percentage of national income from 15.3 in 1969 to 51.8 in 1994, and significant financial deepening in the Indian economy.

In the second period, from the mid-1980s, there was a gradual set of reforms in the money markets with little or no change in policies relating to the provision of credit to firms in the industrial sector. Some attempts were made to develop the government securities period during this time. More radical reforms had to wait till 1991 when, as part of the structural adjustment programme, the statutory liquidity ratio was substantially reduced. The interest rates on short-term loans (provided predominantly by the commercial banks) have also been deregulated in a phased manner since 1992 and by 1994 commercial banks were completely free to set their own lending rates. The interest rates on long-term loans (predominantly provided by All India Development Banks like Industrial Development Bank of India and Industrial Credit and Investment Corporation of India) were also deregulated in a phased manner and by 1992 were freed of all controls. Interest rate deregulation, softening of consortium lending arrangements, and the opening up of the banking sector to the entry of new private banks have set the stage for the emergence of a more competitive financial sector.

Since 1991, there has been a substantial deregulation of the stock market, especially the operation of the new issues market and relaxation of restrictions on the entry of foreign portfolio investors. Transparency of stock trading practices has improved as a result of the introduction of screen-based trading and the establishment of the National Stock Exchange that compete with the Bombay Stock Exchange, the premier exchange in the country. Indian firms with good track records have been allowed to issue bonds and equity in foreign capital markets. On balance, the financial liberalization measures implemented since 1991 have led to a relatively easier access to capital markets, both at home and abroad, for firms and may have eased borrowing constraints on their investment decisions under the new policy regime.

To summarise our discussion, the evolution of economic policies in India in the post-independence period can be classified into three phases. The first phase was one of control and command, which stretched from the mid-1950s to the early 1980s. The second phase from the early 1980s to the early 1990s was a period of slow and uneven reform, with the liberalization measures occurring mostly in the trade and industrial sector. The third phase from 1991 to the present was one of rapid and radical reforms, with the reforms encompassing almost every aspect of the policy regime.

4 Economic sectors¹

In this section, we discuss patterns of growth and development in the core economic sectors—agriculture, industry, and services—in turn.

4.1 Agricultural sector

After a period of slow growth in the 1950s, the new Borlaug seed-fertiliser technology introduced in the mid-1960s had a significant impact on raising yields and output levels of some crops and ushered in the Green Revolution and a rise in India’s aggregate agricultural production. In the

¹ This section draws from Sen (2014).

beginning, the new technology was initiated for wheat in the irrigated north-western region of India, but by the 1970s, the Green Revolution had covered rice and other crops, and had spread to many other parts of the country and to small producers (Farmer 1977, Bhalla and Singh 2009). The growth rate of agricultural output at the All-India level accelerated from 2.24 per cent per annum between 1962–83 to 3.37 per cent per annum between 1980–93. Most of the output growth was due to productivity, with yields accounting for 85.2 per cent of output growth. In the 1980–93 period, agricultural growth kicked off in the previously stagnant states of eastern India (Rogaly et al. 1999). By 1992–93, the diffusion of high-yielding varieties of seeds which formed the basis of the Green Revolution was more or less complete, with about 90 per cent of wheat area and 70 per cent of rice area occupied by them (Kotwal et al. 2011). There was a strong association between agricultural growth and rural poverty decline in this period (Palmer-Jones and Sen 2003).

However, since 1993, output growth has decelerated to 1.74 per cent per annum, a slowdown observed in most states of India. At the same time, there was a shift in cropping pattern changes towards high-value crops compared to the period 1980–93 before the agricultural reforms. In addition, the land/labour ratio has increased in most regions in India, in part due to the weak demand for labour from the non-farm sector and in part, due to the decline in agricultural productivity in the post-reform period, which implied falling productivity-induced demand for labour from the farm sector. The exhaustion of the possibility of an increase in the gross cropped area of most parts of India meant that agricultural development relied heavily on intensive growth. It is not clear what led to the decline in agricultural productivity in the post-reform period—a decline in public investment in agriculture may have been a contributing factor, though input subsidies to agriculture increased during the ‘reforms’ (Harriss-White and Janakarajan 2004). In addition, expenditure on the public-sector agricultural research system for agriculture faltered, as did the productivity of the research system (Kotwal et al. 2011).

The economic reforms themselves were not directly targeted to the agricultural sector, though there were indirect effects working through changes in the credit system for agriculture, with a weakening of the mandatory requirements for commercial banks to open rural and semi-urban branches, as well as an improvement in the terms of trade for agriculture in the 1990s as protection for industry was removed (along with higher minimum support prices for rice and wheat), leading to a fall in industrial prices (Balakrishnan et al. 2008). While the decrease in bank density in rural areas may have had an adverse effect on the financing of private agricultural investment, rising real prices for agricultural commodities in the post-reform period seemed to have a positive effect on output growth in the agricultural sector (Joshi et al. 2006).

4.2 Industrial sector

As we have noted earlier, the sector that has witnessed the largest set of reforms is the industrial sector. Prior to the reforms, the licensing policy served to divorce market-determined investment decisions from any guidelines that international opportunity costs might have otherwise provided (Bhagwati and Srinivasan 1975). In this environment, as we have observed earlier, there was little incentive for firms to export, given the high profitability of producing for the domestic market, and it thus contributed to high levels of inefficiency in the industrial sector.

Following the 1991 reforms, domestic deregulation has had surprisingly little effect on productivity and innovation. Trade liberalization, especially in the form of access to imported intermediate goods, has been the dominant factor behind the increase in productivity growth in Indian manufacturing (Chand and Sen 2002). But there has been little evidence of creative destruction or product churning since the reforms of 1991 (Goldberg et al. 2010). The industrial sector is still dominated by incumbents—state-owned firms and business groups—and there is limited new firm entry in the formal manufacturing sector (Alfaro and Chari 2009). The reasons for this appear to

be first, significant impediments to firm exit in form of stringent bankruptcy laws which still favour restructuring of existing loss-making firms rather than closure, and second, the political connections that incumbents have which allow them to prevent entry of new firms, especially in concentrated, profitable industries and in industries dominated by state-owned corporations (Mody et al. 2010).

4.3 Services sector

The service sector had the fastest growth rate of all three sectors in the post-1991 period. Between 1993 and 2004, the two fastest growing service sectors were business services and communications. This was mostly due to the advent of cellular technology as the government opened telecommunications to the private sector by relinquishing its monopoly control over communication services (Kotwal et al. 2011). Economic reforms that relaxed the entry of foreign firms into the services sector were also directly behind service sector growth as the share of services in foreign direct investment increased from 10.5 per cent in the early 1990s to nearly 30 per cent in the second half of the decade (Chanda 2007). As a consequence of the entry of outward-oriented foreign direct investment (FDI) into the information technology sector after 1992, software exports grew substantially—at nearly six times the rate for world exports of services.

It is often observed that the service sector in India is commonly skill intensive, and that its growth has mostly required skilled labour. This is certainly true for export-oriented information technology related sectors, e.g. communications and business services. However, other fast growing segments of the service sector are intensive in unskilled labour, the most important of which are the trade, hotel and restaurants sector. These services have rapidly increased their share in GDP from 9.1 per cent in 1955 to 16.7 per cent in 2008. Kotwal et al. (2011) show that the trade, hotel and restaurants sector grew rapidly in the 1990s, and was an important sector for the creation of unskilled labour-intensive jobs. Therefore, services sector growth was also driven by the unskilled labour-intensive hospitality and construction sectors, and not just by the skill-intensive information technology sector.

5 Regional growth

As we have discussed, economic growth in India has been strong since the mid-1980s. However, not all regions in India have benefited equally from the improvement in overall economic performance. States like Andhra Pradesh, Gujarat, Karnataka, Kerala and Tamil Nadu have grown at a rate of per capita income which has exceeded 4.5 per cent per annum during the period. On the other hand, states such as Assam, Bihar and Madhya Pradesh have grown at around 2 per cent or less in the same period. In contrast to the experience of China where geographical factors such as land-lockedness and access to the sea explain to a large extent the patterns of regional economic performance, there has been no clear correlation between geography and regional growth in India. Land-locked states such as Punjab and Haryana have exhibited strong economic growth and coastal states such as Orissa have shown significantly weaker economic performance.

India's federal structure and the significant political autonomy and independence in legislative powers enjoyed by state governments, along with regional variations in the collective strength of the economic and political elite, have allowed for the variation in regional institutional quality that has been important for explaining the differences in regional performance. As Sinha (2003) has argued, subnational states in India followed very different strategies with respect to the private sector, with differing outcomes with respect to economic growth. Cali and Sen (2011) have shown where synergistic state–business relations have emerged in Indian states, economic growth has

followed. In addition to differences in institutional quality, initial conditions such as differences in agro-climatic factors have led to the uneven impact of the Green Revolution, and consequently, divergence in agricultural growth (Palmer-Jones and Sen 2003). This has also contributed to the differences in regional economic performance across India.

The economic growth trajectories of the states of Andhra Pradesh and West Bengal provide strong support for the argument that far more than geographical factors, political and economic institutions played a key role in the differing economic performance of these two states. West Bengal had favourable initial conditions at independence with a relatively large industrial sector, and a large professional class. However, West Bengal has witnessed slow economic growth, especially since the late 1960s, and a gradual decline in its manufacturing sector. This can be attributed in part to the adversarial relationship that successive state governments had with private capital that led to an insecurity of private property rights, and in part to the fragmented relationship that the state political elite has had with the national elite that led to under-investment in infrastructure and a lower allocation in industrial licences during the Licence Raj period (Sinha 2005, Chakravarty and Bose 2013). In contrast, for the Indian state of Andhra Pradesh, Alivelu, Reddy and Srinivasulu (2013) identify the coming to power of Chandrababu Naidu as Chief Minister of the state government in 1995 as the ‘critical juncture’ that explains the rapid improvement in state–business relations (that was sustained in the following Congress regime) as being important in Andhra Pradesh’s subsequent successful record in economic growth. In addition, they attribute the emergence of a market savvy agrarian class and a modern middle class as a result of the expansion of modern education; and the proclivity on their part to look for alternative avenues of investment, as being crucial to Andhra Pradesh’s growth success story.

6 India’s economic development in the post 2014 period

In May 2014, a new government led by the Bharatiya Janata Party (BJP), as part of the National Democratic Alliance (NDA) coalition, took office at the central level in India, replacing the United Progressive Alliance (UPA) government which had ruled India since 2004. The government, led by the Prime Minister, Narendra Modi, subsequently was re-elected in the general elections of 2019. In this section, we briefly review the important economic developments that occurred in India since 2014.

Perhaps the most dramatic policy initiative in the post-2014 period was demonetization. In the campaign leading up to the Lok Sabha elections in spring 2014, one of the more important promises that Narendra Modi made was to ‘clean up’ the economy by bringing back to India all the illicit money that was purportedly stashed away overseas. After coming into power, the government led by Modi’s Bharatiya Janata Party (BJP) made a series of attempts to recover the black money held abroad, but without great success.

On 8 November 2016, the Modi government made an unexpected announcement, that it was demonetising all 500 and 1000 rupee notes. It also announced the issuance of new 500 and 2000 rupee notes in exchange for the demonetised banknotes. The aim of the demonetization policy was to deal a death blow to the black economy by reducing the use of illicit cash to fund terrorism and illegal activities. The secondary objective was to create an impetus for the formalization of economic activity by incentivising the use of credit and debit cards in ordinary transactions instead of cash. The available evidence suggests that the primary objective of the policy has not been achieved, with around 99 per cent of the demonetised banknotes having been deposited with the banking system by 2018. In terms of economic impact, economic growth slowed considerably following demonetization. The economy was negatively affected by two large shocks: (a) an

aggregate demand shock due to the reduction in the money supply because of the withdrawal of high value currency notes; and (b) an aggregate supply shock due to the shortage of cash in sectors such as agriculture which depend on the availability of liquid funds for the purchase of critical inputs such as fertiliser and seeds. As a consequence, economic growth slowed to a four-year low in 2018 (Sen 2023).

The Modi government's second bold policy step was to launch the goods and services tax (GST) in July 2017. The new GST system replaced many central and state taxes on the same base with a country-wide common framework and minimized the complexity by applying a common base and rates across the entire country. The system largely used four rates of taxation² along with several exemptions. The new GST system removed any taxation that is applied when goods cross state borders allowing for minimum tax based restrictions on trade. The new system also sought to improve tax compliance by applying strong data reporting requirements electronically and cross-matching of the reported data (World Bank 2018). The aim of the GST policy was to create a unifying tax system in India, as opposed to the many different sales taxes that existed in different Indian states. The initial effect of the introduction of the GST was negative on the economy. However, the new GST system is likely to reduce significant inefficiencies in the previous tax system and lead to the creation of a unified market in India. Therefore, the prospects of higher growth in the Indian economy is positive due to the launch of the GST is high in the medium and long term.

Common to most other economies during the COVID-19 pandemic period, the Indian economy experienced a sharp downturn in the fiscal year 2020–21, with a negative GDP growth rate of 6.6 per cent, due to a combination of national and regional lockdowns and lower economic activity directly attributable to the pandemic itself. There was a mild recovery in economic growth of 8.7 per cent in the following fiscal year. In 2023, the International Monetary Fund expects the Indian economy to grow by 6.1 per cent, one of the highest growth rates among developing countries. A large part of India's growth renaissance in recent years can be attributed to a large and expanding domestic market (fuelled in part by the GST reforms) along with the significant investments that have been made by successive Indian governments in digital infrastructure, that has led to strong growth in the information technology and e-commerce sectors.

However, there has been lack of success in creating jobs for the large proportion of India's labour force who are unskilled and poor, especially in the post-2010 period. A complex set of factors explains why India has not been able to foster job creating growth of the type witnessed in East Asia. One reason is the nature of the trade regime in India is still biased towards capital-intensive manufacturing, in spite of reforms which have reduced the protection towards the capital goods and intermediate goods sectors. A second reason is the nature of labour regulations in India, with stringent employment protection legislation—among the most protective of formal workers in the world—reducing the incentive of firms, especially those in the purview of employment protection legislation, to hire workers on permanent contracts and pushed them towards more capital intensive modes of production, than warranted by existing costs of labour relative to capital (see Saha et al. 2013). Finally, infrastructural bottlenecks (especially in access to electricity) and other impediments to entrepreneurial growth in small firms (such as high costs of formalization) constrain the rate of job creation, especially in the small and medium-sized enterprises, which provide the bulk of India's employment in manufacturing and service sectors. Whether the Indian

² 5%, 12%, 18%, 28%, and additionally 0.25% for precious stones and 3% for gold.

economy can generate productive jobs to its increasingly educated youth will be a primary challenge that policy makers in India will face in the twenty first century.

7 Concluding observations

The Indian economy has shown considerable growth and structural transformation since independence. Starting out with a mostly agrarian economy with a small modern industrial sector and an insignificant services sector, the Indian economy currently is one of the largest in the world in terms of gross domestic product, with many modern industries and an export-oriented dynamic information technology sector. However, challenges remain, and in particular, the performance of the agricultural sector in the recent years has been disappointing, as well as the rate of job creation. India also has not done well enough in formal manufacturing, especially in export-oriented industries. Regional performance has also been uneven. Therefore, while the economic foundation of the Indian economy is significantly stronger in the 2000s as compared to at the time of independence, not all sectors or regions of the economy have shown strong performance.

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