GROWTH AND ECONOMIC REFORMS: Introduction

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Scheme of Presentation

- Introduction
- Distinguishing four phases of economic growth
- Criterion to distinguishing the four phases
- Sector-wise growth rates and the composition of the GDP
- Evolution of the shares of the three sectors in the GDP

Introduction

- Weak growth of world output (2020: -3.27; 2019: 2.76; 2018: 3.57 & 2017: 3.76)
  - declining prices of a number of commodities especially crude oil prices
  - turbulent financial markets especially equity markets
  - volatile exchange rates
  - Covid-19
- Even in these difficult situation, India's growth story has largely remained positive because of
  - the strength of domestic absorption, and
  - a robust and steady pace of economic growth in 2017: 6.8%; 2018: 6.53%; 2019: 4.04; **2020: -7.96**.

Introduction

- Following the slowdown induced by the global financial crisis in 2008-09, the Indian economy responded strongly to fiscal and monetary stimulus and achieved a growth rate of 8.6 per cent and 9.3 per cent respectively in 2009-10 and 2010-11.
- However, during 2011-12, and 2012-13, the growth rate slowed to 6.2 per cent and 5.6 per cent respectively because of low rate of investment which was caused by high RoI by RBI (to curb inflation) as well as policy constraints.

Introduction

- Nevertheless, despite this slowdown, the compound annual growth rate for GDP_{fc}, over the decade ending 2012-13 is 7.9 per cent.
- India gained independence on 15 August 1947 and it launched its development program formally in the year 1951–52 with the First Five-Year Plan.
- The economy grew only 3.8 per cent between 1951–52 and 1987–88. In contrast, the economy of the Republic of Korea took off in a major way, registering an average growth rate in excess of 8 per cent in the 1960s and 1970s.

Introduction

- At least three features distinguish India's growth experience from that of virtually all other countries. First, its growth trajectory is virtually unique among developing countries, i.e. to maintain a sustain growth rate of 3.8 per cent per annum.
- Second, India had a substantial private sector and yet it consistently pursued near autarkic trade policies alongside highly interventionist domestic policies for more than three decades.
- Finally, India is one of the four developing countries (Sri Lanka, Costa Rica, and Jamaica) with effective democracy since the 1940s.

Distinguishing Four Phases of Economic Growth In India

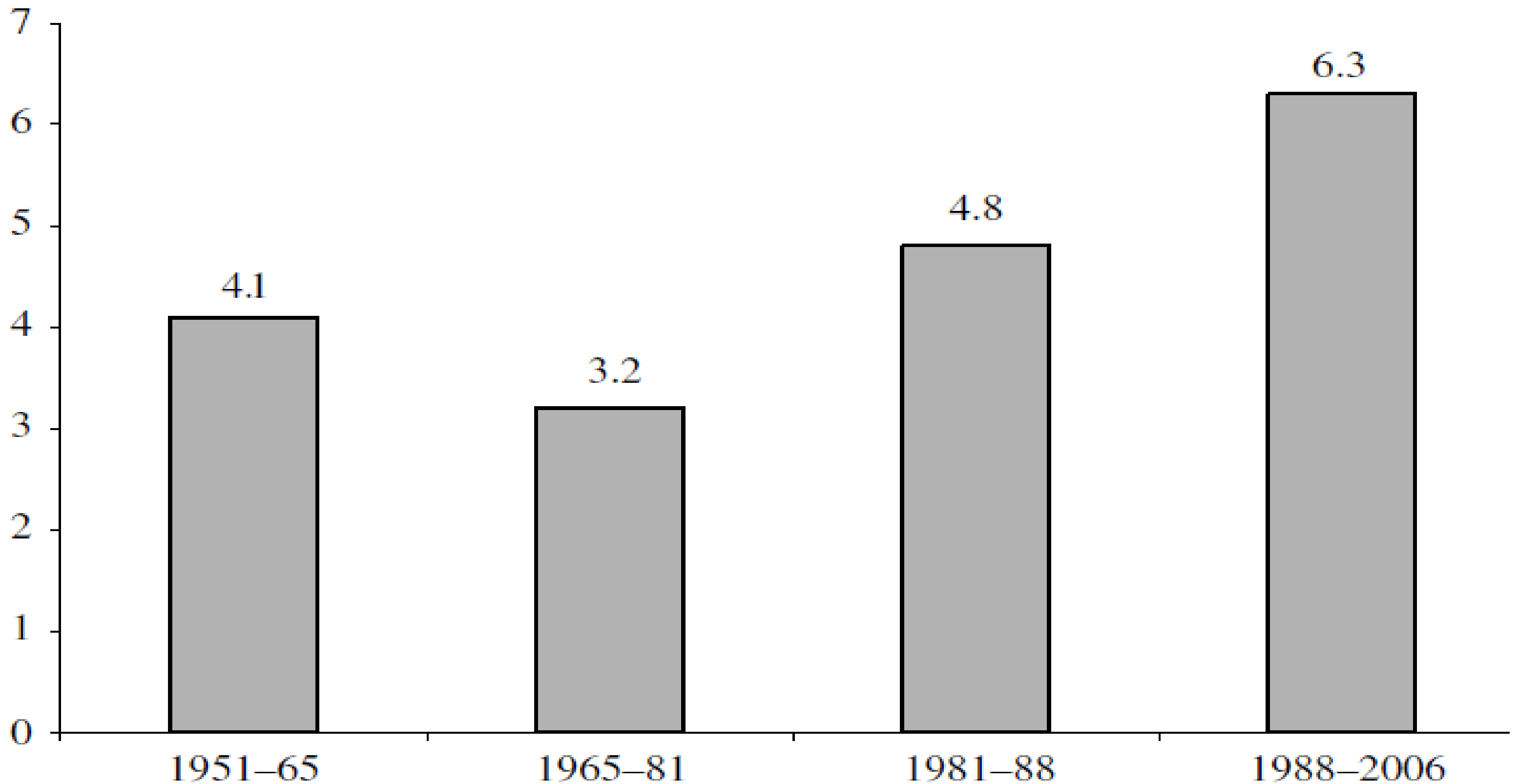

FIGURE 1.1: Four Phases of Growth (percent)

TABLE 1.1: Annual Growth Rates of GDP (at factor cost): 1951–2007

Year	Growth Rate	Year	Growth Rate	Year	Growth Rate	Year	Growth Rate
At 1993–94 Prices						*At 1999–2000 Prices*	
1951–52	2.3	1969–70	6.5	1987–88	3.8	2000–01	4.4
1952–53	2.8	1970–71	5.0	1988–89	10.5	2001–02	5.8
1953–54	6.1	1971–72	1.0	1989–90	6.7	2002–03	3.8
1954–55	4.2	1972–73	–0.3	1990–91	5.6	2003–04P	8.5
1955–56	2.6	1973–74	4.6	1991–92	1.3	2004–05QE	7.5
1956–57	5.7	1974–75	1.2	1992–93	5.1	2005–06QE	9.0
1957–58	–1.2	1975–76	9.0	1993–94	5.9	2006–07AE	9.2
1958–59	7.6	1976–77	1.2	1994–95	7.3		
1959–60	2.2	1977–78	7.5	1995–96	7.3		
1960–61	7.1	1978–79	5.5	1996–97	7.8		
1961–62	3.1	1979–80	–5.2	1997–98	4.8		
1962–63	2.1	1980–81	7.2	1998–99	6.5		
1963–64	5.1	1981–82	6.0	1999–2000	6.1		
1964–65	7.6	1982–83	3.1	2000–01	4.4		
1965–66	–3.7	1983–84	7.7	2001–02	5.8		
1966–67	1.0	1984–85	4.3	2002–03P	4.0		
1967–68	8.1	1985–86	4.5	2003–04QE	8.5		
1968–69	2.6	1986–87	4.3	2004–05QE	6.9		

P, Provisional; QE, Quick Estimate; AE, Advance Estimate.

Source: Author's calculations, using the GDP date reported in the Reserve Bank of India, *Handbook of Statistics on Indian Economy* (2006, table 2, col. 2).

CRITERION TO DISTINGUISH THE FOUR PHASES

- Consider first the dividing line between phases II and I.
- Coincidentally, statistical analysis does supports this division.
- India faced the same global trading environment as the East Asian tigers, why did it stagnate while the latter transitioned from the modest growth rate of the 1950s and early 1960s into near-double-digit growth rates?
- There was profound change in economic policies in the second phase.

CRITERION TO DISTINGUISH THE FOUR PHASES

- The dividing line between phases II and III is the least controversial. Virtually all analysts agree that the era of the so-called Hindu rate of growth ended in the late 1970s.
- The policy regime in 1991 was significantly more liberal than in the late 1970s.
- India grew 4.8% per annum during 1981–88 and 7.6% during 1988–91.

SECTORWISE GROWTH RATES AND THE COMPOSITION OF THE GDP

- Consider the growth rates of the major sectors of the economy: agriculture, industry, and services.
- Agriculture grew slower than the GDP throughout the 55-year period, implying that the share of agriculture steadily declined.
- During 1965–81, when the GDP growth slowed down, it did so across all sectors. The largest drop was in industry.
- During phase III, the growth rate in industry recovered substantially but not entirely. The sector that did the best was services, which grew at an unprecedented 6.5 percent rate.
- In phase IV, all three sectors did better than in the previous two phases.

TABLE 1.2: Growth Rates of Sectoral GDP (at factor cost)

Period	Agriculture & Allied	Industries	Manufacturing	Services	GDP
1	*2*	*4*	*5*	*6*	*7*
1951–65	2.9	6.7	6.6	4.7	4.1
1965–81	2.1	4.0	3.9	4.3	3.2
1981–88	2.1	6.3	7.1	6.5	4.8
1988–2006	3.4	6.5	6.8	7.8	6.3

Note: Allied industries in the first category include forestry and fishing. Industry is defined as the sum of manufacturing, mining and quarrying, electricity, power, and water supply, and construction. All other output is included in services.

Source: Author's calculations, using the data on the components of the GDP reported in RBI, *Handbook of Statistics on Indian Economy* (2006, table 3).

Evaluation of the shares of the three sectors in the GDP

- Consistent with the experience of the other countries, growth has been accompanied by a steady decline in the share of agriculture in the GDP: It fell from 57 percent in 1950–51 to 21 percent in 2004–05.
- But in contrast to the experience of the other countries, the bulk of the growth in GDP share has been in services rather than industry. Why?

Table 1.3: The Composition of GDP (percent)

Year	Agriculture & Allied	Industries	Manufacturing	Services
1950–51	57	15	9	28
1964–65	49	21	12	31
1980–81	40	24	14	36
1987–88	33	26	16	41
2004–05	21	27	17	52

THE GREAT GROWTH DEBATE

- The origins of the debate are to be found in a paper by DeLong (2003, chap. 7, p. 186).

- What are the sources of India's recent acceleration in economic growth? Conventional wisdom traces them to policy reforms at the start of the 1990s. . . . Yet the aggregate growth data tells us that the acceleration of economic growth began earlier, in the early or mid-1980s, long before the exchange crisis of 1991 and the shift of the government of Narasimha Rao and Manmohan Singh toward neoliberal economic reforms.

THE GREAT GROWTH DEBATE

- DeLong (2003, chap. 7, p. 186) continues
- Thus apparently the policy changes in the mid- and late-1980s under the last governments of the Nehru dynasty were sufficient to start the acceleration of growth, small as those policy reforms appear in retrospect. Would they have just produced a short-lived flash in the pan—a decade or so of fast growth followed by a slowdown—in the absence of the further reforms of the 1990s? My hunch is that the answer is “yes.” In the absence of the second wave of reforms in the 1990s, it is unlikely that the rapid growth of the second half of the 1980s could be sustained. But hard evidence to support such a strong counterfactual judgment is lacking.

THE GREAT GROWTH DEBATE

- In his editor's introduction to the volume containing DeLong's paper, Rodrik (2003) interprets the latter as follows:
- How much reform did it take for India to leave behind its "Hindu rate of growth" of 3 percent a year? J. Bradford DeLong shows that the conventional account of India, which emphasizes the liberalizing reforms of the early 1990s as the turning point, is wrong in many ways. He documents that growth took off not in the 1990s, but in the 1980s. What seems to have set off growth were some relatively minor reforms. Under Rajiv Gandhi, the government made some tentative moves to encourage capital-goods imports, relax industrial regulations, and rationalize the tax system. The consequence was an economic boom incommensurate with the modesty of the reforms. Furthermore, DeLong's back-of-the-envelope calculations suggest that the significantly more ambitious reforms of the 1990s actually had a smaller impact on India's long-run growth path. DeLong speculates that the change in official attitudes in the 1980s, towards encouraging rather than discouraging entrepreneurial activities and integration into the world economy, and a belief that the rules of the economic game had changed for good, may have had a bigger impact on growth than any specific policy reforms.

THE GREAT GROWTH DEBATE

- Panagariya questioned Rodrik's assertions along three lines. First, the claim that growth in the 1990s was no higher than in the 1980s.
- Second, super high growth of 7.6 percent per annum during 1988–91 was preceded by significant reforms, especially in the years 1985–86 and 1986–87. But this growth was driven by fiscal expansion and external borrowing causing crisis in June 1991.
- Finally, absent 1990s reforms, it is difficult to imagine that India would have resumed high growth and sustained it in the way it has done.

THE GREAT GROWTH DEBATE

- Rodrik and Subramanian (2005) argue that an "attitudinal change" on the part of the government in favour of private business around 1980, rather than liberalizing reforms, resulted in a permanent shift in the growth rate. They claim that "pro-business" policies that favor incumbent producers, rather than "pro-market" policies that promote new entrants and aim to benefit consumers, account for the once-for-all shift in the growth rate that took place in the early 1980s.

THE GREAT GROWTH DEBATE

- Srinivasan (2005) provides a scathing critique that opens as follows:

  This is a disappointing paper. It sees a mystery and fails to convince through analysis why it does. Had the authors been familiar with Indian economic literature, they might not have written it! The literature has not only noted the growth acceleration in the 1980s but has also questioned its sustainability on the grounds of its possibly being debt-led and fuelled by employment and real wage expansion in the public sector

THE GREAT GROWTH DEBATE

- Panagariya in his book “India: the Emerging Giant” argued that the distinction between “pro-business” and “pro-market” of Rodrik and Subramanian is spurious: “Pro- business” and “pro-market” reforms do not form mutually exclusive sets. Instead, policies that enhance the efficiency and profitability of the incumbent firms—the so-called pro-business policies—are an integral part of the neoliberal, pro-market reform packages.

Reference

- Panagariya, Arvind (2008): *India: the Emerging Giant*, Oxford University Press, New York

Thank you

PHASE I (1951–65): TAKE OFF UNDER A LIBERAL REGIME

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Scheme of Presentation

- Introduction
- Era of Liberal Trade and Foreign Investment Policies
- A Restrictive Industrial Policy Regime
- Agriculture

Distinguishing Four Phases of Economic Growth In India

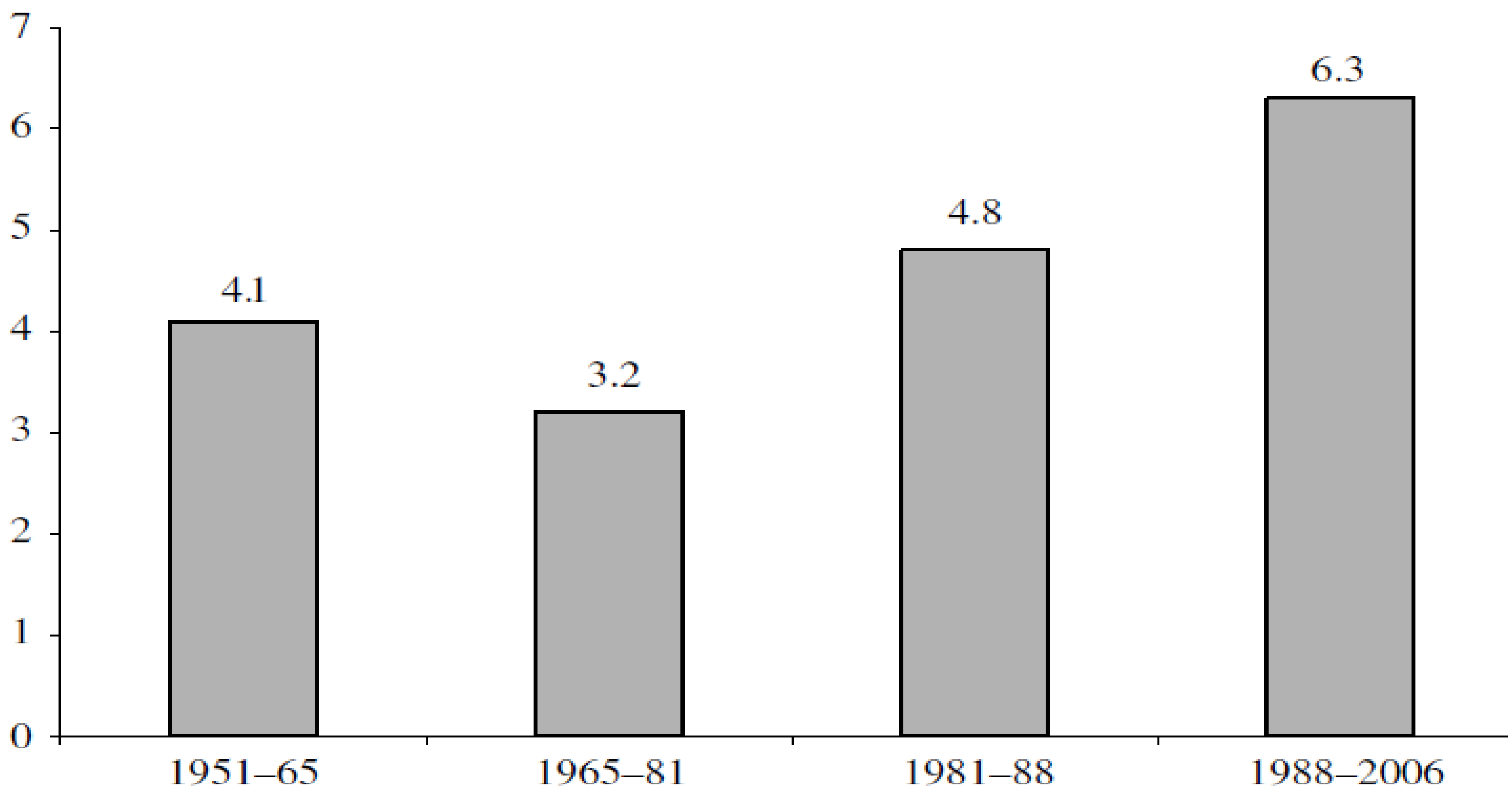

FIGURE 1.1: Four Phases of Growth (percent)

Introduction

- India's GDP grew at nearly 4 per cent per annum during the first two Five-Year Plans and during the first four years of the Third Five-Year Plan, the growth rate averaged even higher, at 4.5 per cent.
- Allowing for the population growth of 2.1 per cent, India thus grew 2.0 per cent per annum on a per capita basis during 1951–65.
- This performance was superior to India's own prior performance during any historical period for which systematic data are available (Maddison, 1971).

Introduction

- At the sectoral level, the effort at industrialization was seemingly successful, with industry growing at rates between 5.9 and 10.9 percent during 11 of the 14 years of phase I.
- Agriculture performed better during the First and Second Plans than the first four years of the Third Plan.
- Services showed some acceleration during the Third Plan.

THE 1950s: AN ERA OF LIBERAL TRADE AND FOREIGN INVESTMENT POLICIES

- **Nehru's Vision of Economic Independence and Trade Policy**
- Nehru's vision of building a socialistic society with particular emphasis on the development of heavy industry, on the one hand, and small-scale, cottage industry, on the other, played a central role in the determination of the policies and institutions put in place during the 1950s.
- Trade policy in particular was not debated extensively. The key element in Nehru's thinking on trade policy was that India needed to be independent of the world markets.

THE 1950s: AN ERA OF LIBERAL TRADE AND FOREIGN INVESTMENT POLICIES

- While Nehru did want domestic production to eventually replace imports, there are no statements in his writings or speeches to suggest that he wanted to achieve this by erecting import barriers.
- Nehru, in *The Discovery of India*, (1946, p. 403) offers the following thoughts on trade policy:
- *The objective for the country as a whole was the attainment, as far as possible, of national self-sufficiency. International trade was certainly not excluded, but we were anxious to avoid being drawn into the whirlpool of economic imperialism.*
- The argument, common in the import substitution industrialization literature, that imports must be kept out so that domestic producers of like products may flourish, was essentially absent from these writings and statements.

Liberal Trade Regime

- According to Bhagwati and Desai (1970, p. 282), the period of the First Five-Year Plan (1951–52 to 1955–56) was one of "'progressive liberalization especially towards the end." But there are several pieces of evidence indicating that the trade regime was open during much of the 1950s.
- Second, to quote him (Nehru, 1997, p. 261):

Liberal Trade Regime

- T. T. Krishnamachari, a most dynamic minister and a most powerful character dominated the economic scene. He was the Commerce Minister but in practice it was he and not the Finance Minister who was in charge of economic policy. . . . TTK wanted the economy to develop and develop fast; for this purpose, he wanted to import and import here and now anything and everything that was not being produced in India. The only opposition he could have faced was from the Minister of Finance. But Deshmukh, who was Finance Minister, having no political clout, seems to have either not opposed at all or yielded far too easily to the pressure that emanated from further east in the North Block.

Liberal Trade Regime

- Third, the Third Five-Year Plan (Planning Commission, 1961, chap. 8, para. 1) reports that 32 percent of the total imports in the First Plan and 23 percent in the Second Plan were accounted for by consumer goods.
- Four, during the 1950s, "established importers" who were licensed to import goods for sale to other buyers were allowed to operate relatively freely. Typically, they were also the importers of consumer goods. Established importers accounted for almost one third of the import licenses in value terms until at least 1957–58. By the early 1960s, this share had dropped to one tenth, with actual user licenses gaining most in importance.

Liberal Trade Regime

- Finally, until at least 1957–58, imports as a proportion of the GDP exhibit no signs of a declining trend. And in 1957–58, the ratio was 7.8 percent, which is comparable to the same ratio in South Korea at the time. Only after 1957–58 did the ratio steadily decline, falling to 5.1 percent in 1964–65.
- In 1956, TTK replaced C. D. Deshmukh as the finance minister, and in 1957 he promoted Nehru to secretary, Department of Economic Affairs.

Liberal Trade Regime

- By this time, Nehru (1997, p. 279) was even more alarmed by the rapid haemorrhage in our foreign exchange resources. In his book, he said that “Once again, I had to take the initiative and re-establish the whole control mechanism through the foreign exchange budget that I had invented nine years earlier.”
- In this juncture, by the initiatives of Nehru, the first foreign exchange budget was presented in the middle of 1958, by which time Morarji Desai had become the finance minister.
- This was the beginning of India’s turn to a much more restrictive trade- and investment-licensing regime. For example, if a large investor needed to import machinery or raw material that exceeded the foreign exchange quota available to the relevant agency, the investment license would be denied in the first place.

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An Open Foreign Investment Regime

- Paragraph 10 of the IPR 1948 states that
  - The Government of India agree with the view of the Industries Conference that, while it should be recognized that **participation of foreign capital and enterprise, particularly as regards industrial technique and knowledge, will be of value to the rapid industrialization of the country**, it is necessary that the conditions under which they may participate in Indian industry should be **carefully regulated in the national interest**. Suitable legislation will be introduced for this purpose. Such legislation will provide for the scrutiny and approval by the Central Government of every individual case of participation [of] foreign capital and management in industry. It will provide that, as a rule, the major interest in **ownership, and effective control**, should always be in Indian hands; but power will be taken to deal with exceptional cases in a manner calculated to serve the national interest. In all cases, however, the training of suitable Indian personnel for the purpose of eventually replacing foreign experts will be insisted upon.

An Open Foreign Investment Regime

- IPR, 1948 indirectly guaranteed that the government would **not nationalize any business holdings**. This guarantee also ruled out the takeover of any foreign firms by the government for the following ten years.
- In the 1949–50 budget, Prime Minister Nehru saw a clear need for foreign investment in India.
- Nehru accorded "**national treatment**" to the existing foreign interests and thus ended any discrimination in favour of domestic enterprises.

An Open Foreign Investment Regime

- The statement provided that the government would encourage new foreign capital by framing "policies to enable foreign capital investment on terms and conditions that are mutually advantageous."
- It **permitted the remittances of profits and dividends** of foreign companies abroad.
- It noted that although majority ownership by Indians was preferred, "Government will not object to foreign capital having control of a concern for a limited period, if it is found to be in the national interest."

An Open Foreign Investment Regime

- It also provided **depreciation allowances and income tax exemption** to a wide range of foreign companies.
- In the 1949–50 budget, the government also abolished the capital gains tax, and in the 1950–51 budget, it reduced the business profit tax, personal income tax, and super-tax as applied to foreign companies and their employees.
- Despite opposition, the government actually liberalized this policy further in the first few years of planning.

An Open Foreign Investment Regime

- In 1957, the government gave a number of concessions to foreign firms, including reduced wealth tax and tax exemption to foreign personnel.
- In the 1959 and 1961 budgets, the government lowered taxes on corporate income and royalties of foreign firms.
- India also signed agreements to avoid double taxation, in order to lower the tax burden of foreign investors.

An Open Foreign Investment Regime

- In 1961, the government established the Indian Investment Center, with offices in the major sources of private foreign capital to disseminate information and advice on the profitability of investing in India to foreign investors.
- The government also appointed an officer on special duty in the Ministry of Commerce and Industry to guide foreign investors on investment opportunities.

An Open Foreign Investment Regime

- RBI made a census survey of private companies in 1969 to know the extent of foreign capital participation and foreign technical collaboration agreements until March 31, 1964. The survey covered a total of 827 private sector companies with foreign participation of some kind. Of these, 591 had equity participation (with 262 having majority foreign holdings), while the remaining 236 had only technical collaboration agreements. Of the 591 firms with equity participation, 351 also had technical collaboration agreements.

Scheme of Presentation

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- IPR 1948
- Budget 1949-50: National treatment
- In 1957: wealth tax and tax exemption
- In 959 and 1961 budgets, the government lowered taxes on corporate income and royalties of foreign firms.
- In 1961, the government established the Indian Investment Center
- RBI made a census survey

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A Restrictive Industrial Policy Regime

- Policies toward industry were considerably more restrictive than those toward trade and foreign investment.
- There are three key elements of the industrial policy as it evolved in phase I:
  - dominant role of the public sector in the development of heavy industry;
  - regulation of private sector investment through licensing; and
  - distribution and price controls.

Role of Public Sector

- **New Classification of Industries (IPR 1956)**:
- Schedule A (exclusively state owned): 17 industries – arms and ammunition, atomic energy, iron & steel, electrical industries, coal, mineral oils & mining, air craft, air transport, railway, P&T et cetera.
- Schedule B (State owned but supplemented by private efforts): 12 industries – Machine tools, Ferro Alloys and tool steel, mining activities not included in Schedule ‘A’, chemical industry, antibiotics and other essential drugs, fertilizers, synthetic rubber, road transport and sea transport et cetera.
- Schedule C (private initiatives): remaining industries not included in Schedule ‘A’, and ‘B’ to suit the social and economic policy of the state.
- In spite of this clear cut grouping of industries under three schedules, these categories were not water tight compartments and room for exceptions could be made.

Role of Public Sector

- The share of the public sector in total investment in the First Five-Year Plan was 46 percent.
- The Second Plan set the explicit goal of raising this share to 61 percent. But because private sector investment greatly exceeded the projection, it fell well short (54 percent) of the target in proportionate terms, despite substantially achieving the objective in absolute terms.
- The Third Plan sought to push the share to 64 percent, but once again fell short, at approximately 50 percent.

Regulation of Private Sector Production and Investment

- The implementing legislation to regulate the activities of private sector was the Industries (Development and Regulation) Act (IDRA), 1951, enacted within the broader context of the IPR, 1948.
- The IDRA sought to regulate industrial investments and production according to the Plan priorities, encourage “small” enterprises, achieve regional balance in industrial development.
- The provisions clearly meant that industries not included in schedule I and undertakings with fewer than 50 workers using power or fewer than 100 workers and not using power were exempt from licensing.

Regulation of Private Sector Production and Investment

- Apart from registration and licensing, the IDRA had three main provisions. First, it empowered the central government to specify criteria along certain dimensions that the small-scale and ancillary industrial undertakings would have to satisfy to be eligible for supportive measures, exemptions, or favorable treatment.
- Second, the act empowered the central government to assume direct management or control of industrial undertakings under certain circumstances.
- Finally, the act empowered the central government to control the prices and distribution of specified scheduled industries or undertakings.

Regulation of Private Sector Production and Investment

- Several related sources indicate that until the end of the Second Plan, the licensing regime was relatively liberal.
- Sengupta (1985), who offers a detailed account of how the licensing regime operated until the mid-1980s, identifies the years until the mid-1960s as relatively liberal, with 1951–58 being the most liberal
- Few official reports pointing to licensing as a critical factor facing industrial efficiency and growth during the 1950s.

Regulation of Private Sector Production and Investment

- But starting around 1964, a host of official reports came out that expressed dissatisfaction with one or other aspects of the system.
- Among the most commonly cited reports are the Report of the Monopolies Enquiry Commission headed by K. C. Dasgupta (1965), the Swaminathan Committee Report (1964), the Report of the R. K. Hazari Committee on Industrial Planning and Licensing Policy (1967) etc.
- Unfortunately, these reports did not lead to liberalization of licensing; instead, they focused on the concentration of economic power and led to the restraining of larger firms and business houses.

Distribution and Price Controls

- The distribution and price controls had three objectives:
  - to ensure allocation of an adequate supply of inputs to “priority” sectors at “reasonable” prices;
  - to ensure “equity” in distribution; and
  - to control “inflationary” pressures.
- As with import controls, powers for the control of distribution and prices of industrial products had existed during the Second World War, under the Defence of India Rules.

Distribution and Price Controls

- As already noted, in the post-independence era, the same powers for the “scheduled industries” were included in the IDRA, 1951.
- In areas not covered by the IDRA, most notably agriculture, the government acquired these powers through the Essential Commodities Act, 1955.
- While distribution and price controls existed throughout phase I, their incidence grew considerably in the 1960s.

Agriculture

- Given Nehru's focus on industry, agriculture did not receive a high priority during this period.
- In the First Five-Year Plan, 15.1 per cent of the total Plan outlay was allocated to agriculture and community development, and 16.3 per cent to irrigation.
- In the Second Five-Year Plan, these allocations were reduced to 11 and 9 per cent, respectively.
- In the Third Five-Year Plan, the allocation to agriculture rose slightly, to 14 percent, but that to irrigation remained 9 per cent of the total outlay.

Agriculture

- Strategy in agriculture mainly relied on what is called the institutional model (land reforms and farm and service cooperatives), though it did contain some elements of the technocratic model (irrigation, HYV, R&D, Fertilizer etc).
- An important piece of policy legislation relating to agriculture enacted during phase I was the Essential Commodities Act, 1955.
- Land reforms were slow and drawn out, and achieved at best very partial success.

Agriculture

- The cooperative movement from which Nehru had hoped so much was an outright failure.
- The main success was in irrigation, especially during the First Five-Year Plan, when several of the river valley projects were successfully launched and completed.
- A particularly important missing element in the strategy was the role for price incentives.
- Systematic studies showing the positive response of farmers to increased prices began to come only in the 1960s.

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- Panagariya, Arvind (2008): *India: the Emerging Giant*, Oxford University Press, New York, Pp.22-46

Thank you

Foreign Exchange Budget

- FEB provides a mechanism for the monetary authorities to determine the use of foreign exchange resources ex-ante rather than reacting ex-post. Hence policy-making becomes more internally oriented as a result of greater leverages to deal with the foreign exchange constraints.

PHASE II (1965–81): SOCIALISM STRIKES WITH A VENGEANCE

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Scheme of Presentation

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- Strangulation of Industry
- Foreign Trade
- Factor Market Regulation: Labour and Land
- Nationalization of Bank
- Nationalization of Insurance
- Agriculture
- Saving and Investment

Introduction

- The years 1965–75 saw the average GDP growth rate of India plummet to just 2.6 percent from 4.1 percent during 1951–65.
- With population growing at 2.3 percent per annum, this meant a per capita income growth of just 0.3 percent – a virtual standstill in the average living standards.
- Because the growth rate spiked to 9.4 percent in 1975–76, the addition of this year brings the average GDP and per capita GDP growth rates over 1965–76 (and also over 1965–81) up to 3.2 and 0.9 percent, respectively.

Introduction

- This is still low compared to what had been achieved during the preceding one and a half decades.
- The decline in the overall growth rate is explained by external shocks, reduced flow of external resources, and further tightening of controls that followed the failed attempt at liberalization in the early part of phase II.

Introduction

- External shocks included two consecutive drought years during 1965–67; a war with Pakistan in 1965 that came on the heels of a war with China in 1962; another war with Pakistan in 1971, which was preceded by a huge influx of refugees and culminated in the creation of Bangladesh; two further consecutive droughts in 1971–72 and 1972–73; and the oil price shock in October 1973, which contributed to a nearly 40 percent deterioration in India's terms of trade over 1972–76.

Introduction

- Industrial growth fell from 6.7 percent in phase I to just 3.6 percent in phase II.
- This is because
  - highly restrictive policies in all spheres, and extra regulations applicable to large enterprises through the MRTP Act, 1969;
  - severe restrictions on foreign investment through the Foreign Exchange Regulations Act, 1973;
  - further tightening of the licensing regime;
  - the small-scale industries reservation; and
  - the nationalization of banks, insurance firms, and the coal and oil industries.
- The decline in the growth rate in agriculture is to be attributed largely to droughts that more than offset the positive contribution of the Green Revolution, which bore fruits in phase III

Annual Growth Rate of GDP (at factor cost), 1965-81

Year	Agriculture, Forestry & Fishing	Industry	Manufacturing	Services	GDP
1965–66	–11.0	3.8	0.9	2.8	–3.7
1966–67	–1.4	3.3	0.8	3.1	1.1
1967–68	14.9	3.1	0.4	3.9	8.5
1968–69	–0.2	5.0	5.5	4.6	2.5
1969–70	6.4	7.8	10.7	5.2	6.3
1970–71	7.1	1.0	2.3	4.9	5.0
1971–72	–1.9	2.7	3.3	3.6	0.9
1972–73	–5.0	3.7	3.9	3.0	–0.5
1973–74	7.2	1.1	4.4	3.3	4.5
1974–75	–1.5	1.6	2.9	4.5	1.2
1975–76	12.9	6.6	2.1	6.8	9.4
1976–77	–5.8	8.7	8.8	4.6	0.9
1977–78	10.0	6.9	6.2	5.0	7.5
1978–79	2.3	7.6	12.4	6.7	5.1
1979–80	–12.8	–3.1	–3.2	2.2	–5.2
1980–81	12.9	4.7	0.2	4.5	7.7
1965–81	2.1	4.0	3.9	4.3	3.2

THE POLITICAL CONTEXT OF PHASE II

- Nehru died in May 1964, and Lal Bahadur Shastri succeeded him as the prime minister.
- Shastri was keener on agriculture than on heavy industry, and successfully brought it to the center of the policy agenda.
- Against much opposition from the Left parties, he laid the foundation of the Green Revolution.
- But his tenure was cut short by his untimely death in January 1966, immediately after he signed a peace accord with Pakistan in Tashkent.

UTKAL UNIVERSITY

THE POLITICAL CONTEXT OF PHASE II

- Indira Gandhi succeeded Shastri and served as India's prime minister until her assassination on October 31, 1984, except between March 24, 1977, and January 14, 1980.
- ***Mrs. Gandhi's relationship with the US was an important external factor influencing the policy changes made by India during phase II***.
- India's extreme dependence on food imports from the US under its Public Law 480 food aid program allowed Lyndon B. Johnson to keep India on what he called "ship to mouth".

THE POLITICAL CONTEXT OF PHASE II

- Recognizing that the U.S. shipments were the only escape from famine for India, he also intruded into domestic policy issues, playing a critical role in forcing the ill-fated devaluation of the rupee in June 1966.
- The Indian public viewed devaluation as an unqualified failure.
- Mrs. Gandhi personally suffered from the episode: Though the Congress Party returned to power at the center in the 1967 elections, its majority was much reduced. More important, it lost elections for the first time in seven states.

THE POLITICAL CONTEXT OF PHASE II

- The entire experience strengthened the socialist convictions of Mrs. Gandhi and reinforced the sentiment that the US was not a reliable ally.
- She became more determined than ever not to count on US aid and support in the future.
- Ten-Point Program was passed through the Congress Working Committee.
- The Ten-Point Program promised wide-ranging policy changes, including nationalization of banks and general insurance companies; ceilings on urban property and income; curbs on business monopolies and concentration of economic power; public distribution of food grains; rapid implementation of land reforms; provision of house sites to the rural poor; and abolition of princely privileges.

THE POLITICAL CONTEXT OF PHASE II

- With the assistance of the RBI, a new program was launched for bank lending to "priority sectors" such as agriculture and small-scale industries.
- In 1969, the death of President Zakir Hussain, and ensuing differences on the choice of the Congress Party candidate for a successor, brought the power struggle between Mrs. Gandhi and the Syndicate into the open.
- Soon after, the party split into the new Congress and the Old Congress, with the former being identified as the traditional Indian National Congress or simply the Congress, and the latter as Congress (O).

THE POLITICAL CONTEXT OF PHASE II

- Congress with Mrs. Gandhi as its leader had firm control over the government. From then on, Mrs. Gandhi systematically proceeded to implement her socialist agenda.
- In the short run, this made her very popular with the electorate and delivered a landslide victory in the parliamentary elections in March 1971. She won 351 out of 525 seats in the lower house of the Parliament.
- In India's war with Pakistan in December 1971, the United States sided with Pakistan, and the Soviet Union with India. This experience led Mrs. Gandhi to move farther away from the United States and sign the 20-year peace treaty with the Soviet Union.

THE POLITICAL CONTEXT OF PHASE II

- The shift also had serious implications for the economic policy: Domestically, it strengthened Mrs. Gandhi's resolve to press ahead with the socialist agenda, and internationally, it redirected India's foreign trade toward the Soviet Bloc countries through a series of bilateral, barter-trade agreements.
- Economic Failure Culminating in the Emergency Rule
- Mrs. Gandhi's popularity was short-lived.
- The droughts in 1971–72 and 1972–73 and the first oil price shock brought high inflation alongside economic stagnation.

THE POLITICAL CONTEXT OF PHASE II

- Controlled in the extreme, the economy simply failed to adjust to the shocks. Though Mrs. Gandhi argued that inflation was a worldwide phenomenon and that external shocks, rather than her policies, were at the heart of India's misfortunes, the public did not offer her a sympathetic ear.
- Instead, this time around, the opposition parties regained some of their lost ground.
- They also organized mass rallies, strikes, and protests calling for her resignation.

THE POLITICAL CONTEXT OF PHASE II

- Rather than oblige, she declared a state of internal emergency on June 26, 1975.
- The elections were held in March 1977.
- Widespread dissatisfaction with the emergency rule resulted in her defeat, with the Janata Party coalition, led by Congress (O), coming to power.
- Morarji Desai served as prime minister from March 1977 to July 1979, and Charan Singh succeeded him from July 1979 to January 1980.

THE POLITICAL CONTEXT OF PHASE II

- The three-year Janata rule was undistinguished, with continuous bickering among the coalition members. In the end, the coalition failed to serve its full term and was forced to call for new elections.
- In January 1980, Mrs. Gandhi returned to power after a resounding victory in the elections. She remained prime minister until her assassination in May 1984. Her son Rajiv succeeded her immediately and remained prime minister until December 1, 1989.

A Note on the Political Economy of Policymaking

- Nehru had enjoyed near universal approval and confidence of the public, so that his vision essentially determined the course of the economic policy during phase I.
- Though Shastri and Mrs. Gandhi did not enjoy the same degree of public approval and support, they continued to have a dominant influence on the policies adopted during their respective reigns.
- In less than two years, Shastri was able to turn agriculture into the highest priority item on the policy agenda.

A Note on the Political Economy of Policymaking

- Likewise, driven by her socialist policy agenda, Mrs. Gandhi substantially transferred the control of the commanding heights of not just industry but also of finance to the government within a few years of coming to power.
- ***The experience during phase II shows that within the parliamentary democracy of India, a determined leader has the decisive role in shaping the economic policies.***

A Note on the Political Economy of Policymaking

- The case of bank nationalization by Mrs. Gandhi also testifies to the decisive role a determined leader can play within the Indian democracy.
- I. G. Patel (2002, p. 135), who served as the economic secretary in the Finance Ministry at the time the banks were nationalized, offers an interesting account of the decision-making process:

A Note on the Political Economy of Policymaking

"It was, I think, later in July 1969 that I was sent for once again. No one else was present. Without any fanfare, she asked me whether banking was under my charge. On my telling her it was, she simply said, "For political reasons, it has been decided to nationalize the banks. You have to prepare within 24 hours the bill, a note for the Cabinet and a speech for me to make to the nation on the radio tomorrow evening. Can you do it and make sure there is no leak?" There was no pretence that this was not a political decision, and the message was clear that no argument from me was required. I assured her that we will keep to the timetable and keep the secret. I summoned courage, however, to make two suggestions: to leave the foreign banks alone, and nationalize only the major ones. The former was intended to avoid sharp reaction abroad; and the latter because the purpose would be served by taking only the major banks and leaving the scores of small banks alone. She immediately agreed and added that she could trust the details to me."

A Note on the Political Economy of Policymaking

- Thus, the prime minister could take the decision for a policy change of far-reaching importance purely on narrowly defined political considerations and almost entirely on her own.
- Later in 1980, when Mrs. Gandhi returned to power with a two-thirds majority in the Parliament, a second set of banks was nationalized.

THE CRISIS AND THE FAILED LIBERALIZATION EPISODE (1965–67)

- Recognizing the tight foreign exchange situation in the early 1960s, the government had begun to introduce measures to stimulate exports. These measures included fiscal incentives and import entitlements for exporters.
- Expansionary fiscal policies also led the government to raise the tariff duties.
- In the process, the government also undertook some rationalization of the tariff structure. In 1965–66, it replaced a complex set of tariffs with five rates—15, 35, 40, 60, and 100 percent.

THE CRISIS AND THE FAILED LIBERALIZATION EPISODE (1965–67)

- By the early 1960s, evidence of dissatisfaction with the working of the licensing system led the government to appoint a number of committees to recommend changes.
- The second Swaminathan Committee on Industries recommended for
  - Development Procedures led to delicensing of 11 industries in May1966.
  - The government expanded the list of delicensed items by two in July 1966 and another 29 in November 1966, bringing the total to 42.
  - In addition, two important industries were freed from distribution and price controls—cement in January 1966 and iron and steel (in a phased manner) in May 1967.

THE CRISIS AND THE FAILED LIBERALIZATION EPISODE (1965–67)

- The government cited two criteria for its choice of the industries: They should not require substantial use of foreign exchange for the imports of intermediate inputs and should not pose a threat to the small and cottage industries.
- Many of these developments took place alongside a macroeconomic crisis. While the failure in agriculture was the most important cause of the crisis, borrowing abroad and expansionary fiscal policies played a role as well.

THE CRISIS AND THE FAILED LIBERALIZATION EPISODE (1965–67)

- The year 1964–65 yielded a bumper crop, but it was immediately followed by drought and debacle for two consecutive years.
- During these latter years, industry also went into a deep recession, with industrial growth declining to below four per cent from rates that ranged from 7 to 11 percent in the preceding five years.
- In terms of the government budget, public fixed investment rose at the rapid rate of 11.2 per cent a year from 1961–62 to 1965–66, reaching an unprecedented 9.6 percent of the GDP.

THE CRISIS AND THE FAILED LIBERALIZATION EPISODE (1965–67)

- Government consumption (wage bill plus supplies) rose from 6.5 to 8.9 per cent of the GDP over the same period.
- As a response to the war with China in 1962, defence expenditure doubled from 2 to 4 per cent of the GDP between 1960–61 and 1963–64. The consolidated government fiscal deficit went up from 5.6 percent of the GDP in 1960–61 to 6.7 percent in 1965–66.
- The 1960s saw foreign borrowing on the rise as well.

THE CRISIS AND THE FAILED LIBERALIZATION EPISODE (1965–67)

- Loans from abroad rose steadily from 1.4 percent of the GDP in 1960–61 to 2.4 percent in 1965–66.
- The resulting debt was beginning to build up the principal and interest payments, which reached 21 per cent of the export earnings in 1966–67 and as much as 28 per cent in 1967–68.
- The one-time jump in agricultural output in 1964–65 could not contain the inflationary pressure resulting from the stagnant output during the previous four years.

THE CRISIS AND THE FAILED LIBERALIZATION EPISODE (1965–67)

- The wholesale price index (WPI) rose 11 percent, and food prices 20 percent, in 1964–65.
- In the following three years, food grain price inflation continued unabated at 6, 18, and 20 percent per annum, respectively.
- In this juncture, under the auspices of the World Bank, a mission headed by Bernard Bell was appointed to study the situation and make policy recommendations.
- The Bell mission gave its final report to the World Bank president in August 1965. Its major concern was the low level of foreign exchange reserves.

THE CRISIS AND THE FAILED LIBERALIZATION EPISODE (1965–67)

- It made two major policy recommendations: a shift away from heavy industry and toward agriculture, and devaluation of the rupee accompanied by an end to licensing on the bulk of intermediate inputs and export subsidies.
- The Bell mission also recommended substantial non-project aid for maintenance imports until the reform secured the necessary improvement.
- In June 1966, the government adopted these changes, devaluing the rupee 36.5 percent.

THE CRISIS AND THE FAILED LIBERALIZATION EPISODE (1965–67)

- Fifty-nine "priority" industries, accounting for 80 per cent of the output in the organized sector, were given the freedom to import their intermediate inputs.
- Various export subsidy schemes, including the import entitlement schemes, were withdrawn.
- Unfortunately, this liberalization experiment was destined to fail for at least three reasons. First, the program had not been launched out of a strong conviction for liberal, market-friendly policies. Virtually no constituency within the government was pushing for an outward-oriented, pro-market policy regime.

THE CRISIS AND THE FAILED LIBERALIZATION EPISODE (1965–67)

- Second, on the import side, the timing of the liberalization worked against the success of the program. The liberalization and rupee devaluation coincided with two successive crop failures in 1965–66 and 1966–67.
- Finally, on the export side, in the public perception the rupee devaluation itself failed to deliver the promised response.
- Agriculture registered a hefty growth of almost 15 percent in 1967–68, which led to a substantial reduction in cereal imports, and hence a favorable balance of payments. With a lag, growth in the WPI, which had been 13.9 and 11.6 percent in 1966–67 and 1967–68, respectively, came down to 1.2 percent in 1968–69. Thus, by the end of 1967–68, the crisis and the liberalization attempt were over.

STRANGULATION OF INDUSTRY

- MRTP Act, 1969
- FERA 1973
- Industrial Licensing Policy, 1970
- Press notes on industrial policy dated February 2 and 19, 1973.

Regulation of Big Business Houses

- By 1963, dissatisfaction with the working of the licensing system had begun to attract the attention of the government.
- The government set up a number of committees to suggest improvements in the system in order to address these problems.
- The committees included the Monopolies Enquiry Commission (1964); the two Swaminathan committees (reporting in 1964 and 1966); the R. K. Hazari Committee on Industrial Planning and Licensing Policy (1967); the Administrative Reforms Commission (1968); and the S. Dutt Industrial Licensing Committee (1969).

Regulation of Big Business Houses

- The Monopolies Enquiry Commission had concluded that licensing restricted the entry of smaller firms and led to increased concentration of economic power.
- The Dutt Committee came down particularly heavily on the big business houses, arguing that they had successfully used the licensing system to concentrate economic power in their hands.
- This Committee report effectively set the stage for the enactment of the MRTP Act, 1969, which gave the government sweeping powers to regulate big business houses.

Regulation of Big Business Houses

- The act introduced several new regulations applying to the so-called MRTP companies, which included
  - (1) undertakings with gross assets of 200 million rupees or more,
  - (2) interconnected undertakings with gross assets of 200 million rupees or more,
  - (3) dominant undertakings (defined as having fixed assets of 10 million rupees or more and market share of 33 percent or more), and
  - (4) interconnected dominant undertakings (defined the same way as dominant undertakings).

Regulation of Foreign Investment

- According to Kumar (1994), liberalization of the policy toward foreign capital lasted until the mid-1960s.
- The crisis during 1965–67 inevitably drew the government’s attention to foreign exchange outflows resulting from remittances of dividends, profits, and royalties, and led it to introduce restrictions on foreign investment and technology imports.
- Severe restrictions was imposed in 1968 with the setting up of the Foreign Investment Board (FIB) at the recommendation of the Mudaliar Committee on Foreign Collaborations (1966).

Regulation of Foreign Investment

- The FIB was given authority to make decisions on all projects involving foreign collaboration with total investment no larger than 20 million rupees ($2.66 million) or foreign equity share no higher than 40 percent.
- Decisions on all projects involving total investment of **more** than 20 million rupees or foreign equity share of more than 40 percent were to be made by the cabinet.
- To further discourage imports of technology and investment, the government issued specific lists of products in which foreign investment and technology imports were to be permitted or denied

Regulation of Foreign Investment

- Three such lists were announced: (1) products in which no foreign collaboration would be permitted; (2) those in which technical collaboration, but not foreign investment, would be permitted; and (3) those in which both foreign investment and technical collaboration would be permitted.
- For technical collaborations, the government specified the maximum royalty payments, which generally did not exceed 5 per cent.
- The term of the collaboration was also reduced from 10 to 5 years.

Regulation of Foreign Investment

- While these measures had already begun to choke off the inflow of foreign investment and technology, the Foreign Exchange Regulation Act (FERA), 1973 administered the final blow to them.
- FERA required all nonbank foreign branches and companies incorporated in India that had foreign equity share in excess of 40 percent to obtain permission from the RBI to continue business in India.
- Two sets of exceptions to the 40 percent limit on foreign equity share were granted.

Regulation of Foreign Investment

- First, the guidelines for the implementation of FERA, issued in December 1973, provided that a company could retain foreign equity share up to 74 percent under one of the following conditions:
- It manufactured one or more products in the core sector
  - (a) listed in appendix I of the press note on industrial policy issued on February 2, 1973
  - (b) It engaged in manufacturing and exported 60 percent or more of its output;
  - (c) It used sophisticated technology;
  - (d) It grew tea;
  - (e) It engaged in trade and developed skills or not available indigenously and contributed significantly to exports; or
  - (f) It was a foreign branch of an airline or shipping company

Regulation of Foreign Investment

- The second exception that a maximum of 51 percent of foreign equity in a company would be allowed provided:
  - (a) It exported 40 percent of its production; or
  - (b) At least 60 percent of its output was in the core sector and it exported 10 percent of its total output.
- Companies that took one of the above exceptions and chose not to dilute foreign equity to 40% or less were not given “national treatment.” Instead, they fell into a category that came to be called “FERA companies,” and were subject to FERA discipline as well as many restrictions applied to the MRTP companies.

Regulation of Foreign Investment

- 29(1) forbade FERA companies from acquiring wholly or partially, or from buying shares in, undertakings in India that were carrying on trade, commerce, or industrial activity.
- By December 31, 1982, 895 companies had applied to RBI under section 29 of FERA, 1973. RBI granted approval to 248 companies without dilution of foreign equity (105 of them already had 40 percent or less foreign equity) and to 361 companies after dilution.
- RBI rejected the applications of 97 companies and directed them to wind up operations.
- Approval of foreign collaborations slowed down considerably in the post-FERA period.

Regulation of Foreign Investment

- Kumar (1994, p. 44) states this succinctly:

“*The gradual liberalization of policy in the early post-Independence period in the wake of the economic crisis of the late 1950s resulted in an almost five-fold increase in the number of collaborations approved per year—from 50 during the period 1948–1958 to 297 during 1959–1966. Since foreign exchange was a major constraint during the period, a high (over 36 percent) proportion of the collaborations approved were with financial participation. The restrictive posture adopted by the government during the 1967–1979 periods brought down the average number of approvals to 242. The squeeze on foreign financial collaborations was far more drastic, bringing their proportion down from 36.36 percent during the period 1959–1966 to just 16.11 percent during 1967–1979.*”

Tightening of the Licensing Regime

- The changes in licensing regime were introduced in two steps: the basic framework was introduced in the Industrial Licensing Policy dated February 18, 1970, and additional modifications were made through the press notes dated February 2, 1973, and February 19, 1973.
- The main provisions of Industrial Licensing Policy of February 18, 1970 were

  1. The policy introduced a list of nine “core” industries that were seen as basic, critical, and strategic products industries. It also deemed all new investments of over 50 million rupees as part of the “heavy investment sector.” The “larger industrial houses,” defined as those with fixed assets of 350 million rupees or more, and foreign firms were confined to investing in these (core and heavy) sectors.

Tightening of the Licensing Regime

- 2. The policy raised the exemption limit on licenses for new undertakings, and also provided for substantial expansion of existing capacity, from 2.5 million rupees to l0 million rupees in investment in fixed assets (land, building, and machinery).
- 3. For undertakings with investments ranging from 10 to 50 million rupees, license applications of parties other than those belonging to the larger industrial houses and foreign firms were to be given special consideration.

Tightening of the Licensing Regime

- 4. The policy continued the existing policy of reservation for industries in the small-scale sector and stipulated that such reservation would be extended from time to time.
- 5. The 42 industries that were delicensed in May, July, and November 1966, brought back into the licensing ambit under the above point 2.
- 6. The past provision of diversification allowing the manufacture of new articles up to 25 percent of the licensed capacity was continued, but foreign firms and domestic firms with 50 million rupees or more in fixed assets were excluded from this provision. Further, the expansion of output was not to require installation of additional machinery and equipment.
- 7. The larger industrial houses and foreign firms were permitted to operate outside the core and heavy investment sectors, provided they undertook to export at least 60 percent of the additional output within three years.

TWO PRESS NOTES

- Two press notes issued by the Ministry of Industry in 1973 further tightened the scope of larger undertakings.
- The note dated February 2, 1973, consolidated the core and heavy investment sectors into 19 industries.
- In turn, the note dated February 19, 1973, restricted future investments of all MRTP companies and foreign firms to the 19 industries.
- The two press notes together also excluded all MRTP and foreign firms, and existing undertakings with 50 million rupees or more in fixed assets, from the licensing exemption.

Foreign Trade

- By 1970–71, import controls and export subsidies had returned with full force.
- Every six months, an import policy with a list of products that could be imported was issued.
- For each listed product, the policy identified the users of inputs that could import it and the proportion of their requirement allowed being imported.
- With rare exceptions, consumer goods were entirely excluded from the list.

Merchandise Exports and Imports as proportion of the GDP_{mp}, 1965-81

Year	Exports/GDP	Imports/GDP
1965–66	2.9	5.1
1966–67	3.7	6.6
1967–68	3.3	5.5
1968–69	3.5	4.9
1969–70	3.3	3.7
1970–71	3.4	3.6
1971–72	3.3	3.7
1972–73	3.7	3.5
1973–74	3.8	4.5
1974–75	4.3	5.8
1975–76	4.8	6.3
1976–77	5.7	5.7
1977–78	5.3	5.9
1978–79	5.2	6.2
1979–80	5.3	7.6
1980–81	4.7	8.7

Foreign Trade

- Starting in 1976, the import control system was reorganized, and some piecemeal liberalization began along with industrial deregulation.
- During the 1970s, exports grew very rapidly because of the real depreciation of the rupee.
- But increased remittances from workers and external borrowing allowed the total imports to grow faster, with the imports-to-GDP ratio rising to 8.7 percent in 1980–81.

FACTOR MARKET REGULATIONS: LABOR AND LAND

- Labor market regulations had begun to turn unfriendly to growth in phase I.
- The march toward socialism in phase II introduced a key amendment to the Industrial Disputes Act (IDA), 1947 in 1976 that made it virtually impossible for the larger firms to layoff or retrench workers.
- The amendment was introduced through the addition of chapter V.B to IDA. The chapter defined an establishment to include factories, mines, and plantations, and provided that establishments with 300 workers or more must get prior permission from the appropriate government authority to retrench one or more workers.

FACTOR MARKET REGULATIONS: LABOR AND LAND

- In 1982, the limit on the establishments subject to the provision was revised downward to just 100 workers.
- As a result, labor strikes became endemic, with the owners of large establishments unable to resist the escalating wage demands of the unions.
- This situation increasingly drove entrepreneurs away from labor-intensive, and toward capital-intensive, firms that did have to employ labor looked for ways to rely on contract labor, which did not have the protection provided by the IDA.

FACTOR MARKET REGULATIONS: LABOR AND LAND

- New regulations were also introduced in the land market.
- The government passed the Urban Land (Ceiling and Regulation) Act (ULCRA) in 1976. It fixed a ceiling on how much vacant urban land could be acquired and held in an urban agglomeration by an individual, a family, a firm, a company, or an association or body of individuals, whether incorporated or not.
- This ceiling varied from 500 to 2000 square meters, with the lower limit applying to the great cities.
- Holders of excess vacant land had to either surrender that land to the competent authority appointed under the act for a small compensation, or develop it only for specified purposes.

NATIONALIZATION OF BANKS

- Nationalization Bank was a major policy changes introduced during phase II.
- RBI, was created through the RBI Act, 1934, commenced operation on April 1, 1935, and nationalized in 1949.
- The first major state-owned commercial bank in India was the SBI
- In 1969, there were 79 scheduled and 16 unscheduled commercial banks in India. The SBI was by far the largest bank, accounting for 31 percent of the scheduled bank branches.

NATIONALIZATION OF BANKS

- But the government held the view that
  - (i) the banking sector as whole primarily served the industrial and urban areas at the expense of agriculture and rural areas;
  - (ii) the banks ignored small entrepreneurs and concentrated lending on big corporations, and
  - (iii) frequent bank failures were also a concern.
- Government realised that many of these concerns could not be addressed without nationalization.

NATIONALIZATION OF BANKS

- This was accomplished through the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1969, which nationalized all banks whose nationwide deposits exceeded 500 million rupees.
- This criterion brought an additional 14 banks, and 54 percent of the bank branches, into the public sector.
- An amendment of the Banking Companies Act in 1980 brought another six of the largest private banks into the public sector.

Scheme of Presentation

- Introduction
- The political context in Phase II
- A Note on the Political Economy of Policymaking
- The crisis and the failed liberalization episode (1965–67)
- Strangulation of Industry
  - MRTP Act, 1969
  - FERA 1973
  - Industrial Licensing Policy, 1970
  - Press notes on industrial policy dated February 2 and 19, 1973.
- Foreign Trade
- Factor Market Regulation: Labour and Land
- Nationalization of Bank
- Nationalization of Insurance
- Agriculture
- Saving and Investment

NATIONALIZATION OF INSURANCE

- The origins of the life insurance industry in India can be traced back to the Oriental Life Insurance Company, which began operations in 1818.
- The first company to insure Indians at “fair value” was the Bombay Mutual Life Assurance Society, beginning in 1871.
- The first general insurance company to operate in India was the Triton Insurance Company, established in 1850.
- The Indian Mercantile Insurance Company, Ltd., established in Bombay in 1907, was the first indigenous general insurance company.

NATIONALIZATION OF INSURANCE

- The Insurance Act, 1912 provided the first legislation aimed at regulating the insurance companies.
- By 1938, more than 100 insurance companies were operating, but the industry was plagued by fraud.
- The Insurance Act, 1938 was passed to give order to the industry; it also brought other fundamental changes, including the creation of an insurance wing in the Ministry of Finance.

NATIONALIZATION OF INSURANCE

- The next major development in the insurance sector was the Life Insurance Corporation Act, 1956 which nationalized life insurance in India.
- In 1956, 170 insurance Companies – 154 Indian and 16 foreign – and 75 provident societies actively issued life insurance policies, and their operations were concentrated mainly in Bombay, Delhi, Calcutta, and Madras.

NATIONALIZATION OF INSURANCE

- Three factors motivated the government’s decision to nationalize life insurance:
  - (1) private companies limited their operations to the major cities, and there were no prospects of their offering life insurance in the rural areas;
  - (2) the government felt it was better positioned to channel the savings so generated into development; and
  - (3) bankruptcies of life insurance companies had reached epidemic proportions.

NATIONALIZATION OF INSURANCE

- The General Insurance Business (Nationalization) Act, 1972 set up the General Insurance Corporation (GIC) as a holding company with four subsidiaries: New India, Oriental, United India, and National Insurance (NOUN).
- The original intent was that these companies would compete with one another in the market.

AGRICULTURE

- The most important positive development during phase II was the successful launch of the Green Revolution.
- India was in the grip of a food crisis in the mid-'60s. It was indeed a situation of a *ship-to-mouth* food economy.
- Efforts were being made in India to raise foodgrain production since the early 1950s, but without any major success.

AGRICULTURE

- In March 1963, Norman Borlaug visited India and sent in 100 kg of seed for each of the four high-yield varieties (HYV) of wheat for trials. Lerma Rojo and Sonora 64 performed best.
- C. Subramaniam, the then minister for agriculture in Shastri's Cabinet, realized that agriculture sector was weak and under severe pressure because of low-yielding varieties of seeds and an exploding population.

AGRICULTURE

- He began to systematically set the stage for an overhaul of the way foodgrain was grown, sold and distributed. He started off with a remunerative price policy for farmers, which gave birth to the Agricultural Prices Commission and Food Corporation of India in 1965.
- An officer, Ralph Cummings from Rockefeller Foundation met Subramaniam and told him about HYVs of wheat, but also conveyed that Indian scientists and bureaucracy were going very slow on these.

AGRICULTURE

- In 1965, 250 tonnes of Sonora 64 and Lerma Rojo were imported for seed multiplication, which yielded about 5,000 tonnes of seed.
- Now, he wanted to import a large quantity of these HYV seeds from Mexico to give the effort a single, massive boost. But there was severe opposition to it in Parliament as well as in public fora, especially from the Left parties, some economists and bureaucrats.
- Finally, 18,000 tonnes of HYV wheat seeds were imported in 1966 and cultivated.

AGRICULTURE

- India harvested 17 million tonnes of wheat in 1967-68, five million tonnes more than the previous best of 12 million tonnes.
- There was no place to store this sudden burst of grain. Schools in rural Punjab were closed down to store the new harvest in classrooms.
- Indian scientists quickly got down to the job of indigenising these Mexican varieties, especially their colour and baking qualities. M.S. Swaminathan, G.S. Athwal, S.P. Kohli, V.S. Mathur, to name a few, took a lead in this daunting task.

AGRICULTURE

- Today India harvests more than 94 million tonnes of wheat.
- Whom do we acknowledge for this wonder on the food front? There is no doubt that Subramaniam's vision, dynamism and design to launch what is now called the new agricultural strategy was unique for which he was honoured with a Bharat Ratna in 1998.

SAVINGS AND INVESTMENT

- Another important achievement of phase II was the steady rise in the savings rate.
- Gross savings climbed from 12–13 per cent in the first half of the 1960s to 18–19 percent by the mid-1970s and to 21–22 per cent by the late 1970s.
- While an increase in income was the key factor behind the increase, greater access to banks probably played a role as well.

SAVINGS AND INVESTMENT

- The rapid increase in the savings rate helped in two ways. First, it more than made up for the sharp decline in the inflow of foreign financial resources during this period. Second, it prevented an even sharper decline in the economic growth rate.
- All of the growth in private investment was concentrated in the household sector. This investment as a percentage of the GDP rose from 4.9 per cent in 1964–65 to 9.7 percent in 1980–81.

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SAVINGS AND INVESTMENT

- Investment as a percentage of the GDP in the corporate sector actually fell from 3.6 percent to 2.5 percent of the GDP over the same period.
- The decline took place despite a rise in financially intermediated household savings from 2.9 percent of the GDP in 1964–65 to 6.3 percent in 1980–81.
- Though the government absorbed much of the increase in household financial savings, public investment did not rise correspondingly.

Reference

- Panagariya, Arvind (2008): *India: the Emerging Giant*, Oxford University Press, New York, Pp.47-77

Thank you