Understanding Economic Growth of India: A Historical Perspective

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Abstract

India's economic growth trajectory has been shaped by a complex interplay of historical legacies, political institutions, policy choices, and societal constraints. From independence in 1947 to the present, India has undergone several phases of economic transformation—state-led development, cautious liberalization, structural reforms, and a period of high growth followed by uneven progress. This paper examines India's economic growth through a historical lens, analyzing how institutions, crises, political bargains, and global forces shaped key reforms. The paper argues that India's growth experience is fundamentally path-dependent, influenced by democratic negotiations rather than top-down state autonomy. Understanding this trajectory is essential for explaining both the successes of post-1991 reforms and the persistent challenges of inequality, agricultural stagnation, and uneven human development.

Introduction

The Indian state has always been more open to influence from social groups than many of its East and Southeast Asian counterparts. Unlike China, India neither eliminated private enterprise nor embraced globalization with the same speed or intensity. Achieving either full nationalization or an aggressive state-led push toward globalization would have required a state capable of exerting far stronger control over influential groups such as industrialists, farmers, and trade unions. In India, policies aimed at economic growth and development had to emerge gradually, built step-by-step through broad social agreement. This created a development model shaped by constant negotiation between the state and society, where even at its strongest, the state's authority was tempered by the power of social actors.

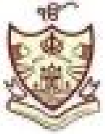
India's growth trajectory began to resemble China's only after 2003. A major shift occurred after 1991, when reforms transformed attitudes toward private enterprise and global trade. Growth averaged more than 6 percent from 1991 to 2004, and climbed above 8.5 percent between 2003 and 2007. This surge placed India among the fastest-growing economies in the world, second only to China (Acharya, 1984 and Mohan, 1992).

India's democratic complexity and the often messy nature of its policy processes are widely recognized. Much of the literature on East Asian developmental states emphasizes state autonomy—the ability of governments to distance themselves from powerful societal interests. India, in contrast, was long portrayed as a country where politics and patronage hindered industrialization and growth. Yet India's sustained post-1991 economic expansion challenges this narrative and raises important questions.

This paper explores the many twists and turns in India's development policies since independence in 1947—policies that ultimately produced the country's high-growth phase. It also examines why certain sectors, such as telecommunications and the stock market, became globally competitive, while others, like power generation, continued to lag. Finally, it investigates the social and political roots of persistent issues such as low literacy rates, agricultural decline, enduring poverty, and rising inequality.

The Political Economy of Growth

The Indian state's relationship with business has varied over time, shaped largely by how much influence business houses could exert within the political system. From independence until the late 1960s, regulation was moderate. This changed dramatically between 1969 and 1974, when the government imposed tight controls on both domestic and foreign firms. Low productivity, poor growth, and the rising demands of an increasingly mobilized population eventually pushed India toward gradual liberalization between 1975 and 1990, giving the private sector more room to operate. Yet the tilt toward state ownership and self-reliance did not fully recede until the balance-of-payments crisis of 1991. That crisis opened the door for a technocratic leadership—convinced of the need for globalization and private enterprise—to use India's reliance on IMF assistance to push through decisive reforms. After this shift, India's private sector flourished, and its rise has been closely linked to the country's later high-growth phase (Patnaik, 1987 and Dhar, 1988).



The Slow-Growth Phase: 1947–74

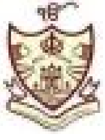
At independence, the business community held significant sway, having supported the freedom movement even at the cost of short-term profits. Leaders like Gandhi publicly praised Indian industrialists as “trustees” of wealth who were expected to act in society’s interest. Debates also raged over the role of the Planning Commission—whether it would implement or merely advise. Ultimately, ministries retained most of the control, relieving the private sector of the fear of Soviet-style centralized planning. Industrial controls began formally with the Industrial Development and Regulation Act of 1951 but Industrial Policy Resolution of 1956 limited private enterprise much more sharply (Ahluwalia, 1996). The Second Five-Year Plan emphasized heavy industry and strengthened the Planning Commission’s authority, earning it the title of “super-cabinet.” Foreign investment was generally welcomed and industrialists like Birla continued to participate in electoral politics. Yet business remained dependent on the state for direction and permissions—Tatas could make steel but not cars, while the Birlas had the opposite experience (Viramani, 2004).

In 1964, Lal Bahadur Shastri succeeded Nehru and—surprisingly—began reversing major elements of the Nehruvian model. He decontrolled steel and cement, and under his leadership India devalued the rupee to encourage exports. Scholars argue that India might have moved toward an East Asian-style trade-oriented model. However, widespread domestic skepticism about trade promotion made such reforms difficult (Brecher, 1977) .

Indira Gandhi and the Shift toward State Dominance (1969–74)

Indira Gandhi became Prime Minister after Shastri’s sudden death in 1966. She faced a severe economic crisis marked by drought, the 1965 war with Pakistan, food shortages, and dependence on PL-480 wheat imports from the US. With scarce resources, India sought external aid and under donor pressure, agreed to a temporary liberalization and a major devaluation in 1966. But there was no internal consensus: industry opposed the devaluation, intellectuals condemned it, and Parliament fiercely resisted. Consequently, the liberalization attempt collapsed (Kudaisya, 2002).

By 1969, the government reversed course. Indira Gandhi nationalized banks, coal, insurance, wheat procurement, and parts of steel. The MRTP Act placed stringent limits on big business.



Even giants like Birla and Tata lost influence. The Foreign Exchange Regulation Act (1974) further restricted multinational companies, prompting firms like IBM, Coca-Cola, and Shell to leave India. This sharp turn toward socialism also had political roots: Indira Gandhi used nationalization and left-leaning policies to undercut the Syndicate within the Congress Party and solidify her authority. Her coalition with socialist and communist leaders lasted until about 1974 (Kohli, 1989). However, by the mid-1970s, economic stagnation, inflation, and social unrest spiralled (Mukherji, 2008).

The Moderate Growth Phase: 1975–90

Despite political turbulence, the period after 1975 marked a slow but steady shift toward private-sector orientation, setting the foundation for later reforms. Growth exceeded 5 percent during this phase. As early as 1975, the government created a special Cabinet Committee on export promotion. Influential internal reports criticized rigid controls and pushed for freer imports for exporters. The newly created Department of Electronics anticipated India's software potential long before it emerged (Balasubramanyam and Forsyth, 1978). In the 1980s, both Indira Gandhi and Rajiv Gandhi recognized the success of China's export-led model and the inefficiencies of the Soviet system. Yet unlike China, India could not rapidly dismantle decades of regulation due to political constraints. Industry itself was protectionist and often resistant to competition—famously opposing any attempt to increase automobile production capacity in light of the upcoming Maruti–Suzuki venture (Ahluwalia, 1987; Joshi and Little, 1989). Still, several significant reforms were achieved as industrial deregulation, telecommunications reform, shift in business state relations, birth of software industry**.** Researchers (Ahluwalia 1991; Acharya 1984; Mohan, 1992; Kelkar, 1987) found the intellectual blueprint for the 1991 reforms. By 1990, even before the crisis hit, India had begun thinking seriously about economic restructuring.

The High-Growth Era: 1991–Present

The 1991 balance-of-payments crisis marked a decisive break. Unlike 1966, India did not retreat once conditions stabilized. This time, technocrats within the government believed deeply in globalization and used IMF leverage to advance reforms.

Finance Minister Manmohan Singh—already known for his pioneering research on the role of trade in development—led the reforms with strong support from Prime Minister Narasimha Rao. Singh argued that fiscal excesses and low productivity had caused investor pessimism and external imbalances. Rao, understanding the geopolitical shifts after the Cold War, allowed his finance minister significant autonomy.

Why did industry accept reforms it had resisted earlier? Because India had only two weeks of foreign exchange left and desperately needed IMF assistance. Without it, domestic industry would not even have been able to import essential inputs. The Confederation of Indian Industry (CII), which Rajiv Gandhi had helped shape, became a key supporter of the reforms (Thomas, 2005).

Technocrats agreed with the IMF on trade, investment, and industrial policy reforms, but diverged on issues such as fiscal contraction and labour reforms. Importantly, India's restructuring of telecommunications, stock markets, and airlines was inspired internally, rather than imposed by the World Bank. Singh declared in 1995 that globalization in India had become irreversible—a statement that has proved true across successive governments (Kelkar, 1987).

Drivers of Post-1991 Growth: Tariff liberalization reduced costs of intermediate goods and made Indian finished products more competitive. India also expanded its network of preferential trade agreements. The other factors that also determined the economic growth are industrial de-licensing, rupee devaluation, selective openness to foreign investment. Sectors such as IT services, business process outsourcing, pharmaceuticals, and automotive components helped India integrate into global value chains. Post-2003, manufacturing also gained strength. Indian firms expanded overseas—Tata's acquisition of Tetley and Corus being landmark examples.

Infrastructure Reforms

India has seen remarkable progress in areas like telecommunications, aviation, stock markets, and banking. But not all sectors have moved at the same pace—power reforms remain largely unsuccessful, and progress in ports, airports, and highways has been uneven. Indian Railways,

meanwhile, has slowly become more commercially focused as it faces competition from both improved road networks and low-cost airlines.

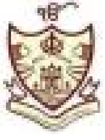
One striking pattern across the successful sectors is that reform did not depend on privatizing state-owned firms. Instead, India introduced competition by creating space for private players to challenge government monopolies. Crises often played a key role in pushing incumbents to accept this competition. Importantly, with the exception of the power sector, most of these reform stories emerged from India's own political and administrative processes—messy, democratic, but ultimately effective (Joshi et al. 1996; Subramanian & Dani, 2004; Panagariya, 2005).

Challenges for Development

India's high growth has not been equally shared. Agriculture has stagnated since the mid-1990s. Rigid labor laws encourage firms to remain capital-intensive, limiting employment growth and expanding the informal sector. Manufacturing continues to face regulatory bottlenecks, and human development indicators—especially in primary education and healthcare—remain weak. Although poverty has declined, a more inclusive growth strategy would have reduced poverty faster (Aggarwal, 2011, Datt et al. 2020).

Agriculture: A Second Crisis in the Making

India appears to be heading toward a second agrarian crisis. The first crisis of the 1960s stemmed from the neglect of agriculture during a period of heavy industrialization. After 1966, India corrected course by investing in farm technology, irrigation, and pricing policies, which led to the Green Revolution and eventual food self-sufficiency (Rao, 2005). But between 1996–97 and 2004–05, agriculture grew at only about 1.65 percent, even though the sector supports over 60 percent of the population. Subsidies for better-off farmers—such as free power, water, fertilizer, and price supports—remain entrenched, while broader public investment has dropped. For example, the 2008–09 farmer loan waiver of US$15 billion bypassed 80 percent of marginal farmers who lacked access to formal credit. Using that money to drought-proof 60 million hectares would have had far wider benefits. Democratic politics often gets captured by powerful interest groups, obstructing long-term development (Frankel, 2005; Chakraborty, 2011).



Labor Laws: Obstacles to Job Creation

The Industrial Disputes Act protects less than 10 percent of the workforce by making it extremely difficult to dismiss workers in firms with more than 100 employees. Since obtaining government permission for layoffs is hard, most unionized workers remain concentrated in the public sector. Private firms respond by avoiding unions altogether and outsourcing work to smaller units that fall outside labor law coverage. The result is high capital intensity, low employment generation, and a weak employer–worker contract. For inclusive growth, India needs labor-intensive industries supported by rational, balanced labor laws (Panagariya, 2008; Daughert, 2009).

Regulation, Infrastructure and Investment Climate

India's regulatory environment still makes it harder to invest in manufacturing compared to China. Firms require numerous approvals from state and central governments—for land, labor, energy, water, environment, and taxes. These procedures often become avenues for rent-seeking rather than transparent decision-making. Poor infrastructure—especially roads, ports, airports, and electricity—further hinders industrial competitiveness. Some proactive states have begun streamlining procedures and building more investor-friendly institutions, but progress is uneven (Pedersen, 2000).

Land Acquisition: The Need for Consent and Fairness

As industrialization expands, demand for land has grown. Land acquisition must be rooted in the consent of local communities, with clear compensation and welfare measures. Fertile, multi-cropped land should generally be avoided. Forced acquisition has triggered unrest in several regions, whereas states like Tamil Nadu, Andhra Pradesh, Gujarat, and Maharashtra have had more success by involving local people and ensuring development benefits (Bardhan & Mookherjee, 2011; Roy, 2009).

Entrepreneurship and Interstate Inequality

Indian entrepreneurs have thrived despite bottlenecks, especially in sectors like software that depend less on physical infrastructure and more on telecommunications and financial

systems—areas where India succeeded after 1991. Interstate inequality has grown since reforms began. As central funding declined, states had to attract private investment. Well-governed states advanced more rapidly, while lagging states fell further behind (Singh, 1999; Bardhan & Kroll, 2006).

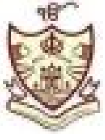
Education and Health: Persistent Gaps

Unlike many Asian countries, India did not eliminate illiteracy early on. India's elite tolerated child labor, which deprived millions from education. States like Kerala, Goa, and Mizoram improved literacy through social mobilization and missionary education. Rajasthan saw progress thanks to NGOs such as Sewa Mandir and the Social Work Research Centre, while Andhra Pradesh benefited from the work of the MV Foundation. Despite improvements, India's literacy rate of 61 percent in 2001 lagged behind China's 91 percent. Health outcomes were similarly disappointing. Infant mortality fell sharply in the 1980s but slowed dramatically in the 1990s. By 1999, Bangladesh had overtaken India in infant survival rates. Inequality in health outcomes is stark: the poorest 20 percent in India have worse IMR than Pakistan and Bangladesh, while the richest 20 percent outperform both countries.

Poverty and Inequality

Studies by Deaton and Drèze shows that the share of Indians living on less than US$1 per day dropped from 36 percent in 1993–94 to 26 percent in 1999–2000. Even so, India has around 270 million people living in absolute poverty—far more than China's 110 million. Economic gains have benefited the middle and upper classes far more than the poor. While India's income inequality is lower than that of China, the US, Singapore, and Latin America, it is higher than in Pakistan, Bangladesh, and most of Europe. Rising inequality poses risks for social stability within a democracy. The World Bank's 2022–23 figures place India's Gini coefficient at 25.5**,** one of the lowest globally, though critics note that income-based measures may understate wealth and gender inequality.

Conclusion: India's economic journey has been shaped by its history. From 1947 to 1975, policy emphasized state leadership in a closed economy. Gradual shifts toward deregulation began in the mid-1970s, laying the foundation for the sweeping reforms of 1991. Change took time because powerful groups benefitted from the old system and resisted new policies.



Unlike China's rapid shifts, India's reforms evolved slowly through democratic consensus—making them harder, but also more durable. Crises played a decisive role in breaking opposition. The drought and foreign exchange crisis of 1966 pushed India toward agricultural reform; the 1991 crisis pushed it toward globalization, trade liberalization, and competition-driven industrial policy. Post-1991, India's strategy of private-sector promotion through competition, rather than privatization, proved highly successful. The public sector adapted, especially in telecom and aviation, entrepreneurship flourished.

The main challenge now is inclusive growth. Although reforms improved living standards and reduced poverty, the poorest have benefited the least. Industrialization remains skill- and capital-intensive, even though hundreds of millions still live on less than a dollar a day. Without major advancements in education, health, agriculture, and labor-intensive manufacturing, India risks slowing it's long-term growth. India's growth is no longer debated in terms of 3 percent vs 6 percent—the question is whether it can sustain 6 percent, 8 percent, or even 10 percent. This is a major achievement for a large democracy. But sustaining high growth and ensuring that millions more join the middle class will require an active, capable state working hand-in-hand with society.

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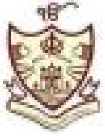

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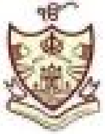

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