CHAPTER 1

INTRODUCTION
1.1 Underpinnings of Development in Theories of Economic Growth

After facing an identity crisis for years, at last development found its niche in the realm of theories that were said to throw light on the growth paths travelled by the developed economies. The ever changing perspective of development has had different meanings and connotations over the time-period. Though, development would mean graduating to a continuously progressive state but, then again it varied with myriad hues. And one of the most primitive forms that happen to define development is economic development. The obviousness of its definition ruled the train of thought for fairly long time. The perfect interweave of economic growth and development was praised in full vigour.

Here, we would like to take a minute to mention that economic development was deemed to be understood as both economic and social development. For others, social development was reckoned to be an offspring of economic development which meant that if countries could attain economic development, social development would follow. Moreover, economists who devoted their understanding to trace the development path of nations came out with development theories that were formed in the backdrop of developed nations that left the intricacies of underdeveloped countries unfathomed. It is contended by many economists that the studies undertaken by the economists of these times (1950s) were centred on the already developed nations. For developing nations, these doctrines were inflicted upon them as panaceas for their backwardness. In fact, economists did not have conceptual apparatus to address the issues faced by Third World countries after World War II (Todaro, M.P. & Smith, S.C., 2003).

Until a long period of time, economic development traced its origin in the definition of economic growth and economic growth in turn had a magical measuring rod in GNP. Higher the GNP of a country, higher will be the country's economic growth and higher would be the resultant economic development. That is to say that the implied meaning behind the higher growth of a country meant that it was also experiencing development. Many economists missed the conspicuous element of distinction between the ardent association of development and growth. Brinkman, R. (1995) beautifully highlights how Kuznets used the term Economic Growth when he
actually talked of structural, institutional and technological transformation and Rostow’s stage approach which actually was the result of ‘developmental process of sequential structural transformation’. He remarks by adding that a tepee cannot become a skyscraper simply by growing i.e. more and more of a replication of growth structure would not ensure development.

Hence, economic development is a much wider concept than economic growth because it takes into account the structural transformation that an economy undergoes and not only the increases in aggregate product.

1.2 Growth and Development in Indian Context

Though, economists while discussing growth and development theories found it easier to distinguish the countries on the basis of economic growth (read GDP figures), but not all countries clubbed together under the hat of underdeveloped economies display the same pattern of growth though they may loosely face similar issues of development. And when the issues were similar, the approach differed because of different political ideologies and economic policies. The road to development as travelled by an underdeveloped country at its formation like India presents an interesting case for studying development dynamics of an underdeveloped economy because of Fabian socialism that was at the heart of development.

On the eve of independence, the mammoth Indian economy stood looming towards its stagnation. With abysmally low income, consumption and saving levels, the vicious trap of poverty was difficult to unfetter. The embryonic state of Indian economy was festooned with a rural setup and traditional agriculture dominance which provided a no-escape route from the stagnant economy. The lack of capital formation because of low savings could not provide a thriving base for the entrepreneurs to flourish. Even if they managed, the limited size of the market demand offered additional hurdles thereby limiting productivity surge in the economy. Moreover, the occupational structure was heavily skewed towards the agriculture sector with more than 70 per cent of the employed workforce contributing 50 per cent to the national income. The irony of the fact was that bulk of human resource could not produce food that could suffice the needs of the countrymen. Furthermore, the low level of industrialization crippled the prospects of the
development of the economy. In 1950-51, approximately 2 per cent of the workforce was employed in the organized industries when less than 11 per cent of the total workforce found employment in the whole industrial sector. As Chakravarty S. (1984) notes that shortage of savings was a limiting factor in accelerating the rate of material capital formation for Indian economy. The possible causes of structural backwardness as identified by Chakravarty S. (1989) were: lower level of capital accumulation owing to low savings, structural limitations in converting savings to productive investment, assumption that surplus labour will be absorbed by the industrial sector operating on increasing returns of scale, again assuming that with a market led growth strategy, excessive consumption by upper income groups with a simultaneous under-investment in sectors that are deemed essential for the accelerated development of economy and sudden transformation of ownership of productive assets that further fuelled the income inequality gap.

Bhatt, V.V. (1982) argues that at the time of independence, the growth strategy adopted by India was part of the inward-looking protectionist policies. The economic ideologies adopted were such that could fathom the framework of newly independent India. And therefore, development models of successful countries were taken into consideration.

The State-led development with its autonomous bureaucratic agencies, regulations and legislations envisaged a trajectory of State led industrialization in 1947. In the aftermath of Second World War, the role of a developmental State in the form of State intervention was revered but the Indian model of development suggested that the crippling effect of State failures was more pronounced than market failures.

The wounded economy of India strongly abhorred the idea of an open economy which was the result of the bitter experience of subjugation under British colonial rule. Though, Desai, M.(2007) strongly contends that British did not de-industrialize India as by the time of Independence, India had one of the largest railway networks, jute and textile industries of world stature. Although, opening up of the economy brought with it a wave of multi-faceted development but somewhere, it was felt that the trade contacts with Portuguese, European and English proved detrimental to the national autonomy which was suspected to be the main reason for
subjugation and an economic drain of the national wealth. And so, the leaders of Independent India opted for higher trade barriers, import substitution and control practices for international trade. In a way, it can be said that the advantages of international trade were intentionally thwarted to encourage self-reliance.

India ushered into a Centralized Planning Model where it undertook planned model of development in the form of Five Year Plans to make the process of planning more target oriented and time-framed. As mentioned above, the Indian planning model was quite influenced by the Soviet model of Planning. The setting up of objectives was in the backdrop of the developmental issues faced by the country. And it was observed that industrialization was greatly stressed since Second Five-year Plans as the focus of the First Five Year Plan was to attain food self-sufficiency. Apart from laying emphasis on attaining food self-sufficiency, the centralized planning model also laid greater stress on self-reliance which in a way meant an inward looking strategy by pressing on import substitution. The protectionist policies adhered to were intended to make the country self-reliant. Under the aegis of the first Prime Minister of India, India ventured into the era of planned economic development. The focus of the multi-pronged strategy of Five Year Plans was quite evident in the First Five Year Plans.

India at its nascent stage after independence needed heavy infrastructural and industrial investments to stimulate the growth wave in the economy. Rangarajan clearly outlines the fact that India in its move to accelerate economic growth which was identified with industrialization at that time went on with heavy emphasis on heavy industries as that could help to build the infrastructural base of the country. The objectives set forth by the leaders of the independent India found solace in the theory of socialism where the highest autonomy in decision-making rests with the State. Socialism as an economic theory/idea states that the Govt. should be in charge of economic planning, distribution of goods. Soviet Union was a great proponent of socialism. But, gradually with time the pitfalls of this system was being felt ever so strongly.

The rebuilding of the country needed a well-articulated and planned strategy in the wake of heavy agricultural imports, inflationary trends in the economy and also the aftermath of the Second World War. But as argued by Rao, V.K.R.V. (1952), the
First Five Year Plan was not a plan de novo for the economic development of India as the role was more of integrating the existing Central and state programmes that had started before the Five Year Plans were made because writing off the old schemes would mean scrapping off the huge expenditures undertaken for irrigation and power projects in the midway. He also argues that the First Five Year Plan did not mention the roadmap for economic development but was more of a recuperating mechanism for the shattered economy. With greater emphasis on agriculture, irrigation and power projects and public sector undertakings, the country adopted the socialist approach. But, it would be worthwhile to mention here that though the approach could be termed as socialist but the elements of capitalism were integrated to give the mixed economy approach. At least, so was mentioned in the Commission which urged the private sector to provide its dynamism to the production and distribution system of the economic machinery. But, the greater leeway enjoyed by the public sector in its operations thwarted the entrepreneurial spirits of the private sector. Moreover, bottlenecks in the form of obtaining licenses because of elaborate procedural delays i.e. red-tapism was the most annoying forms of supporting economic growth in a country which strived for a major boost from the Govt. machinery.

It was by this time that the need for reformatory policies was felt and in fact steps were taken in this regard.

1.3 Economic Reforms: Expectations and Consequences

Kapila, U.(2008) in her articulate analysis of the reform process mentions how the macroeconomic crisis owing to both the internal and external shocks paralysed the economy. Increased public spending leading to inflated budget deficits during the 1980s along with liquidity crisis of 1999-91, collapse of India’s major trading partner, Soviet Union and Gulf War of 1991 coupled with lowering of credit rating for India’s short and long term borrowings brought the Indian economy to a severe fiscal crisis. By borrowing from IMF and mortgaging gold to the Bank of England, the govt. had to further resort to stabilisation policy and structural reforms to fight the menace.

Economic Reforms broadly concentrated around the following areas:

- **External Sector/Trade Policy Reforms**: The tighter control of the economy was an attempt to regulate balance of payment and henceforth protect the
This phase was characterized by high tariff structure, quantitative restriction on imports, ban on manufactured consumer goods, import licensing with non-transparent delays. With the reformatory measures, the import licensing system was done away with and excepting consumer goods, all Non-tariff barriers were phased out. (Kapila, U. 2008)

• Industrial Sector Reforms: Abolition of industrial licensing, opening of industries like roads, petroleum refining, ports etc. to private sector that were exclusively kept for public sector; restrictions on threshold limits for investments by large industrial houses under MRTP Act were abolished; liberal outlook towards foreign direct investment was adopted (Kapila, U. 2008). Eighteen industries viz. iron and steel, heavy plant and machinery, telecommunications and telecom equipment, minerals, oil, mining, air transport services and electricity generation and distribution solely covered by public sector were now reduced to three namely defence aircrafts and warships, atomic energy generation, and railway transport (Ahluwalia, M. S. 2002). Disinvestment of public sector enterprises among others was some of the radical changes that the New Industrial Policy of 1991 brought with it.

• Financial/Banking Sector Reforms: To bolster higher investment in once closed now open economy, the need for a vibrant financial sector was the much Mohan R. (2006) divides financial sector reforms into two phases viz. first generation where financial system functions with operational flexibility and functional autonomy and second generation reforms provided for structural facelifts in the financial system. Kapila, R. and Kapila, U. (2002) highlight four major directions of financial sector reforms (a) removing the operational constraints of financial system by liberalizing Cash Reserve Ratio and Statutory Liquidity Ratio (b) relaxing entry and exit norms, access of banks to capital markets for meeting their fund requirement, reduction in public ownership of public sector banks (c) interest rate liberalization and operational flexibility for asset management and (d) prudential norms to ensure safety of financial system.

Apart from this, exchange rate reforms brought about full convertibility on current account. In addition to this, the inflated fiscal deficits which posed as a
serious macro-economic deterrent to sustainable economic growth required effective stabilisation policies. Kapila, U. (2008) argues that although bringing down fiscal deficit from 8.2 per cent of GDP during late 1980s to 5.7 per cent in the post reform period was commendable, but the method adopted to curb fiscal deficit raised concern about the issue of fiscal sustainability.

1.4 Regional Disparities in India Economy

Various States have responded to the economic reforms severally; some of them basked in its glory and others lay deprived. In the era of colonization, development was spread in chunks in different parts of the country that pleased the economic interests of the British colonizers. In this context, Ghosh P. (2005) contends that natural endowments, historical growth patterns and the working of State Governments in exercising their autonomy are the important factors that were responsible for creating this bias. Liberalization policies enabled States to chalk out their own development paths so as to respond to market economy (Ferrari A. & Dhingra I.S.). States that were able to register higher growth figures found more and more investment coming to their States while others juggled with their state of backwardness falling short to take advantage of liberalization regime. Various studies were undertaken to look for a possible divergence for sub-national regions in Indian economy especially after liberalization and many of them have admitted to the existence of regional divergence. Dholakia, R.H. (2003) finds that it is not the disparity in the human indicators across regions that should be prioritized as a concern for the national policies but the endeavours in promoting economic growth because disparities are more stubborn on the economic front.

There exists a lot of related literature that have actually worked on the crucial aspects of this Convergence hypothesis. An inter-related theory is forwarded by Kuznets where he states that as countries move up the development ladder, the regional inequalities grow sharper but after a certain threshold level, these inequalities fade away because of strong spillover effects. Had the notion been true, there would not have existed stark regional disparities across different states of India. The barometer of GDP Per Capita Income in judging the status of development in a country like India is façade owing to the gruesome socio-economic conditions of the
States. Moreover, Nirvikar Singh et al (2003) refute the idea of increasing regional inequalities to have sizeable consequence as the statistical evidences ignore inter-state remittances. If we are able to analyze how the growth story has translated itself into a development story at the sub-national level, then that will prove to be the litmus test to know the impact of economic reforms.

In the First Plan (1951-56) itself, as Chakravorthy, S. (2000) argues that planners had identified regional disparities as a pressing concern and therefore directing investments through Industrial Licensing, distributing financial incentives in the lagging districts and setting a common price across the nation for essentials like coal, steel and cement was prevalent in the pre-reform era. As a result, large PSUs were located in lagging regions of Bihar, M.P. and Orissa on one hand and entrepreneurs were dissuaded to locate heavy industries in metropolitan centres on the other. This implies that the top-down approach of ensuring balanced regional development did not quite materialise as private investment found its way to industrially advanced states like Kolkata, Mumbai and Chennai (Mitra; 1965 & Kashyap; 1979).

On the other hand, the post liberalization development experience of India demonstrated higher but disproportionate growth figures across the country. The reason may be that as Centre became more liberal, the flexible role or the quality of taking initiative by the States became more pronounced. In response, as Chakravorthy, S. (2000) notes, Indian states pursued their own industrial reforms with the following inherent features like single window clearance system, assuring time bound clearances, lowering environmental hurdles, attracting foreign capital and technology along with wooing NRIs to invest in their homeland which could place them at the cutting edge of their competitive states. And this was in addition to the variegated natural resource and historical endowments that led inequality to grow existed at the sub-national as well as the sub-regional levels which grew in every hue and the contrast simply got starker.

Furthermore, as Kumar, N. (2001) notes that annihilating the industrial licensing system also took the power from Govt. to channelize investment to relatively deprived regions which to an extent, explained the inter-state disparities after 1991.
Though, a shift from State-led supply driven economy to market driven economy with an active interplay of demand and supply forces pushed up growth figures but it could not ensure inclusiveness across all sectors, states/regions and sections. Moreover, abysmally low rate of employment growth was observed during the decade of 1990s (Ramaswamy, K.V. (2007). Regional disparities were more pronounced now owing to historical, geographic, political dimensions of development among various States in terms of economic indicators like income, employment and output and social indicators like HDI, standard of living and poverty. Many research studies have devoted their time and attention to the problems of regional income inequalities (Bhattacharya and Sakthivel, 2004; Shetty, 2003; Sachs et al, 2002; Ahluwalia, 2001; Cashin and Sahay, 1996) and found the increasing divergence in NSDP and per capita income across States. While on the other hand, the National Human Development Report 2011 states that the national HDI has increased by 21 per cent from 1999-00 to 2007-08 with an improvement of around 28 per cent in education and furthermore report convergence of HDI across comparatively poorer states is much sharper than that of the country on an average. The development paths, hence seems to be at cross roads. While some states have prioritized higher trajectories of economic growth over social development; others are struggling to prioritize between the model of welfare state and liberalized regime. The theories that mentioned economic growth as a necessary condition for bringing about social development faltered with the Kerala Model experience. A brief sketch of two Indian States is put forth wherein they tread along two different development paths to reach a common goal of economic and social prosperity. One is the Kerala Model, looked upon as the epitome of social development in terms of education and health with exemplary performance in almost all the human development indicators but pulled down with a sluggish economic growth performance that is soon trying to catch up with its immense human capital and then there is the Vibrant Gujarat Model that is thriving with its continuously higher economic growth rate backed by a strong secondary sector and one of the finest investor friendly states of the country held back by its poor human development indicators that stands in contrast to theories that stated economic development was deemed to mean social development.
1.5 Development Models of India States

Gujarat Model of Development

Gujarat had been an avid performer in the post reform period. Its Vibrant Gujarat Model with emphasis on industry led growth makes it count among the few states that have a strong secondary sector to boost up growth momentum of the State. The thriving industrial and service sector can surely attribute this success to strong industrial policy and Govt. support to the private sector along with providing subsidies and this practice was way before economic reforms had come into effect. In fact, this growth path was often accused of isolating the agriculture sector which although was higher than the national average but was rather erratic. But, lately agriculture sector in Gujarat has seen spectacular growth rate with 9.6 per cent when agricultural states like Uttar Pradesh, West Bengal and Maharashtra are still lagging below the national average and even Rajasthan and Bihar have raced ahead though with high volatility (Gulati, A., Shah T., Shreedhar, G., 2009). Although, there are many research studies that counterfeit the result. The development model of Gujarat is often accused as treading the unbalanced approach with thrust on manufacturing sector while distancing itself from creating social overhead capital. Low per capita income and poor performance of social indicators in the State raises the issue of equal distribution of income and translating of economic development to social development. Rural roads are the most important investment for agriculture. Gujarat has one of the best rural road networks in India. Dholakia, R.H. (2003) Though Hirway (2011) strongly contends that Gujarat can be termed as neither a sustainable or role model for other states.

Kerala Model of Development

When the ambit of development expanded to include social development as a separate entity which is not merely a trickle-down effect from economic development, the whole planning process was redefined. Standing tall on the economic indicators and failing to catch up at the social indicators presented a distorted picture of the development model. Gujarat is one such state which has yet to deliver on the social front compared to the success attained in economic indicators whereas the Kerala model of development as it is usually called has carved its niche with its breakthrough achievements on the social front with impressive record in education and health.
sector. The peculiarity associated with this model stems from the fact that despite high levels of social indicators bringing in better living conditions because of successful state interventions, there exists low levels of output, per capita income and a sluggish economic growth rate (Ramachandran, K., 1997; Chakraborty, P., Chakraborty, L., H.K. Amarnath, Mitra, S., 2010). The sustainability of this model has been under serious review because of high fiscal constraints due to sluggish economic growth rate on the one hand and rising social sector expenditures on the other. In this context, it is worth to be noted that a healthy and educated population along with high NRI remittances is not able to deliver to economic growth. Again, the bulk of the high NRI remittances are not used for the productive activities of the State. The economy is highly dependent on tertiary sector for its growth momentum with more than 58 per cent. (P., Chakraborty, L., H.K. Amarnath, Mitra, S., 2010).

Development Strategy of Madhya Pradesh

The state languished with its poor economic growth in the pre-reform period. Bearing the onus of being termed as a BIMARU State owing initially to high fertility rates and then to economic indicators was heavy and then bifurcation of the State in 2000 further added to the already lament as many of the mineral resources power sector went to the newly carved State of Chhattisgarh. But the economic growth immediately after bifurcation was not so encouraging. But in later years after 2004, economic growth saw a major upsurge. Agriculture sector, the highest employment provider witnessed a stupendous growth performance in the State although services sector contributed heavily to the growth in GDP of the State. This was also the time period when the State of M.P. which was otherwise low on most of the social development indicators saw a vast improvement not only compared to its previous levels and All-India average but also when compared to other States. Female literacy rate saw a major rise.

The State recognising its low levels of economic growth coupled with poor indicators of social development opted to create a social engineering mechanism along with trying to build a strong foundation of economic growth.
1.6 Rationale of the Study

In the light of the above, we intend to analyze the development path as followed by the state of Madhya Pradesh. One of the oft discussed contentions is that Madhya Pradesh has been relieved of the 'BIMARU' malady. Though the average growth rate of M.P. from 2004-05 to 2010-11 with 8.24 per cent is somewhat close to the national average of 8.65 per cent but the inherent instability looms large with a 35.56 per cent of co-efficient of variance in its growth rate. In the similar vein of national statistics, Madhya Pradesh too has majority of employment dependence on agriculture sector. Although, the fervour for development in Madhya Pradesh has scaled new heights with phenomenal growth rate in the past six-seven years, but this growth rate reveals a very inconsistent pattern besides being accused of showing a strong proclivity to the agriculture performance of the State. Thus, in the wake of all appreciations, achievements and accusations, we hereby make a modest attempt to study the development dynamics of the State which will focus on the post liberalization period.