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Capitalism in India: Out of Nehru's Shadow?

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Abstract

India's development journey began in the 1950s under the watch of its Fabian socialist prime minister Pandit Jawaharlal Nehru. The planned development model had some crucial elements: importance to the public sector, a policy of exclusion of private sector from strategic areas of operation, centralized economic planning to steer the economy, socialist economic philosophy, neglect of the external sector, and state-led industrialization and modernization. These policy items were in sharp contrast to the one generally advocated in a free-market capitalism that gives more space to individual freedom and risk taking by individuals. However, since 1991 India's development strategy has witnessed a dramatic change with the adoption capitalistic economic reforms. The private sector has now become the major driver of economic growth and social transformation. India is now a large recipient of foreign capital. The capitalistic philosophy views economic freedom as a prerequisite for sustained economic transformation and enhanced global power. The intellectual influence of Nehruvian socialism however continues to this day among policymakers and the intelligentsia.

Keywords: capitalism, socialism, development, economic growth, globalization

1. Introduction

India has remained a functioning democracy for over seven decades now. Our democratic and development experience offers rich insights into the workings of Indian political economy. We have had experience with both statist development strategies where economic planning based on heavy industries served as the cornerstone of our quest to attain growth with justice, and economic reforms that views private initiative as a key driver of growth. Despite a commitment to socialism and a state-guided economy the performance remained poor. In 1991 capitalistic economic reforms were launched to accelerate the pace of development. The philosophy of development has changed in the preceding decades. At the political level the rhetoric of socialism continues to this day in some quarters.

However, we no longer hear the robust advocacy for socialism. The policy instruments implemented to create socialism did not deliver as expected. A regime of control and regulation that circumscribed individual initiative birthed inefficiency and corruption instead of competitiveness and fair play. It was realized by the late 1908s that India had become a high-cost economy. The sixth Five Year Plan identified the weaknesses of the planning process and the shortfall in its achievements. There were not sufficient resources for investment. Poverty had not fallen sharply because there was sharp variation in annual growth rates. It was not sufficient enough to carry the poor and the vulnerable out of poverty. The

Nehruvian Development Model[1] had failed to meet the laudable objectives it had set out to achieve. Import substitution industrialization policy did not succeed in the industrial transformation of India. India continued to remain an agricultural dependent economy where bulk of its workforce was engaged. It did achieve some self-sufficiency in foodgrain production however it remained far off from the economic transformation some nations had achieved over the previous decades.[2] Nehruvian socialism had failed to deliver.

The economic freedom guaranteed under the capitalistic policies since 1991 has changed the socio-economic landscape of India in three decades. India today is poised to become the third largest economy in the world. The triumph of capitalism marks an important milestone in its ideological battle against socialism. The *legacy effects of socialism* however continue to remain an ideological challenge. The Nehruvian socialism continues to have sway over the political imagination of policymakers and the intelligentsia.

2. Fabian Socialism: Nehru in the mid-Twentieth century Intellectual Ferment

Fabianism was a socialist movement that emerged from the activities of the Fabian society in the late 1880s in Britain. The Fabia Society was named after a Roman General, Quintus Fabius Maximus, who famously adopted *delaying tactics* in his effort to defeat Hannibal of Carthage. Harold Laski, G.D.H. Cole, G B Shaw, Sidney and Beatrice Webb, were some famous Fabian socialists. They rejected the revolutionary appeal of Marxism and instead advocated gradualism and public action in economic and social affairs.[3] A better society was possible through gradual economic and political reform and not through class conflict as advocated by the Marxists.

Fabian socialists believed in gradual evolution of society. They believed that to achieve better economic and political outcomes parliamentary reforms, social action, government legislation and public control of the economic sphere was necessary. This would free the masses of the economic hardships they had been facing under capitalism. The Fabians did not believe in class struggle that Marxists advocated for change. Their main indictment of the capitalist system came from their understanding of the classical theory of rent.[4]

They rejected the Marxian view of surplus value as a source of capitalistic exploitation. Prime Minister Nehru was the chief architect of post-independence plan for economic development in India. He established the Planning Commission in 1950 and became its first chairman. It was the nodal agency for centralized planning in India and remained so until 2015 when it was replaced by the NITI Aayog. Nehru flirted with communism and radical socialism in early years of his career before finally settling for a more moderate Fabian socialism.

The Marxist historian Eric Hobsbawm has called the twentieth century has been as the *Age of Extremes.* The production structure was largely capitalist in nature in most countries. Liberal democracy and the capitalism were in stress during the inter-war years. The state had a limited role in these societies. The

[1] Arvind Panagariya 2024
[2] Nancy M. Birdsall 1994
[3] Britannica Money
[4] George Stigler 1959

industrial revolution that first originated in England and later spread to other parts of Europe created rapid economic growth and social progress. It however also led to a demand for greater employment security, better working conditions and rights for the workers. Many prominent thinkers of Marxist and socialist intellectual persuasion offered their critique of the working of the capitalist economic system and called for either reforms or its complete overthrow. The Marxists saw industrial capitalism as a machinery to exploit the *proletariat*. They appealed to the working classes to come together and create a fairer system. T

he Fabian socialists suggested piecemeal political and economic reforms. The *Beveridge Report* provided a blueprint for social policy in post-war Britain. Harold Laski, a prominent political scientist and highly reputed public intellectual of Britain in the first half of twentieth century saw the state as an important instrument to effect change. He advocated planned economy and public ownership of production. He however, also championed civil liberties and representative democracy.[5] The success of *New Deal* policies in America justified enhanced government engagement in the economy.

In such an intellectual ferment and given his political inclinations it is not hard to believe that Nehru saw in state and in its institutions an opportunity to implement a socialist vision. The planned economic development that he adopted saw a major role for the public sector in the economy. The industrial policy of 1956 set the future direction of industrialization in India. The economic policies in India ware driven by a few important goals: self-sufficiency, poverty eradication and creation of a socialistic pattern of society.[6]

3. Socialism in India: 1950s and beyond

The economic analysis of the role of the state and the market has been a subject of considerable interest right since the days of Adam Smith and David Ricardo. To the early economists the whole purpose of studying economics was to find out the nature and causes of wealth of nations, and what the role of government should be in the market economies. They devoted considerable attention on explaining the causes of economic growth and on defining the role of the state. The classical economic thinkers like Adam Smith and David Ricardo suggested a limited role for the state. However, by the middle of the twentieth century the idea of a state as an instrument to promote welfare through direct intervention in the economy was ascendent and waiting to be established.

The Indian State assumed upon itself many functions during the 1950s and strengthened regulation during the late 1960s and early 1970s. Since the early 1990s there has been a steady withdrawal of state from many sectors of the economy allowing for a greater role of market forces in allocation of resources. Starting in 1947 the country was economically backward with savings rate abysmally low and this called for a concerted state action to improve the quality of life of people by encouraging investment and employment generation. In the first four decades the economic scene did improve compared to the scenario that existed when the planned development process began in the 1950s.

The decline in poverty however wasn't steep enough. The bulk of the population continued to rely on agriculture for livelihood. Industrialization did pick up some much-needed momentum however the base

[5] Peter Lamb 1999
[6] Arvind Panagariya 2024 pp 26-27

was limited to a few industrial sectors located in a few towns and cities. The Import-Substitution strategy and the Industrial Policy of 1956 that reserved many sectors for the public sector had failed to build a strong industrial base. The regional imbalance in development remained a challenge to be overcome. Various sectors of the economy – health, education, infrastructure, energy, communications, transport – all saw some improvement but that was not enough to meet the needs of a rising population. The foodgrain production improved considerably which led to a lessened dependence on PL-480 Scheme and imports.

It is interesting to note that the East Asian countries had started freeing up their economy since the 1970s. China, a communist nation, opened up its economy under Deng Xiaoping in 1978. India however started economic reforms in 1991 when faced with a Balance of Payments (BoP) crisis and under the guidance of International Monetary Fund (IMF) and the World Bank. The critics accused India of succumbing to international capitalist forces.[7]

4. Capitalism in India: 1990s and beyond

The economic reforms introduced in 1991 changed the face of policy regime in India and set in motion an era of high economic growth and enhanced resource mobilization. For the cheerleaders of reforms, the market friendly policy changes brought an end to their long struggle for economic change, whereas for the critics it was a step in the wrong direction taken at the behest of international institutions. The quiet revolution initiated in 1991 has been gradual in its approach[8]. There are still large swathes of the economy that remains unreformed. But since its inception there have been no policy reversals. New reforms have been slow to come by yet now and then they have definitely happened.[9]

Over the last three decades economic growth has steadily accelerated leading to a rise in per capita income indicating a faster rise in average standard of living. The contribution of agriculture to GDP has come down to 14 percent. The services sector emerged as a major driver of economic growth since the 1990s. The secondary sector, particularly manufacturing, however, at 16 % of the GDP, has yet to flourish like China. Foreign reserves have gone up finally solving India's perennial problem. Due to high growth tax revenues have increased making possible the implementation of large number of welfare schemes. This has added to the inclusivity of the growth process. High growth combined with large public spending on anti-poverty schemes has led to a sharp fall in poverty. Both FDI and FII have seen substantial increase since 1991.

The *Capitalistic Development Model* with its emphasis on a liberal economic policy regime and a more open economy saw opposition in the 1990s. So powerful had been the ideological influence of the *socialists* and the *Leftists* on the politics and economics of India that even genuine policy reforms would meet severe opposition in the name of compromising with the socialistic ideals. The intellectuals with such leanings have opposed market-oriented economic reforms in India since 1991. However, questions about growth and poverty, about state and market, about trade and globalization cannot be settled at the dogmatic level. Of course, all debates have ideological overtones. Our own development experience and those of other

[7] Prabhat Patnaik
[8] Montek S Ahluwalia 2002
[9] Ashutosh Varshney 2013

nations should be the standard reference point in deciding about what policies to follow and what to reject. The global economic landscape, with China and other emerging powers ascendant, is undergoing a major shift. The United States and Europe continue to remain pivotal economic powers yet the centre of economic gravity, analysts point out, is shifting to the east. This is both an opportunity and a challenge for India.[10]

5. Economic Growth vs Redistribution: Bhagwati-Sen Debate

There are two school of thought on the *'Growth vs. Redistribution debate'* in India: the first school is led by the Harvard professor Amartya Sen, a Nobel laureate in economics, does not attach high importance to economic growth and instead suggests that for rapid progress state must increasingly channelize its resources particularly on health and education. He lays emphasis on human development as a true measure of progress and advocates for an activist state.[11] He suggests a major role for redistributive policies in the development process. He has been skeptical about the role of private capital and individual action in generating sustained economic progress and human development.

The second school led by Columbia professor Jagdish Bhagwati, argues that achieving high growth rates is the first essential condition for economic progress and without high rates of economic growth there cannot be any sharp reduction poverty in quick time. The higher the growth more the revenue generated for antipoverty programmes and thus by following pro-growth policies we can greatly improve our chances of fighting poverty and raising the standard of living of the masses.[12] High growth has benefitted us. It has meant a decent rise in per-capita income indicating rising living standards. The huge resources generated have made running large welfare schemes possible. That definitely is good news for a country that not only aspires to eradicate poverty and other forms of deprivation but also expects to be counted among the most advanced economic powers of the world.

Economic growth does not help everyone and every region in equal measure. In India the indirect benefit of high growth, taking place elsewhere, to the laggard states, is through transfer of resources by constitutional channels like the Finance Commission. The revenue generated in high growth areas is used to help the lot of the people living in relatively poorer regions through vertical transfers[13]. Growth does create opportunities however it is not true that it will pull up all the poor into gainful employment. Even though growth opens the doors, as Jagdish Bhagwati noted, the traction in the legs of the poor may not be enough to carry them through these doors.[14]

It is here that the role of state becomes important in giving the marginalized the right skills and education and facilitate their entry into the mainstream of the economy. Market is a tool not just to generate wealth and prosperity but also a devise to eradicate poverty. Both the legs – the state and the market – are needed

[10] Kishore Mahbubani
[11] Amartya Sen and Jean Dreze 2002
[12] Jagdish Bhagwati 1988, 2004, 2007
[13] The Finance Commission, a constitutional body, is tasked with distribution of revenue between the center and the states
[14] Jagdish Bhagwati 2004, 2007

to get the best results in a fast-globalizing world. But without economic growth sustained redistribution is not possible to achieve.

India needs more growth friendly policies and institutions with adequate safeguards for the poor. Growth creates opportunities and it is only in a growing economy, as Adam Smith reminded us, that the fate of the laboring class is most secure and the happiest! However, if the pattern of growth is tilted heavily towards the economically better off, it should be a cause of worry then. Thus, for shared prosperity getting the balance right in policy making is important. Both the rich and the poor should have strong incentive to work hard and fulfill their economic aspirations contributing to the growth process and benefitting from it in a manner that is just and equitable.

In comparison to the first four decades after independence, the Indian economy has done better after 1991. The growth rate has picked up and the industrial and services sector have expanded producing opportunities for many. The growth process has generated huge revenues that has enabled the implementation of large number of welfare schemes for the underprivileged. The development experience of the past three decades has established the centrality of the economic growth in the development process. Higher growth has brought huge benefits for the economy and also for the government.

6. Globalization: Indian economy finally Unshackled

India's early development strategy paid little attention to the benefits it could derive from the international trade in goods and, by following a liberal door policy towards foreign capital. Like any other developing economy India was poor and suffered from lack of capital to support economic growth. With an avowed commitment to self-sufficiency, it followed the Import-Substitution industrialization strategy that emphasized the need to protect domestic industry under high tariff walls and generate domestic savings to support capital formation and initiate establishment of heavy and basic industries. In the period before 1991 the exposure of Indian economy to foreign capital and technology was rather limited. It was only with the trade and liberalization of foreign direct investment policies in 1991 that India finally unshackled itself from suspicious view towards the world economy.

International trade is as old as human society itself. In its modern avatar the flows of goods, services, finance capital and people have grown massively on a scale incomparable with earlier periods. It would be naïve to blame the international system for being carriers of economic shocks alone. A more balanced analysis would show that by bringing newer technologies and serving markets for our exports they have added to our output and increased the range of our choices. To be sure, it is hard to find a single country that has grown and reduced poverty faster by being inward-oriented in its trade strategy. Outward-oriented trade policy is a necessary condition for rapid economic growth and faster poverty reduction.[15]

The current form of capitalism and globalization has seen a steady evolution since the advent of Industrial Revolution two centuries ago lifting billions of ordinary people out of abject poverty. Global economic integration has been as old as human societies. However, the development of modern means of transport and communication has increased the scale of this integration. The trade integration slowed down between the two World Wars. It however picked momentum after the second world war when multilateral efforts were made to bring down barriers to trade and investment. This period saw a major expansion of

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international trade. After the opening up of China in 1978 there has been a massive expansion in trade with many countries in East and Southeast Asia using external trade a key element of their development strategy. This regime of freer trade saw a major decline in global poverty.[16]

The integration of the Indian economy with the global economy has expanded international trade and created jobs and reduced poverty. India has reaped the benefits of globalization. There has been a substantial improvement in the trade to GDP ratio. India is a large recipient of foreign direct investment and is emerging as a major node in the global supply chain. Our share of exports and imports in the world trade however remain small compared particularly to China. Recently, even small nations like Vietnam and Bangladesh are doing better in labor-intensive sectors that has the potential to create jobs for the less-skilled workforce. Therefore, any protectionist turn in trade would hurt the interest of those for whom international trade could serve as an engine of growth, and an opportunity to improve their economic condition.

7. Markets and Growth: Some useful Lessons

Based on the experience of Indian economy over the last seven decades, and making an assessment particularly in terms of growth rates achieved, resource mobilization made for welfare spending and poverty reduction, and some other crucial socio-economic indicators the post-reform years tend to outweigh the pre-reform years that gave us low growth and unsustainable levels of public debt leading to an economic crisis in early 1990s.

The development experience of nations over the last six decades supports the proposition that market oriented economic policies work better and produce beneficial economic outcomes.[17] Nations with a more restrictive policy regime see low growth rates and widespread corruption as supply fails to match demand. The lure to increase tax rates lead to evasion and less resource mobilization. This adversely affects welfare spending. Nations which follow outward oriented growth strategies and allow markets a greater play in resource allocation witness faster growth and sharper poverty reduction. They successfully reaped the opportunities offered by a fast-expanding world economy.

The Southeast Asian experience and more recently the Chinese experience shows how an effective use of state and market can deliver better economic outcome. However, mindless policy deregulation without putting in place adequate safeguards could also make one susceptible to situations like East Asian financial crisis of the late 1990s. Similarly, an excessive state control as practiced in India in pre-reform period could lead to inefficiency and supply bottlenecks resulting in harmful bureaucratization and corruption seriously compromising economic freedom and hurting economic growth and poverty reduction.

Despite the formidable challenges facing the Indian economy, we have witnessed a major improvement in the past seven decades operating under the guidance of democratic governments of different ideological colours and persuasion. We might have failed to achieve high growth rates and a sharper decline in poverty in pre-reform period however we did some useful gains in many areas including strengthening of India's democracy, improving food security and self-reliance, expanding our industrial base and integrating and moulding the erstwhile princely states and British India into a single cohesive political and economic unit. The Indian states and regions, because

[16] David Dollar 2004
[17] Douglas Irwin 2015

of different historical reasons and natural endowments, have grown at different rates. However, economic reforms have been instrumental in lifting even those states and regions that saw limited growth and economic improvement.[18]

In the post-reform phase, as a result of better growth, resource mobilization has increased manifold enhancing state's capacity to carry out welfare programmes. This is a welcome development for a nation which for a major part of its development history has had to face resource constraint. The same is true for foreign exchange reserves. In the pre-reform period the government of the day imposed several exchange controls and imports of many items were canalized just because we were always running short of foreign reserves. Now who would believe that a nation which had reserves just enough for six weeks of imports and was struggling in the early 1990s now has more than $ 500 billion in its foreign exchange reserves! That is a tremendous achievement by any standards.

However, when compared with China that faced similar problems during its formative years after independence has experienced faster growth and poverty reduction, the manufacturing contributes around 35% to the GDP against India's paltry 16 percent, the economy has seen a boom in unskilled labor-intensive manufacturing and the country has close to two trillion dollars in foreign exchange, and is a major holder of US debt. It is all set to surpass United States as the largest economy in the world, being rightly tipped by international scholars as the next superpower. Our achievements since the 1990s have been exceptional when compared to the pre-reform years. We however look small when faced with the China mirror. The Chinese economy has showed signs of slowing down recently and therefore this offers us an opportunity to press the reforms pedal harder and create the conditions for even a faster growth regime.

8. Concluding Remarks

The launching of the First Five Year Plan in April 1951 initiated a process of development that aimed at raising the standard of living of the people by ameliorating poverty. India has come a long way since the 1950s. A largely agrarian economy at the time of independence it has transformed into an economy dominated by services and industrial sectors. Income and consumption levels have risen. The consumption basket has diversified. Incidence of poverty has visibly declined. The death and the birth rates have declined, and the average life expectancy has risen. Literacy has improved and the educational base has expanded. India now has a robust and resilient agricultural economy with near self-sufficiency in food production. It has a large pool of skilled manpower and ample entrepreneurial capabilities.

The major economic transformation occurred only after 1991 when market-oriented capitalistic economic reforms were launched. It accelerated the pace of development. Economic reforms have catapulted the economy to a higher growth trajectory. The expansion of external trade and investment has established that outward-oriented trade policies is an essential condition for sustained economic growth and poverty reduction. The first four decades were visibly guided by the quest to establish in India a socialist pattern of society. Nehru's The policy instruments used to achieve this produced a slow growing economy that failed to lift the masses out of poverty and secure them an improved standard of living. A change of policies worked to India's advantage after 1991. India has continued to reform its policies since1991

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however the *legacy effects of socialism*[19] continue to obstruct future and speedy implementation of economic reforms.

India therefore needs more policy and institutional reforms that ensures the economy remains on a high growth trajectory. That should be seen as the first necessary condition for inclusive and rapid economic progress. The second condition requires a strong and efficient state to better deliver to the poor the support they deserve. What India needs today is not just piecemeal reforms but wholesale overhaul of the governance structures and processes of the socialist days that no longer serve the purpose for which they were instituted. The to-do list includes greater investment in health and education, better job creation and more inclusive economic institutions to maximize the pay-off from the world economy and its much-vaunted demographic dividend. The socialist experiment in India has been an unqualified failure; its legacy however continues to this day.

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