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A LOOK BACK AT EARLIER DEBATES MAY GUIDE OUR ECONOMY AHEAD

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Revisiting the economic discourse of the 1970s that proved seminal for later reforms could help us address current problems

The 1970s were turbulent years for the Indian economy, dominated by a toxic combination of economic stagnation and runaway prices. The economy expanded at an average rate of less than 3%, barely more than the rate of population growth. Inflation averaged 7.7%; there were two years when it crossed 20%. Average incomes stagnated. The industrial slowdown that began in 1965 deepened.

The same decade paradoxically saw some of the best debates on Indian development strategy. It was the high noon of structural thinking. Many of these debates were conducted in the pages of the Economic and Political Weekly. One of these debates was about the long crisis in the country’s industrial sector. Parts of the debate are worth retelling in our times, even at the risk of oversimplification, because the issues raised four decades ago can resonate today.

There were three main ways economists tried to explain the industrial stagnation that began in 1965. First, India had been unlucky to be hit by a series of exogenous shocks that weakened the economy—two wars, two oil crises and two severe droughts. Second, there were explanations on the demand side—demand for capital goods was weak because of a fall in public investment, while demand for consumer goods was anaemic because of low income growth as well as rising inequality. Third, there was a set of reasons on the supply side—a web of industrial controls, trade restrictions and poor allocation of investments across sectors had led to an inefficient industrial structure, as was evident in the decline in capital efficiency across the economy.

Some of the best economic minds of that era took part in the debates. What follows is a whistle-stop tour because of the word limit on a newspaper column such as this one. Ranjit Sau argued in 1972 that industrial stagnation was linked to rural inequality and the inability of the Indian government to destroy semi-feudalism in the countryside. Prabhat Patnaik proposed a model on economic fluctuations. Rising food prices reduce real wages and thus demand for consumer goods produced by industry. Capacity utilisation in the private sector shrinks. Governments sensitive to the political costs of high inflation also cut public investment to reduce aggregate demand. That leads to a growth slump. The rise in unemployment and the decline of inflation creates a new round of economic growth as public investment picks up and private investment follows.

Perhaps the clearest overview of the policy challenge was provided by Sukhamoy Chakravarty in a 1979 article that this column has cited previously as well. “The rate of growth of industrial production could not be stepped up on a sustained basis because neither the home market nor the foreign market could absorb them… While the inability to push exports was considered to be closely related to the lack of competitiveness of Indian manufactured exportables, the limitations of the domestic market were supposed to reflect the unevenness in the distribution of incomes."

Another fine piece was written by A. Vaidyanathan in 1977. He made five key points while assessing the policy options for the government amid a growth slowdown. First, economic growth was being held back by problems in India’s farm sector. Second, going ahead with ambitious investment plans would be inflationary under the circumstances. Third, greater exportorientation would require radical changes in the fundamental principles of Indian planning. Fourth, modest growth would make redistributive measures inevitable. Fifth, a growth model focused on employment generation, infrastructure investments and productive agricultural projects “is possible provided that the fiscal instrument is effectively used to contain the consumption of the rich".

Almost all the analyses above focused on the problem of inadequate domestic demand for industrial goods. The elephant in the room was the international market, at a time when the countries of East Asia were already accelerating on the back of rising global trade. The article by Vaidyanathan drew a sharp response from T. N. Srinivasan. He argued that the opportunities for easy import substitution had been exhausted by the mid-1960s. India now needed to become more outward oriented, especially given the narrow home market for industrial goods. How? The trio of Padma Desai, Jagdish Bhagwati and Srinivasan had spent most of the decade arguing for a bonfire of controls. Indian economic growth was being held back by rigidities on the supply side. Meanwhile, C. Rangarajan showed in a 1982 article that higher investment rates were not translating into higher growth because of a decline in the efficiency of capital.

The rich debates of the 1970s seeded some of the ideas that led to the radical economic reforms of 1991. The situation today is very different. India no longer faces food, savings and foreign exchange constraints. It is now integrated into the global economy—even though protectionist pressures are growing. Yet, the economic boom of the first decade of this century is now a distant dream. The Indian economy has lost momentum. Some elements of the old debate—a limited home market, trends in wage growth, the role of public investment, demands for redistribution when job creation is low, the capital efficiency of domestic industry—need a fresh airing.

Niranjan Rajadhyaksha is a member of the academic board of the Meghnad Desai Academy of Economics

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