

Ray, Saon; Kar, Sabyasachi

Working Paper

Kuznets' tension in India: Two episodes

WIDER Working Paper, No. 2020/24

Provided in Cooperation with:

United Nations University (UNU), World Institute for Development Economics Research (WIDER)

Suggested Citation: Ray, Saon; Kar, Sabyasachi (2020) : Kuznets' tension in India: Two episodes, WIDER Working Paper, No. 2020/24, ISBN 978-92-9256-781-1, The United Nations University World Institute for Development Economics Research (UNU-WIDER), Helsinki, <https://doi.org/10.35188/UNU-WIDER/2020/781-1>

This Version is available at:

<https://hdl.handle.net/10419/229248>

Standard-Nutzungsbedingungen:

Die Dokumente auf EconStor dürfen zu eigenen wissenschaftlichen Zwecken und zum Privatgebrauch gespeichert und kopiert werden.

Sie dürfen die Dokumente nicht für öffentliche oder kommerzielle Zwecke vervielfältigen, öffentlich ausstellen, öffentlich zugänglich machen, vertreiben oder anderweitig nutzen.

Sofern die Verfasser die Dokumente unter Open-Content-Lizenzen (insbesondere CC-Lizenzen) zur Verfügung gestellt haben sollten, gelten abweichend von diesen Nutzungsbedingungen die in der dort genannten Lizenz gewährten Nutzungsrechte.

Terms of use:

Documents in EconStor may be saved and copied for your personal and scholarly purposes.

You are not to copy documents for public or commercial purposes, to exhibit the documents publicly, to make them publicly available on the internet, or to distribute or otherwise use the documents in public.

If the documents have been made available under an Open Content Licence (especially Creative Commons Licences), you may exercise further usage rights as specified in the indicated licence.



UNITED NATIONS
UNIVERSITY
UNU-WIDER

WIDER Working Paper 2020/24

Kuznets' tension in India

Two episodes

Saon Ray¹ and Sabyasachi Kar²

March 2020

Abstract: Developing countries face a trade-off between the twin objectives of structural transformation and inclusive growth. This is the ‘developer’s dilemma’. This study analyses the dilemma as it manifested itself in the Indian context, and identifies two distinct episodes over the post-independence period. We characterize these two episodes as ‘inclusion without growth’ and ‘growth without inclusion’. We argue that the trade-off in each of these episodes is explained by political factors and the economic ideology pertaining during this period, which in turn, drive the policy regimes and economic outcomes. We draw a few conclusions. First, economic ideology played an important role in driving structural transformation in India. Second, structural transformation did not lead to manufacturing-based industrialization in India due to increasing political competition. Third, the lack of manufacturing growth intensified the dilemma in the Indian context. Finally, we predict three alternative trajectories that structural transformation and inclusiveness may follow in this country.

Key words: developer’s dilemma, India, inequality, Kuznets, policy, politics, structural transformation

JEL classification: D31, O1, O14, P48

Acknowledgements: This work was supported by UNU-WIDER as a part of a book project entitled ‘The developer’s dilemma: structural transformation, inequality dynamics, and inclusive growth’. We are thankful for the comments from Ravi Kanbur, Deepak Nayyar, Prema-chandra Athukorala, Siddiqur Osmani, and other participants in the WIDER Development Conference – Transforming Economies organized by UNU-WIDER in Bangkok, in September 2019. The paper gained significantly from the guidance provided by Andy Sumner, Kunal Sen, and Arief Yusuf and from the detailed comments by Kunal Sen on an earlier draft.

¹ Indian Council for Research on International Relations, New Delhi, India, corresponding author: saonray@gmail.com;

² Institute of Economic Growth, Delhi, India

This study has been prepared within the UNU-WIDER project [Varieties of structural transformation](#), as part of the subproject ‘The developer’s dilemma: structural transformation, inequality, and inclusive growth’.

Copyright © UNU-WIDER 2020

Information and requests: publications@wider.unu.edu

ISSN 1798-7237 ISBN 978-92-9256-781-1

<https://doi.org/10.35188/UNU-WIDER/2020/781-1>

Typescript prepared by Joseph Laredo.

The United Nations University World Institute for Development Economics Research provides economic analysis and policy advice with the aim of promoting sustainable and equitable development. The Institute began operations in 1985 in Helsinki, Finland, as the first research and training centre of the United Nations University. Today it is a unique blend of think tank, research institute, and UN agency—providing a range of services from policy advice to governments as well as freely available original research.

The Institute is funded through income from an endowment fund with additional contributions to its work programme from Finland, Sweden, and the United Kingdom as well as earmarked contributions for specific projects from a variety of donors.

Katajanokanlaituri 6 B, 00160 Helsinki, Finland

The views expressed in this paper are those of the author(s), and do not necessarily reflect the views of the Institute or the United Nations University, nor the programme/project donors.

1 Introduction

The Indian development experience has been a unique one. On the one hand, India is one of the fastest growing economies in the world today, and its growth has completely transformed the life of billions of its citizens. On the other hand, it is the world's largest democracy. Surely, there has been some tension between these twin objectives—transforming the economy in order to achieve high growth, and ensuring equity, which is demanded in a democratic system. How did the Indian State handle this Kuznetsian tension, which we call the ‘developer’s dilemma’?

This paper attempts to answer this question. We start by analysing the trends in structural transformation and inclusiveness that define the Indian development trajectory. Looking beyond these broad trends, we next identify the economic regimes that have attempted to resolve this dilemma in different ways. We find two such episodes. We then attempt to understand the political factors affecting each of these episodes. We argue that the extent of political competition, together with the economic ideology of the policymakers, affected the policy paradigms driving these episodes; and we show how the policy paradigms addressed the dilemma in each of the episodes. Finally, we draw conclusions about the lessons that can be learnt from the Indian experience. We also discuss possible future trajectories of structural transformation and inclusiveness in the Indian economy.

In terms of broad trends, we find that India, which started with a largely agricultural and stagnant economy at the time of her independence, achieved significant structural change during this period. However, the extent of industrialization, particularly in the manufacturing sector, was limited. Most of the transformation was in the business and non-business services sectors and to a certain extent in utilities & construction. These structural changes and the resultant growth helped the economy bring down poverty rates, making it somewhat more inclusive. The extent of inclusiveness was, however, limited to poverty reduction, with inequality rates going up significantly over time.

We find that there are two distinct episodes of the developer’s dilemma in post-independence India. The first episode (1960 to 1980) represents a period of dirigisme when the State intervened aggressively to keep inequality from rising, at the cost of any structural transformation. Thus, the dilemma was resolved in this period by focusing completely on equity at the cost of prosperity. The growth rates during this episode were very low as a result of these interventions. It was a period of ‘inclusion without growth’. The second episode (1980 to 2010) saw a gradual move towards liberalization and globalization. The objective of the State during this episode was to achieve structural transformation and growth; hence the focus shifted from equity to prosperity. The resultant transformation spread to some of the more productive sectors of the economy—particularly business services—and, in line with the Kuznets hypothesis, this led to higher and rising levels of inequality. This resulted in what may be termed ‘growth without inclusion’. However, given the democratic set-up, inclusiveness could not be ignored completely, and the regime attempted to achieve a balance by bringing down poverty through aggressive anti-poverty programmes.

In the political space, the first episode witnessed gradual erosion in the popularity of the political behemoth, the Indian National Congress, which finally lost its electoral majority towards the end of this episode. This process led to increasing political competition, with the ruling political party looking for a new political narrative to regain its popularity. The economic ideology for most of this episode was strongly influenced by theories of export pessimism and import substitution. A combination of these two factors—the search for a new political narrative and an ideology that

was suspicious of privatization and globalization—led to an extremely dirigiste economic policy paradigm. The objective of policy was to achieve greater inclusiveness through a regulated process of industrialization. As mentioned earlier, this policy paradigm was very successful in stabilizing inequality but completely unsuccessful in bringing about any significant structural transformation in the economy.

The politics during the second episode became even more competitive with the emergence of regional political parties, as well as becoming more clientelist, leading to a bigger role of money power. These changes forced the political parties to become much more pro-business during this episode. The economic ideology also underwent significant changes during this episode; cutting across parties, politicians became much more market-friendly. These political changes turned the economic policy paradigm towards liberalization and globalization. The result was significant structural transformation and growth in the economy. Intense political competition, however, prevented any reforms of the factor markets and this limited growth in the manufacturing sector.

We draw a few conclusions about structural transformation and the developer's dilemma from this study. First, structural transformation does not necessarily lead to a Lewis-type manufacturing-based industrialization in a developing country. Second, the nature of structural transformation could be very different over different episodes of development. Finally, the Kuznetsian tension could manifest itself differently in separate developmental episodes. We also suggest three alternative trajectories that structural transformation and inclusiveness in the Indian economy may follow in the future.

This paper presents each of these discussions in some detail in the subsequent sections. The structure of the paper follows from this. Section 2 analyses the trends in structural transformation and inclusiveness during the period 1960 to 2010. Section 3 identifies and analyses the features of the developer's dilemma in the two episodes described above. Section 4 describes the politics and the resultant policy paradigms during these episodes. Section 5 concludes by drawing lessons about the Indian experience and suggesting possible future trajectories of structural transformation and inclusiveness in India.

2 Trends in structural transformation and inclusiveness in the Indian economy

Understanding any transformation requires a clear idea about the initial conditions and how they have changed over time. From this perspective, we start by looking at structures of the Indian economy and evidence of inclusiveness in the pre-independence period. The beginning of the 20th century provides a natural starting point. We go on to analyse the trends in structural changes and inclusiveness in the post-independence period. For this period, we focus on trends between 1960 and 2010, restricted by the availability of data for this analysis.

2.1 The historical perspective

India gained independence from British rule in 1947. Before that, under colonial rule, the growth rate of national income was 1.45 per cent while the growth rate of per capita income was 1 per cent between 1900 and 1914. Between 1914 and 1947, growth rates fell further, with national income growing at 1.14 per cent and per capita income at 0.06 per cent (Sivasubramonian 2000). Needless to add, the Indian economy remained completely underdeveloped and nearly stagnant over long periods.

Structurally, the Indian economy prior to independence was largely based on land-intensive agriculture. Other sources of employment included labour-intensive small-scale industry and natural resource-intensive plantations. There were some modern industries, but they made up a small part of total industrial output and national income. The rest of the economy consisted of government administration, commerce, transport, and real estate—what could be termed the services sector. India was an open economy during this period and exports comprised mostly agricultural raw materials and products. Agricultural expansion was the mainstay of economic growth in the period before the First World War. However, cultivated land area stopped growing after 1915 due to stagnation in demand; then, in 1925, world agricultural trade entered a crisis and the demand for Indian agricultural products began to stagnate; and the rural crisis deepened further after the Great Depression. As a result, agricultural production in 1946 was only 0.31 per cent higher than it had been in 1900. Industry, in contrast, avoided this stagnation: large-scale industry, such as mills, grew at 4 per cent per year between 1900 and 1947. However, overall industrial growth was limited by the small-scale sector, which included artisanal factories. This grew at less than 1 per cent during the same period. The services sector also had low growth rates, with government administration expanding at 2 per cent while the commerce, transport, and real estate sectors grew at just 1.5 per cent (Roy 2000).

Inclusive growth was impossible with such low rates of growth in the economy. As a result of the overall stagnation, the country presented a picture of acute poverty, particularly in rural areas, despite some industrialization. The reason for the persistence of poverty was that real wages in most types of unskilled or semiskilled manual labour did not rise quickly enough (Roy 2000). Chancel and Picketty (2017) provide evidence that inequality rates also shot up to very high levels during the 1920s, making them comparable to the highest inequality rates ever since.

While the economy was mostly stagnant, there was some degree of structural transformation during this period (Roy 2000). In 1900, the sectoral share of agriculture in total national income was 51 per cent, while that of industry was 11.5 (2.5 per cent large-scale, 9 per cent small-scale). The share of the services sector was 37.5 per cent. By 1925, due to the agricultural crisis, the share of agriculture in national income had fallen to 42 per cent, while that of industry had risen to 13 per cent (5 per cent large-scale, 8 per cent small-scale). The share of the services sector also rose, to 45 per cent. By 1946, the share of agriculture had further diminished to 40 per cent while that of industry had risen to 17 per cent (11 per cent large-scale, 8 per cent small-scale). The services sector's share fell somewhat to 43 per cent.

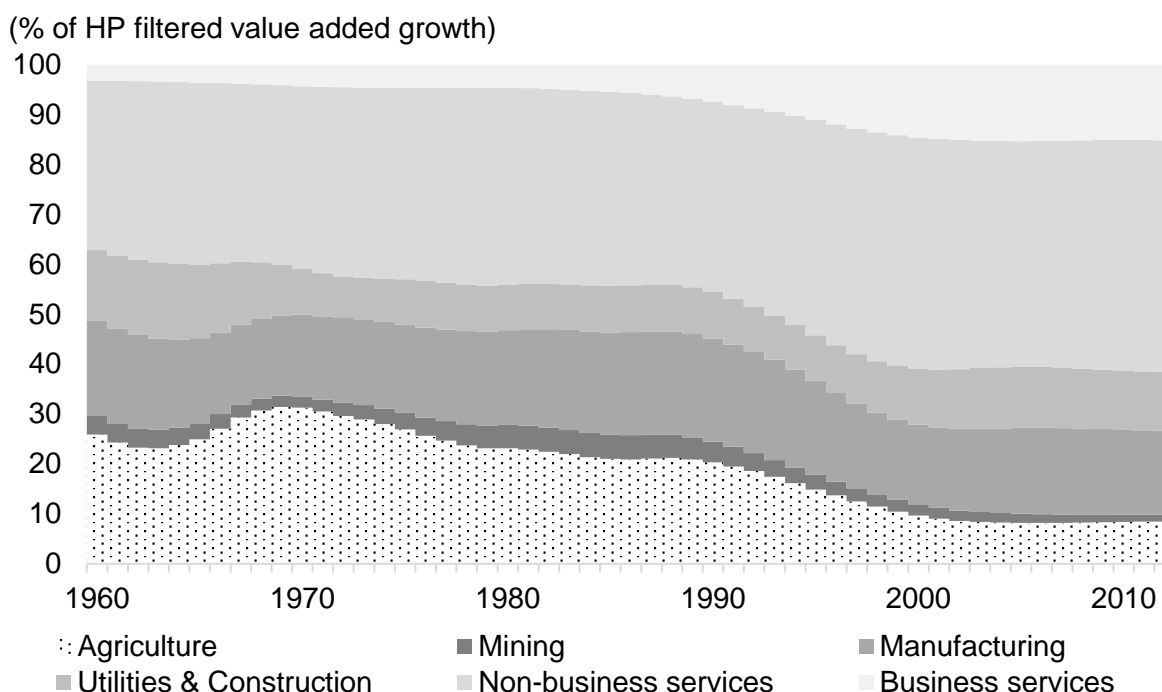
Overall, in terms of national income, there was some industrialization and tertiarization in the economy. In terms of employment shares, agriculture employed 74.9 per cent of the workforce in 1900, which increased to 76.5 per cent in 1925 and fell back to 74.8 per cent in 1946. The share of industry in the workforce was 10.6 per cent in 1900, fell to 9 per cent in 1925, and increased slightly to 9.6 per cent in 1946. The services sector's share in employment was 14.5 per cent in 1900; it remained the same in 1925 and rose slightly to 15.6 per cent by 1947. All these trends clearly highlight the limited structural transformation that took place in pre-independence India. Industry and services attained higher labour productivity during this period but were unable to absorb a higher share of labour from the agricultural sector.

2.2 The post-independence experience: 1960–2010

The Indian economy has experienced a remarkable transformation since independence. The average growth rate of GDP between 1960 and 2010 was about 5.1 per cent. Agricultural growth was about 2.8 per cent and industry and services grew at around 5.9 per cent and 6.6 per cent, respectively, during the same period. Figure 1 shows the decomposition of growth rates during this period by major sectors of the economy. Clearly, the contribution of the agricultural sector in

the growth of output diminished remarkably over this period. The shares of non-business services and business services both went up. Manufacturing and utilities & construction maintained their shares, while the contribution of mining diminished. Overall, there is a clear indication of a tertiarization of the economy in terms of value added.

Figure 1: Growth decomposition by sector, India, 1960–2012 (% of HP filtered value added growth)



Note: business services: financial intermediation, renting, business activities; non-business services: (a) wholesale and retail trade, repair of motor vehicles, motorcycles and personal and household goods, hotels and restaurants, (b) transport, storage, communications, (c) public administration, defense, education, health, social work, and (d) other community, social, and personal service activities, activities of private households. This note applies to Figures 1, 2, 3, 8, 10, and 11.

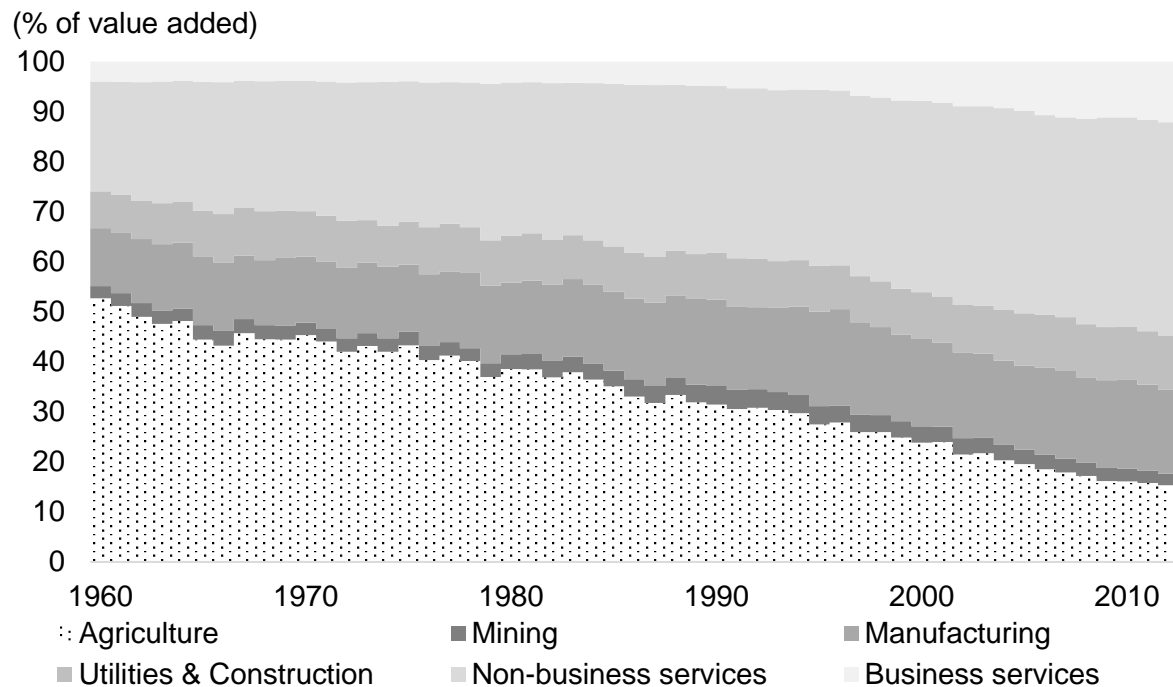
Source: authors' construction based on GGDC 10-Sector Database Version 2015 (Timmer et al. 2015).

Figures 2 and 3 show the effect of the different sectoral growth rates on the structure of the economy. Figure 2 gives the composition of value added in the economy. The continuous fall in the contribution of agriculture to overall growth led to the share of this sector falling from 52.7 per cent in 1960 to 15.3 per cent in 2010. The non-business services sector was the biggest gainer from this transformation, going up from 21.9 per cent in 1960 to 41.8 per cent in 2010. Business services also gained considerably, although from a very small base (from 4.0 per cent in 1960 to 11.1 per cent in 2010). The share of mining remained stagnant at around 2.4 per cent. Manufacturing increased from 11.6 per cent to 17.7 per cent and utilities & construction increased from 7.4 per cent to 10.7 per cent. This figure again highlights the strong tertiarization that was indicated in Figure 1. Although there is evidence of some industrialization, the increase in share over a 50-year period is very small. This is true for both the manufacturing sector and the utilities & construction sector.

Figure 3 shows the composition of employment in the various sectors. As we found earlier, the sectoral share of employment in pre-independence India had always been disproportionately monopolized by agriculture. We find here that between 1960 and 2010, the share of agricultural employment fell from 71.8 per cent to 54.6 per cent. This fall is significant, but less than that of value added from this sector. The shares of employment in mining and in business services were very small, although the latter showed significant growth from a very small base (0.2 per cent in 1960 to 2.2 per cent in 2010). The share of manufacturing employment increased very slightly from

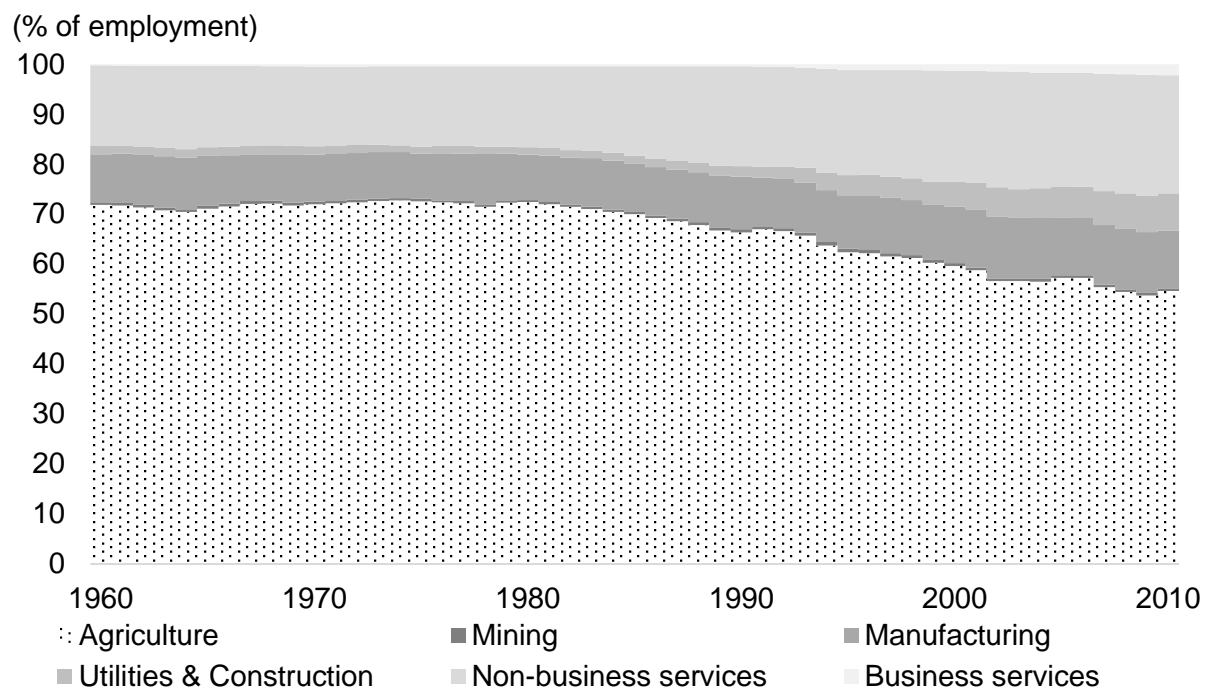
9.6 per cent in 1960 to 11.5 per cent in 2010. The two sectors that showed a significant increase in employment share were utilities & construction and non-business services. The former grew from 1.6 per cent in 1960 to 7.4 per cent in 2010, while latter grew from 16.1 per cent in 1960 to 23.6 per cent in 2010.

Figure 2: Value added composition, India, 1960–2012 (% of value added)



Source: authors' construction based on GGDC 10-Sector Database Version 2015 (Timmer et al. 2015).

Figure 3: Employment composition, India, 1960–2010 (% of employment)



Source: authors' construction based on GGDC 10-Sector Database Version 2015 (Timmer et al. 2015).

These trends highlight a number of points. First, structural transformation was more successful in terms of value added share and less successful in terms of employment share. Second, industrialization was limited in terms of employment in manufacturing, but this was compensated by employment in the utilities & construction sector. In the manufacturing sector, we find that neither value added share nor employment share increased significantly over a 50-year period; hence this experience may be characterized as a prolonged ‘secular de-industrialization’, using terminology from Kim and Sumner (2019). In the utilities & construction sector, while the increase in the share of value added was limited, the increase in the share of employment was very significant. This sector may therefore be characterized as having experienced ‘primary industrialization’, again using terminology from Kim and Sumner (2019). Finally, the tertiarization that was found in value added is also reflected in employment.

The trends in structural transformation in India discussed above are confirmed by other studies. Rodrik et al. (2016) note that in India, agriculture’s share in both GDP and employment has fallen significantly. They argue that, while structural change has contributed to growth in India, the economy has not undergone the rapid structural change that has been achieved in other countries, such as China or Viet Nam. Instead, India has had a less rapid decline in the employment share of agriculture, exacerbated by the lack of employment in the labour-intensive manufacturing sector. According to them, since India has not witnessed the kind of structural change that Brazil or East Asian countries like Viet Nam did, the growth prospects in this economy remain brittle. Kochhar et al. (2006) focus on the nature of the manufacturing sector in India, which has been skill-intensive rather than labour-intensive. According to them, together with the low scale of production compared with world averages, this has led to manufacturing absorbing less labour than in other countries.

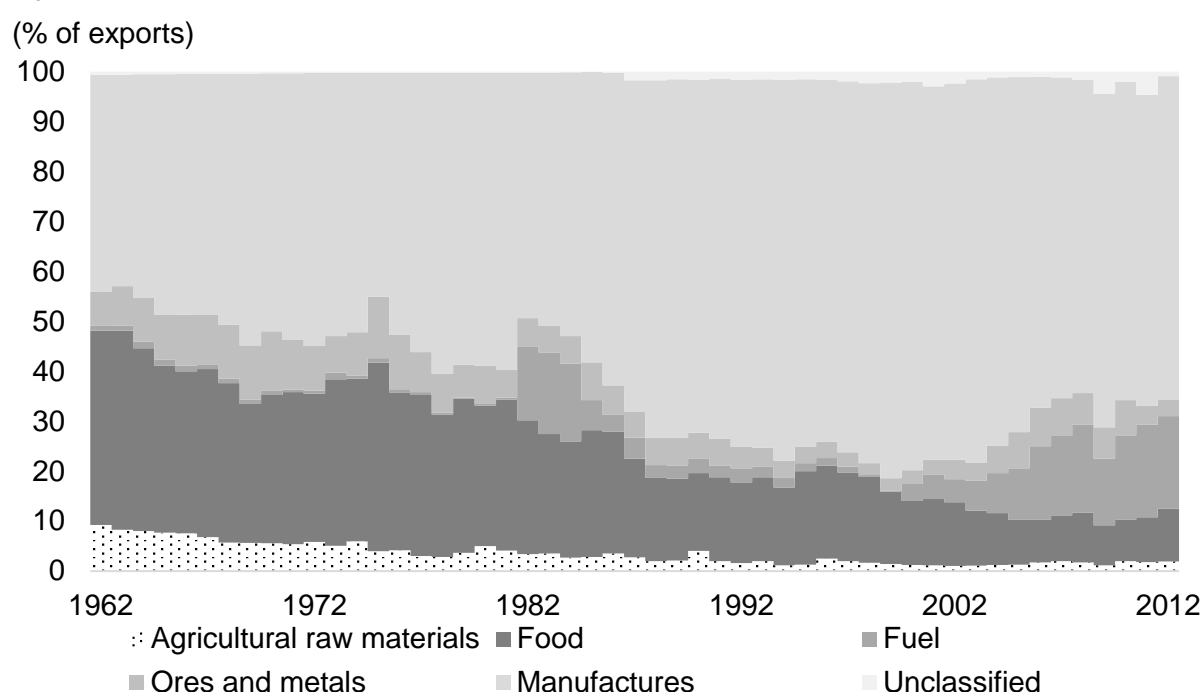
This pattern of development in India’s manufacturing sector has been the result of the creation of a diverse set of skills through import substitution, emphasis on tertiary education, and a government-induced expansion of the banking network that helped mobilize savings for such development. Kotwal et al. (2011) studied the dominance of the services sector as the distinctive feature of the Indian growth experience. They argue that this is because India’s growth has not been state-driven like that of other Asian countries, but occurred as result of the coincidence of new technology and skilled manpower that could take advantage of the technology. Diao et al. (2017) find that in the Indian context, rapid productivity growth in the modern services sector outpaced the shifts in employment, primarily because the modern sector employs relatively few workers; hence employment shares in the modern sector have changed very little. All of these contributions highlight the services-led nature of growth in the Indian economy.

Structural transformation, of course, involves more than just changes in sectoral composition. Following Kuznets (1971), the definition of structural transformation should look beyond industrialization. One of the factors that define this broader concept is the extent of globalization. Figure 4 throws light on this by identifying trends in merchandise export composition by sector for the Indian economy over this period. These clearly show the diminishing role of food exports and to a lesser extent that of agricultural raw materials. On the other hand, manufactures, which were always a large part of India’s merchandise exports basket, have become even more significant. One interesting trend here is the increase in share of fuels in recent years, driven by the export of refined petroleum. These trends seem to indicate some transformation in the composition of Indian merchandise exports.

Other studies have looked into the multi-dimensionality of structural transformation in India. Amirapu and Subramanian (2015) define five attributes that are necessary for a sector to qualify as an engine of structural transformation. These are: high level of productivity, unconditional convergence (both domestic and international), expansion (so as to absorb labour from

agriculture), alignment with comparative advantage, and tradability. Using Rodrik's (2013) and (2014) framework, they examine structural transformation in major sectors of the Indian economy (registered manufacturing; trade, hotels, and restaurants; transport, storage, and communications; financial services and insurance; real estate and business services; construction). They conclude that registered manufacturing has high levels of productivity (in the period 1984 to 2010), has converged domestically, and is tradable, but that it has not converged internationally, and is not aligned to its comparative advantage. Among the services subsectors, the picture is more complicated. While the financial services & insurance sector and the real estate & business services sector are productive, the others are not. There has been domestic convergence among all the subsectors, and international convergence in all except trade; hotels & restaurants; and transport, storage, & communications. All the subsectors except financial services & insurance have absorbed labour. Finally, most of the services subsectors except financial services & insurance are not tradable.

Figure 4: Export composition, India, 1962–2012 (% of exports)



Source: authors' construction based on World Development Indicators Version June 2019 (World Bank 2019a).

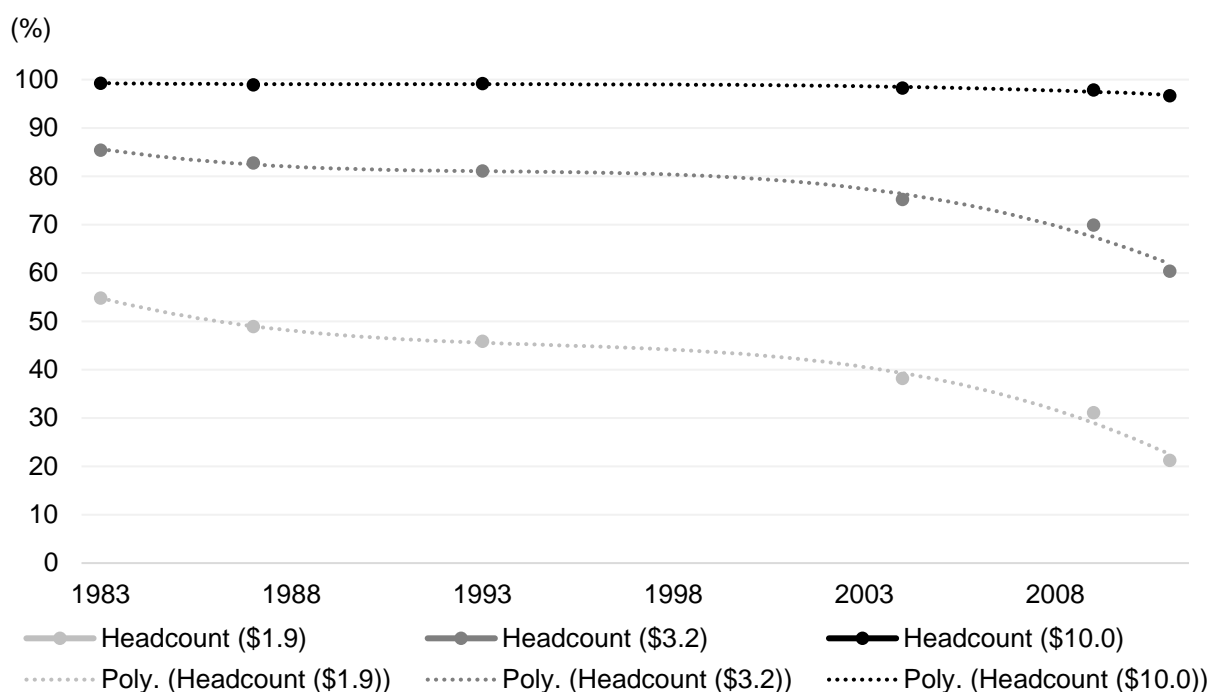
We now turn to trends in inclusive growth in the Indian economy for the period up to 2010. We use two different measures of inclusiveness—poverty and inequality—to understand whether the Indian economy has become more or less inclusive during the post-independence period. Needless to say, these two measures throw light on two different aspects of exclusion—absolute exclusion and relative exclusion.

Measuring poverty is a complex exercise, and getting comparable poverty indices over time even more so. There have been some attempts at understanding and measuring poverty for the early period after independence. Dandekar and Rath (1971) was the first systematic approach to this exercise, and others followed. Although there were differences of opinion about exact poverty rates due to differences in methodology among these studies, a consensus evolved that poverty did not reduce much over the 1960s and 1970s and started declining only after that. Datt (1998), for example, calculated urban, rural, and national headcount ratios and showed that poverty rates were around 50 per cent at the beginning of the 1960s, increased significantly during the decade,

and fell back to around 50 per cent by the late 1970s. His calculations show that after 1980, national headcount ratios indicated a steady downward trend in poverty.

Figure 5 shows comparable measures of poverty headcount ratios from the early 1980s to 2011. It depicts separate trends corresponding to US\$1.9, US\$3.2, and US\$10 poverty lines. Poverty rates according to the US\$1.9 headcount show a decline from 54.8 per cent to 21.2 per cent over this period. This is, of course, a very significant fall in poverty rates for the poorest sections of the population. The poverty rates for the US\$3.2 headcount also fall from 85.4 per cent to 60.4 per cent but the fall in poverty for the less poor is clearly smaller. Finally, the poverty rates corresponding to the US\$10 headcount hardly fall, moving from 99.3 per cent in 1983 to 96.7 per cent in 2011. These trends show that since the 1980s, absolute poverty has decreased very significantly for the poorest section of the population, and to that extent we can say that growth has been inclusive in this period.

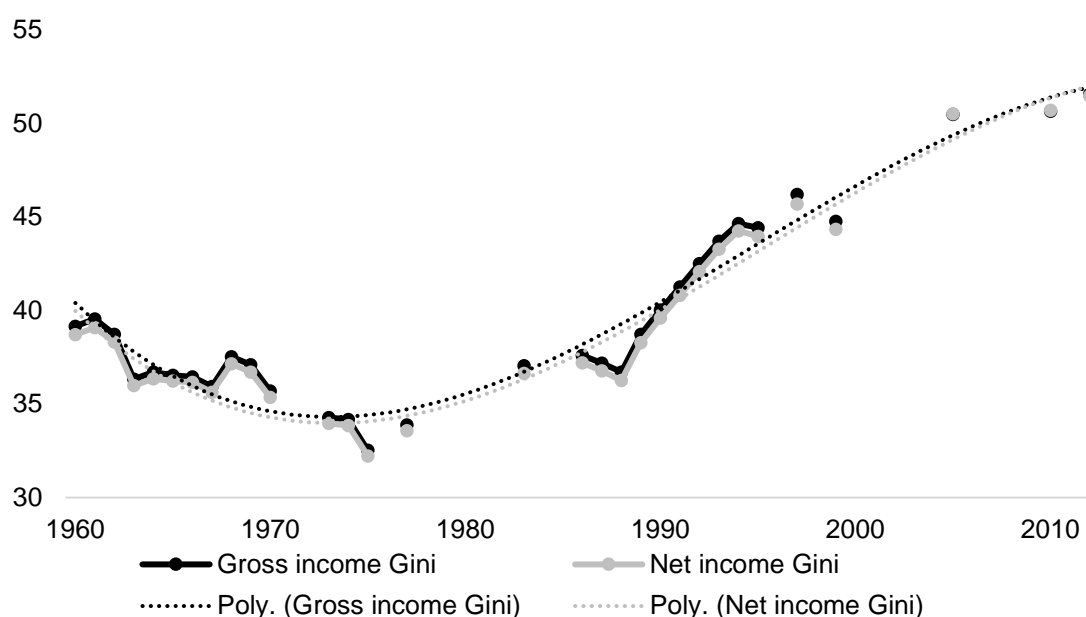
Figure 5: Poverty rates, India, 1983–2011



Source: authors' construction based on Povcalnet Version March 2019 (World Bank 2019b).

However, inclusive growth is not only about the poorest, but about other sections of the population as well. In order to get an idea of the distribution of income or consumption across the whole population and its dynamics over time, we look at relative measures of inclusiveness. Figure 6 presents the gross and net income Gini for India for the period under study. We find that inequality had a downward trend for the first part of this period, followed by a long upward trend during the second part. Overall, there is an increase in income inequality in India during this period. Chancel and Piketty (2017) also document this reduction in inequality up to the 1970s and a large increase since the mid-1980s. They find that the share of the top 1 per cent in national income was 10.3 per cent in 1949/50, came down to 6.2 per cent by 1982/83, and thereafter increased to 21.3 per cent by 2014/15. They attribute the rise in inequality in the mid-1980s to the pro-business policies followed by India in that period.

Figure 6: Gross and net income Gini, India, 1960–2012



Source: authors' calculations based on UNU-WIDER's World Income Inequality Database (WIID).

3 Developer's dilemma: two episodes

In the last subsection, we studied the trends in structural transformation and inclusiveness in India for most of the post-independence period as two independent economic phenomena. However, the developer's dilemma highlights the trade-off that is usually faced by developing countries when they attempt to achieve both structural transformation and inclusive growth. How has this dilemma manifested itself in the Indian context and how has it been addressed by the Indian State?

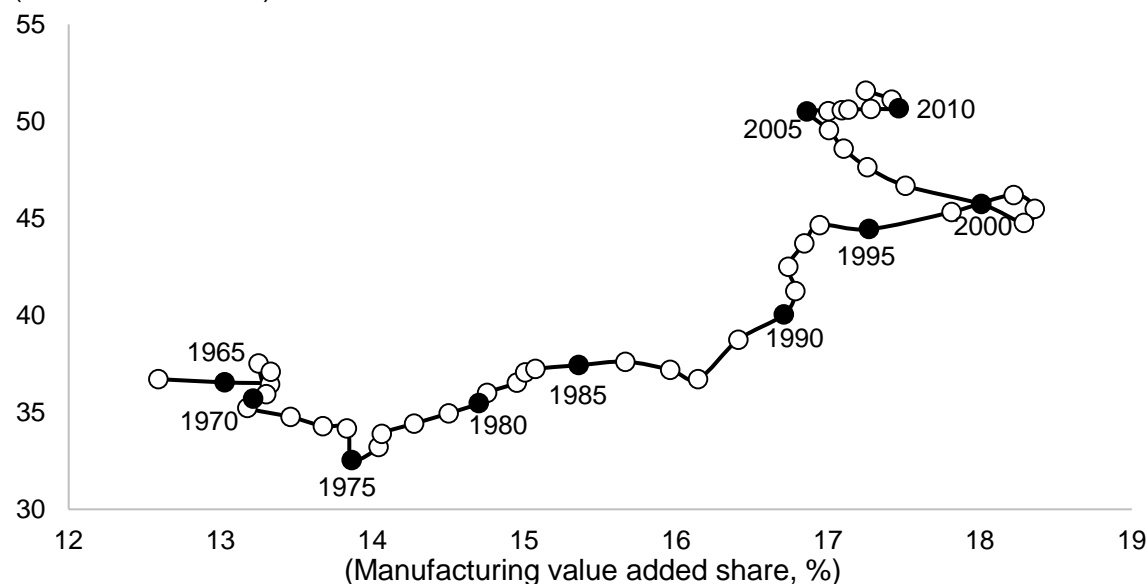
If we focus on the value added share of the different sectors of the Indian economy, we do not get a clear indication of the dilemma. Figures 7 and 8 present the value added share of manufacturing and non-business services, respectively. These are two of the major non-agricultural sectors in the Indian economy. In both sectors we find periods where inequality remain stable despite significant increases in sectoral share (roughly before 1980) and periods when inequality clearly rises with increases in sectoral shares. Thus, in terms of output, it seems that the dilemma is absent in the first period (1960 to 1980) but manifests itself in the second period (1980 to 2010).

The developer's dilemma becomes much more clearly apparent when we focus on the employment shares of the different sectors of the Indian economy. Figures 9 and 10 present the employment share of manufacturing and non-business services, respectively. In both sectors we find that for most of the period before 1980, there is a fall in sectoral share and stability in inequality rates. In the period after 1980, both the sectoral shares of employment and inequality rates go up. Thus, in terms of employment shares, we find two distinct episodes of the developer's dilemma manifesting themselves in the post-independence period of the Indian economy. In the first episode (1960 to 1980), economic inequality is stabilized while there is negligible structural transformation of the economy. In the second episode (1980 to 2010), there is significant structural transformation together with large increases in inequality. As we shall discuss in detail in subsequent sections, these two episodes roughly correspond to the two distinct economic regimes that were adopted in the Indian economy. The first was an economic regime characterized by dirigisme that resulted in

a period of very low growth rates. The second regime was characterized by a gradual liberalization and globalization of the economy with rising growth rates during this period.

Figure 7: Gross income Gini and manufacturing value added share, India, 1964–2012

(Gross income Gini)

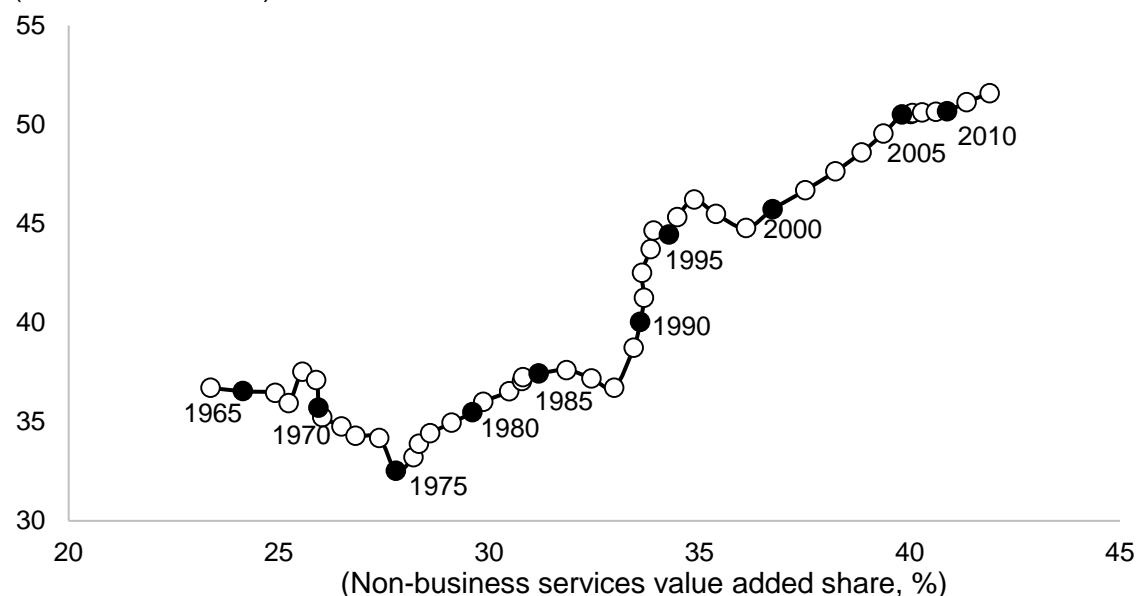


Notes: (i) the missing Gini coefficients were calculated using linear interpolation. See Figure 6 for the original data. (ii) Manufacturing value added and employment shares are five-year moving averages. For example, the data for 1975 are an average of data for 1971–1975. See Figures 2 and 3 for the original data. These notes apply to Figures 7, 8, 9, and 10.

Source: authors' construction based on GGDC 10-Sector Database Version 2015 (Timmer et al. 2015) and WIID.

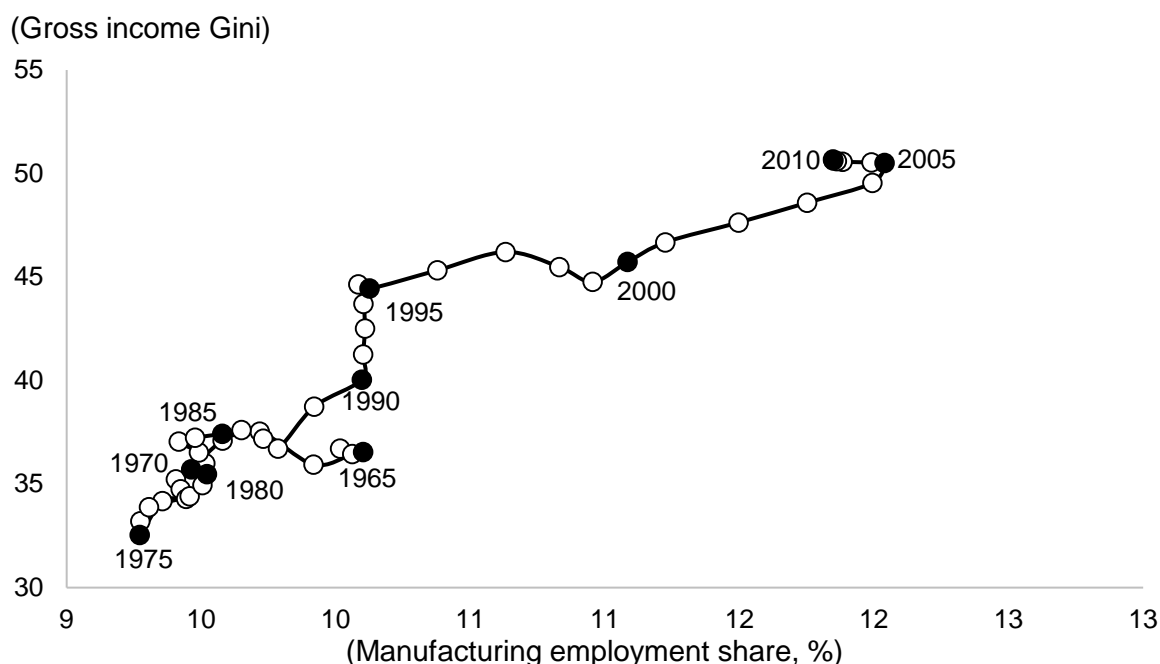
Figure 8: Gross income Gini and non-business services value added share, India, 1964–2012

(Gross income Gini)



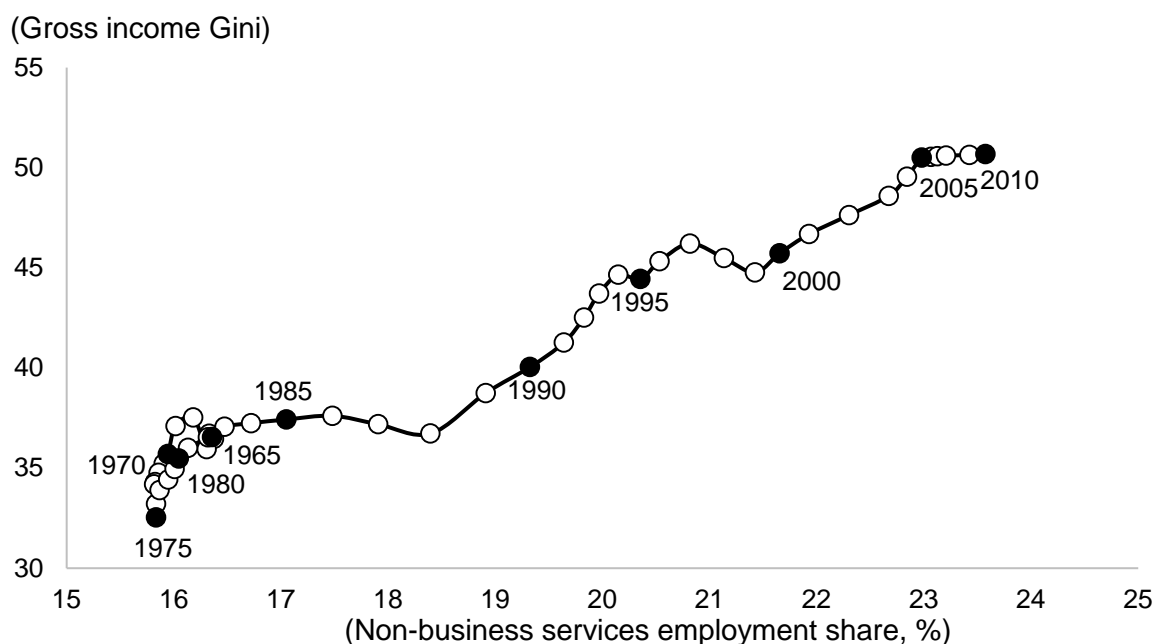
Source: authors' construction based on GGDC 10-Sector Database Version 2015 (Timmer et al. 2015) and WIID.

Figure 9: Gross income Gini and manufacturing employment share, India, 1964–2010



Source: authors' construction based on GGDC 10-Sector Database Version 2015 (Timmer et al. 2015) and WIID.

Figure 10: Gross income Gini and non-business services employment share, India, 1964–2010



Source: authors' construction based on GGDC 10-Sector Database Version 2015 (Timmer et al. 2015) and WIID.

So, what explains the trade-off highlighted in the developer's dilemma in the Indian context? Figure 11 gives some answers to this question in terms of the Kuznets hypothesis. This figure focuses on the changes in labour productivity and employment share in each of the major non-agricultural sectors during these two episodes.

Figure 11: Changes in labour productivity and employment share, India, 1960–2010

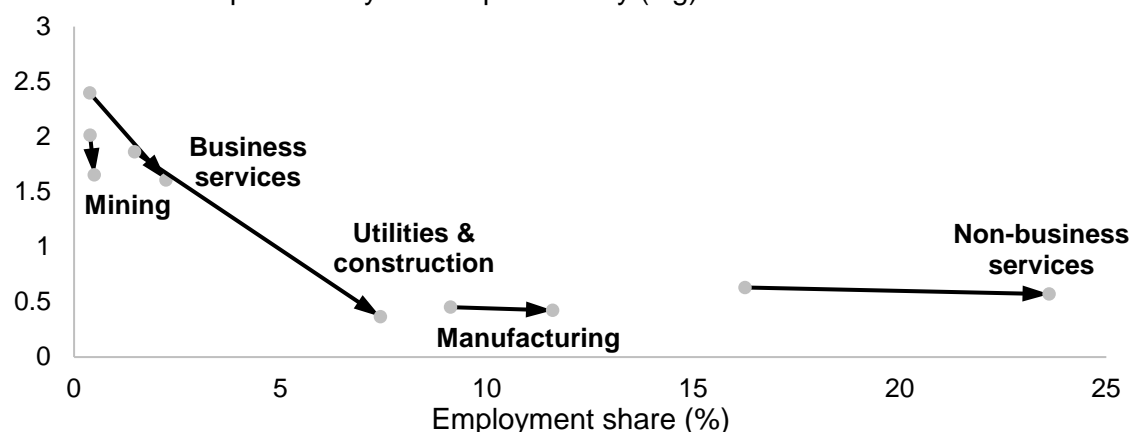
1960–1980

Ratio of sectoral productivity to total productivity (log)



1980–2010

Ratio of sectoral productivity to total productivity (log)



Notes: sectors with higher than economy-wide average labour productivity that experienced an increase in employment share are in bold.

Source: authors' construction based on GGDC 10-Sector Database Version 2015 (Timmer et al. 2015).

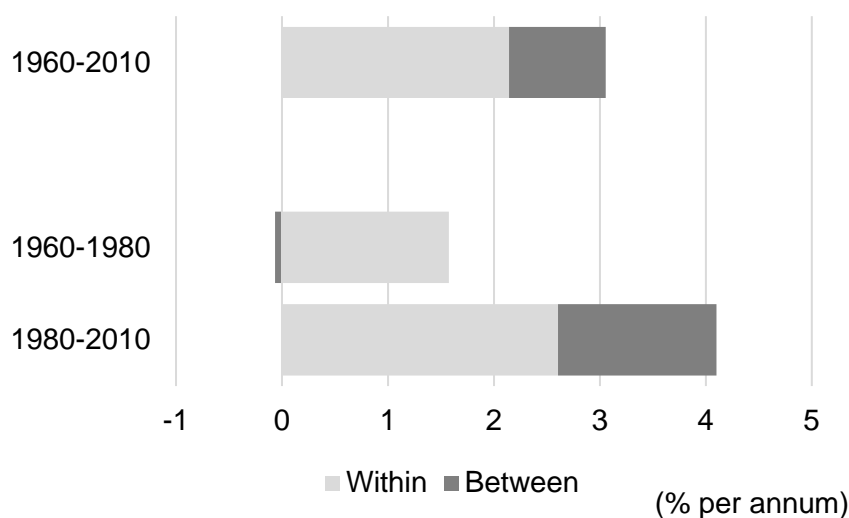
The upper panel represents the first episode. Here, consistent with our previous discussion, we find that there are very small increases or decreases in employment share in any of the five non-agricultural sectors, indicating negligible structural transformation during this period. Since there is very little increase in the employment share of the higher productivity sectors, the Kuznetsian channel to higher inequality is restricted, allowing this episode to resolve the dilemma by stabilizing inequality in the economy.

The lower panel represents the second episode. Here, structural transformation is significant in all sectors except mining. It is notable that with significant structural transformation taking place in this period within the higher productivity sectors—particularly business services and to a certain extent also utilities & construction—the Kuznetsian channels of increasing inequality play an important role during this period. This explains the rising inequality in this episode.

What was the impact of the two distinctly different approaches to the developer's dilemma in each of these episodes, especially in terms of growth? Figure 12 throws light on this question by presenting the labour productivity growth for the whole period and the two episodes separately.

It also gives the decomposition of this growth into two parts: (i) labour productivity growth within sectors ('within') and (ii) labour productivity growth due to movement of labour to other sectors ('between'). The first point to note is that, while productivity growth was reasonable for the whole period, it was mostly due to much higher growth in the second episode, which made up for the lower growth in the first episode. Second, productivity growth in the first episode was completely within sectors, and structural transformation has a negative effect on 'within' growth by moving labour into less productive sectors. In contrast, in the second episode, more than one-third of the productivity growth was due to structural transformation, i.e. between sectors. Thus, structural transformation enabled higher overall growth in the second episode.

Figure 12: Decomposition of labour productivity growth, India, 1960–2010



Note: decomposition uses the methodology of McMillan and Rodrik (2011).

Source: authors' construction based on GGDC 10-Sector Database Version 2015 (Timmer et al. 2015).

One important point to note here is that the first episode had low productivity growth compared with the second episode due to both lack of growth-enhancing structural transformation and lower 'within' productivity growth. As we shall discuss later, this was due to the economic policies associated with dirigisme, which kept inequality rates stable but also resulted in the low growth rates mentioned earlier. Thus, in terms of inclusive growth, it was successful in being inclusive but without much growth. In the second episode, by contrast, the growth rate was high but not very inclusive as inequality shot up in this period. Thus, neither episode has proved to be successful for the Indian economy as far as inclusive growth is concerned.

The episodic nature of structural transformation has been indicated in Ahsan and Mitra (2017). Using the Rodrik et al. (2016) framework, they find that structural change in India has been mostly positive. While 2000–2004 saw the largest growth in labour productivity, most of this growth was accounted for by within-sector growth. The biggest contribution of structural change was in the 1990s, followed by the 1980s. The only period that, according to them, experienced undesirable structural change in the form of a negative contribution to growth was the 1970s—a period that also saw negative within-sector growth.

4 Structural transformation and inclusive growth: politics and policies

The developer's dilemma is really about policy choices that developing countries make in order to achieve a balance between structural transformation and inclusiveness. These policy choices are in

turn strongly influenced by two factors. The first is the extent of political competition in these countries. The more intense the political competition among political groups or parties, the lesser the possibility of the state adopting policies that bring about long-term development and wellbeing (Khan 2010) and the greater the possibility of the policies being short-sighted, avoiding any policies that are politically fraught. The second factor is the global trade possibilities available to developing countries. The greater the opportunities for participating in global trade and gaining from it, the stronger the possibility that the economic ideology of the policymakers will be pro-privatization and pro-globalization. In this section, we focus on these two factors and discuss how they influenced the policy paradigm during the two episodes defined above and the effect they had on structural transformation and inclusiveness during these episodes.

4.1 Politics and economic ideology: 1960–1980

The Indian National Congress (INC) was the dominant political party in the period immediately after independence in India (Joshi and Little 1994). Jawaharlal Nehru, the leader of the INC, became the first prime minister of independent India. The immense popularity of the INC and the lack of a viable opposition ensured that he held this office continuously until his death in 1964. A national election was held in 1967, and the INC won again, with Indira Gandhi, Nehru's daughter, leading the party. The INC's popularity had started to fall, however; its share in total seats fell from 73.1 per cent in 1962 to 53.4 per cent in 1967. Indira Gandhi soon started facing opposition from regional leaders of the party and this led to a split in the INC in 1969. In 1971, Indira Gandhi won a landslide victory in the election, securing a clear two-thirds majority in parliament. The economy, however, was hit by a macroeconomic crisis in 1973 and 1974, following the global oil price shock, and this led to a sharp increase in oil prices and the worsening of inflation. There was increasing unrest in the country, with food riots, student unrest, and industrial disputes, culminating in 1974 with the threat of a strike by 2 million railway employees in the public sector, which was the first political challenge to the national government by a trade union since independence. In 1975, Indira Gandhi declared a national emergency, suspending some democratic rights for two years. In 1977, she rescinded the emergency and called for a new election (Kohli 2012). In this, the Congress Party was comprehensively beaten, and a new anti-Indira coalition, led by the Janata Party, came to power. However, this new government was riven with factionalism and power struggles between individuals, leading to its collapse in 1979. Fresh elections were called, and Indira Gandhi returned to power in 1980.

The INC was therefore the politically dominant party for most of this episode. However, as we have seen, it gradually lost its dominant power and was finally defeated in the election of 1977. Together with the numerous economic shocks that India faced in this period, the INC's objective of maintaining popularity and remaining in power ensured that it turned away from the public-sector-led industrialization strategy initiated by Nehru to a very short-sighted pro-poor and anti-business economic regime under Indira Gandhi during this episode. The nationalization of domestically owned commercial banks in 1969 and the adoption of the Monopolies and Restrictive Trade Practices (MRTP) Act were part of this policy regime.

In terms of the global economy and global trade outlook, this first episode covered a period when the participation of developing countries in trade was largely restricted to the export of primary products to developed countries. Since the terms of trade were perceived to be very strongly against primary product exports, there was a strong feeling of export pessimism amongst developing country policymakers. India was no exception to this and the economic ideology during this period was one of anti-globalization and import-substitution. This economic ideology was further strengthened by two more factors. The first of these was the adverse experience of free trade in the pre-independence period under colonial oppression. The second was the highly

successful Soviet experience at that time, which was also very statist with a focus on the public sector.

4.2 Policies and outcomes: 1960–1980

A combination of two factors—the search for a new political narrative due to increasing political competition and an ideology that was suspicious of privatization and globalization—led to an extremely dirigiste economic policy paradigm during this first episode. Initially, the emphasis of this statist approach was on industrialization through massive investment in the public sector.

Roy (2000) argues that this industrial policy followed from the Mahalanobis model (based on an adaptation of the Harrod-Domar model) and focused on the capital-intensive industries. The Industrial Policy Resolution of 1948 set out the goals of this industrial policy and the Industries (Development and Regulation) Act of 1951 created the instruments of implementation of the policy, namely, industrial licensing, tariffs on imports, and public investment.

The Industrial Policy Resolution of 1948 also emphasized on the role of the state in the development of industry. The four basic industrial areas were: (i) items under central government control (arms & ammunition; atomic energy; railways); (ii) items under state government control (coal; iron & steel; aircraft; shipbuilding; telephone, telegraph, & wireless apparatus (excluding radio receiving sets); mineral oils, etc.; (iii) items of basic importance (salt; automobiles & tractors; electric engineering; other heavy machinery; machine tools; heavy chemicals; fertilizers & pharmaceuticals; power; cotton & woollen textiles; cement; sugar; paper & newsprint; etc.); (iv) items other than those listed above, which were to be open to the private sector. The 1948 Resolution also underlined the role of small-scale and cottage industry in the development of the country.

The Industrial Policy Resolution of 1956 classified industries into three categories, based on the role the state was expected to play in each: (i) industries in Schedule A (mostly public utilities and basic and strategic industries, which were exclusively reserved for the state to develop); (ii) industries in Schedule B (mostly heavy industries that were to be progressively owned by the state, although private firms were also allowed to operate them); and (iii) industries outside Schedules A and B, which were open to private firms. The Industrial Policy Resolution of 1956 laid emphasis on reducing disparities in income and wealth, regional disparities, and the concentration of monopoly power and private monopolies. It also emphasized the role of the state in setting up new industrial units and developing transport facilities.

The thrust towards industrialization weakened in the 1970s, as the country faced multiple shocks including wars, severe droughts, and the global oil-price hikes. All of these put the ruling party under pressure, and it turned to more short-sighted policies focused on controlling inequality rather than on encouraging industrialization and growth. The Industrial Policy Resolution of 1973 highlighted the structural distortions that had crept in, and sought to remove these. Emphasis was laid on the interaction between the agricultural and industrial sectors. It introduced legislation to protect cottage industry. The investment limits for tiny and small-scale units were increased in the Industrial Policy Resolution of 1977, which also aimed at optimum utilization of energy supplies and alternative sources of energy. The Industrial Policy Resolution of 1980 (based on the Industrial Policy Resolution of 1956) had four main objectives: optimum use of installed capacity; maximization of production and increased productivity; employment generation; and promotion of export-oriented industries.

As we have seen in the previous sections, the policies for structural transformation were a complete failure in achieving this objective. As a result, they kept growth rates pegged at very low levels

(leading to the term ‘Hindu rate of growth’). Ahluwalia (1985, 1991) argues that the key elements of the policy framework that constrained economic growth in India are the Industries (Development and Regulation) Act of 1951 and the Industrial Policy Resolution of 1956. The first piece of legislation introduced the system of licensing for private industry that governed almost all aspects of firm behaviour in the industrial sector, controlling not only entry into an industry and expansion of capacity, but also technology, output mix, capacity location, and import content. The principal aim of this Act was to channel investments in the industrial sector in ‘socially desirable directions’. The system of controls was reinforced in the 1970s with the introduction of the Monopolies and Restrictive Trade Practices (MRTP) Act in 1970 and the Foreign Exchange Regulation Act (FERA) in 1973. The MRTP Act stipulated that all large firms (defined on the basis of a minimum capital base) were permitted to enter only selected industries, subject to approval on a case-by-case basis. Also, by 1980, any item that could be produced by the small-scale sector was banned from production by other means (there were 800 such goods), and all investment proposals by large firms required separate approvals from the government. The FERA provided the regulatory framework for the commercial and manufacturing activities of branches of foreign companies in India and Indian joint-stock companies with a foreign equity holding of over 40 per cent. The Act specified industries where such firms would be allowed to operate, and all new investments and substantial expansions required separate approval from the government. In addition, there was a restrictive trade regime. Nearly all imports were subject to discretionary import licensing or were channelled by government monopoly trading organizations. The only exceptions were commodities listed in the Open General License (OGL) category.

The combination of an industrial licensing system and an import licensing regime led to the elimination of the possibility of competition, both foreign and domestic, ‘in any meaningful sense of the term’ (Bhagwati and Desai 1970: 272). As the systems became increasingly complex over time, they resulted in ‘a wasteful misallocation of investible resources among alternative industries and also accentuated the under-utilisation of resources within these industries’ (Bhagwati and Srinivasan 1975: 191), thus contributing to high levels of inefficiency in the industrial sector. The three main elements of this policy—extensive bureaucratic control over production, investment, and trade; inward-looking trade and investment policy; and the extension of the public sector beyond public utilities and infrastructure (Bhagwati 1993)—led to an increase in capital intensity and a falling output-to-capital ratio in almost all industries (Ahluwalia 1985).

The policies specifically targeting inclusive growth during this period focused on poverty, rural backwardness, and food sufficiency. The slogan ‘Garibi Hatao’ (remove poverty) was coined in the late 1960s for this purpose by Indira Gandhi. Schemes included the extension of rural roads, building of schools, opening of bank branches, and installation of electricity connections in villages (Roy 2000). Another development was the introduction of the Public Distribution System (PDS). Food distributed through the PDS was initially meant to serve the poor, when food prices increased. India’s agricultural policy was targeted to achieve food security, which for years after independence was mainly done by expanding the area under cultivation.¹ The focus shifted to productivity in the 1950s as uncertainties linked to international political developments brought changes in import flows. The Green Revolution in agriculture was a continuation of the focus on agriculture productivity and the most notable active policy for inclusiveness adopted in the first episode. This policy introduced high-yielding varieties of wheat and greater application of chemical fertilizers to Indian farmers. Other measures introduced to boost this policy included credit to farmers from nationalized banks, subsidized electricity for the extraction of water, and subsidized

¹ The agrarian reforms between 1950 and 1965 included the imposition of a ‘land ceiling act’, abolition of intermediary landlordship, and strengthening of cooperative credit institutions.

fertilizers from nationalized producers. These were highly successful, and agricultural production increased by between 2 and 4 per cent per year between the 1970s and the 1990s.

Overall, the policy paradigm of the first episode was extremely harmful to the structural transformation of the economy. Specifically, industrialization in the manufacturing sector and in the utilities & construction sector was similar to what Kim and Sumner (2019) have termed ‘advanced industrialization’, because of highly capital-intensive public sector undertakings in these sectors, and this led to negative growth of employment in these sectors. Overall, the lack of structural transformation during this episode kept inequality from increasing, but at the cost of very low growth rates. It was a case of ‘inclusion without growth’.

4.3 Politics and economic ideology: 1980–2010

The politics of the early 1980s were defined by growing conflict between the national government and the sub-national states and the beginning of separatist politics among a section of Sikhs in Punjab (Joshi and Little 1994). In order to quell the separatist problem, Indira Gandhi launched an assault on the Golden Temple, the religious centre of the Sikh religion, which had become a terrorist headquarters. This, however, led to her assassination in 1984. Her son, Rajiv Gandhi, then became Prime Minister and called an election the same year. The Congress Party won with an overwhelming majority, riding on a huge sympathy wave. However, support for the Congress dissipated over time, with growing regional and ethnic assertiveness, and allegations of corruption. An anti-Congress political front began to emerge, and in the 1989 general election, the Congress suffered an embarrassing defeat. A coalition of parties, led by the Janata Dal, formed a minority government with outside support from the Bharatiya Janata Party (BJP). This government did not last very long, however, as the BJP withdrew its support and new elections were held in 1991, when the Congress came back to power.

Rodrik and Subramanian (2004) argue that there were significant political economy factors underlying the change to a pro-business approach during this period. There was a realization that India’s democracy was deepening and, as a result, the dominance of a single party was threatened by new opposition parties. At the same time, India saw the emergence of business class that had the required capital to provide the political parties with funds to effectively fight their opposition. While the business class was getting stronger both economically and politically, other political elites that had been dominant in the past (for example, the rich farmers and white-collar professionals described by Bardhan 1984) gradually receded into the background. It was clearly in the interest of Indira Gandhi to garner political support from the new business class rather than to go against them by opening up the economy with policies that fostered competitiveness. Thus, the institutional changes brought about during this period were driven mainly by a political bargain between the Congress Party and the business class, rather than for reasons of enhancing the productivity of the economy. This pro-business approach was further strengthened by Rajiv Gandhi after he came to power in 1984.

During the 1990s, there were a variety of national-level political experiments to form a non-Congress government as a substitute for the old Congress Party. As a consequence, the country moved to a competitive political environment, with two or more political groups jockeying for power, a decreasing share of seats held by the majority party, and no single party assured of victory in national elections. The level of political fractionalization increased sharply in the late 1990s with the rise of regional parties, and it remained high in the 2000s. There were frequent changes of ruling party, the BJP and the Congress alternately holding power in the period 2002–2010. The regional parties became important components of the ruling coalition and exerted a significant influence on what the main ruling party (whether the Congress or the BJP) could or could not do. Thus, whereas the political systems in many parts of the world (such as Bangladesh and Ghana)

are characterized by classic competitive political settlements, India's political system became multi-polar, rather than bi-polar (Varshney 1999).

These changes in the political space had two distinct effects. First, the regional parties mostly used clientelist strategies in order to maintain their popularity and, given their importance in the new political space, the political environment became much more vulnerable to money power. This was accentuated by the rapid turnover of governments and closely contested elections, at both the national and regional levels, which led to a shortening of the time horizon of political parties. Second, again due to the increased fractionalization, election campaigns became increasingly expensive as political parties tried to attract voters with various inducements. Both of these effects led to an increasing pro-business economic ideology as political parties realized that their ability to fund their political activities depended on the growth of the economy and good relationships with the business class.

During this episode, too, a significant change took place in the economic ideology of the political parties. In the international trade arena, a number of countries from East Asia had started gaining tremendously from exporting manufactured products to the West. When China joined this bandwagon, it soon became clear that the global economy and international trade gave a rare opportunity to developing countries to transform their economy through industrialization and exports. This led to a shift in the ideas and beliefs of Indian political leaders from a deep suspicion of the market and the private sector to a more pro-business orientation. This shift occurred across the political divide. Among the two dominant political parties, the right-of-centre BJP was more pro-market than the Congress but, with its nationalist leanings, was still suspicious of foreign investors, and therefore resistant to the easing of restrictions on foreign direct and portfolio investment. The left-of-centre Congress had been historically anti-business, but had become markedly pro-market under the leadership of Narasimha Rao. As Mehta and Walton (2014) note, 'the policy changes on de-licensing and trade liberalisation can be seen as a product of the confluence of a changing cognitive map of state elites, and an evolving, rather than a radical, shift in the relationship with business interests' (p. 30).

These political and ideological factors came together to bring about a gradual process of liberalization and globalization in the Indian economy, in terms of both policy and economic outcomes, during this episode (Kar and Sen 2016).

The rising political competition during this episode, however, also acted as a restraint on certain aspects of liberalization. The business class had been articulating for some time that manufacturing growth in India was running into land constraints, labour market rigidities, and other supply-side issues. It was clear that in order to achieve manufacturing-led transition, there was a need for crucial supply-side reforms, including land reforms and labour reforms. However, this was a politically fraught issue, and reforms could only be pushed through if there was some consensus on the details of those reforms across the political parties—and the intense political competition during this period did not allow such a consensus to evolve. Thus, this episode threw up a political consensus for product market reforms without a corresponding consensus on factor market reforms.

4.4 Policies and outcomes: 1980–2010

The policies that brought about structural transformation in this episode were those that enabled a gradual process of liberalization and globalization of the Indian economy. In the mid-80s, under the government of Rajiv Gandhi, there was liberalization of industrial controls when some industries were taken out of the purview of industrial licensing. Modernization of equipment was also allowed in a limited manner, and expansion of capacity up to a mandated efficient scale was

permitted in industries where economies of scale were considered to be significant. Finally, the coverage of industrial licensing was also relaxed to allow not only small firms but also medium-sized firms to fall outside its purview. On trade policies, there were a gradual shift from quotas to tariffs as well as a renewed emphasis by the new administration on export promotion.

The policies followed in the 1980s by the government included prioritizing economic growth, making alliances with big businesses, adopting an anti-labour stance, and putting brakes on the public sector (Kohli 2006). The new industrial policy laid emphasis on improving production and 1982 was dubbed the ‘year of productivity’. Constraints on the expansion of businesses were eased by dilution of the MRTP Act, and private firms were encouraged to invest in areas such as chemicals, drugs, ceramics, and cement, which had earlier been reserved for the public sector. Tax relief was also provided for businesses to encourage investment. Labour activism was opposed, with special legislation to discourage strikes. Despite all this, however, productivity did not increase significantly, partly due to labour rigidities (Kohli 2006). In fact, the labour intensity of Indian industry declined steadily in the 1990s (Chaudhuri 2002), and the unregistered sector of Indian industry did not attract investment in the post-reform period (Nagaraj 2003). The Industrial Policy Resolution of 1991 dismantled the ‘licence permit raj’ by removing the requirement for industrial licensing for new projects, expansion of capacity, or product diversification.² Barriers to entry in the form of entry clearance for large and dominant firms under the MRTP Act were eliminated.

The services sector also underwent reforms in the 1990s and 2000s. With liberalization, greater freedom of establishment was possible for both domestic and foreign service providers. The pace of reforms varied from sector to sector, with slower reforms in sectors in which restructuring would lead to large lay-offs, and sectors where reform could reduce access to services by rural or poor communities (Arnold et al. 2016). As a result, the services sector can be divided into three categories: significantly liberalized, moderately liberalized, and closed. The first group includes sectors such as telecommunications, while the second group includes the banking and the insurance sector (Arnold et al. 2016). The sectors that are closed include professional services such as accounting and legal services, retail distribution, and postal and rail transport. It may be noted that the manufacturing and services sectors are linked through two important channels (Dehejia and Panagariya 2014). First, the manufacturing sector uses domestic services such as transport, telecommunications, and business activities as inputs. Second, an increase in manufactured income leads to an increase in demand for non-traded services such as passenger travel, tourism, restaurant food, and real estate activity. Thus, policies that promote the industrial sector also have a strong positive effect on the services sector.

As discussed previously however, the policies of liberalization and reform could not include crucial factor market reforms, particularly land and labour reforms, due to the increasing political competition during this episode. This had a dampening effect on the growth of the manufacturing sector and shaped the trajectory of both structural transformation and inclusiveness in India during these decades. Structurally, the lack of significant manufacturing growth led to a strong tertiarization of the economy, which also became more unequal and less inclusive, as a large part of the increase in employment share went to high-productivity sectors like business services and utilities & construction.

As inequality increased in India during the second episode, particularly following the adoption of the reforms of the 1990s, it was felt that policies focusing on inclusion would have to be adopted, albeit within the liberalized framework of the economy. By the middle of the first decade of the

² Except in 18 industries (Bhagwati 1993).

new millennium, it was becoming clear that the social and political sustainability of the growth process would need explicit policies that would address this issue. This gave rise to the anti-poverty MGNREGA programme, which guarantees 100 days of unskilled manual work to all rural households in India. Launched in 2006, it is the largest social security scheme in the world. The scheme gives an opportunity to rural households to earn a minimum income by getting the 100 days' work, once a job card has been issued to their family. Until 2019, the scheme has covered 691 districts. The MGNREGA programme focuses on many aspects of inclusive growth, since it provides job opportunities to women and the marginalized (women accounted for 54 per cent of the total person-days worked in this programme). The success of the scheme lies in the fact that not only have the poor used it to climb out of poverty, but others have also used it to supplement their income by working during lean agriculture periods.

To sum up, the change in the global trade outlook for developing countries during this episode brought about a change in the economic ideology in India. The change in the ideology in turn brought about changes to the policy paradigm. These led to significant structural transformation in the economy, with a diminishing role of agriculture. Rising political competition, however, limited the extent of manufacturing industrialization. The rise in the share of value added in manufacturing was not significant, while the rise in employment share was barely significant. Thus, using Kim and Sumner terminology, manufacturing could be characterized as experiencing either 'secular de-industrialization' or 'primary industrialization' during these two decades, while the utilities & construction sector, which also had a small increase in value added but a very significant rise in employment share, can be characterized as a case of 'primary industrialization'. Most of the rise in value added and employment was in the services sector. The lack of a significant rise in manufacturing sector employment and a corresponding rise in the non-manufacturing sectors with much higher labour productivity (utilities & construction and business services) also led to a rise in inequality during this episode. This may be termed 'growth without inclusion', and it brought back the Kuznetsian tension. Facing increasing political pressure, the State attempted to manage this tension through anti-poverty programmes.

5 Conclusion

The structural transformation of an economy is a complex process and its trajectory depends on the relative growth of productivity, employment, and value added in different sectors. It takes very different paths in different countries depending on how exogenous factors like the global economic outlook, local politics, or technological changes shape up in different periods. In turn, the impact of structural transformation on inclusiveness brings to the fore the developer's dilemma. What do we learn about these phenomena from the Indian experience?

The first lesson here is that structural transformation does not necessarily lead to a Lewis-type manufacturing-based industrialization. For the 50-year period that we study here, we find that India moved towards a significantly smaller agricultural sector, both in terms of value added and, to a lesser extent, in employment. This was mainly due to a strong trend towards tertiarization during this period. This mostly took place in non-business services, but also in a business services sector that was becoming increasingly significant, particularly in terms of its share in value added. Industrialization, on the other hand, remained rather slow. As we have discussed above, the manufacturing sector could be characterized as having exhibited 'secular de-industrialization' over this post-independence period, while the utilities and construction sector exhibited only 'primary industrialization'.

Second, the nature of structural transformation can be very different over different episodes of development. We find that the manufacturing sector exhibited an ‘advanced-industrialization-like’ trajectory during the first episode, and ‘primary industrialization’ during the second episode. The utilities & construction sector also experienced an ‘advanced-industrialization-like’ outcome during the first episode, while in the second episode it had a very strong ‘primary industrialization’ experience.

The final lesson here is that the Kuznetsian tension can differ in different developmental episodes. Figure 13 characterizes the Kuznetsian tension for the Indian economy. As we have discussed above, the first episode is defined by the global trade environment and local politics focused on stabilizing inequality; as a result, structural transformation and growth were low. This kept a check on the Kuznetsian tension during this episode, as represented by the lower-left box in Figure 13. In the second episode, global trade conditions changed and so did the economic ideology, favouring policies that resulted in significant structural transformation. However, rising political competition prevented the supply-side reforms that were needed for the growth of the manufacturing sector. As a result, the share in employment rose sharply in relatively high-productivity sectors like business services and utilities & construction, and this in turn led to higher inequality. This brought back the Kuznetsian tension during this episode. The upper-right box of Figure 13 represents this outcome.

Figure 13: Characterizing the Kuznetsian tension in the two episodes

		STRUCTURAL TRANSFORMATION	
		WEAK	STRONG
INEQUALITY	INCREASING	Kuznetsian tension: Weak ('Adverse')	Kuznetsian tension: Strong Episode II (1980–2010)
	STABLE OR DECLINING	Kuznetsian tension: Ambiguous Episode I (1960–1980)	Kuznetsian tension: Weak ('Benign')

Source: authors' construction.

Based on the Indian experience in these 50 years, what can we speculate about the future trajectory of structural transformation and inclusiveness in the Indian economy? Falling back on the previous discussion, there are two factors that significantly influenced the policy regimes that have thus far determined the trajectories of structural transformation and inclusiveness in India. The first of these was global trade opportunities for developing countries and their influence on the economic ideology of those countries. The second factor was the nature of the political competition in the country. Based on this analysis, there are three possible future trajectories that structural transformation and inclusiveness could take in India. We name them Trajectory 1, Trajectory 2, and Trajectory 3.

In Trajectory 1, we assume that in future, the world trade environment is characterized by low global growth and protectionist policies towards developing countries. We also assume that political competition remains intense in India. If this combination holds, then, much as in the first episode, the economic policy paradigm might turn anti-globalization, protectionist, and focused

on controlling inequality. As in that episode, this would give rise to very little structural transformation and growth, although inequality might remain under control.

In Trajectory 2, we assume that in future, world trade becomes favourable to developing countries, but political competition remains intense in India, with no consensus on supply-side reforms. This would enable India to continue the kind of transformation that was experienced in the second episode. This means achieving higher levels of de-agriculturalization, but with limited manufacturing industrialization. Since the manufacturing sector usually absorbs low-skilled workers, slower rates of manufacturing growth would also lead to higher levels of inequality. In such a case, the State would have to manage this Kuznetsian tension by increasing anti-poverty policies.

Finally, in Trajectory 3, we assume a future where world trade is favourable to developing countries and political competition does not derail a consensus on supply-side reforms. This will enable India not only to achieve significant structural transformation, but also to enjoy significantly increasing shares of manufacturing industrialization. The higher levels of manufacturing growth will also ensure higher levels of inclusiveness, keeping down the Kuznetsian tension in this case. Needless to add, this is the kind of structural transformation that would enable India to achieve truly inclusive growth.

References

- Ahluwalia, I.J. (1985). *Industrial Growth in India: Stagnation Since the Mid Sixties*. New Delhi: Oxford University Press.
- Ahluwalia, I.J. (1991). *Productivity and Growth in Indian Manufacturing*. New Delhi: Oxford University Press.
- Ahsan, R.N., and D. Mitra (2017). ‘Can the whole actually be greater than the sum of its parts? Lessons from India’s growing economy and its evolving structure’. In M. McMillan, D. Rodrik, and C. Sepulveda (eds), *Structural Change, Fundamentals, and Growth: A Framework and Case Studies*. Washington, DC: IFPRI.
- Amirapu, A., and A. Subramanian (2015). ‘Manufacturing or services? An Indian illustration of a development dilemma’. Working Paper 409. Washington, DC: Center for Global Development.
- Arnold, J.M., B. Javorcik, M. Lipscomb, and A. Mattoo (2016). ‘Services reform and manufacturing performance: Evidence from India’. *The Economic Journal*, 126: 1–39. <https://doi.org/10.1111/ecoj.12206>
- Bardhan, P. (1984). *The Political Economy of Development in India*. Oxford: Basil Blackwell.
- Bhagwati, J. (1993). *India in Transition: Freeing the Economy*. Oxford: Oxford University Press.
- Bhagwati, J., and P. Desai (1970). *Planning for Industrialization*. London: Oxford University Press.
- Bhagwati, J.N., and T.N. Srinivasan (1975). *Foreign Trade Regimes and Economic Development: India*. New York: Columbia University Press.
- Chancel, L., and T. Piketty (2017). ‘Indian income inequality, 1922–2015: From British Raj to Billionaire Raj?’ WID.world Working Paper 2017/11. World Inequality Database.
- Chaudhuri, S. (2002). ‘Economic reforms and industrial structure in India’. *Economic and Political Weekly*, January 12: 155–62.

- Dandekar, V.M., and N. Rath (1971). 'Poverty in India'. *Economic and Political Weekly*, 6(1): 25–48.
- Datt, G. (1998). 'Poverty in India and Indian states: An update'. *The Indian Journal of Labour Economics*, 41(2): 191–211.
- Dehejia, R.H., and A. Panagariya (2014). 'The link between manufacturing growth and accelerated services growth in India'. NBER Working Paper 19923. Cambridge, MA: National Bureau of Economic Research.
- Diao, X., M. McMillan, and D. Rodrik (2017). 'The recent growth boom in developing economies: A structural change perspective'. NBER Working Paper 23132. Cambridge, MA: National Bureau of Economic Research.
- Joshi, V., and I.M.D. Little (1994). *India: Macroeconomics and Political Economy, 1964–1991*. New Delhi: Oxford University Press.
- Kar, S., and K. Sen (2016). *The Political Economy of India's Growth Episodes*. London: Palgrave Pivot. <https://doi.org/10.1057/978-1-352-00026-9>
- Khan, M. (2010). 'Political settlements and the governance of growth-enhancing institutions'. Unpublished manuscript.
- Kim, K., and A. Sumner (2019). 'The five varieties of industrialisation: A new typology of diverse empirical experience in the developing world.' ESRC GPID Research Network Working Paper 18. London: Economic and Social Research Council.
- Kochhar, K., U. Kumar, R. Rajan, A. Subramanian, and I. Tokatlidis (2006). 'India's pattern of development: What happened, what follows?'. *Journal of Monetary Economics*, 53: 981–1019. <https://doi.org/10.1016/j.jmoneco.2006.05.007>
- Kohli, A. (2006). 'Politics of economic growth in India: 1980–2005'. *Economic and Political Weekly*, 61(1): 1251–59.
- Kohli, A. (2012). *Poverty amid Plenty in the New India*. Cambridge: Cambridge University Press.
- Kotwal, A., B. Ramaswami, and W. Wadhwa (2011). 'Economic liberalization and Indian economic growth: What's the evidence?'. *Journal of Economic Literature*, 49(4): 1152–99. <https://doi.org/10.1257/jel.49.4.1152>
- Kuznets, S. (1971). *Economic Growth of Nations*. Cambridge, MA: Harvard University Press; London: Oxford University Press.
- McMillan, M., and D. Rodrik (2011). 'Globalization, structural change and productivity growth.' In M. Bacchetta and M. Jansen (eds), *Making Globalization Socially Sustainable* (pp. 49–84). Geneva: International Labour Organization and World Trade Organization.
- Mehta, P.B., and M. Walton (2014). 'Ideas, interests and the politics of development change in India: Capitalism, inclusion and the state'. ESID Working Paper 36. The University of Manchester.
- Nagaraj, R. (2003). 'Industrial policy and performance since 1980: Which way now?'. *Economic and Political Weekly*, 30: 3707–15.
- Rodrik, D. (2013). 'Unconditional convergence in manufacturing'. *The Quarterly Journal of Economics*, 128(1): 165–204. <https://doi.org/10.1093/qje/qjs047>
- Rodrik, D. (2014). 'The past, present, and future of economic growth'. In F. Allen et al., *Towards a Better Global Economy: Policy Implications for Citizens Worldwide in the 21st Century*. Oxford and New York: Oxford University Press.

- Rodrik, D., and Subramanian, A. (2004). 'From Hindu growth to productivity surge: The myth of the Indian growth transition'. NBER Working Paper W10376. Cambridge, MA: National Bureau of Economic Research.
- Rodrik, D., M. McMillan, and C. Sepulveda (2016). 'Structural change, fundamentals and growth'. In M. McMillan, D. Rodrik, and C. Sepulveda (eds). *Structural Change, Fundamentals, and Growth: A Framework and Case Studies*. Washington, DC: IFPRI.
- Roy, T. (2000). *The Economic History of India: 1857–1947, 3rd Edition*. New Delhi: Oxford University Press.
- Sivasubramanian, S. (2000). *National Income of India in the Twentieth Century*. New Delhi: Oxford University Press.
- Timmer, M.P., G.J. de Vries, and K. de Vries (2015). 'Patterns of structural change in developing countries'. In J. Weiss and M. Tribe (eds), *Routledge Handbook of Industry and Development* (pp. 65–83). Abingdon: Routledge.
- Varshney, A. (1999). 'Mass politics or elite politics: India's reforms in comparative perspective'. In J.D. Sachs, A. Varshney, and N. Bajpai (eds), *India in the Era of Economic Reforms*. Delhi: Oxford University Press.
- World Bank (2019a). World Development Indicators. Available at: <https://databank.worldbank.org/reports.aspx?source=world-development-indicators> (accessed 20 September 2019).
- World Bank (2019b). PovcalNet: The on-line tool for poverty measurement developed by the Development Research Group of the World Bank. Available at: <http://iresearch.worldbank.org/PovcalNet/povOnDemand.aspx> (accessed 20 September 2019).