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India as a New Model of Late Development: Assessing the Relationship between Service Led Growth and Democracy

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INDIA AS A NEW MODEL OF LATE DEVELOPMENT?

ASSESSING THE RELATIONSHIP BETWEEN DEMOCRACY AND SERVICE-LED GROWTH

A Thesis

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ABSTRACT

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This paper assesses the relationship between democracy and a service-led model of economic growth by analyzing the political and economic development of India. The Indian model of development is unique for two reasons. First, India's economic growth is due, in large part, to the success of its service sector as opposed to growth in traditional industry. Second, it has seen its economy take off under democratic rule. This paper asks whether these two unique features of the Indian case are related. Does democracy necessitate a service sector path to development? It appears that linkages exist between democracy and the service-led path to development. This paper explores the generalizability of the India model of development and assesses the sustainability of services led growth.

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Chapter 1

Problem/Purpose

This thesis explores the relationship between regime type and economic growth. Specifically, it assesses the extent to which democracy[1] and high rates of economic growth are compatible. The current work builds off the work of Deutsch (1961), Gerschenkron (1966), Huntington (1966, 1991), and Kohli (2004, 2006, 2009) who argue that democratic regime types are poor promoters of high levels of late economic growth and development[2]. However, this thesis departs from previous work as it is argued that democracy is, in fact, compatible with high rates of late economic growth, but incompatible with the traditional development model of industrialization.

The method of analysis is a case study on India. India was chosen because it has maintained democracy since its independence from Great Britain in 1947 and allows for the evaluation of economic growth prospects under conditions of democratic rule. While a single case study is limited in terms of generalizability, the political and economic development of India is still worth studying because while democracy has remained constant, economic growth has varied dramatically. India's first four decades following independence were characterized by stagnant economic growth. However, over the past two decades, the Indian economy has exploded, projecting an average growth rate of almost 9% for 2010 (Lamont 2010). What explains the variation in India's economic

[1] Democracy is defined as a system of government in which political leaders are elected periodically through relatively fair and honest elections. Constituents have rights to assembly and association and can express political preferences via voting. The party in power remains in power until a new party is voted in through an election. Opposition parties must be present and considered viable alternatives to the party in power (Burdekin 2009).

[2] Late economic growth and development refers to countries in pursuit of growth after 1950. These countries are considered "late" because major industrialization and modernization has already taken place in the United States and Europe by this time.

growth? Upon exploration and examination of the India case, it is argued that democracy in India discouraged traditional industrialization but has supported a new model of late development: service-led growth.

The Plan of the Thesis

In order to assess the relationship between Indian democracy and its new model of service-led growth, it is necessary to trace both political and economic development in India prior to Independence through the present. Chapter 2 begins with an exploration of democratization in India. It is argued that British colonial rule and India's incredible demographic diversity are the two factors primarily responsible for Indian democracy. Chapter 3 traces Indian economic development theory and explores the compatibility of democracy and traditional industrialization. Chapter 4 ties chapters two and three together and explores potential explanations for the compatibility of democratic regime types and service led growth models of development. Chapter 5 concludes by assessing the generalizability and sustainability of India's new model of service-led growth.

Chapter 2

Indian Democracy, 1947-2010

India, the seventh largest territorial state in the world, home to four major religions and twenty-eight different languages, and a population of 1.1 billion people, is one of the most diverse countries in the world (Index Mundi 2010; World Bank 2009)[1]. India's vast diversity and size presents unique national governance challenges (CIA World Factbook 2010). Despite these challenges, however, India has maintained electoral democracy since independence from Great Britain in 1947 and today holds the title of the world's largest democracy (World Bank 2009). That Indian democracy has survived nearly seventy years in a country wrought with widespread poverty and incredible diversity of interests and groups at first glance seems remarkable. However, this thesis argues that it is exactly India's incredible diversity that makes democracy not only possible, but necessary. The success of Indian democracy is largely a consequence of its history of indirect British colonial rule and its incredible demographic diversity. The success of democracy in India suggests that, despite the conventional wisdom of the economic and development literature, democracy can survive in a diverse developing country (Gershenkron 1966; Moore 1966; Kohli 2009).

British Colonial Legacy

The relationship between Great Britain and India began in the early 17th century with the creation of the British East India Company (BEIC). The BEIC's initial interest in India was purely economic. India's geographic location made it a very valuable point of

[1] India's population is 80.5% Hindu, 13.4% Muslim, 2.3% Christian, 1.9% Sikh, 1.9% Other. The five most common languages spoken are Hindi (41%), Bengali (8.1%), Telugu (7.2%), Marathi (7%), and Tamil (5.9%). "English enjoys associate status but is the most important language for national, political, and commercial communication" (Index Mundi 2010, http://www.indexmundi.com/India/demographics_profile.html).

transit for trade to and from Europe, the East Indies, and China. By the 17th century, the BEIC became a crucial element in Great Britain's economy as India became Britain's primary supplier of "raw materials, a safe field for capital investment [and] a crucial element in her balance of payments" (Gallagher and Seal 1981, 387). India became the focal point and necessary ingredient for the "continued expansion of world trade" (Gallagher and Seal 1981, 387). As the BEIC expanded its presence in India, the once purely economic relationship became political as leaders of the BEIC partnered with local Indian princes, in what was referred to as the system of the Raj, and acquired increasing control over local Indian affairs. Over time, however, it became clear to the British government and the BEIC that its success and "the pattern of trade and investment …depended upon dominion" in India (Gallagher and Seal 1981, 387).

As British economic dominance manifested itself into British political dominance in India, distrust and hostility grew between native Indian princes and the BEIC. It became increasingly clear that Britain's role in India was purely exploitive. "The British were anxious to pull resources out of India, not to put them into it. So a cardinal rule was that India was not to be a burden on the British tax-payer; she had to be self-supporting, secure and at peace" (Gallagher and Seal 1981, 389). This is evidenced by the fact that the BEIC orchestrated the construction of a rail, road, and port system to facilitate trade paid for by the Indian government and profited by the BEIC (Gallagher and Seal 1981).

The economic and political tension between India and the British East India Company culminated in The Mutiny of 1857, a rebellion of native Indians against British domination (Belmekki 2008). "What distinguished the events of 1857 was their scale and the fact that for a short time they posed a military threat to British dominance" (Bayly

1990, 170). The Mutiny signaled the British Crown that the BEIC was no longer strong enough to control and manage the political system in India and that more official British involvement was necessary. In 1857, the BEIC was absorbed by the British Crown, marking the beginning of official colonial rule in India (Bayly 1990, 194-197).

Under British colonial rule, a new system of indirect rule was put in place. India was divided into Princely territories, 565 in total. Native Princes remained in control of their local territory while the British crown maintained control over India's military and foreign affairs (Belmekki 2008). The system of indirect British rule relied upon the cooperation of local Indian princes. A political bargain was struck which allowed Britain to take its cut of Indian revenues while promising to play a limited role in local politics. Under this system, local princes handled the distribution of resources and resolution of conflicts without much accountability to the British Raj. "By necessity the British had to be a laisser-faire regime…the rhetoric of their proconsuls disguised a ground-floor reality where they governed in name but Indians ruled in practice" (Gallagher and Seal 1981, 390).

From the beginning of British colonial rule in India, Britain's democratic norms of tolerance and rule of law were rhetorically encouraged in India. In order to sustain the system of British governance and Indian local rule, it was imperative that India remained peaceful. As such, Britain encouraged the Indian population to embrace norms of tolerance and respect for the rule of law. In Queen Victoria's Proclamation of 1858, she promised to,

> respect the rights, dignity and honour of native Princes… as we desire that they, as well as our own subjects, should enjoy the prosperity and …social advancement which can only be secured by internal peace and good government...[W]e disclaim alike the right and desire to impose our convictions

> on any of our subjects. We declare it to be our royal will and pleasure that none be in anywise favoured, none molested or disquieted, by reason of their religious faith or observances, but that all alike shall enjoy the equal and impartial protection of the law; and we do strictly charge and enjoin all those who may be in authority under us that they abstain from all interference with the religious belief or worship of any of our subjects on pain of our highest displeasure (Queen Victoria Proclamation 1858).

The introduction of democratic norms in India is not inconsequential. By introducing cultural norms of respect for human rights, individualism, property rights and the rule of law, British colonial rule can be credited for laying the foundation of what would eventually become an independent democratic Indian state.

However, as British economic interest in India intensified through the 20th century, London encouraged Calcutta to shift from a system of indirect rule to system of more centralized, direct rule. It was argued that an increase in control and participation in local Indian affairs would allow Britain to increase its extractive power. "Step by step the British imposed upon India an interconnected structure of government which stretched from its summit at Whitehall to the districts and taluks at the base, an administration close at the top, however lightly it rested upon the base" (Gallagher and Seal 1981, 390). Increased British involvement in local Indian affairs required a restructuring of local government. First, installment of the British administrative structure at the local level required increased involvement and participation of the indigenous Indian population. The British administration needed more employees to staff its growing infrastructure. In so doing, the British conditioned the local Indian political leaders to work within a democratic administrative bureaucracy. The unintended consequence of the centralization of British colonial government in India resulted in greater unification and organization of local Indian politics.

> As [British colonial] government intervened from above in spheres which previously it had left alone, it was brought into more direct contact with interests, once safely insulated in the localities; [local Indian rulers] now had to shift their attention to the higher levels from where the intervention was coming in order to protect their franchises and immunities. The modest representative bodies which the British created were themselves an incentive for Indians to build a matching structure of political organization, connected from the centre to the periphery, capable of negotiating with the British at the top in the name of constituents at the base. Thus one largely unintended result of these greater interventions into Indian society, and the steps taken to soften their impact, was to edge Indian politics out of their local arenas (Gallagher and Seal 1981, 392).

In effect, greater centralization of the British colonial state resulted in a stronger, more unified, more democratic and representative Indian political structure than ever before. British administrative infrastructure was designed to accommodate electoral politics. Indians were allowed to run for a seat on government councils at the local, provincial and national level. Election was indirect, but required the support of the local Indian population for nomination and a peaceful approach to negotiation and governance for approval of election by the British Raj. The development of government councils encouraged broader participation by Indians in political affairs which further solidified the norms of electoral democracy within the indigenous Indian population. It also encouraged attention to local, provincial and national politics as increasing centralized control at the top required approval from above for local action.

Both World War I and World War II acted as decentralizing forces in British colonial government in India. During World War I, with British attention focused on the war efforts, indigenous Indian politics turned inward and developed a degree of autonomy that was unprecedented. By the 1930s, Britain was in a considerably weaker financial position and so retracted its control over Indian regional and local politics, granting provincial power back to indigenous Indian leaders. Great Britain still maintained control at the center over matters that affected the homeland, notably defense, foreign policy and internal security (Gallagher and Seal 1981, 406). The impact of WWII on British colonial rule was similar to the impact WWI had on British governance in India and by the close of the war, Britain handed over power and withdrew from India completely (Menon 1958).

The British fluctuation between decentralized, indirect rule and centralized, direct rule in India is not without historical consequence. It ultimately mobilized the local Indian population and increased participation in national political affairs. It also created a class of leadership in India, most notably the local Princes and those elected to governance councils at the local, provincial and national level which acquired increasing control over Indian politics. British colonial rule also laid the foundation for a federal organization of states in India following independence. The development of indigenous political leadership and the wellsprings of a federal state organizational structure along with the imbuement of values like tolerance, rule of law, and property rights provides at least a partial explanation for India's democratic form of governance following independence.

The relationship between Great Britain and India during colonial rule was not one characterized by partnership but rather by domination and convenient exploitation. However, it appears that the legacies of British colonial rule can, in several ways, be credited for the stability of democracy in India today. In a recent study of British colonial rule, Lange (2004) assesses the relationship between direct and indirect British colonial rule and a variety of post-colonial development indicators. His quantitative study of thirty-three former British colonies provides evidence that supports the findings of Boone

(1994), Mamdani (1996), Migdal (1988), and Reno (1995) whose qualitative research suggests that "institutional legacies of indirect rule left ineffective central administrations, empowered local chiefs, and thereby created a system of decentralized despotism that has left the state both ineffective and near collapse (Lange 2004, 906). Lange also finds support for the arguments of Amsden (1985), Huff (1994), Kohli (1994), Lange (2003) and Wade (1990) who posit, "alternatively …that direct and bureaucratic colonial rule left legacies that made possible effective states and thereby state-led development" (Lange 2004, 906).

Lange finds that indirect British colonial rule is highly and significantly associated with lower levels of post-colonial political stability, less bureaucratic effectiveness, lower levels of rule of law, and higher levels of corruption and an increased state regulatory burden. Additionally, while the relationship is less robust, Lange finds that indirect British colonial rule is also negatively associated with post-colonial democracy[2].

The Indian case partially confirms and partially disconfirms Lange's findings. First, it is important to note that India is a unique case. British colonial rule in India was not uniformly direct or indirect, but rather fluctuated over time and circumstance. While it appears that India's historical bureaucratic effectiveness, lack of state regulatory burden, rule of law and lack of government corruption (to be discussed in detail below) are consistent with the findings, what is most surprising is that despite the largely indirect style of British colonial rule in India, India emerged following independence as not only a relatively stable state, but a democracy. It appears that the combination of indirect colonial rule in rural India and the relatively direct and centralized role at the center in

[2] Lange's 2004 study included a set of 33 former British colonies, one of which was India.

India is responsible for the weak, but relatively effective bureaucratic, democratic post-colonial Indian state.

Independence: Nehru and The Congress Party

The transition to independence in India began long before 1947. As early as the end of WWI, Britain recognized that a British Indian empire was unrealistic given the decline in their relative economic and political standing following the war (Spear 1958). Discussions of transitions to Indian independence began. Three main players emerged in the independence debate: The Indian National Congress (largely a Hindu party), The League (largely a Muslim party) and the British. Britain's declared goal was to hand over power to a united India (Spear 1958). However, distrust between The Congress and the British had been long established and The Congress questioned whether Britain truly sought to establish a "united India by general agreement" (Spear 1958). The League and The Congress were divided on religious grounds: according to Jinnah, the leader of the League, "Islam and Hinduism are not religions in the strict sense of the word but are in fact different and distinct social orders" (Jinnah quoted in Spear 1958, 175). By 1945, it appeared that a general agreement between all three groups was impossible and in 1947 the partition of the British Indian Empire resulted in the creation of the states India and Pakistan. Partition, according to Spear, "became imperative to avoid civil war and anarchy" (Spear 1958, 176).

Unfortunately, partition only successfully prevented anarchy. The Punjab massacres and massive migrations that occurred following independence resulted in the deaths of about one million people. The partition required the division of the Sikh people, just the catalyst necessary to spark violence. Over 12 million people crossed the India-

Pakistan border in either direction. Violence occurred as Muslims fled from Eastern Punjab, the newly created state of Pakistan, and Hindus and Sikhs moved west from Pakistan to India.

In light of the violence that occurred immediately following independence, it is even more remarkable that democracy survived in India. On the whole, countries which gained independence following WWII in Asia, Latin America and Africa were highly susceptible to authoritarian government as a result of the high level of political and social unrest that occurred following independence. Independent India, however, had two unique factors that contributed to democratic success: a well established Congress party dating back to 1885 and a highly effective Civil Service administrative institutional structure (Huntington 1968). During the 1950s,

> India entered independence with not only two organizations but two highly developed- adaptable, complex, autonomous, and coherent- institutions ready to assume primary responsibility for these functions. The Congress Party, founded in 1885, was one of the oldest and best organized political parties in the world; the Indian Civil Service, dating from the early nineteenth century, was appropriately hailed as 'one of the greatest administrative systems of all time.' The stable, effective, and democratic government of India during its first twenty years of independence rested far more on this institutional inheritance than it did on the charisma of (India's first Prime Minister) Nehru (Huntington 1968, 84).

It is clear that while the British may be discredited for failing to promote Indian social and economic development during the colonial period, the institutions that were put in place during the colonial period contributed significantly to the success of democracy following India's independence. The British colonial period can be credited with the institutionalization of democracy, tolerance, rule of law, and pluralism in India.

British colonialism can be credited for both the development of the Congress Party and the Civil Service, though for different reasons. The Congress Party, established in the late nineteenth century, rose out of an Indian nationalist movement. In effect, British domination provided a single target for Indian nationalists. Uniting not along religious lines, the Congress Party pitted itself against colonial domination and in effect, created an organic pluralist political organization in Indian society. The Congress Party attracted members throughout Indian society, most notably from various castes. Following Huntington, the stability and longevity of the Congress Party can, in part, be explained by its foundation in India's traditional patronage networks. For Huntington, patronage "has been a major source of strength" for the Congress party (Huntington 1968, 70).

India's caste system, the social stratification of different groups in society, served as the basis for the Congress Party's link throughout and within society (Huntington 1968). While most if not all party leadership came from the upper Castes in Indian society, especially during the twenty years following independence, the hierarchical social network provided the foundation for political linkages from the upper castes to lower castes, in effect capturing the entire population. "[E]specially during the 1950s... the Congress forged patronage links with regional and local influentials, thus creating a chain of authority that stretched from the capital city to villages" (Kohli 2009, 23). While the caste system was a system of social hierarchical stratification that resulted in widespread prejudice and inequality, it also functioned as a legitimate social organizational institution in India. The Caste system initially provided the patronage network on which stood Congressional Party control and may be at least partially credited as an explanation for democratic and political stability following independence.

The second explanation for democratic and political stability in post-colonial India, the "highly developed" Civil Service, can be directly credited to the British. As discussed in detail above, the tendency towards centralization and institutionalization during the late nineteenth and early to mid twentieth centuries of British colonial rule in India resulted in the creation and establishment of a highly effective administrative state within India, adequately equipped to handle the multiple demands a young democratic state must address. However, while India's administrative infrastructure was well equipped to handle multiple demands from a democratic society, it was not tested, at least during the first ten or fifteen years of independence.

> [L]evels of political mobilization in India during the 1950s and the early 1960s were relatively low, and elite politics tended to accommodate intra-elite struggles. While Nehru was definitely 'first among equals,' the fact is that cabinet government during this early period was a reality, the parliament functioned as an important deliberating and debating forum, opposition was treated with respect, the Congress party had internal democracy and an identity independent of the government, chief ministers of states often possessed independent political base, and such other state institutions as the constitution, the civil service, and the judiciary enjoyed a degree of non-partisan integrity. There were thus important institutional checks on the personal power of Nehru (Kohli 2009, 26).

Politics, during the Nehru and Congress party years, were on the whole dominated by a small group of elites in intra-elite struggles, orchestrated in large part by the Caste system. "Members of the dominant castes and other influential 'big men' in villages were thus often able to sway the political behavior of those below them, namely, the middle and lower rural strata" (Kohli 2009, 26). Mass mobilization of India's masses would not occur until the mid 1960s, as democracy spread from the top, down.

Indira Ghandi and Populism/Clientelism

One of the great ironies in India's democratic history is that as democracy took root in a broader sense among the lower castes and rural classes, the stability of democracy in India began to crumble. During the mid 1960s and 1970s, Indian politics increasingly came to be characterized by populism and clientelism. As Kohli describes, “the more the power relations in the social structure, especially in the villages, were democratized, the more personalized and centralized became decision making at the top of India’s political pyramid” (Kohli 2009, 26). The old Caste based patronage networks that the Congress Party relied upon were disintegrating, causing the party to lose ground and legitimacy with the newly mobilized citizens (Singh 1971). The “Congress system [of the 1950s and early 1960s]...in which the ruling party acted like a *party of consensus* and the opposition acted like *parties of pressure*...provided the chief competitive mechanism of the Indian political system in which competition had been internalized and carried on within the ruling party” (Singh 1971, 66-67, see also Kothari 1964).

Beginning in the early 1960s, however, the Congress Party base was destabilizing and the old ‘Congress System’ was being challenged by many new political parties that no longer saw themselves as ‘parties of pressure’ but as legitimate opposition parties. Recognizing the disconnect between the old elite Congress Party of the 1950s and the newly politically mobilized lower caste and rural voting population, Indira Gandhi ran for Prime Minister on a pro-poor campaign. In an attempt to redefine the Congress party and capitalize on the failure of older Congress Party members to identify and connect with the majority of India, Indira Gandhi based her electoral campaign on promises to alleviate poverty, to be a “champion for the poor” (Thakur 1976, 264). She was elected Prime Minister in 1966 in a landslide election based on big promises, many of which she would fail to keep.

By the 1967 general elections, it became clear to all that the era of one party dominance had passed (Narain 1969).

> For the first time since independence, 9 out of 17 states, with 65 per cent of India's population, came under the rule of inherently unstable [new] coalitions. Since the Congress, the largest party in these states, did not have a majority, the highly fragmented opposition found an opportunity to come to power-- so much so that principles, programmes and ideologies were set aside in order to find a place in the ministries. Political parties that had never cooperated, even for the sake of winning elections, were now eager to join hands (Singh 1971, 69).

Coalitions formed between the unlikeliest pairings of political parties including the "communists, the socialists, splinter Congress groups, the Jan Sangh [the militant Hindu party], the Muslim League, [and] the Swatanantra [a party of free enterprise and vested interests]" (Singh 1971, 69). The decline in the Congress Party's dominance over Indian political affairs sparked power-hungry interests in the leadership of the opposition parties. Untenable alliances were formed purely on the basis of gaining power, often along conflicting ideological lines. By the late 1960s, the stability of India's party system, one of the two major pillars on which political and democratic stability in India rested, was in serious decline.

Indira Gandhi's popular and clientelistic style of rule, in large part a consequence of the decline in old-style Congress Party dominance and increased political mobilization and participation from the lower castes and rural classes, ultimately resulted in the destruction of the autonomy of the state infrastructure as well. Once in office, Indira Gandhi's cabinet and political appointments were made based on loyalty and favoritism and she politicized the Civil Service, police, armed forces and even the Constitution. Under Indira Gandhi, nothing in Indian politics was immune from "partisan political struggles" (Kohli 2009, 26-27). What was once referred to as the "greatest administrative systems of all time" no longer resembled its post-colonial structure (Huntington 1968, 84).

For early modernization theorists, this change in Indian politics does not come as a surprise. According to Huntington (1968, 70), "Corruption is...a product of modernization and particularly of the expansion of political consciousness and political participation." India did not experience the populist and clientelistic tendencies of the late 1960s and 1970s sooner after independence in large part because democratic politics were limited to a small group of elite Congress Party members, whose patronage networks successfully limited the political influence of the masses. "The reduction of corruption in the long run requires the organization and structuring of that participation. Political parties are the principal institution of modern politics which can perform this function" (Huntington 1968, 70-71). Furthermore, if political parties are to provide the structure for democratic participation, they must be organized by ideology and interests. In short, effective and stable parties have to identify themselves based on specific positions on specific interests.

When tested by mass political mobilization and participation, weaknesses in India's Congress Party were exposed. The "all-India" Congress party was not unified by ideology and interests but rather acted as the catch-all Indian nationalist party. A charismatic leader like Prime Minister Nehru together with the momentum and excitement of independence carried the Congress party for the better half of two decades. However, increased mobilization and participation by a larger percentage of Indian society uprooted the Congress Party's foundation. Without the stability of Congress

Party hegemony, power hungry opposition leaders took advantage of the new, largely unaffiliated class of new voters.

Without the stability of the Congress Party system, Indian politics transformed into the all-too familiar populist and clientelistic politics common in other newly-independent post-colonial states following WWII in Latin America and elsewhere. The political situation in India became so critical that in 1975, Prime Minister Indira Gandhi declared a state of emergency. This is arguably this darkest period in Indian democracy. The state of emergency was proclaimed to

> counter an alleged conspiracy aimed at violently overthrowing the legal Government. Thousands of opponents of Mrs. Gandhi's regime were arrested under specially enacted preventive detention laws that left them with no legal recourse to freedom; fundamental rights and liberties of all were suspended; and even the legality of the emergency measures was decreed to be no longer subject to judicial review (Thakur 1976, 263).

While the events of 1975 are extreme, in many ways they were a natural progression of events during Indira's Gandhi's administration. The previous year, in 1974, several popular uprisings in response to the Indira Gandhi administration's failure to make good on her campaign promises, most notably reducing poverty, led to a "ruthless suppression of the railways workers' strike, using tactics of imprisonment, and repression" (Thakur 1976, 263-264). In addition, "runaway inflation and ever-growing numbers falling below the poverty line; and increasing restlessness and violence manifested in strikes and demonstrations. ...Mrs. Gandhi's popular image as a champion of the poor had slipped from its peak of 1971-72" (Thakur 1968, 264).

While some argue that Indira Gandhi's declaration of emergency rule was more a reflection of her loss of control and power over the political situation, the events of 1975 would likely have jolted any head of state. “In 1975 India experienced its greatest political crisis since independence...a crisis of deterioration, and a crisis of democracy” (Palmer 1976, 95). While it is not surprising that popular uprisings and protests would result from Indira Gandhi’s poor record of public performance, her general failure to follow through on her campaign promises, and the sluggish economic performance of the recent past, what is surprising is the method by which the opposition voiced their concerns. Members of opposition parties assassinated the Railways Minister, L.N. Mishra and the Inspector-General of Police, Mizoram.

> In the succeeding months serious acts of violence occurred almost daily. They indicated that not only was there a breakdown of law and order, but also that political opponents of the existing regime were resorting increasingly to extra-constitutional methods. These are the conditions that Mrs. Gandhi must have had in mind when, in her broadcast to the nation on June 26 immediately following the proclamation of a national emergency, she charged that ‘forces of disintegration are in full play and communal passions are being aroused, threatening our unity (Palmer 1976, 95-96).

Remarkably, the state of emergency ended peacefully, Indira stepped down from power, and elections resumed. In 1979, opposition party member of the Janata Party, Shri Desai, was elected Prime Minister (Prime Ministers of India 2010).

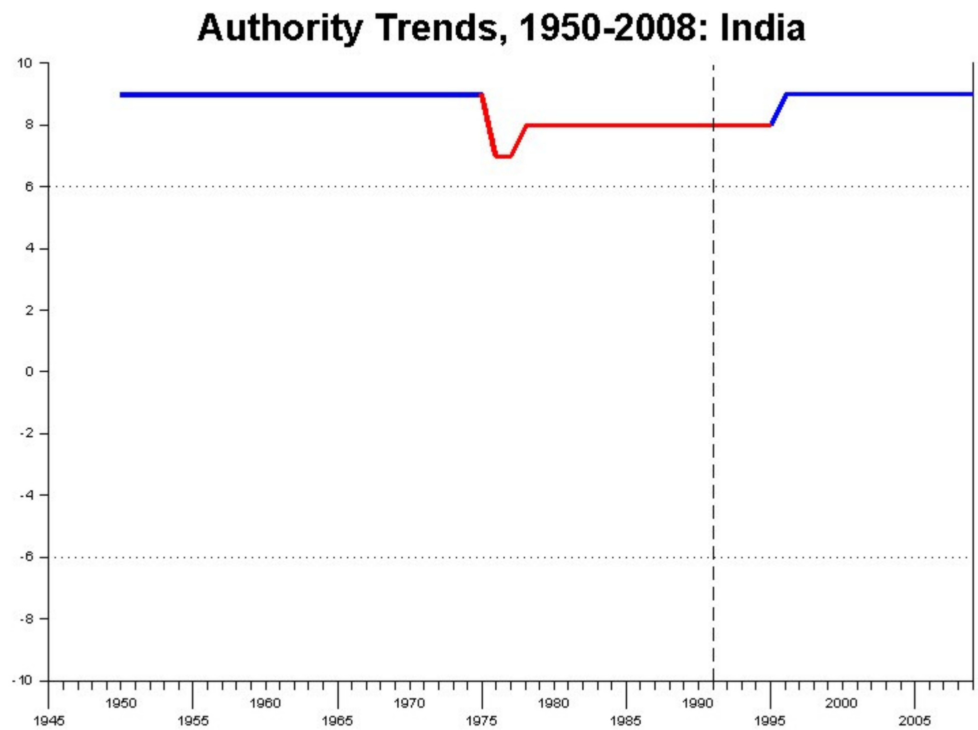

Figure 1: This graph depicts democratic authority in India from independence in 1947 to 2009. Despite the decrease in democratic stability from the mid 70s to early 90s, it is clear that democracy has consolidated in India, as it is the only game in town. The data used to create this graph are Polity IV scores of regime type. The Polity IV measure of regime type ranks countries from -10 (pure autocracy) to +10 (pure democracy). It is clear that India has scored highly on the democracy scale since independence. Source: Marshall and Jaggers 2010 <http://www.systemicpeace.org/polity/ind2.htm>.

Contemporary Indian Democracy

While Indian democracy has faced challenges since Prime Minister Indira Gandhi's brief declaration of emergency rule in the late 1970s, democracy has prevailed, as depicted in Figure 1. Considering that when India set out to be democratic, successful democracies tended to be white, rich, Christian and with a single dominant language, its success over 60 years is significant in two ways. First, Indian democracy suggests that democratic rule not only can prevail, but manages politics in a highly diverse society quite well. Poverty, massive illiteracy and social diversity on a sub-continental scale were not arguments against democracy, they were arguments for it. Second, “India's Republican democracy is premised on a national myth of pluralism, not the standard nationalist invocation of a shared history, a single language and an assimilationist culture” (Kesavan 2007, http://news.bbc.co.uk/go/pr/fr/-/2/hi/south_asia/6943598.stm).

While the challenges that faced Indian leadership in the 1950s 60s and 70s are still largely the same challenges that face the leadership of 2010, Indian democracy remains. Despite widespread poverty, illiteracy, significant income inequality, an imbalance in rural and urban economic development and flares of ethnic violence, the legitimacy of democratic government in India survives. “The press has remained vigorous, free and unafraid to challenge the government,” the judiciary remains autonomous and independent, election turnout continues to rise, India’s party system continues to function and serve it’s representative function and most importantly, elections continue unabated, opposition parties frequently win and incumbents peacefully hand power over to his/her challenger at both the national and state level (Varshney 1998).

India’s history of indirect-direct British colonial rule is in large part responsible for the consolidation of democracy in post-colonial India. The creation of the Congress Party in 1885 along with the development of an administrative state infrastructure, originally designed to serve the interests of the colonial state, provided the necessary framework for democracy to take root in India. However, while the party system remains strong, some question the strength of the administrative infrastructure in India. As democracy has consolidated, and India has experienced increasing levels of mass mobilization and political participation, the effectiveness of the Indian state has become increasingly in doubt (Kohli 2009).

In the next chapter we turn to India's economic development. Since Independence, Indian economic leadership has put the state at the center of economic policy and has pursued a state-led economic development program. Unfortunately, despite the best of intentions, government intervention in the Indian economy has on the whole caused harm and not good. Indeed, the most recent "miraculous growth" over the past two decades has been largely a function of deregulation and privatization. India's "miraculous growth" in the 1990s and 2000s is bittersweet: while the high levels of economic growth are improving the lives of a few, India's economic development continues to be narrow and shallow. In the next chapter, the intersection of economic policy and social policy highlight the relationship between democracy and two different models of economic growth.

Chapter 3

Indian Economic Development, 1947-2010

Today, India's economy is considered one of the fastest growing economies in the world. Since the late 1990's, India has experienced an average gross domestic product (GDP) growth rate of over nine percent per year and has achieved the status of one of the fastest growing economies going into the twenty-first century (CIA World Fact Book, 2009). However, this has not always been the case: only in the past several decades has the Indian economy taken off. Under British colonial rule, India's economy was characterized by "near-stagnation" (Kapila 2009, 31). The poor performance of the colonial laissez-faire capitalist economic policies acted as a catalyst for change. The newly independent state recognized the failures of the laissez-faire economic program to promote economic growth and development in India and pursued a state-led development program going into the second half of the 20th century.

However, early efforts to achieve higher rates of economic growth via India's state-led development program were relatively unsuccessful. The slow growth that characterized the thirty years following independence came to be known as the "Hindi growth rate" (Kohli, 2004). The protectionist and interventionist developmental program that increasingly emphasized socialist economic policy was poorly executed: the gap between state intentions and capability became clear.

It was not until the 1980s that India began to slowly liberalize its economy and break ties with its socialist past. By the late 1980s, the Indian economy began to take off, though the state still played a central role in development planning (Kohli, 2004; Kapila, 2009). High rates of government spending and public investment drove economic growth during the 1980s and by 1991, India found itself in a serious balance-of-payments crisis. The economic crisis of the early 1990s forced India to reevaluate its state-led approach to economic growth and development. The 1990s were characterized by further liberalization mixed with a more perfect marriage between the state and business. The higher growth rates in the 1990s and 2000s can be explained by India's shift away from socialist-inspired economic planning towards a pro-business economic program (Kohli, 2007).

Interestingly, the Indian model of development is significantly different than the traditional model of industrial development. Instead of industry and manufacturing driving economic growth and development, the service sector has acted as the modernizing force in India. The past 30 years of strategic economic openness and protectionism has allowed the service sector, most importantly tradable services, in India to flourish. India's service-based model of development indicates a new path to economic growth and development under democratic rule.

India's British Colonial Period: Laissez-faire policies and exploitation

Inspired by Smithonian economics, the British colonial state in India pursued economic growth and development through laissez-faire capitalism. The rationale behind the pro-market approach was twofold: first, economic openness and competitiveness were thought to generate "higher rates of production growth via more efficient allocation of scarce resources" (Kohli 2004, 6). Second, state interventions were thought to cause "distortions that hurt economic growth" (Kohli 2004, 6). Consequently, the British colonial government saw it their responsibility to ensure the operation of free-markets and the prevention of government induced market distortions. Unfortunately, laissez-faire policies would prove ineffective at achieving economic growth in India.

In the latter half of the 19th century, India began to feel the changes that correspond with industrialization. Imports of machine made goods first became available in the late 1800s (Kapila, 2009). However, the introduction of "machine-made goods from abroad…reacted adversely on the traditional pattern of economic life, [and] did not create the impulse for development along new lines" (First Five Year Plan 1951, 28). Instead of sparking an industrial revolution, the arrival of machine made goods resulted in the destruction of India's "traditional arts, crafts and industries" (First Five Year Plan 1951, 28). As a result, productivity plummeted and underemployment increased.

> In such an environment there could be little economic or social progress. …Whatever surpluses were available….were directed to the purchase of imports, partly of better finished products from abroad and partly of equipment for the new transportation system designed primarily in the interests of foreign commerce….Up to the end of the 19th century, the only major large scale industries which had taken root in the country were textiles. Little attention was paid to improvement of agriculture or the needs of the rural areas (First Five Year Plan 1951, 28).

Colonial India was "characterized by a low-tech, low-productivity agrarian economy" (Kohli 2004, 222). While the British did provide "political unity, a 'national' market, and infrastructure," these were not enough to support economic growth or industrialization (Kohli 2004, 222). Despite the structural foundations for development laid by the British, the colonial regime had little influence on the relatively low savings and investment rates of the domestic population, "primitive technology, and poor economy with little internal demand" (Kohli 2004, 222).

Britain's interest in India's development and industrialization was primarily based on financial self-interest, characteristic of most colonial relationships. The British regime failed to invest in "growth-promoting activities" such as technology development and "maintained an open economy that could overwhelm any indigenous dynamism that might have emerged" (Kohli 2004, 222). What is remarkable, despite the considerable hurdles for a class of industrial entrepreneurs to develop in colonial India, a small group of capitalists flourished. Upon independence, "these capitalists and India's nationalist political elite agreed that rapid future industrialization would require protection and active state intervention" (Kohli 2004, 223). Upon independence, India began its state-led development program.

India at Independence: 1947

The newly independent, democratic state of India faced remarkable challenges following independence. The most significant problems the new state had to address were mass poverty and widespread illiteracy (as high as 84% in 1947) exacerbated by income inequalities across regions and groups (Kapila 2009, 32). To combat these largely economic and social development problems, India's first Prime Minister, Jawaharlal Nehru, made it his first priority to improve the standard of living of the Indian population via a state-led economic development program. From independence, the Indian state played a central role in economic development planning.

In 1947, the Indian economy was mostly agrarian: nearly 80% of the population lived in villages and participated in agriculture. However, despite the high percentage of the population working in agriculture, "the country was not self-sufficient in food and raw materials for industry" (Kapila 2009, 32). Alleviation of food shortages and Indian self-sufficiency became of primary importance, encouraging the new state to implement protectionist and interventionist economic policies. Import substitution industrialization

(ISI) theory informed India's early efforts toward economic growth and development (De Costa, 2006)[1].

India implemented a massive state-wide economic planning program and developed a series of Five Year Plans to lead India down the path of economic growth and development. According to the First Five Year Plan (FYP):

> The central objective of planning in India at the present stage (1951-1956) is to initiate a process of development which will raise living standards and open out to the people new opportunities for a rich and more varied life…But the economic condition of a country at any given time is a product of the broader social environment, and economic planning has to be viewed as an integral part of a wider process aiming not merely at the development of resources in a narrow technical sense, but at the development of human faculties and the building up of an institutional framework adequate to the needs and aspirations of the people (1951, Chapter 1).

The plan emphasized the importance of the wellbeing of the Indian people and saw economic development as a facilitator of improved standards of living. Economic growth and development were seen as means to an end: a means to protect the Constitutionally defined "right to work, the right to adequate income, the right to education and to a measure of insurance against old age, sickness and other disabilities" (First FYP 1951, Chapter 1). The first FYP approached economic development from a social perspective. Successful development was defined as that which would not exacerbate income inequality or the "concentration of wealth and economic power in the hands of a few" (First FYP 1951, Chapter 1). This commonwealth perspective acted as the bedrock of socialist tendencies that would take root in India in the following years.

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[1] ISI is an approach to economic growth and development that limits foreign imports in an effort to encourage self-sufficiency in the developing state. By limiting imports, domestic industry is supposed to fill the gap and produce what the economy needs. However, ISI in developing countries is often challenged by low domestic savings and investment rates, requiring that public investment finance development.

The first FYP recognized the importance of increasing capital accumulation and redirecting capital into industry. The traditional model of industrial development helped shape India's economic policies in the years following independence. Drawing from the industrialization experiences of Great Britain, the United States, Japan and the former Soviet Union, India's first FYP noted that higher rates of capital formation resulted from higher levels of net investment which in turn resulted in dramatic increases in national income (First FYP 1951, Chapter 2).

Of particular interest was the Soviet path to development: state-directed development by way of public financing and investment (First FYP 1951, Chapter 2). Early Indian economic policy reflected former Soviet Union economic policy of the 1920s and 1930s. During the 1920s and 1930s, the former Soviet Union dramatically increased government spending and public investment in an effort to increase productivity, capital accumulation, and ultimately the national income. India was inspired by the former Soviet Union's "deliberate state policy and action" to improve the standard of living of its people. Soviet investment during the 20s and 30s averaged twenty percent of national income, resulting in the overall increase of Soviet national income by 130% (First FYP 1951, Chapter 2).

India was particularly interested in the Soviet path to development for at least two reasons: first, the Soviet Union played a central role in development as India envisaged for its own development and second, Soviet industrialization occurred more recently and was therefore assumed to be a more relevant historical analogy. India's first FYP concluded, "It would appear on the whole that, in under developed countries with low standards of living and rapidly increasing population (characteristics of which are similar to both the Soviet Union and India), a rate of growth commensurate with needs cannot be achieved until the rate of capital formation comes up to around 20 per cent of the national income" (First FYP 1951, Chapter 2).

Capital formation and investment rates are directly related to domestic savings rates. In order to increase the rate of capital formation and investment, the rate of domestic saving must also increase. The most reliable, consistent means to ensure increased domestic savings rates is for the state to effectively force its people to save more through taxation or price inflation (First FYP 1951, Chapter 2; see also Gerschenkron, 1966; Moore, 1966). As national income rises, the more aggressive a state is in shifting the increase in income to savings as opposed to consumption, the faster the development process. As such, the First FYP held, "such a programme for stepping up capital formation calls for sustained austerity" (1951, Chapter 2). The First FYP predicted that if India could increase its domestic savings rate from five percent to twenty percent of national income, India could maintain GDP growth around five percent per year (Kapila, 2009)[2]. Furthermore, at the target savings rate of twenty percent of national income, the related problems of low capital accumulation and investment would improve.

In an effort to stimulate economic growth, India allocated Rs. 2069 crores (equivalent to $44 million USD today) over the period 1951-59 towards its state-led development program (First FYP 1951, Chapter 4). Public expenditure during this period targeted both agriculture, in an effort to achieve self-sufficiency and reduce poverty, and infrastructure, to provide the foundation for industrialization (Five Year Plan 1951,

[2] Low savings rates often indicate either (1) a poor domestic population and/or (2) a lack of investment opportunities and incentives to encourage savings. Unfortunately, both were characteristic of India in the 1950s.

Chapter 4). The central role of the state in India's development program is reflected in the distribution of public funding toward state owned enterprise versus private enterprise.

> …nearly 60 per cent of the planned outlay will result directly in the creation of productive capital in the ownership of the Central and State Governments; this will be mainly under irrigation and power, transport and communications, and industry. The remaining 40 per cent will partly add to productive equipment in the private sector, partly provide assistance in the form of working capital or of advisory and administrative services, partly help to maintain and expand social services, and partly act as an incentive for community effort in development (First FYP 1951, Chapter 4).

In sum, over the period of the first FYP, India managed to increase national income by eighteen percent, food grains production increased by twenty percent, cotton and major oilseeds output increased forty-five and eight percent respectively, and over six million acres of land were brought under irrigation "through major works; another 10 million … benefited through smaller works" (Second FYP 1956, Chapter 2). Furthermore, India exceeded its GDP target growth rate of 2.1 % per year for the period. The actual growth rate achieved for this period was 3.6 % (http://business.mapsofindia.com/india-planning/first-five-year.html). While the GDP growth target could be considered modest, it was a sharp improvement over the sluggish growth rate achieved under colonial rule, which averaged less than one percent per year between 1900 and 1950, equivalent to population growth (Das 2006)[3]. To the extent that India experienced higher than expected GDP growth and a modest increase in national income, the First FYP was moderately successful in improving India's standard of living.

[3] Because GDP growth was equivalent to population growth, India experienced no increase in per capita income during this 50 year period.

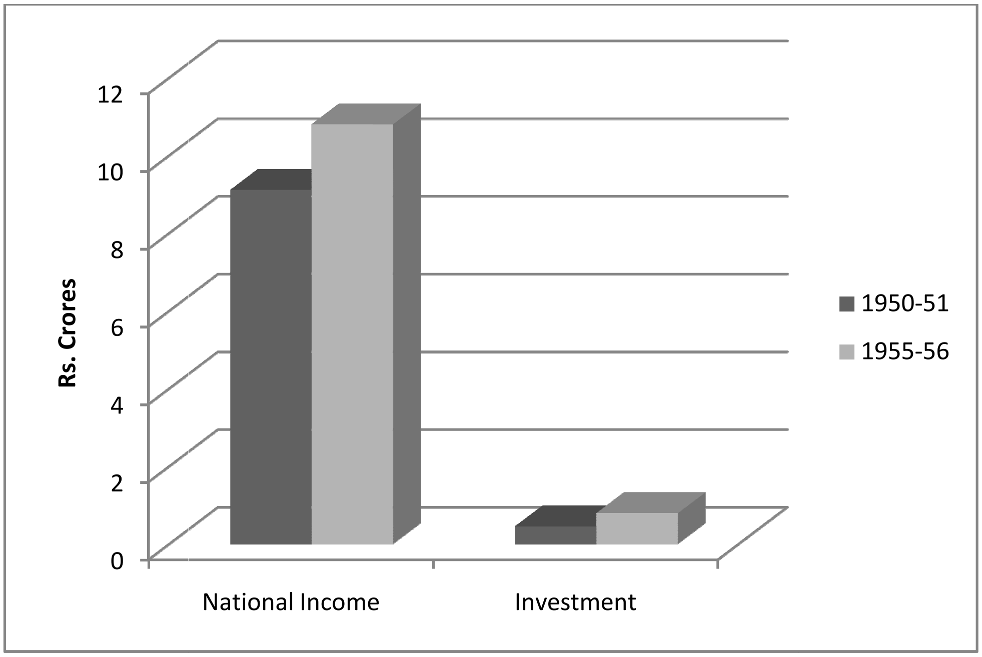

Figure 2: The first FYP was effective in increasing both investment and national income. Source: First Five Year Plan, 1954.

The Second FYP: 1956-61

In an effort to build off the modest success of the First FYP, the Second FYP (1956-61) was considerably more aggressive and "intended to carry forward and accelerate the process of development initiated in the first plan period" (Second FYP 1956, Chapter 3). The Second FYP aimed to increase national income by 25%, "enlarge employment opportunities at a rate sufficient to absorb the increase in labor force consequent on the increase in population…and to take a major stride forward in the direction of industrialization so as to prepare the ground for more rapid advance in the plan periods to come" (Second FYP 1956, Chapter 2). In many ways the second plan was a continuation of the priorities of the first plan, "but there (was) inevitably a shift in priorities with a larger accent on industrialization, especially the development of heavy industry, and the necessary ancillaries like transport" (Second FYP 1956, Chapter 2).

"The 1956 Industrial Policy Resolution emphasized that the state must play a progressive role in the development of industries" (Kapila 2009, 41). To achieve higher rates of economic growth and development, beginning with the Second FYP, the State began to play an even larger role in the economy.

> The adoption of a socialist pattern of society as the national objective, as well as the need for planned and rapid development, require that *all industries of basic and strategic importance, or in the nature of public utility services, should be in the public sector*…The State has, therefore, to assume direct responsibility for the future development of industries over a wider area (emphasis added 1956 Industrial Policy Resolution).

Commensurate with the increased role of the state, public expenditure increased dramatically during this period. The Second FYP allocated Rs. 4800 crores (102.8 Million USD) toward state-led development between 1956 and 1961, a significant increase over the First FYP budget. As noted earlier, development of heavy industry was emphasized in spending priorities and increased from 7.6% in the first FYP to 18.5% in the Second FYP of the allocated development budget (Second FYP 1956, Chapter 2). Consequently, relative expenditure on agriculture declined (15% in the First FYP to just under 12% in the Second FYP) (Second FYP 1956, Chapter 2).

The Second FYP proved to be too aggressive and too ambitious. Additionally, the socialist, import-substitution platform on which the plan was based required the Indian state to borrow in large quantities from abroad to finance the plan's programs and initiatives. The Second FYP was "much more ambitious, much more dependent than its precursor on borrowing abroad and on deficit finance" and ultimately faced considerable financial challenges as the state was unable to borrow abroad on a scale commensurate with the volume of its imports of capital goods" (Bareau, Bird, and Shonfield 1957, 301).

Public investment during the Second FYP was financed by foreign loans and as production lagged behind spending, India's debt grew during this period.

The Third FYP: 1961-66

The principal aims of the Third FYP were to increase national income by 5% per year, maintain investment to sustain the target growth rate, achieve agriculture self-sufficiency, expand basic industries "so that the requirements of further industrialization can be met…mainly from the country's own resources," increase the rate and opportunities of employment, "and establish progressively greater equality of opportunity and to bring about reduction in disparities in income and wealth and a more even distribution of economic power" (Third FYP 1961, Chapter 4). The Third FYP estimated that if executed properly, " national income should go up by about 30% and per capita income by about 17%" over the plan period (Third FYP 1961, Chapter 5). Furthermore, the Third FYP called for a more "intensive effort" and "greater sense of urgency" than previous plans, highlighting the need for "the maximum rate of investment that can be achieved" (Third FYP 1961, Chapter 4).

While agriculture had been largely ignored to this point, the Third FYP placed a significantly greater emphasis on food grain production in an effort to achieve self-sufficiency. The State was compelled to do whatever it took to achieve the "socialist" style of living it desired. The projected cost of the Third FYP programs totaled Rs. 8098 crores (about a $174 million USD), over double the expenditure of the Second FYP (Third FYP 1961, Chapter 5 Annex II). In order to do so, the State borrowed extensively from foreign sources and India's balance of payments became of critical concern. The Third FYP called for an increase in net investment from 11 to 14% of national income.

Part of the increase in investment was financed by external sources (Third FYP 1961, Chapter 6). India's growing reliance on external financing would prove to be a limitation in further development, as production lagged behind spending.

The principal goal of the first three FYPs was to improve the standard of living of the Indian population. On most accounts, the first three FYPs were only modestly successful in this regard. Not only did gross national income remain low, but GDP remained relatively stagnant and hovered at 3.7% per year between 1950 and 1964 (Kohli 2009). Unfortunately, public investment in all three sectors: infrastructure, agriculture and industrial development did little to reduce unemployment and increase the supply of consumer goods. During the same period, industrial growth averaged 7.4% per year, agricultural growth averaged 3.1% per year and gross investment as a percentage of GDP averaged 13% per year (Kohli 2009).

Despite the common goal of improving the standard of living for the Indian population, in practice, the first three FYPs lacked unity in rhetoric and action. According to Basu, the ideologies behind the first three Plans were competing, if not contradictory (Basu 2004).

> "A soviet-style planning system was developed, but without the state having a monopoly of control over the resources. Capitalism was allowed to flourish, but a large bureaucracy was nurtured. Huge investments were made in basic industries, but at the same time several sectors were protected as belonging to the small-scale sector. Capitalism was criticized but it was also relied upon. Socialism was never practiced, but the rhetoric of socialism was the norm. A burgeoning bureaucracy became the surrogate for socialism" (Basu 2004, 19).

The two decades following independence in India were characterized by the Nehruvian model of state-led, import substitution industrialization. The Nationalist movement that occurred leading up to, during, and after independence sparked an increased interest in national sovereignty, a belief in the "superiority of the state in steering progressive capitalist development, and the need for India's poor to share in the fruits of development (Kohli 2009). As a result, the nationalist leaders of India were suspicious of an open economy and, despite low domestic savings rates, were also unwelcoming to foreign investment. The slow economic growth and unchanging standard of living for the Indian population during the Nehru era laid the bedrock for the next, more extreme, wave of socialism as articulated by Prime Minister Indira Gandhi (1966-77).

The Fourth FYP: 1969-74

The Indira Gandhi Era was characterized by "economic rhetoric (that) moved further to the Left, and the gap between the state's developmental capacities and economic goals widened even further, to the detriment of industrial development" (Kohli 2009, 121). The Fourth FYP reiterated the goal of improving India's standard of living, especially of the poor (Fourth FYP 1969, Preface). The Fourth FYP notes:

> "The 'socialist pattern of society' means that the basic criterion for determining lines of advance must not be private profit, but social gain, and that the pattern of development and the structure of socio-economic relations should be so planned that they result not only in appreciable increases in national income and employment but also in greater equality in incomes and wealth (Fourth FYP 1969, Chapter 1).

The leftward shift in Indira Gandhi's political rhetoric effectively politicized industrialization (Kohli, 2009). The food crises of the late 1960s further exacerbated the problem. An even greater emphasis was placed on agricultural self-sufficiency and less emphasis was placed on industrial development. Unfortunately, the left-leaning political orientation of Indira Gandhi's political campaign "helped neither economic growth nor redistribution" (Kohli 2009, 122). As characterized by Atul Kohli, this was an era of “missed opportunities” (Kohli 2009, 123). “From the mid-1960s on, the global economy became more open to manufacture exports from developing countries…India…moved in nearly the opposite direction, becoming more and more obsessed with ‘politics’” (Kohli 2009, 123). In an effort to maintain political legitimacy, Indira Gandhi redirected public resources for investment aimed at development into special interest groups, hurting economic growth. Domestic and foreign investors were alienated by the politicization of development policies, discouraging private investment. The increasing alliance with the Soviet Union created a greater distance between the Indian economy and those of the more “dynamic economies” of the West (Kohli 2009, 124).

In sum, the somewhat narrowly defined national goal of economic development which was solidified under Nehru derailed under Indira Gandhi and economic growth declined. Between 1965 and 1979, GDP grew at a sluggish 2.9%, down from 3.7% under Nehru. Industrial growth averaged only 3.8% compared to 7.4% during the Nehru era. Agricultural growth, despite being a major focus of the Indira Gandhi economic plan, decreased from 3.1% under Nehru to 2.3% under Indira Gandhi. The little progress that was achieved under Nehru was largely erased by Indira Gandhi. More importantly, by further institutionalizing the import-substitution economic policy, India failed to take advantage of its “key resource:” cheap labor (Kohli 2009, 128). When the global economy was becoming more global, India retracted from the international economy and consequently was not able to take advantage of export-led growth like other, more open, export-oriented developing countries. Going into the 1980s, India’s economic outlook looked similar to that immediately following independence.

Economic Progress 1980-1990: Sixth, Seventh, Eighth and Ninth FYPs

The ISI inspired economic restrictions of the 1960s and 1970s were gradually relaxed in the 1980s (DeCosta 2006). The Sixth FYP aimed to achieve a target GDP growth rate of 5.2% per year. To do so, the projected public outlay increased dramatically. The Sixth FYP called for Rs. 97,500 crores (about $2.1 Billion USD) in public expenditure to finance the development effort. The Sixth plan increased public expenditure on development over 80% compared to the fifth plan (Sixth FYP 1980, preface).

The election of Rajiv Gandhi and the development of the Sixth Plan marked India's departure from a uniformly ISI informed economic policy towards an export-oriented approach to development, allowing a closer alliance between the state and private business (Kohli 2007). The Sixth FYP draws a distinction between self-reliance and self –sufficiency, determining that self-sufficiency, being able to pay state debts, is all that is required to be independent. The Sixth FYP called for increased growth in exports and selective protection of industries in which India had a comparative advantage (Sixth FYP 1980, Preface).

The Sixth plan demonstrates the shift in Indian economic policy following the Indira Gandhi era. India now aimed to promote exports, and *strategically* protect its indigenous industries in which it had a comparative advantage. This required a more intimate alliance between the state and business (Kohli 2009). India's economic policy would develop into a state-led pro-business approach to economic growth and development. This shift in policy and attitude would be the foundation for India's economic growth in the next three decades.

Table 1:

Targeted and Actual Growth Rates under India's FYPs

	Target	Actual	Growth Rate For
First Plan	2.1	3.6	National Income
Second Plan	4.5	4.0	National Income
Third Plan	5.6	2.2	National Income
Fourth Plan	5.7	3.3	Net Domestic Product
Fifth Plan	4.4	5.2	Gross Domestic Product

As indicated in Table 1, the gap between India's targeted rates of growth and actual growth rates revealed the gap between state interests and state capabilities. One of the best practices Indian leadership gleaned from the First through Fifth plans was the centrality of public investment in driving growth. The Sixth FYP concluded that if executed properly, India could increase the rate of capital formation from 21.5% of GNP in 1979 to 25% over the plan period. Additionally, the Sixth FYP projected that the rate of investment would stabilize around 27% by the end of the plan and that the economy would grow (GDP) at about 5.5% per year over the next 10 years. India also expected to "achieve a modest surplus in balance of payments by 1994-95 (Sixth FYP 1980, Chapter 1).

The Sixth FYP was relatively successful. It met its target GDP growth rate of 5.2% per year over the five-year period. However, the mining and manufacturing industries underperformed during this period, and agriculture and services over performed. Growth in the service sector was credited for helping the Sixth plan meet its target GDP growth rate (Seventh FYP 1985, Vol I)[4].

Seventh FYP 1985-90

The Seventh plan was cognizant of India's growing balance of payments problem as a result of the increased reliance on external borrowing to finance development (Seventh FYP 1985, Vol I). While continued external borrowing was necessary, the Seventh FYP also aimed to increase net savings by 2% over the period to an average of just under 25% per year in an effort to offset the need for external financing (Seventh FYP 1985, Vol I). Given this target savings rate, the Seventh FYP projected that total borrowings would amount to Rs. 20,000 crores (or about $428 million USD) over the plan period (Seventh FYP 1985, Vol I). "The process of structural adjustment to strengthen the balance of payments undertaken in the Sixth Plan period will thus need to be intensified in order to forestall the equally undesirable alternative outcomes during the second half of 1980s, namely, excessive external indebtedness or slowing down of growth due to import shortages" (Seventh FYP 1985, Vol I).

While the Seventh FYP faced significant challenges, it produced an average GDP growth rate of close to 7.6% by the end of the plan period (Panagariya 2004). By 1985, the "pace of reform picked up significantly" (Panagariya 2004, 14). According to Joshi and Little, the growth in exports can be attributed Rajiv Gandhi's "quasi-Southeast Asian style" reforms (Joshi and Little 1994, 184). Of particular importance, the 1985 budget made revenue from exported goods income tax deductible and relaxed indigenous value-

[4] A robust discussion of the service sector is provided in Chapter 4.

added requirements on exports, making India much more business friendly (Joshi and Little, 1994).

Unfortunately, the 1980 reforms were heavily financed by deficit spending. The literature recognizes "the role of reforms but regard fiscal expansion financed by external and internal borrowing as the key to the acceleration of growth during the 1980s" (Panagariya 2004, 6). Panagariya demonstrates that the growth in the 1980s was fragile and variable and ultimately unsustainable due to the dependence on internal and external financing (2004). DeLong argues that while Rajiv Gandhi did implement necessary reforms, the true significance was attitudinal:

> Under Rajiv Gandhi, the government made some tentative moves to encourage capital-goods imports, relax industrial regulations, and rationalize the tax system. The consequence was an economic boom incommensurate with the modesty of the reforms...The change in official attitudes in the 1980s, towards encouraging rather than discouraging entrepreneurial activities and integration into the world economy, and a belief that the rules of the economic game had changed for good may have had a bigger impact on growth than any specific policy reforms (DeLong 2003, 3-4).

While the attitudinal change should not be understated, the effect of the economic reforms during this period should also not be understated. The reforms of the 1980s, while "limited in scope and without a clear road map" gave Indian politicians the confidence needed to continue down the more liberal path of development (Panagariya 2004, 5). However, the balance of payments problem that began in the 1980s ultimately culminated in India's financial crisis in 1991 (Ahluwalia, 2002; Joshi and Little, 1994; Panagariya, 2004).

> The 1991 balance of payments crisis forced India to procure a $1.8 billion IMF loan and acted as a "tipping point" in India's economic history. The IMF bailout wounded the pride of a country that had strove above all for self-sufficiency through its post-independence socialist policies. The bailout announced to Indian

policymakers and the world the country's policy failures (University of Chicago Task Force Report 2006, 7).

1990 Economic Reforms

Role of State Planning: The 1991 foreign exchange reserve crisis forced Indian leadership to reevaluate the role of government planning and action in economic growth and development. While the 1980s reforms were successful in increasing GDP growth rates, public investment drove GDP growth rates. One of the main lessons India learned during the 1980s was that economic growth is not sustainable when supported primarily by government spending and public investment.

The reform period of the 1990s was characterized by strategy to "improve the efficiency of the economy and the international competitiveness of the industrial sector by dismantling quantitative restrictions which crippled the capacity of the (public sector enterprises) and of the economy to grow" (Chai and Roy 2006, 26)[5]. Specifically, public sector enterprises were made more efficient by "forcing them to operate more like private sector enterprises, to face international competition, to disinvest a certain portion of their capital which [was] not earning reasonable returns or making losses, and to reduce the size of overstaffing" (Chai and Roy 2006 26).

The 1991 reforms finally "allowed India's integration into the global economy — and laid the groundwork for the high growth of today" (Das 2006). Manmohan Singh, current Prime Minister of India, led the 1990s reform movement as the then Finance Minister. His reforms included lowering tariffs and other trade barriers, eliminating state-required industrial licensing, lowering taxes, devaluing the rupee, encouraging foreign

[5] An example of quantitative restrictions would be limits on imports of technological goods or indigenous value-added requirements.

investment and reducing currency controls (Das 2006). The economy immediately responded and GDP growth during this period rose to averages between 6 and 7% per year, "inflation plummeted and exports and currency reserves shot up" (Das 2006). What is remarkable about India's growth in the 1990s and beyond is its foundation in the service sector. India presents a new model of service led growth that is promising for other late developing, democratic states. The next chapter explores the relationship between democracy and service-led growth.

Chapter 4

Democracy and Service Sector Led Economic Growth

As the previous two chapters have indicated, democracy in India has remained relatively constant since independence while India's economy, aside from the past two decades, has underperformed. Indian economic theory during the first four decades following independence reflected a dedication to the traditional model of traditional industrialization. The Indian case provides evidence for the claim that late traditional industrialization is unlikely to be successful in a democratic regime. However, democracy is, in large part, responsible for India's recent high rates of economic growth. India's new model of service-led growth depends on democratic governance and democratic norms and values.

The Indian case is unique for two reasons: first, India has achieved remarkable rates of economic growth despite being a democracy and second, it has done so with a new model of service sector led development. This chapter argues that there is a relationship between democratic development and India's service sector model of economic growth. Many students of Indian economy have highlighted the uniqueness of India's service-led model of economic growth; however, none acknowledge the important significance of India's democratic regime type. This chapter concludes by arguing that India's miraculous growth over the past two decades has been a function of the compatibility of Indian democracy and service-led growth models of development. India's 1991 economic reforms, the relative importance of capital accumulation in the service sector, India's comparative advantage in skilled labor, the increase in international demand for tradable services and the necessity of political openness to foster service led growth explain India's services revolution.

The following chapter explores the relationship between democracy and service-led development. First, a brief literature review on development models is presented. Second, possible explanations for the failure of traditional industrialization in India are explored. Third, explanations for India's successful service-led growth model are presented. Finally, the chapter concludes by anticipating the sustainability of India's new model of service led growth and makes recommendations to increase the likelihood of future growth.

Democracy and Development

An analysis of the democracy-development relationship can take two forms depending on which is defined as the independent or dependent variable. Defining economic development as the dependent variable and democracy as the independent variable requires the hypothesis that higher or lower levels of democracy will "cause" higher or lower levels of economic development. The goal in this research design is to explain variation in economic development based on changes in regime type. The direction of the relationship is assumed: regime type "causes" economic development, at least to some degree. Alternatively, defining democracy as the dependent variable and economic development as the independent variable implies a hypothesis that higher or lower levels of economic development will cause higher or lower levels of democracy. In this research design, the goal is to explain variation in democracy based on changes in the level of economic development.

There is no shortage of literature on the democracy-development relationship but to date, no consensus has been reached as to the exact specification and direction of the relationship. For example, some students of democracy and economic development "see democracy as an effective tool for safeguarding the private sphere, maximizing economic freedom, stimulating investment, and allowing for the most efficient use of resources" (Baum and Lake 2003, 334). This theoretical orientation names democracy the independent variable, economic development the dependent variable. Here, democracy is argued to be "good" for economic development because it protects the market from government intervention which may negatively impact economic growth.

The alternate theoretical perspective argues the opposite, that democracy may not be "good" for economic development but rather that autocracy, not democracy, best promotes economic growth (Baum and Lake, 2003). According to this theoretical perspective, the process of economic development by way of industrialization in late developing states requires the state to encourage rapid urbanization and modernization of the population. The state-led effort often results in massive societal upheaval. Therefore, "autocrats are both better able to resist (populist) demands and, indeed, to suppress labor unions, wages, and consumer demands" (Baum and Lake 2003, 334). The assumption is that autocratic regime types are better able to narrowly define their goals and interests. If an autocracy narrowly defines its interest in terms of economic development, it is better suited than a democracy (which theoretically is more responsive to citizen demands) to ignore citizen demands for social welfare programs that could potentially cause growth stagnation and threaten the state's primary goal of economic development. Barrington Moore echoes this argument and claims that "a strong conservative government has distinct advantages" as compared to a more liberal democratic government during economic development (Moore 1966, 441). Strong authoritative government is better able to suppress the lower classes, those that typically foot the bill and suffer the most from economic development (Deutsch 1961; Moore 1966).

There are several explanations for a democratic regime's inefficiency and ineffectiveness in achieving high rates of economic growth and development. First, democracies may not be politically and institutionally strong enough to force its citizens through the industrialization process without losing political legitimacy and support, ultimately resulting in the political failure of leadership and an abandoned effort at economic growth and development. This explanation assumes that the state is required to achieve late economic growth and development. Accordingly, the laissez-faire, non-interventionist democratic approach to late economic growth and development may fail because the state is needed, at least to a degree, to jumpstart the development process (Kohli 2004). The laissez-faire approach, while successful in early developers like the United States and Great Britain (Gerschenkron 1966), is ineffective today. Late economic development must happen faster, over a period of years not centuries, which requires the state to coordinate and orchestrate development efforts (Gerschenkron 1966; Kohli 2004).

Higher levels of democracy in a developing state may actually negatively impact economic development, leading to state instability and the overall failure of both economic development and the consolidation of democracy. This assertion prompted Lipset to reverse the direction of the democracy-development relationship when he defined democracy as the dependent variable and economic development the independent variable (1959). Lipset, argued a "threshold approach" to economic development under autocratic rule (1959). He argues, "If other countries become as rich as the economically advanced nations, it is highly probable that they will become political democracies… the sequence of events one would expect is one of poor authoritarian countries developing and becoming democratic once they reach some level of development …" (Przeworski 1997, 158). The idea is that higher per capita income will allow the population to have more leisure time and participate more in politics which will increase the demand for democratic representation.

However, while participation and activism may be good for democratic consolidation (Almond and Verba, 1965), it has also been argued that mass political mobilization can have a destabilizing effect on a state if the proper institutions are not in place to handle the increase in popular activity. For example, a prominent argument in the literature suggests that economic development does not promote democracy (Gerschenkron 1966; Huntington 1968).

> In developing countries of today…the increasingly ineffective and unpopular traditional authorities cannot be replaced successfully by their historic successors in the Western world, the classic institutions of 18th and 19th century liberalism and laissez-faire. For the uprooted, impoverished and disoriented masses produced by social mobilization [as a result of economic development], it is surely untrue that the government is best that governs least. [Late developers] are far more likely to need a direct transition from traditional government to the essentials of a modern welfare state (Deutsch 1961, 498).

Major changes in regime type and economic orientation have huge ripple effects on society (Huntington 1968). Countries undergoing economic development require social institutions, programs, and policies that intervene in the development process to mitigate some of the harsher effects of economic growth (Deutsch 1961).

In a compelling discussion of democracy and economic development, Kohli argues that late development efforts tend to become unfocused when various interest groups have access to the political process and as a result, the goal of economic development and growth tends to derail (Kohli 2004). Kohli finds in his comparative case study of four late developers (Brazil, Korea, India and Nigeria) that states in which leaders are less dependent on popular support and legitimacy to remain in office are better suited to effectively pursue economic development. In a democracy, the need for popular support to remain in office prevents leaders from narrowly defining their goals, as they are subject to the demands of multiple groups in society, often with conflicting interests. In "fragmented multi-class states" (similar to democracies), "a public arena within them is often well enough established that leaders are held accountable for poor public policies and performance" (Kohli 2004, 11). During economic development, it is likely that the public perception of policy choices designed to achieve higher rates of economic growth may be negative and could potentially be politically costly. Conversely, in autocratic or "cohesive-capitalist states" where authority is centralized and often not based on public support, narrowly defining the state's interest in terms of economic development and growth is in many ways easier because autocrats are not dependent on their citizens for legitimacy and political support. For Kohli, the relationship between democracy and late economic development tends to be negative.

The literature suggests that the relationship between democracy and development, depending on the context, can be both positive and/or negative. These results suggest that the relationship between democracy and development remains underspecified and that perhaps the relationship is not unidirectional but rather reciprocal and possibly contingent upon interaction with other variables. The purpose of this thesis is not to explain the relationship between regime type and economic development across all time and place. The purpose of this thesis is to explore the unique Indian case where democracy precedes high rates of economic growth and development. Lessons from the Indian case could potentially be quite valuable in light of the increasing democratization of states worldwide and for other late developers. While it is inappropriate to draw large generalizations from a single case study, it is possible to gain interesting insights into the unique character of democratic economic growth and development.

The historical record demonstrates that economic growth and development efforts have largely been pursued under non-democratic regime types and the effectiveness of these efforts have been mixed. India presents a puzzle in that it has been an electoral democracy since its independence from Great Britain in 1947 and while it has achieved miraculous growth rates over the past two decades, on the whole, the Indian economy has underperformed. The first four decades of Indian independence appeared to provide evidence in support of the argument that democracy is “bad” for economic development. However, since the 1990s, India’s economy has taken off and today is one of the top performing economies in the world. What explains India’s stagnant economic growth during the first four decades of independence? What explains India’s miraculous growth in the 1990s through today? Why has economic development in India been both narrow and shallow? How has India’s democratic regime type impacted Indian economic development?

These following sections explore the relationship between democracy and economic development in India. I argue that democracy has been both a blessing and a curse for Indian development. India's democratic regime type explains, at least in part, the high rates of economic growth in the 1990s for its relationship with service sector led development. However, India's democratic regime type has also been a curse in that it is largely responsible for India's narrow economic development: democracy has prevented traditional industrialization from taking place. I argue that in order for India to sustain high rates of economic growth in the future, India must (1) create more jobs in the service sector to correct the imbalance between service sector employment and service sector contribution to GDP; (2) build off the success of India's service-led model of development and increase capital investment in manufacturing to diversify its economic base, and (3) increase education expenditure in an effort to increase employment opportunities for more of the population and simultaneously decrease the number of people living below the poverty line.

India and Traditional Industrialization

Two factors contributed to India's inability to undergo traditional industrialization: the impact of British colonial economic policy and India's democratic regime type following independence.

> Before the Industrial Revolution, India accounted for a quarter of [the] world's industrial output. The exports consisted chiefly of manufacture like cotton and silk fabrics, calicoes, artistic ware, silk and woolen cloth. The impact of the British rule and the Industrial Revolution led to the decay of Indian handicrafts. Machine-made goods started pouring in to the country. The decline of handicrafts was not followed by the rise of modern industry in India because of the British policy of encouraging the import of manufactures and export of raw materials from India...One thing was quite obvious that during the British period, no effort was made to foster the development of capital goods industries (Kapila 2009, 317).

Upon independence, in response to the British colonial period, one of India's top priorities was to foster economic growth and development through state-led development planning (see chapter 2). India's state-led development program can be attributed, at least in part, to "the socialistic leanings of some of the founding fathers of the country" (Kapila 2009, 319). In reaction to the laissez-faire economic policy of the British colonial period, post-colonial Indian leadership emphasized the importance of Indian self-sufficiency and sustainability. The ISI program that was put in place acted as a barrier to entrepreneurial activity. Most notably, India's licensing requirements for new and existing businesses acted as a huge barrier to economic growth (Kapila 2009). The ISI program suffered from bureaucratic inefficiency and ineffectiveness, negatively contributing to India's economic growth.

In addition to bureaucratic inefficiency and ineffectiveness, India's democratic regime type also acted as a barrier to economic growth and development. Following the work of Atul Kohli, I argue that Indian democratic leadership was not able to narrowly define India's interest in terms of economic growth and development as a consequence of the large poverty lobby in Indian society. India's considerable population living below the poverty line demanded political recognition and attention. The poverty lobby prevented Indian leadership from narrowly defining the state interest in terms of economic growth and development, which is conventionally understood to be a prerequisite for achieving rapid late-economic growth and development (Kohli 2004). Instead of focusing all resources on the accumulation of industrial capital, Indian political leaders, dependent on popular support to maintain legitimacy, were forced to allocate resources to social programs to alleviate poverty.

Additionally, according to the conventional wisdom of the late development literature, rapid economic and social transformation of society from traditional to modern is required to make the giant leap from an agrarian to industrial economy. Democratic accountability again acted as a barrier to making these large societal and political changes because the policies required to achieve these changes are often politically unpopular and result in civilian hardship.

> Modern factory industry requires methods of organizing productive activity that are significantly different from those employed in preindustrial societies. If the shift from traditional modes of production to industrial technology is to be successful, it is necessary to mobilize a labor force which will serve the necessities of this novel situation. Labor must somehow be drawn out of the old and transferred into the new environment. It must be given new tasks and sufficient training to perform them; it must be taught to work to a different pattern of rules and relationships. Scholars have tended to stress the radical character of this transformation and the difficulties of its achievement. For example, it has been the claim of students of the subject that during the past century Indian industrialization was inhibited in many ways by the tenacious persistence of commitments to the traditional social order in the countryside....It is argued that the institutions of the older social order seriously inhibited the creation of an industrial labor force. Claims of kinship, caste, and village supposedly served as bonds keeping people on the land or operated as powerful forces to bring them back (Morris 1965, 198).

During traditional industrialization, the population is forced to transform itself from a traditional agrarian subsistence economy to a modern industrial economy. The most challenging aspects for the population undergoing industrialization are urbanization and the specialization and diversification of the labor force. Urbanization requires the social reorganization of society from the rural countryside to cities which has profound effects on the cultural organization of groups in society (Morris 1965). Specialization and diversification of the labor force requires a sometimes costly transition that requires the individual worker to choose a single profession, often associated with working in factories. The transition from subsistence living to high-productivity surplus living requires dramatic changes in lifestyle. Ultimately, India’s representative government was incapable of breaking the “traditional social order of the countryside” and “forcing” its population through the tough process of industrialization. As a result, India's economy remained relatively stagnant through the 1980s.

India's Model of Service Sector Led Growth

What makes the Indian case unique is the dramatic growth of its economy in the 1990s through today. Despite the British colonial legacy of economic exploitation and despite its democratic regime type, India's deregulation and increased openness to trade in the early 1990s resulted in the miraculous expansion of its economy led by the service sector. "The emergence of services as the most dynamic sector in the Indian economy has, in many ways, been a revolution. The most visible and well-known dimension of the take-off in services has been in software and IT enabled services (including call centres, design and business process outsourcing)" (Kapila 2009, 470).

What is interesting about India's model of service sector led economic growth and development is that India appears to have skipped the step of traditional industrialization and made the giant leap to a service-based economy. The India model of development challenges the traditional model of development where agriculture is replaced by industry which is eventually replaced by services. "Thus, India seems to be an aberration in terms of the service sector having a much greater role in its economy than in other countries at similar or even higher levels of income" (Kapila 2009, 471). "India has sidestepped the manufacturing sector, and made the big leap straight from agriculture into services...Despite being a low income region, India...[has] adopted the growth pattern of middle and high income countries" (Ghani 2010, http://www.voxeu.org/index.php?q=node/4673).

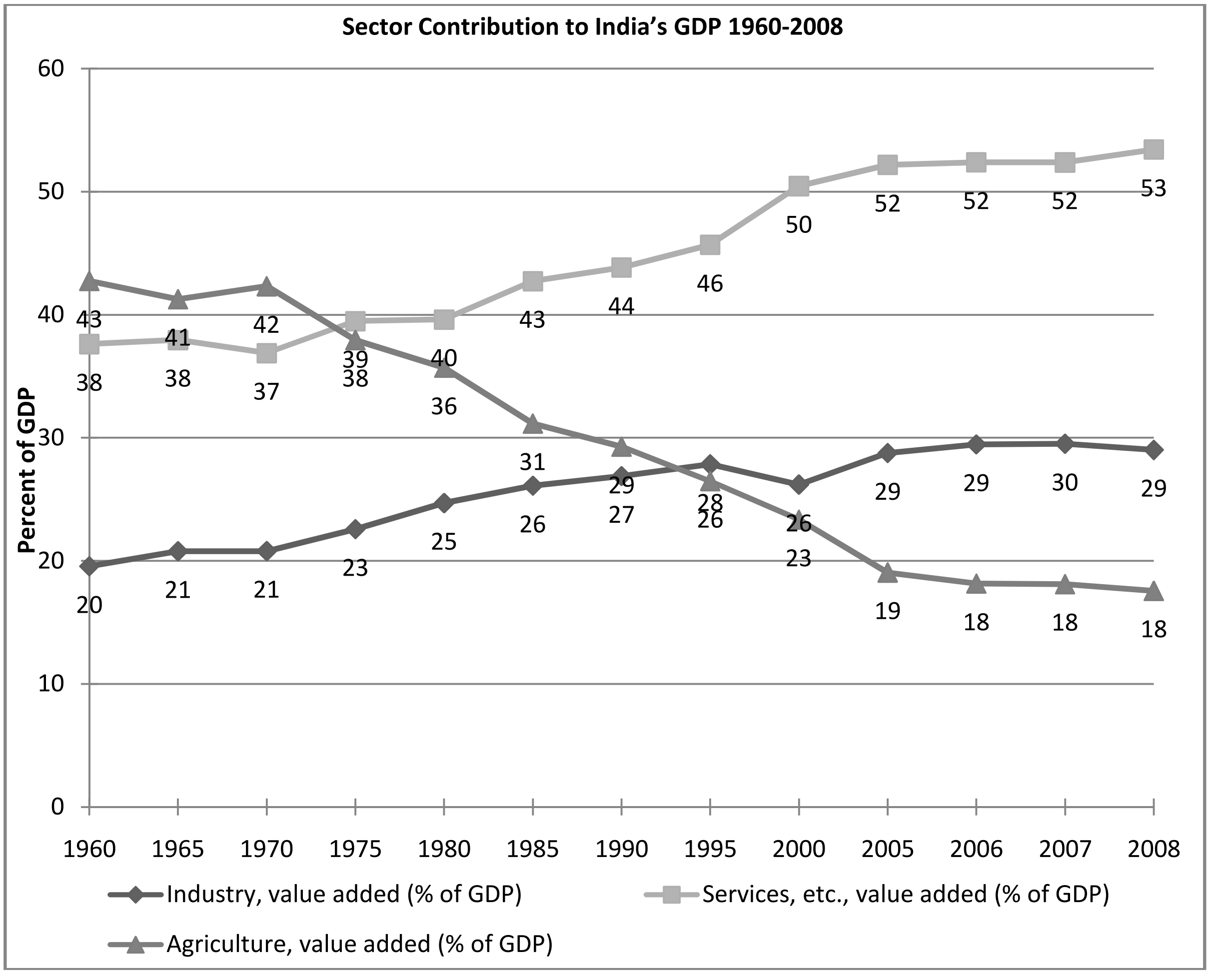

Figure 4: This figure depicts India's rising share in Services from 1960 to 2008. It demonstrates that although India is classified as a developing country, India's market sectors are distributed like that of a developed country. Source: World Bank.

The 1991 Economic Reforms

India's liberalizing economic reforms of 1991 are arguably the single most important contributing factor to the services revolution. Reforms in the industrial sector stimulated internal industrial demand for producer services and "liberalization of the financial sector provided an environment for faster growth of the financial services" (Kapila 2009, 484). India's opening of its economy contributed significantly to service sector growth. "Evidence suggests that services that have been liberalized most have typically experienced higher growth rates. Areas such as business services (mainly IT and IT-enabled services), communication, banking and insurance, which have been liberalized, have exhibited higher growth rates, with wider efficiency and growth benefits to the rest of the economy. On the other hand, services where there has been limited opening, like air transport, legal and real-estate services have grown much more slowly, with likely adverse effects on economy-wide competitiveness and growth performance" (Kapila 2009, 490; see also Chandra, 2007). India's balance of payments crisis in 1991 appears to have been a blessing in disguise, for without the crisis, it is likely that India would have continued to slowly open its economy to international trade as it had been through the 1980s. However, it is clear that the dramatic liberalizing reforms of 1991 deserve significant credit for the services revolution of the 1990s and 2000s, though the liberalizing reforms in IT and IT-enabled services appear to be nothing more than a wonderfully successful historical accident.

The Relative Importance of Capital Accumulation in Services

In addition to liberalizing reforms which opened the Indian economy to increases in service sector productivity, another explanation for the success of India's service sector led development model is that the service sector is different, and in important ways, from the manufacturing and industrial sectors. Most importantly, the service sector differs from the industrial and manufacturing sector in demand and supply side factors that contribute to economic growth.

> There is a basic difference in the operation of demand and supply side factors in driving economy-wide and sectoral growth. According to the mainstream consensus in macroeconomics, demand factors are predominant in governing the short-term growth of an economy; but in the long run growth is governed entirely by supply side factors like capital accumulation (including investment in human

> capital), growth of labour, and technical progress, endogenous or exogenous (Rakshit 2008, 113-114).

The importance of capital accumulation for traditional industrialization and ultimately long run growth, as explained above, is what prevented India from achieving manufacturing and industrial led economic growth during the first several decades following independence. To experience growth in the service sector, less capital accumulation is required, making the service led growth model a better fit for India's democratic, representative government (Rakshit 2008; Reder 1941).

What makes industrial and manufacturing led growth challenging for democratic populations is the need for significant capital accumulation in a relatively short period of time. For manufacturing and industry led development, high rates of capital accumulation must be achieved in order to experience high rates of economic growth. To accumulate manufacturing and industrial capital, it is necessary for states to introduce politically unpopular, severe austerity measures to increase domestic (both public and private) savings, decrease domestic consumption, and increase domestic (both public and private) investment in industrial and manufacturing capital. These austerity measures tend to depress the national living standard for a period until higher manufacturing and industrial sector productivity is achieved. Because the service sector is less capital intensive, a service led model of development requires less severe austerity measures and therefore is a better development model for representative governments like democracies.

> The fact that services are in general much less capital intensive and many of them were relatively new implied that unlike industries, burdened with large, outmoded and inefficient capital equipment and catering to a sheltered domestic market in the pre- reforms [pre 1991] period, it was much easier for the services sector entrepreneurs to switch over to or adopt the most efficient technology and organizational structure, and focus on economizing cost as well as on the quality and timely delivery of their products in a fiercely competitive environment.

> Again, in view of the relatively low financial requirement of the [service] sector capital, market imperfections did not cause insurmountable hurdles for entrepreneurs, new or old, to move quickly to their optimal scale of operation and adjust their production in line with changing market conditions (Rakshit 2008, 111-113).

International Increase in Demand for Tradable Services

The international increase in demand for tradable services also deserves partial credit for India's services revolution (Gordon and Gupta 2004; Jensen and Kletzer 2005). The convergence of India's liberalizing reforms and increasing openness to international trade with the international increase in demand for tradable services can be described as nothing but historical accident. And what a miraculous historical accident it was. Traditionally, services were not considered tradable goods (Banga 2005). However, international trade in services has grown dramatically since the early 1990s (Banga 2005). While conventional wisdom on service industry growth holds that service sector growth is predominantly driven by increases in public consumption, India's services revolution was driven by external international demand (Banga 2005; Kapila 2009; Rakshit 2008). "Indeed, emergence of foreign demand as a major source of services growth constitutes perhaps the most striking feature of India's macroeconomy over the last decade" (Rakshit 2008, 104). International demand for tradable services increased as India's service sector began to boom and is responsible, at least in part, for India's miraculous service led economic growth in the 1990s and 2000s.

India's Comparative Advantage: Skilled Labor

Another significant contributor to the success of India's service led growth model of development is India's comparative advantage in skilled labor. India's "huge labour endowment, varied skill sets and low-cost but quality manpower" has made India one of the largest destinations for business process outsourcing, foreign direct investment and ultimately one of the largest exporters of tradable services (Kapila 2009, 494). Service industry giants in internet technology, communications, and software industries have responded to the global increase in demand for tradable services by expanding their international footprint and increasing business process outsourcing and foreign direct investment (FDI) abroad (World Investment Report 2009). India has been and continues to be at the top of the list of places to invest because of its highly skilled, inexpensive, English speaking, educated labor force (Kapila 2009). "India has one of the largest pools of low-cost, English speaking, scientific and technical talent. This makes India one of the obvious choices" for business process outsourcing. Well known companies like "Dell, Sun Microsystems, LG, Ford, GE and Oracle have announced plans to scale up their operations in India. Others like American Express, IBM and British Airways are leveraging the cost advantages India has to offer [by] setting up call centres [in India]. Several foreign airlines and banks have [also] set up business process operations in India" (BPO India 2010, http://www.bpoindia.org/about/intro.shtml).

India's comparative advantage in skilled labor has made India one of the most popular destinations for business process outsourcing and foreign direct investment, contributing to the overall success and growth of India's service sector. "The faster growing services activities seem to be more intensive in skilled labour, with which India is well endowed" (Kapila 2009, 483). "Within the services exports, rising prominence of business services reflects the high skill intensity of the Indian workforce...The growing role of software and business services in India's service sector exports reflects India's comparative advantage in skill and knowledge-intensive labour based services" (Kapila 2009, 485-487; see also Reder 1941).

Political Openness and Service Sector Growth

Finally, the most critical contributing variable to the success of India's new model of service led growth appears to be that it is a democracy. Democracies tend to be more politically open societies which have higher respect for individual and civil liberties such as free speech (Hathaway 2003; Neumayer 1999). Information technology, communications, and software services are unlikely to flourish in relatively restricted and closed societies that do not allow the free flow of information and opinion. Democracies are likely to be a more friendly environment than non-democracies for the successful execution of service-led models of development to the extent democracies are better promoters of free speech and the free flow of communication and opinion. The liberal norms and values of "individual rights, the free market, and political democracy" provide the friendly environment for service sector growth (Gilpin 2001).

An interesting direction for future study would be an analysis of political openness and an evaluation of the extent to which liberal norms dominate in Indian society during the 1990s and beyond, as compared to the 50s, 60s, 70s, and 80s. If it could be shown that liberal values and norms become more concrete or "deeper" in society during the 1990s and beyond, it would provide support for the claim that normatively, democracies provide good environments for the successful execution of service-led models of development.

Is India's Service Model of Development Sustainable?

In 2009, India's GDP was $3.6 trillion USD making it the fifth largest economy in the world (CIA World Fact Book, 2010). It is widely accepted that the service sector has and continues to drive Indian economic growth. However, many students of the Indian economy question the sustainability of India's service led model of development primarily because of the imbalance between the service sector contribution to GDP and the percent of India's labor force employed in services. In 2009, services contributed over 50% to India's GDP but only 30% of India's labor force was employed in the service sector (see above graph). "Despite high growth, labour absorption in services has been abysmally small" (Rakshit 2008, 91). Indeed, "It is found that growth in the service sector has been lopsided and jobless. Some sectors have witnessed a double digit growth rate in the last decade, e.g., communication and business services, while some have experienced a fall in their growth rates, e.g., railways, real estate and dwellings. The sectors that have witnessed negative growth rates and those that have experienced slow growth rates are also the sectors that have large potential for generating employment, e.g., construction, transport and professional services. Rising labour productivity in the faster growing sectors has further reduced the scope for increasing employment in these sectors" (Banga 2005, 30-31).

In many ways, India's services revolution has been bitter sweet. The high productivity, high growth services are driving GDP growth in India but doing little to address India's "growing crisis of governability" (Kohli 1990). Despite having one of the world's largest GDPs, India ranks 164th in income per capita. Poverty and un- and underemployment remain huge problems. Unfortunately, growth in the service sector has done little to improve either. In order to sustain economic growth, and stable democracy, India must find a way to incorporate a larger portion of the population in the modern economy. To do so, India must expand job opportunities in both services and manufacturing. “To resolve the problem of lack of employment growth in services, there is a need to achieve uniformity in the growth of different services” (Banga 2005, 31). To improve the sustainability of its service led model of development, India must increase investment and encourage growth in the slower growing services that have large potential for generating employment. Additionally, India must expand its economic base and encourage the development of traditional manufacturing and industrial sectors. These sectors are important to support because they generate job creation. Certainly, “The revealed comparative advantage of services does not imply that industry and agriculture should play a minor role in the development process or that the government should adopt a hands-off policy in respect of sectoral allocation of resources” (Rakshit 2008, 91). India must use its service sector success to generate spill over and splintering effects into the rest of the economy in order to maintain its recent high rates of economic growth (for more on splintering see Gordon and Gupta 2004).

Chapter 5

Conclusion

The purpose of this thesis was to explore the relationship between democracy and economic growth and development. Chapter two argued that the consolidation of Indian democracy is both a function of its British colonial past and its incredible demographic diversity. The British colonial period in India can be credited with the development of India's Congress party, the pluralistic, "One India" party that identifies members based on national heritage not based on religious or ethnic heritage. The Congress party contributed greatly to the consolidation of democracy in India following independence as it provided the social structure for maintaining elections and establishing political legitimacy. Furthermore, British colonial rule can be credited with imbuing in Indian society the democratic norms of political representation and voting, along with the liberal norms of tolerance, individualism, and education.

Democratic consolidation in India is also a function of India's incredible demographic diversity. With so many different linguistic, ethnic, and socioeconomic groups in India, it continues to be impossible for any one group to dominate all others. Consequently, democracy is the best form of governance in Indian society as it allows for peaceful dispute resolution and access to government through political representation for all groups in society.

In chapters three and four, it has been argued that democracy has been both a blessing and a curse for Indian economic development: Indian democracy has prevented traditional industrialization and is responsible for nearly four decades of stagnant economic growth but is also responsible for creating a friendly environment for India's services revolution and the two most recent decades of miraculous growth. The presence of various powerful interest groups in India prevented Indian leaders, dependent on popular support for political legitimacy, from narrowly defining the country's interest in terms of economic growth immediately following independence. The poverty lobby in India effectively prevented traditional industrialization from taking place during the first four decades of independence because of its demands for social spending.

Interestingly, the relationship between democracy and traditional industrialization and democracy and service-led growth are different. Democracy is the critical variable which allowed India to experience the past two decades of explosive economic growth. Democratic regimes appear to be a good environment for India's new model of service-led growth to the extent they embrace liberal values of free speech and the free flow of information.

Finally, it is important to assess the generalizability of the Indian model of service-led growth. First, and most obviously, India's service-led model of development is most relevant for strong democracies in pursuit of rapid, late economic growth and development. The number of strong, consolidated *undeveloped* democracies is relative few (Marshall and Jaggers 2010). However, because democratic regimes are becoming more and more common (Marshall and Jaggers 2010), a model of development which promises high growth under democratic rule is promising for the future development of young democracies. The India model of development may apply to these young democracies as they undergo democratic consolidation.

Second, the Indian case demonstrates that a country must possess a comparative advantage in *skilled* labor for effective implementation of India's service-led growth model of development. India's workforce is what makes India unique. While the percentage of people working in services is frighteningly low, India's comparative advantage in skilled, English speaking and urban labor made India ripe for communications and technology outsourcing, the catalyst of India's services revolution. The Indian case suggests that in order for a service model of development to be effective, it is necessary to have a decent size educated and skilled labor force.

In summary, the India model of service-led growth is unique. While it offers some promise of generalizability, future research is necessary to assess the extent to which the India model can be applied elsewhere. Furthermore, future work needs to be done to determine the sustainability of India's service-led model of development to determine if the traditional trajectory of development can be rewritten. Can growth in services have spillover effects that contribute to the growth of manufacturing[1]? If so, will service sector spillover effects into manufacturing improve India's employment rate? India's biggest challenge going into the twenty-first century is no different than its biggest challenge following independence and that will be to address the continuing problems of poverty and illiteracy. While India has done well, it still can do better. With 25% of its population living below the poverty line, a literacy rate of less than 50% for women and just under two thirds for men, and unemployment hovering around 11%, India's success in services is tempered by the reality that it still has a long way to go to modernize all of Indian society (CIA World Fact Book 2010). The key to future growth in India is bringing the benefits of development to all of Indian society.

[1] Under the traditional model of industrialization development, as industry develops, spillover effects accumulate and promote the growth of services.

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