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A note on the debates on Indian Industrial stagnation in 1960s

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Abstract

This note delves into the subject matter of Industrial Stagnation of the Indian Economy in its mid 60s referring to the collected works of Raj (1976), Nayyar (1978), FYP documents on industry and I J Ahluwalia's book "Industrial Growth In India" published in 1985. The claims forwarded by these experts have been critically examined, while doing so it was needed to follow a structure and then proceed with accepting or refuting the claims. Thankfully Nayyar (1978) presents a wide coverage of literature and his structure of paper allows one to progress gradually, for this reason we have followed Nayyar's paper to systematically present our ideas trailing with him and substantiating it with Ahluwalia's work, for most of her work can be seen to challenge Nayyar's claims. Though it would have been evident later itself, we would mention here that our own understanding of the possible hypothesis explaining stagnation is quite close to that forwarded by Patnaik and Rao (1977) as quoted in Nayyar(1978) with some added qualifications after deliberating through various contesting claims and we argue at length to justify our claims.

JEL Classification: L50, L60

Introduction

The mid-1960s saw decline in overall industrial activity by some measures. There exists vast literature centered on the same which can be seen as demand and supply side considerations to explain the phenomenon. The demand side of the story tries to link the sluggishness with growth of income which in turn is determined by agricultural growth (as discussed in most papers) and distribution of income while the supply side of the story tries to link the sluggishness/stagnation with level of saving/investment, capacity utilization and role of government policies which plays its roles via both DD and SS linkages.

What happened to Industrial production in 60s?

With the claims of stagnation it becomes imperative to look into data of industrial production. Nayyar points out unavailability of complete time series data on index of industrial production and change in base years causing difficulty in estimating unbiased data. He completes one series of data with 1960 as base splicing with data from 1956 and 1970 as base years (Source: CSO). He calculates growth rate of industrial production during 1951-65 to be 7.7% per annum while for the period 1965-75 it turned out to be 3.6% per annum, thus earmarking the decade from mid-sixties to be

characteristic of sluggish industrial production growth. While looking for the same preliminary exercise in Ahluwalia, the table A.1.3 gives an almost continuous decline in IIP starting from 1960 till 1980 except for a sharp spike during 1976-77 (Source: NA, ASI, NSS, Chandhok) which is evident given emergency rule and for this reason only Nayyar choose to limit the analysis till 1975 only not playing with outliers.

Why it happened?

Exogenous factors: The short term analysis identifies the immediate causes as (a) wars of 1962, 1965 and 1971 derailing potential investment into unproductive uses, (b) successive droughts in 1965-66, 1966-77 and later in 71-72 and 72-72 which curtailed supply of raw inputs and DD for industrial goods from agricultural sector forcing halt in production, (c)supply constraints in terms of infrastructural bottlenecks or shortage of intermediate goods accentuating the crisis and (d) oil crisis causing bop problems in 1973 halting imports of capital goods due to foreign exchange limitations. He admits that even now (1978) it's naïve to deny such occurrences had no impact but then he claims these factors can't explain persistence of stagnation simply because after these shocks were gone the economy didn't move to normalcy. We have two objections to his refusal of the exogenous factors (a) these shocks were continuous and repetitive in nature, it becomes clear if one simply looks at years and mention of "successive". Now these shocks with such periodicity sufficiently explain derailment till 1975 which is terminal year for period of his analysis, (b) even if one buys the argument that these shocks were one time shock so after they were gone economy should have returned to normalcy, there lies a problem in terms of an unstated assumption. For such a normalcy to restore, it amounts to tell that economy is moving on a stable time path equilibrium which will restore normalcy arising from such shocks. While it's highly plausible that the time path was unstable and such a shock has sent it to disequilibrium, one can draw the analogy from cow-web model where time path goes away from equilibrium in case of a shock affecting the variables and in fact this perfectly explains persistence of stagnation and/or deterioration of industrial production.

Neo-classical Attacks: Nayyar criticises the neo-classical argumentation of inefficiency stemming from government intervention and web of regulations halting the industrial progress on grounds of their focus on evaluating import-substitution strategies, economic efficiency of industrialisation, inability to explain the functioning till 1965, inability to explain comparison across similar economies and lack of dynamic analysis in neo-classical theory to talk about growth story. His refusals are perfectly valid to talk back the neo classical analysis of Bhagwati and Desai (1970) and Bhagwati and Srinivasan (1975).

Agricultural Drag: We come across three principal linkages between industry and agriculture through role of agriculture as (a) supplier of wage goods (food) to industrial sector (b) provider of raw material to industrial sector (c) generator of agricultural

incomes creating final DD for industrial output. Ahluwalia (1984, ch-3) discards any wage good linkage seeing the pattern of industrial stagnation for it would have implied an adverse impact on growth of industrial sector with largest impact (-) on relatively labour intensive industries for in that industry labourers would be the first to switch work for food. Since the slowdown was in relatively more capital intensive industries and with no slowdown in production of food grains or overall agriculture, no trend in per capita net availability of food grains in economy over the entire period one safely assumes zero wage good impact. On the raw material side story, the growth performance of agro based and textile based (two most significant industry groups in this context) industries is dependent on policy matrix than alone on their production, hence to read a conclusive picture seems unethical here. On the DD side linkage through agricultural income evidence of slow growth of agricultural incomes posing a demand side constraint on industrial consumer goods is visibly minimal. The agriculture grew at 2.3% per annum; in light of growth of rural population by 1.7% per annum the per capita growth rate remained negligible. This suggests while the DD side constraint doesn't seem an important explanation for consumer goods sector for it kept on growing at the rate of 4-5% per annum pre and post mid-sixties. Level of Investment: One finds work of Patnaik and Rao (1977) which has carefully explained the scenario and is intuitive in explaining the halt. They argue that rapid growth till 1965 follows from rapid expansion in public investment and expenditure during that period. Where the former ensures supply of basic industrial inputs and the later absorbs the DD for goods manufactured in private sector. Further, import substitution provides a guaranteed market for domestic manufacturers giving stimulus for continuous investment. This story of growth toppled because of two reasons advanced (a) import substitution was a privilege for limited time! (b) There was evident deceleration in public expenditure and investment. GFCF in public sector and public expenditure during 1960-61 to 1964-65 grew at 9.1% per annum and 13.2% per annum respectively while for 1964-65 to 19173-73 these rates were 0.7% per annum and 2% per annum respectively. The result of which, they argue was decline in basic input production in public sector and falling DD of private sector manufacturing output causing deceleration of industrial growth. Nayyar finds the analysis incomplete and tries connecting it with lack of domestic DD story for he has to advance his case for the same. We find it objectionable to discount Patnaik and Rao's version on grounds where the causal relation is expected to answer policy prescriptions. Patnaik and Rao have simply given an explanation of what led to this and they have mentioned it's a cumulative process whereby in the present scenario certain key variables are missing, thus explaining the crisis. They have already hinted at the inevitability of the stagnation by mentioning that in LR any sustainable increase in public investment be backed by mobilisation of domestic resources otherwise the former will have to follow. The mention of appropriation of economic surplus from private sector to public sector is hinting at two things, (a) the size of public sector should grow encompassing as many as commodities

possible, (b) the authors are aware of exploring the unutilised capacity, growth in size of public sector would ensure vertical integration across industries which would remove barriers from investing beyond a level. In fact Nayyar has cited government's inability from investing beyond a point citing DD reasons which can be taken care of in this mechanism whereby a large public sector would be well utilised and there would be generation of income to support the production. This extension might seem impractical for a while but one has to appreciate that Rao and Patnaik have suggested sustainability of the present model which was in operation till 1965 leading to growth in a departure from market to command economy, we should also mention that mention of investment-mix by Nayyar is well taken care of in this transition only. We would return to this point again in the essay whereby we shall explain our understanding with some added qualifications to this analysis to present a plausible story of stagnation.

Income distribution and DD factor: The studies of Indian industrial stagnation centred around role of income distribution are dichotomous in nature (a) one relating pattern of DD and (b) relating to level of DD and therefore of savings. Mitra (1977), Nayyar (1978) can be placed in former whereby they have stressed upon pattern of DD resulting from such unequal distribution and its drag on growth while Bagchi (1970) can be placed in later whereby relation between growing income inequality and overall level of DD and therefore of savings is explored with that of growth performance. In fact Bagchi (1970) has stressed inability of government to maintain high rate of investment irrespective of unequal distribution of income and corresponding DD generated by it, which is reinforcing Patnaik and Rao's claims whereby for such sustainable growth story there should be appropriation of surplus by the state than in private hands or as inferred that a large public sector should be in operation. Nayyar argues that DD base was quite narrow in India in terms of population spread which was halting utilization of capital and intermediate goods industries during 1964-65. He quotes studies of Sau (1974) to establish worsening income equality and another calculation from CSO whereby he has shown how relative increase in agricultural prices have squeezed manufacturing DD. However Ahluwalia (1985, ch-4) in her book has empirically tested the hypothesis for worsening income inequality and both Nayyar and Mitra's claim fall apart in that sense. One can argue that Ahluwalia's calculation are of the Gini coefficient so they might not be able to essentially capture micro details for a country as diverse as India, in fact this could be a take away from Raj (1972) paper whereby he has specifically shown how regions with stable agriculture production, thus income were showing better results for industrial growth than their counterparts. In fact evidence on growth of consumer goods (durable and non-durables) further refutes claims of Sau (1974), Nayyar (1978), the growth of output of consumer non-durables remained unchanged at 5.7% both prior and after mid-sixties, while that of consumer durables slowed down only slightly but insignificantly hovering around 12%. Further, growth of consumer durables being faster than non-durables could be understood drawing analogy from Engel's effect.

Towards a plausible Explanation:

Nayyar argues the significant lack of domestic DD as the central theme in the whole story and very succinctly goes on to prescribe an equitable distribution of income being the key to sustained industrial growth. At the centre of it lies the idea of broad base DD for industrial manufactured goods within the economy. He further argues why such practice of growth sustained till 1965 and how sticking to his prescriptions will ensure that such stagnation isn't repeated. In fact all of it seems perfectly coherent but his explanation lacks the story even such policies of rapid public sector investment and expenditure were followed till 1965? Hereby we depart from his views; we consider that seeds of this stagnation were rooted in Nehru-Mahalanobis plan whereby focus was on capital goods industries and there was relatively less focus on SS side invisible variables like human resources, academic and industrial training, education. The uneven focus on capital goods industries despite having good intentions for LR growth failed to trigger appropriate forward and backward linkages. While the planners thought that private sectors might just respond to incentives and appropriation problems in terms of capacity utilization and lack of DD would not emerge, there is no doubt that such appropriation of linkage benefits didn't occur in the then India leading to lopsided growth. The very idea of crowding-in private investment didn't work aptly. One may refer to the argument "Indian business class was a trading class mostly surviving on arbitrage and they are less of risk loving entrepreneurial industrialist" which might explain lack of sufficient entrepreneurial activity by private entities prior to 1965. Now with this lopsided path, stagnation was inevitable because India was a mixed economy and state doesn't have the full rights to appropriate economic surplus from private hands, with the exogenous variables giving continuous shocks during the period from 1960s to 70s, one registered the decline in industrial activity during mid-sixties. There onwards one can see the trend as explained by Patanik and Rao coupled with these shocks. We would prefer this version of stagnation over Nayyar's emphasis on inequality because during the mid-sixties Patnaik and Rao have given more empirically sound data to establish their claim whereas Nayyar has simply used NSS data for year 1964-65 to show consumption pattern to establish worsening inequality over a period of time, in fact such was his contention to Chakravrty and Srinivasan that he writes, "while using neo-classical framework how can they talk about growth story?" Nevertheless other than this parable of stagnation, one can also think in neo classical framework, where economy is in equilibrium unless these shocks came and derailed India towards path of stagnation as discussed in exogenous factors. To conclude we reiterate arguments advanced by Patnaik and Rao along with the fault lines in Nehru-Mahalanobis plan as the reason behind stagnation observed in mid 1960s.

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