India Unbound

Gurcharan Das
Penguin Books, 2000

Introduction

One of the intriguing questions of history is why India failed to industrialise as rapidly as some other countries. By 1914, India had the third-largest railway network, the world's largest jute manufacturing industry, the fourth-largest cotton textile industry and the largest canal system. India controlled 2.5 percent of world trade. It also had a merchant class consisting of businessmen like G. D. Birla and Kasturbhai Lalbhai who made huge trading profits during the First World War and reinvested them in setting up industries. In his fascinating book, "India Unbound," Gurucharan Das outlines the reasons for India's slow progress. One problem was agriculture, which remained stagnant. "You cannot have an industrial revolution without an agricultural surplus or the means to feed a rapidly growing urban population." Moreover, after India won freedom, Jawaharlal Nehru and his planners attempted to industrialize the country through the state. Not trusting private entrepreneurs, they made the state the entrepreneur. India is still paying a huge price for their follies. India also put political freedom before economic freedom. This was like putting the cart before the horse. Indians are not tinkerers. They are a conceptual people, who have traditionally had a Brahminical contempt for manual labor. Such labour was relegated to the lowest caste, Shudras, who were also denied knowledge. A tinkerer combines knowledge with manual labor. It is often the two together which produce innovation. Recall what happened during the industrial revolution. Indian entrepreneurs, who come mainly from the higher merchant caste have shied away from manual labor and technology. This may be another reason why India did not produce innovation and failed to create an industrial revolution. But Das is optimistic that in the coming years, India will be well placed to compete in the knowledge society.

A faulty development strategy

There were at least six things wrong with India's development strategy. One, it adopted an inward-looking, import-substituting path, rather than an outward-looking, export-promoting route. Two, it set up a massive, inefficient, public sector to which it denied operational autonomy, resulting in heavy unproductive investments. Three, it over regulated private enterprise with the worst controls in the world, leading to diminished competition. Four, it discouraged foreign capital, denying itself the benefits of technology and world-class competition. Five, it pampered organized labor to the point where the country had extremely low productivity. Six, and perhaps most important, it ignored the education of children.

There were two competing visions at the time of independence. Both were faulty. Mahatma Gandhi visualised self-reliant villages, with a reinvigorated agriculture and craft production. He opposed modern urban industry because it dehumanized man. Nehru who had a modern scientific mind, was much impressed by the economic gains of the Soviet revolution. But he was also committed to democracy. He had a vision of democratic socialism with the state leading the process of industrialization. He spurned capitalism because it created inequalities. Gandhi distrusted technology but not businessmen. Nehru distrusted businessmen but not technology. Instead of sorting out the contradictions, India mixed the two up and created holy cows. Small companies are better than big ones (Gandhi); public enterprises are better than private ones (Nehru); local companies are better than foreign ones (both). They so mesmerized us that their ideas remained live and kicking even after they passed away.

If Nehru had not been carried away by the Soviet Union's economic success, or if Indira Gandhi had changed course when Korea and Taiwan did and opened our economy in the late 1960s, we might have lifted our growth rate and become an economic success. Nehru taught Indians to be liberal and tolerant. He inculcated in Indians a respect for democracy and a distaste for feudal behavior. He infected us with his idealism. But he also reinforced our prejudice against businessmen and profit. India never learned about the virtues of entrepreneurship and competition.

Das lambasts the planning model adopted by India. The famous economists, Friedrich Hayek and Ludvig von Mises, argued that the most powerful computers of the planners would never be able to acquire the billions of pieces of information on constantly changing consumer needs and preferences and match them with the resources of society, the production processes, and the technologies. Even if they got the information, they would not be able to react to it as speedily as the market. Moreover, in a planned economy, the factory managers would not have the incentive to provide truthful and rapid information to the planners. Since they were evaluated based on how much they produced, they would try to corner the raw materials to ensure that their production targets were met. As such, the planned economy would have enormous waste and inefficiency compared to the market.

India primarily focused on how to raise savings and thereby increase investment. Policy makers naively assumed that once the government made the investments, the returns from the capital would come automatically. Their innocent faith in state companies turned out to be altogether misplaced. There were many reasons for this, including the lack of training, autonomy, and accountability of the senior managers in the public enterprises. It was a management failure. Our leaders could have instilled a strong bias for profit and efficiency. This would have made all the difference. But they did not.

An alternative model

In the 1950s, there was an alternative vision to that of Mahalanobis. It belonged to the Bombay economists C. N. Vakil and P. R. Brahmanand. It was neither as glamorous nor as technically rigorous as that of Mahalanobis, but it was probably more suited to the underdeveloped Indian economy. They argued that India lacked capital but had plenty of people. There was huge disguised unemployment in the countryside. These people could be made to do productive work at a low cost to produce simple consumer products-clothes, toys, shoes, snacks, radios, and bicycles. These low-capital, low-risk businesses would attract loads of entrepreneurs, for they would yield quick output and rapid returns on investment. Labor would eventually consume these goods with the wages it earned in producing the goods. They were called "wage goods" because the wage earners would create the demand for the goods that they produced. The "wage goods" strategy would have channelised investments into agriculture, rural infrastructure, agro-industry, and simple consumer goods for both the home and export markets. It would have meant postponing the ambitious projects in capital and heavy industry. We would have imported capital goods in the near term, and the foreign exchange for their import would have been earned from the export of simple consumer manufactures-the sort of products that Japan. and the Asian tigers started with. The result would have been high economic growth, high employment, rising exports, and prosperity. Unfortunately, it was the vision of Mahalanobis which triumphed leading to the consequences we are aware of.

The impact of the British Raj

The British Raj was the most important event in the making of modern India. Britain gave us democracy, the rule of law, an independent judiciary, and a free press. It built railways, canals, and harbors, but it could not bring about an industrial revolution. In the United States, Russia, and Germany, the railways had been a dynamo of the industrial revolution. It had no such effect in India, even though the country's network by 1947 was more than 50,000 miles long. It could not raise economic growth or lift the people out of poverty. It could not avert famines.

The British were different from other invaders. They gave India modern values and institutions, but did not interfere with the country's ancient traditions and religion. They did not merge with Indians and remained aloof to the end. India therefore preserved its spiritual heritage and the old way of life continued.

Britain gave India the English language. However, Britain also divided India into two nations-the 10 percent elite who learned English and shut out the 90 percent who did not.

Many Indian scholars have argued that Britain's trade policies, encouraged the import of manufactured goods and the export of raw materials. And by heavily taxing the farmer, Britain contributed to the stagnation of Indian agriculture.

Das argues that the Indian colony was not terribly profitable to Britain. After the crude period of exploitation in the eighteenth century was over, Britain's rising prosperity in the next century owed more to its tree trade with the "new world" and to its investments in America. If there was a "drain," it was by the transfer of dividends by English companies from America. A few Englishmen did become very rich from India-the owners of the tea and indigo plantations, the shareholders of the East India Company and other commercial firms, the employees of the managing agencies, the railway builders, the civil and military personnel, and others connected with India. But the profit to Britain as a whole was meager.

Das argues that there was no British conspiracy to deliberately underinvest in India, or to sabotage Indian business interests. Bombay's textile mills in the nineteenth century were built with credit, technical assistance, and machines from the British textile machinery makers even when these mills were a competitive threat to Manchester's mills. Burn and Company, a full-blooded European company, had no hesitation to start making steam vessels in India when it found it cheaper to do so than to import them from Britain.

Das admits that in the eighteenth century, the British plundered and looted India's wealth, as all conquerors have done in history. But the British did not deliberately deindustrialize India. It was the industrial revolution that threw millions of weavers out of work. It would have happened anyway when the new technologies reached India. British government policy could have cushioned the impact by erecting trade barriers, but protecting handlooms would have been a temporary palliative at best.

Britain did not become poorer after losing India. Instead, it enjoyed prosperity in the 1950s and 1960s, at the very time that it was losing its colonies. In the end, whether Britain impoverished or enriched India is really an academic question. What is more relevant is why the forces of global capitalism in the second half of the nineteenth century and early twentieth century did not release widespread growth and development in India, as they did, for example, in Japan. The rapid building of railways and canals and the simultaneous expansion of foreign trade should have acted as a strong engine of growth. India also had an experienced merchant class to take full advantage of the circumstances.

The Raj was economically incompetent. It just did not know how to "develop" a country. Had it known it, Britain could have gained much from having a larger market for its manufactured goods. Odd as it may seem, Britain did not "exploit" India enough. Had Britain made the same massive investments in India as in the Americas, India would have become prosperous and a much bigger market for British goods. A richer India would have been even a better customer, a better supplier, and a firmer basis for the Empire.

Lessons from the US

Das is skeptical of cultural or geographic explanations for analyzing India’s failure to develop rapidly. He believes it is more important to consider economic factors that motivate an entrepreneur to invest in a business – the size of the market, the capability of suppliers, the costs of production, the distribution hurdles, the availability of technology and the state of competition. Businessmen invest where profit can be made. Their decisions have little to do with nationalism or racial considerations. The key lies in reducing regulation and providing incentives.

The author draws some important contrasts between USA and India. America is truly the land of opportunity. A competent, hardworking person can hope to rise to the top in every field. Almost everyone believes that the best person will get ahead. Americans are positive and optimistic.

The Americans throw their numerous immigrant communities into the “melting pot.” Their ethnic immigrant minorities do not form separatist movements. They eagerly embrace the English language and the American way of life in order to get ahead in that land of opportunity.

The American education system has many flaws, but it is far fairer (and more creative) than most systems. The great thing about an American liberal education is that it allows an undergraduate the freedom to explore many subjects.

India pursued faulty policies guided by a misguided sense of socialism. Indeed, Das emphasizes that there is a moral basis for inequality. People may willingly accept inequality under some circumstances. A worker might not mind the president of the company earning more than him as long it motivates the president to earn more profit for the company and the worker got a bigger bonus or a higher salary as a result. The greater benefits earned by a few are justified, if the inequality improves the situation of the worst-off.

In the real world, no society (not even America) is completely open. The key is to try to ensure that everyone has an equal start in life and can hope to rise to the top. Thus, an "open" primary school system is essential.

Alleviating poverty is more important than achieving equality. Improving the income distribution in a society should be an instrument for enabling the poorest and the most unfortunate to rise above the poverty line rather than achieving equality per se.

The Caste system

Observers have often noted the tolerance of Indians. They are surprised that people of such diversity can live together in reasonable harmony. The answer may well lie in the caste system.

Ironically enough, the much aligned cast system tends to promote trust. Business requires trust. A kin or a familiar name from one's caste is likely to be more trustworthy. Traditionally, Indian merchants engaged in trade, cover vast distances. A caste member, whether an employee or an agent or a business partner, adds to one's comfort.

The socialist system ensured that every businessman would break some law or the other every now and then. Hence, it was important to have members of one's caste and kin in sensitive positions. With liberalization in the 1990s, the situation has changed, however. Competition has become fierce and survival is at stake. Business families increasingly look outside their caste for talent. In some functions, like marketing, professionals are much sought after and salaries have multiplied manifold. Caste loyalties seem now to be diminishing as businessmen recognize that they must have the best person for the job, no matter what his or her caste.

Das argues that there has never been a significant "caste barrier" to entry in modern jobs, despite the myth perpetuated by backward-caste politicians. Education holds the key to raising the backward castes, not reservations or quotas.

The caste system has had its impact on our competitiveness. He believes that being endowed with commercial castes is a source of advantage in the global economy. Bania traders know how to accumulate and manage capital. They have the financial resources and, more importantly financial acumen. They have an austere lifestyle and the propensity to take calculated risks. They have shown that they can graduate from trading to industry.

At the same time, the caste system is also responsible for at least some of our industrial failings. As already discussed, Brahmins monopolized learning and looked down on Shudra artisans, who worked with their hands. Since Brahmins were role models, these attitudes including contempt for manual labor, filtered down to the other castes. Thus, the worlds of knowledge and labor remained separate and inhibited technological innovations. Our goods are shoddy, and our businessmen rarely know how their product works.

But our natural affinity for conceptual thinking may stand us in good stead in the knowledge age. Das points out that Brahmins have had thousands of years of experience in dealing with abstract philosophical and spiritual concepts of the Upanishads. Indians are especially good at mathematics and theoretical physics (as opposed to experimental physics). Indians invented the zero. The information age thus plays to our strengths. It is not surprising that many of our information technology entrepreneurs, both in Silicon Valley and in south India, come from the Brahmin caste, not from the traditional trading castes.

Understanding reforms

In other countries, the entrepreneur's battle is with competitors. In India, the main enemy is the government bureaucracy. Indira Gandhi's government became even more rigid, introduced more controls, and became bureaucratic and authoritarian. It nationalized banks, discouraged foreign investment, and placed more hurdles before domestic enterprise. In the past ten years, the government has been trying to undo the mistakes of the past.

Das argues that in any society, the top 15 percent of the people will do well and look after themselves. The bottom 15 percent will fail and will need to be looked after by the state. The focus of the reforms must be the 70 percent in between, the vast majority of the people, who in successful economies form the middle class. Given the right circumstances, the middle class invariably pulls itself up through hard work, self-reliance, and education in a competitive economy. This did not happen in India because our earlier policies suppressed growth. Our middle class was less than 10 percent of the population in 1980. Since the economy started seriously growing in the eighties and accelerated after the reforms, the middle class has tripled but is still a small fraction of the population.

The new middle class is confident, full of energy and drive and is making things happen. It is different from the older bourgeoisie. The new middle class is street-smart. It has had to fight to rise from the bottom, and it has learnt to maneuver the system. It is easy to despair over its vulgarity, its new-rich mentality. But whether India can deliver the goods depends a great deal on this group of people.

It is a popular pastime with the old middle class to grumble about the new rich and the decline in values. The author believes that the young are no less virtuous today. Nor is the new middle class any greedier. The chief difference is that there is less hypocrisy and more self-confidence.

In the long term, reforms will help the poor. Reforms lead to growth, more jobs, lower inflation, cheaper goods, more labor-intensive manufacturing, more opportunities in services and agriculture. Reforms mean fewer subsidies for rich farmers and the middle class and less bleeding from an inefficient public sector. With growth, there will be more resources available for poverty alleviation programs. However, the most powerful and immediate reform for the poor is more and better primary schools and primary health centers. This is their ticket to prosperity. Unfortunately, this has not happened.

The Indian Corporate Sector

Indian companies are still small in size by global standards. Family businesses remain dominant. However, the inability of Indian business to create large-scale non-family organizations may not necessarily be a constraint. What small companies give up in terms of financial clout, technological resources, and staying power, they gain in flexibility, lack of bureaucracy, and speed of decision making.

Whether businesses here can create managerial capitalism depends partly on the Indian society's ability to build "social capital." Where strangers spontaneously trust each other and cooperate with each other, there is high social capital. Trust and cooperation are necessary for a well functioning market. Social capital can help companies make the transition from small units to large, professionally run enterprises. High trust can dramatically lower transaction coasts, corruption and bureaucracy. Family capitalism can be successful but it has to be accompanied by education and a strong work ethic. Otherwise, it leads to nepotism and stagnation. Many large and successful Indian companies have begun to realize that educated, hardworking professionals usually outperform lazy, uneducated relatives. But thousands of small and medium enterprises, which form the core of the private economy, are still struggling with this issue.

The bigger failing of Indian companies, according to Das is that they venture into unrelated business in an opportunistic fashion. The tendency to diversify goes back to the origins of Indian businesses, to the managing agency system that prevailed during the British days, when a single management oversaw varied business activities – tea, jute, textiles, cement, shipping, etc.

To be globally competitive, Indian companies must focus on a single area of competence. They must initially win in the domestic market and then leverage their economies of scale overseas. They must be able to capitalize on global trends. They must not ignore quality even when they are pursuing a low-cost strategy.

Concluding Notes

Das believes that cultural factors are of limited use in explaining why we have lagged behind in the race for global competitiveness. What the country needs are good economic policies. Here, we can learn useful lessons from others.

The Far East countries efficiently employed their resources more productively. They emphasized labor-intensive manufacturing for export. They vigorously educated their population. Their government intervened to build competitiveness and to correct distortions. In India, by contrast, government policy has created distortions. It made scarce capital cheap, labor expensive, overvalued our exchange rates, and reduced competitive pressures.

India's economic reforms have begun to eliminate some of these distortions. India has begun, in effect, to replicate some elements of the Far East's success. However, India has not yet begun a serious reform of the educational system, which more than anything is capable of delivering equity with growth.

Will capitalism and globalization, succeed in establishing a comfortable place for themselves in India? The answer depends on their ability to deliver prosperity broadly. It also depends on leaders in the government and in business to champion the classic liberal premises of free trade and competition. Das emphasises that capitalism's success in India is threatened not so much by the leftists or protectionists as by the timidity of its defenders. Leaders must come out and say that (1) some people will not fare as well in the competitive marketplace; (2) the winners will far outnumber the losers; (3) capitalist democracy is by far the best arrangement; (4) globalization is not only a good thing, it is a great leap forward in history.

The new India is increasingly one of competition and decentralization. And thanks to intellectual capital and the opportunities opened by technology and globalization, India has a real chance of eliminating poverty. We have every reason to be optimistic that the lives of the majority of Indians in the twenty-first century will be more prosperous than those of their parents and grandparents. Never before in recorded history have so many people been in a position to rise so quickly.

Das argues that India stands at a critical moment in our history when the stars appear to be on her side. If the country does not seize the moment and improve governance and accelerate the reforms, then history will not forgive us. But he adds that it will be difficult to make a clean break with the past. India's future will not be a creation of unbridled capitalism. The reform process will evolve through a daily dialogue between the conservative forces of caste, religion, and the village, the leftist and Nehruvian socialist forces which dominated the intellectual life of the country for so long, and the new forces of global capitalism. The plurality of interests, the contentious nature of the people, and the lack of discipline and teamwork imply that the pace of economic reforms will be slow and incremental. And if we cannot accelerate reforms, we may not grow as rapidly as the Asian tigers.