2.1 INTRODUCTION

On 15 August 1947, India woke to a new dawn of freedom. After nearly two hundred years of British rule, the responsibility of nation-building was finally in the hands of Indians. One of the major challenges facing the leaders of independent India was to determine the most suitable economic system for the country—one that would promote the welfare of all, not just a privileged few.

Choosing an Economic System

There are different types of economic systems (see Box 2.1). Among these, socialism appealed most to Jawaharlal Nehru, India's first Prime Minister. However, he was not in favour of the Soviet-style socialism, where the government owned all means of production, and private property did not exist.

Such a model was not suitable for a democratic country like India, where private property rights are constitutionally protected. Therefore, Nehru and other leaders sought a middle path, avoiding the extremes of capitalism and socialism. They envisioned a system that combined the best features of socialism, while preserving democracy and private ownership.

India thus adopted a model of mixed economy, with:

- A strong public sector
- Private property
- A democratic political structure
- Central planning by the government (see Box 2.2)

Planning and the Mixed Economy

In this framework, the private sector was also encouraged to participate in the planning process. This vision was reflected in:

- The Industrial Policy Resolution of 1948
- The Directive Principles of State Policy in the Constitution

To operationalize this vision, the Planning Commission was set up in 1950, with the Prime Minister as its Chairperson. This marked the beginning of the era of Five Year Plans, which aimed to systematically raise living standards and expand opportunities for all.

Central Objective of Planning in India: *To initiate a process of development which will raise the living standards and open out to the people new opportunities for a richer and more varied life.*

Types of Economic Systems

Every society must answer three basic economic questions:

1. What goods and services should be produced?
2. How should these goods and services be produced — with more labour or more machines?
3. For whom should they be produced — how should they be distributed?

Capitalist Economy (Market Economy)

- Based on market forces of supply and demand
- Production focuses on what is profitable
- Methods of production are based on cost-effectiveness
- Distribution is based on purchasing power, not need
- Tends to neglect needs of the poor, e.g., low-cost housing
- Example: United States

This system did not appeal to Nehru as it left the majority of people behind without improving their quality of life.

Socialist Economy

- The government decides what, how, and for whom to produce
- Distribution based on need, not purchasing power
- No private property — all resources owned by the state
- Ensures essential services like free healthcare
- Examples: Cuba, China

Mixed Economy

- Both government and market work together
- Market produces what it can efficiently
- Government provides essential services and corrects market failures
- Reflects the vision of independent India

What is a Plan?

A **plan** defines how a nation's **resources** should be utilized to achieve certain **development goals** within a **specific time period**.

Key Features of a Plan:

- It includes **general goals** and **specific objectives**.
- In India, plans were typically for **five years**, known as **Five Year Plans**—a concept borrowed from the **former Soviet Union**, the pioneer in national planning.
- Alongside the Five Year Plans, India also prepared a **long-term 'Perspective Plan'**, projecting goals over a **20-year period**.
- The **Five Year Plans** served as the **foundation** for achieving the broader goals outlined in the **Perspective Plan**.

Planning Challenges:

- Not all goals in a plan can be given **equal priority** in every plan.
- Some goals may **conflict** with others:
    - For example, adopting **modern technology** may **reduce employment** opportunities, which conflicts with the goal of **generating more jobs**.
- Planners must **balance** these competing objectives—a complex and delicate task.

Role of the Plan in India:

- India's Five Year Plans did **not specify the exact quantities** of every good or service to be produced.
- Unlike the former Soviet Union (which attempted and failed to do so), India's plans focused on being **strategic**, not overly **prescriptive**.
- Plans were clear about sectors where the **government would play a commanding role**, such as:
    - **Power generation**
    - **Irrigation**
- Other areas of production were **left to the market forces**.

2.2 THE GOALS OF FIVE YEAR PLANS

Each plan aimed at achieving specific developmental goals. The **four major goals** were:

1. **Growth**
2. **Modernisation**
3. **Self-reliance**

4. **Equity**

Note: Not all goals were prioritized equally in every plan due to **limited resources.** However, efforts were made to ensure that policies did not contradict the core goals.

1. Growth

Growth refers to a **steady increase** in the country's **capacity to produce goods and services**. In the language of economics, this is measured by a continuous rise in the **Gross Domestic Product (GDP).**

- **GDP** is the **market value of all final goods and services** produced within a country in a year.
- You may think of GDP as a **cake—**if the cake grows bigger, **more people can have a share** in it.
- Growth is essential to help the people of India live (as stated in the **First Five Year Plan**) a "**more rich and varied life**".

Sources of GDP

- GDP comes from three main sectors:
  - **Agricultural Sector**
  - **Industrial Sector**
  - **Service Sector**

The share contributed by each of these sectors represents the **structural composition** of the economy.

In some countries, **agriculture** drives GDP growth. In others, it's **industry** or **services** that contribute more

2. Modernisation

Modernisation means adopting **new technology** to improve productivity.

- For example:
  - A **farmer** can increase crop yield by using **new seed varieties.**
  - A **factory** can raise output using **modern machinery**.
- Thus, modernisation is essential to enhance the **efficiency and quality** of production.

However, modernisation is **not limited to technology—**it also includes changes in **social attitudes**.

- A modern society believes in **gender equality**.
    - It allows **women to work** in banks, schools, factories, etc.
    - This inclusive approach leads to **greater prosperity**.

3. Self-Reliance

A country can modernise and grow by using:

- **Its own resources**, or
- **Imported resources** (technology, capital, goods).

In the **first seven Five Year Plans**, **self-reliance** was a key priority:

- The aim was to **reduce dependence on imports**, especially for **essential items like food**.
- This was crucial for a **newly independent country** that wanted to safeguard its **economic sovereignty**.
- Overdependence on foreign aid, food, or technology was seen as a **risk to national freedom** and policy autonomy.

4. Equity

Growth, modernisation, and self-reliance **alone** may not lead to a better life for all citizens.

- A nation could achieve high growth and cutting-edge technology **yet still have millions in poverty**.
- Hence, **equity** is essential.

Equity means:

- Ensuring that **benefits of development** reach the **poor and marginalised**.
- Every citizen should have **access to basic needs**: food, housing, education, and healthcare.
- Reducing **inequality in income and wealth distribution** is a must.

Mahalanobis — The Architect of Indian Planning

One of the most significant contributors to India’s planning process was the statistician **Prasanta Chandra Mahalanobis**.

- **The Second Five Year Plan** marked the real beginning of planned development in India, based on Mahalanobis's ideas.

- His approach laid the foundation for many core aspects of Indian planning.
- Thus, he is often called the **architect of Indian planning**.

Biography Highlights:

- Born in **1893**, Calcutta; educated at **Presidency College** and **Cambridge University**.
- Founded the **Indian Statistical Institute (ISI)** and the journal **Sankhya**.
- Became a **Fellow of the Royal Society (1945)**—a rare honour.
- Invited **top Indian and international economists** to collaborate on the Second Plan—some later became **Nobel Laureates**.
- Notably open to criticism, Mahalanobis welcomed ideas even from critics of his socialist leanings—a true hallmark of scholarly integrity.

Though many of his methods are debated today, his role in putting India on the **path of planned economic development** remains unquestioned. His contributions to **statistical theory** continue to influence the discipline worldwide.

The Service Sector

As a country develops, it experiences a process known as **structural change**—a shift in the relative contribution of different sectors (agriculture, industry, and services) to the economy.

Typical Pattern of Structural Change

- In most developing countries:
    - **Agriculture** initially dominates the GDP.
    - As development progresses, **industry** becomes the dominant sector.
    - At advanced stages, the **service sector** surpasses both agriculture and industry in its contribution to GDP.

India's Peculiar Pattern

India followed a somewhat **unusual pattern** of structural change:

- At the time of independence, the **agriculture sector** contributed **more than 50%** to the GDP, which is expected for a low-income country.

- However, by **1990**, the **service sector's share** rose to **40.59%**, **exceeding** the contributions of both agriculture and industry.
- This was a **departure from the typical development pattern** seen globally.

Post-1991 Acceleration

- After **1991**, with the onset of **globalisation** and economic reforms (explored in Chapter 3), the **growth of the service sector** accelerated significantly.
- The **service sector** became a leading force in India's GDP growth, similar to trends seen in **developed nations**.

The Service Sector

When a country develops, it undergoes **structural change**. Normally:

- The **share of agriculture** in GDP **declines**,
- The **industrial sector** becomes dominant,
- Eventually, the **service sector** takes the lead at higher stages of development.

India's Unusual Pattern

- Initially, **agriculture contributed more than 50%** to India's GDP.
- By **1990**, the **service sector's share rose to 40.59%**, surpassing both agriculture and industry.
- This trend resembles patterns seen in **developed nations**.
- After **1991**, with **globalisation** (discussed in Chapter 3), this shift accelerated significantly.

2.3 AGRICULTURE

As you learned in Chapter 1, during **colonial rule**, India's agricultural sector suffered from **low productivity** and **widespread inequality**. After Independence, policymakers aimed to correct this through **land reforms** and the introduction of **modern agricultural technology**, such as **High Yielding Variety (HYV) seeds**, which sparked a revolution in Indian agriculture.

Land Reforms

At the time of independence, the **land tenure system** in India was dominated by **intermediaries** (zamindars, jagirdars, etc.) who

collected rent from actual tillers without contributing to the land's improvement. This system:

- Resulted in **low agricultural productivity**.
- Forced India to **import food**, especially from the **United States**.

To promote **growth and equity**, land reforms were introduced, which included:

1. Abolition of Intermediaries

- Intermediaries were removed.
- **Tillers were made the owners** of the land they cultivated.
- About **200 lakh tenants** came into **direct contact with the government**, freeing them from exploitation.
- **Ownership incentives** encouraged increased output and productivity.

2. Land Ceiling Laws

- **Land ceiling** refers to fixing the **maximum land area** an individual could legally own.
- The goal was to prevent **concentration of land** in the hands of a few and promote **more equitable distribution**.

Challenges in Implementing Land Reforms

Despite these policies, the **results were mixed**, and the goals of **growth and equity** were not fully realized due to several challenges:

- **Loopholes in legislation** were exploited by landlords to retain excess land.
- Many **former zamindars** continued owning land by:
  - **Evicting tenants**
  - **Claiming to be self-cultivators**
- The **poorest agricultural labourers** (e.g., sharecroppers, landless workers) did **not benefit** from these reforms.
- **Land ceiling implementation** was **delayed by legal challenges**, giving landlords time to **transfer land to relatives**.
- **Regional differences** in political commitment:
  - **Successful** land reforms in **Kerala and West Bengal**, due to strong political will.

- Limited success in other states, where the commitment to "land to the tiller" was weak.

Reflection: Equity and Incentive

While land reforms **encouraged growth** by providing incentives to cultivators, the **goal of equity** was only **partially achieved**. The **unequal distribution of land** remains an issue in many parts of India even today.

Ownership and IncentivesT he principle of "land to the tiller" rests on the belief that **ownership** increases the **incentive** to invest in andimprove agricultural land.For instance, in the former **Soviet Union**, farmers packed **rotten fruits** with fresh ones, knowing that theyneither **profited from success** nor **suffered from losses**, as the land wasn't theirs.In contrast, ownership motivates farmers to act efficiently, ensuring better outcomes.

The Green Revolution

Background

At the time of Independence, nearly **75% of India's population** depended on **agriculture** for their livelihood. However, the **agricultural sector suffered from low productivity**, primarily due to:

- Outdated farming **technology**
- **Poor infrastructure**
- Heavy **dependence on monsoons** with limited irrigation facilities

As a result, even a slight failure in the monsoon season meant widespread distress among farmers. This stagnation in agriculture, which had persisted during colonial rule, was **permanently broken** by the advent of the **Green Revolution**.

What Was the Green Revolution?

The **Green Revolution** refers to a **large increase in food grain production**, especially **wheat and rice**, resulting from the use of **High Yielding Variety (HYV) seeds**.

Key Requirements of HYV Seeds:

- **Fertilisers and pesticides** in the correct quantities
- **Reliable irrigation** or regular water supply
- **Financial capacity** to afford these inputs

Phases of the Green Revolution

First Phase (Mid-1960s to Mid-1970s):

- Adoption of HYV seeds was **limited to affluent states** like:
    - Punjab
    - Andhra Pradesh
    - Tamil Nadu
- Benefits were largely restricted to **wheat-growing regions**
- Required inputs meant **only wealthier farmers** initially benefitted

Second Phase (Mid-1970s to Mid-1980s):

- **Spread of HYV technology** to more states
- Benefitted a **wider variety of crops**
- Led to **self-sufficiency in food grains**

India was no longer dependent on foreign countries like the USA for food imports.

Marketed Surplus and Its Importance

Growth in agricultural output alone is **not sufficient**. It matters **how much of that output is sold in the market**.

- **Marketed surplus** is the portion of agricultural produce **sold by farmers** rather than kept for personal consumption.
- During the Green Revolution, a **good portion** of wheat and rice was marketed.
- This led to:
    - **Lower food grain prices** relative to other goods
    - **Benefits for low-income groups**, who spend a large share of income on food
    - The government was able to **procure and stock food grains** for emergencies and shortages

Risks and Concerns

Despite its success, the Green Revolution posed certain **risks**:

1. **Rising Inequality:**
    - Initially, only **large/wealthy farmers** could afford HYV inputs.

    - This raised concerns that the rich would become richer while **small farmers** would be left behind.

2. **Pest Vulnerability:**
    - HYV crops were **more prone to pest attacks**.
    - **Small farmers** adopting these seeds without protection could **lose everything.**

Government Intervention and Outcomes

To address these challenges, the **government played a vital role**:

- Provided **low-interest loans** to small farmers
- **Subsidised fertilisers** to make inputs affordable
- **Established agricultural research institutes** to develop solutions against pest attacks

As a result:

- **Small farmers** began to **match output levels** of large farmers
- The Green Revolution **benefitted both rich and poor farmers**
- Government support was crucial in ensuring **equitable gains** from the new technology

Conclusion: The Green Revolution marked a **turning point in India's agricultural history**. It ensured food security, supported economic development, and helped uplift many farmers—**thanks largely to proactive state policies** that balanced growth with equity.

The Debate Over Subsidies

Subsidies in Indian Agriculture: A Double-Edged Sword

The **economic justification of agricultural subsidies**, especially for fertilisers, has become a **hot topic of debate** in recent years.

Why Were Subsidies Introduced?

At the time of the **Green Revolution**, subsidies were considered **essential** for the following reasons:

- To **encourage adoption** of new and risky **High Yielding Variety (HYV) technology**, especially among **small farmers**
- To **reduce the cost burden** on farmers experimenting with a new, untested method

- To support **early-stage transformation** of agriculture from traditional to modern systems

The Case Against Continuing Subsidies

Some **economists argue** that:

- Once the technology becomes **profitable and widespread**, the **need for subsidies diminishes.**
- **Subsidies**, particularly on fertilisers, often end up **benefiting the fertiliser industry** rather than the intended poor farmers.
- In practice, the majority of subsidy benefits go to **wealthier farmers in more prosperous states**, defeating the purpose of **equity.**
- Fertiliser subsidies place a **huge burden** on the **government's budget** and reduce available funds for other development needs. (referred): Likely expands on how subsidies are misdirected and create economic distortions.

The Case for Continuing Subsidies

Other experts argue that:

- **Farming in India remains risky**, and most farmers are still **very poor.**
- Removing subsidies could make **agriculture unaffordable** for **small and marginal farmers.**
- Eliminating subsidies would **widen the gap** between **rich and poor farmers**, violating the **goal of equity**.
- Instead of **abolishing subsidies**, the government should:
  - **Target subsidies more effectively**
  - Ensure that **only poor farmers benefit**

Broader Agricultural Context (1950–1990)

By the **late 1960s**, the **Green Revolution** had increased agricultural **productivity** significantly, leading to **self-sufficiency in food grains**—a major milestone in Indian economic history.

However, some **structural issues** remained:

- Despite growth in productivity, around **65% of India's population** continued to depend on **agriculture for employment** as late as **1990**.

- Between **1950 and 1990**, agriculture's **contribution to GDP declined significantly**, but the **share of population working in agriculture** only dropped **marginally** (from **67.5% in 1950 to 64.9% in 1990**).
- In contrast, in more **prosperous nations**, both agriculture's **GDP share** and its **employment share** decline steadily with development.

Why Did So Many Continue in Agriculture?

The main reason:

- The **industrial and service sectors** did **not absorb** the **excess labour** from agriculture.
- This **failure of employment diversification** is considered a **major weakness** of India's development policy during **1950–1990**.

Aspect	**Pro-Subsidy Argument**	**Anti-Subsidy Argument**
Adoption of HYV tech	Helps small farmers afford inputs	No longer needed after adoption becomes widespread
Benefit distribution	Needs better targeting for poor farmers	Benefits fertiliser industry and rich farmers disproportionately
Equity	Supports inclusion and reduces inequality	Widening inequality if not phased out

Box 2.6: Prices as Signals

Understanding Prices in a Market Economy

You may have studied earlier how **prices are determined in markets** through the interaction of **supply and demand.** But prices also serve a deeper economic function—as **signals** about scarcity and availability.

How Prices Act as Signals

- When a **good becomes scarce**, its **price rises.**
- A **higher price** acts as a **signal** to consumers, encouraging them to:
    - **Use the good more efficiently**
    - **Reduce unnecessary usage**

  - **Seek alternatives**

Example: Water

- If the **supply of water** declines and its **price increases**, people might:
  - Use less water for non-essential purposes (e.g., stop watering gardens).
  - Conserve water more carefully.

Example: Petrol

- When **petrol prices rise**, people often blame the government.
- However, the rise reflects **greater scarcity**.
- The **price signal** encourages:
  - Reduced usage
  - Exploring **alternative fuels or transport options**

Subsidies and Distorted Price Signals

Some economists argue that **subsidies** interfere with these crucial **price signals**, leading to **inefficient and wasteful use** of resources.

How Subsidies Distort Usage:

- **Free or subsidised electricity and water** lead to:
  - **Overuse** of these resources
  - **Neglect of environmental concerns**
- Farmers may:
  - Cultivate **water-intensive crops** even in **water-scarce regions**
  - Overuse **fertilisers and pesticides**, harming soil and ecology

Consequences of Ignoring Price Signals

- **Misuse and overuse** of scarce natural resources
- **Environmental degradation**
- **Long-term resource shortages**
- **Economic inefficiency**

Key Take away

Subsidies, when misdirected, provide **perverse incentives** that encourage **wasteful consumption** of critical resources.

Think critically: Is it **economically wise** to provide **free electricity or water** to all farmers regardless of region and crop choice?

2.4 INDUSTRY AND TRADE

At the time of **independence**, India's industrial sector was **narrow and underdeveloped**, mainly limited to **cotton textiles** and **jute**. There were only **two well-managed iron and steel firms**, located in **Jamshedpur** and **Kolkata**. For a country aiming at **economic growth**, expanding the **industrial base** across various sectors was essential.

Importance of Industry in Economic Development

Economists agree that **poor nations can progress** only with a **strong industrial sector** because:

- It provides **more stable employment** than agriculture.
- It encourages **modernisation**.
- It leads to **overall economic prosperity**.

Recognising this, the **Five Year Plans** gave **high priority to industrial development** as a key component of national growth.

Prices as Signals

Prices in the market are **not just numbers**—they are **signals** about the **availability or scarcity** of goods.

- When a **good becomes scarce**, its **price rises**, prompting users to **conserve or reduce usage**.
    - Example: If water becomes scarce, higher prices will **discourage wasteful usage** like watering gardens.
    - When **petrol prices rise**, it's a signal of **lower availability**, encouraging people to **reduce consumption** or **switch to alternatives**.

Subsidies and Distorted Signals

While subsidies aim to support producers or consumers, they can **disrupt price signals**, leading to **inefficient and wasteful usage**:

- **Free or subsidised electricity and water** may cause overuse and resource depletion.
    - Farmers may grow **water-intensive crops** in **drought-prone areas**, worsening the scarcity.

- **Fertiliser and pesticide subsidies** can lead to **overuse**, harming both the **soil** and **environment**.

Economic Insight: Subsidies may offer short-term relief but can **encourage inefficiency** and **environmental degradation**. It's important to **evaluate subsidies** based on **economic incentives** they create.

Ask yourself: Is it wise to provide **free electricity to farmers** if it leads to **unsustainable water use**?

Conclusion

India's **industrial development** was critical after independence to reduce reliance on a narrow set of industries and ensure **sustainable, modern economic growth**. At the same time, understanding **market signals through prices** and evaluating **economic policies like subsidies** is vital for ensuring that **resources are used efficiently**.

Public and Private Sectors in Indian Industrial Development

At the time of **independence**, Indian policymakers faced a critical question:

What should be the role of the government and the private sector in industrial development?

Challenges in the Post-Independence Era:

- **Indian industrialists lacked capital** to make large-scale investments needed for industrialisation.
- The **domestic market was too small** to justify large private investments, even for those who had capital.

Government's Role in Industrialisation:

Given the limitations of the private sector, the **government had to take the lead** in industrial development:

- The goal was to **promote industrial growth** and build a **self-reliant economy**.
- India chose to develop along **socialist lines**, which influenced the direction of policy.

Commanding Heights of the Economy:

- The **Second Five Year Plan** adopted the idea that the **government would control key industries** vital to national development (referred to as the "commanding heights" of the economy).

- The **public sector** would lead the way, while the **private sector** would play a **complementary role**.

Work These Out: Activities for Deeper Understanding

1. **Case Study on Farming Methods:**
    - Visit a local farm and study:
        - Types of **seeds, fertilisers, irrigation**, and **machines** used.
        - **Costs involved**, **marketable surplus**, and **income earned**.
    - Talk to an **elderly farmer** to learn how farming methods have changed.
    - **Class Discussion**: Share findings and insights.
    - **Group Activity**: Prepare a **comparison chart** showing:
        - Variations in cost, productivity, irrigation, time, and income.
2. **Global Institutions and Agricultural Subsidies:**
    - Collect **newspaper clippings** on:
        - **World Bank**, **IMF**, **WTO**, and **G7/G8/G10 summits**.
    - Discuss the **views of developed vs. developing countries** on **farm subsidies**.
3. **Occupational Structure – Pie Chart Analysis:**
    - Use the following data to draw **pie charts** and discuss changes:

Sector	1950–51	1990–91
Agriculture	72.1%	66.8%
Industry	10.7%	12.7%
Services	17.2%	20.5%

4. **Debate on Agricultural Subsidies:**
    - Study arguments **for and against** subsidies.
    - What is your personal view? **Discuss in class**.
5. **Global Competition and Indian Farmers:**

- Some economists argue that **developed countries** heavily subsidise their farmers and encourage **agricultural exports**.
- Do you think **Indian farmers** can compete under such conditions? **Debate with your peers**.

Industrial Policy Resolution, 1956 (IPR 1956)

In alignment with the objective of the **state controlling the commanding heights** of the economy, the **Industrial Policy Resolution of 1956** was adopted. This resolution became the foundation of the **Second Five Year Plan**, which aimed to establish a **socialist pattern of society** in India.

Classification of Industries under IPR 1956

The resolution **classified industries into three categories**:

1. **Category I – Exclusively owned by the government**:
   - Strategic and important industries like **defence, atomic energy**, and **railways.**
2. **Category II – Joint responsibility**:
   - Industries where **private sector could supplement** public sector efforts.
   - The government held the **sole authority to initiate new units**, while the private sector could contribute later.
3. **Category III – Private sector industries**:
   - All remaining industries were left to the private sector but under **state control.**

Role of Licensing: Control Over the Private Sector

Though certain industries were assigned to the private sector, they were **not free from government regulation.** A system of **industrial licensing** was introduced:

- **No new industry** could be established without a **license from the government.**
- The license policy was used to:
  - **Promote industrialisation in backward regions.**
  - Provide **incentives** like:
    - **Tax benefits**

- **Lower electricity tariffs** for units in underdeveloped areas.

Objective: To ensure **regional equality** in industrial development.

Control Over Expansion and Diversification

Even **existing industries** were subject to licensing for:

- **Expanding output**
- **Diversifying production** (introducing new goods)

The idea was to prevent **overproduction** and maintain **economic balance**.

- A license to expand was issued **only if the government was convinced** that the additional output was necessary for the economy.

Conclusion

The **IPR 1956** reflected the socialist vision of India's planners by:

- Ensuring **state control over core industries**,
- Regulating the **private sector through licensing**, and
- Promoting **balanced regional development** through targeted industrial policy.

Small-Scale Industry in India

In **1955**, the **Village and Small-Scale Industries Committee**, also known as the **Karve Committee**, highlighted the potential of small-scale industries to **promote rural development** and generate employment.

Definition of Small-Scale Industry

A **small-scale industry (SSI)** is defined based on the **maximum investment** allowed in the assets of a unit.

- In **1950**, the investment limit was **₹5 lakh**.
- At present (as per the Rationalised 2023–24 curriculum), the maximum allowed investment is **₹1 crore**.

Role and Importance of SSIs

Labour-Intensive: SSIs are **more labour-intensive** than large-scale industries, meaning they **use more human labour** per unit of output.

Employment Generation: As a result, they **generate more employment**, which is especially important in a country like India with a large rural workforce.

Need for Protection

However, SSIs **cannot compete** with large industrial firms due to:

- Smaller production capacity
- Limited resources and technology

To ensure their survival and growth, the government introduced **protective measures**:

Government Support to SSIs

1. **Product Reservation**:
    - Certain products were **reserved exclusively** for production by small-scale units.
    - This was based on the **ability of SSIs to manufacture** those products efficiently.
2. **Financial and Tax Concessions**:
    - **Lower excise duty** on their products
    - **Bank loans at lower interest rates**

Objective: To create a level playing field and promote **inclusive industrial growth**, especially in rural and semi-urban areas.

Conclusion

Small-scale industries have played a **vital role** in India's development by:

- Creating employment
- Supporting rural development
- Encouraging decentralised industrial growth

With **government protection and incentives**, SSIs have contributed significantly to India's economic landscape.

2.5 TRADE POLICY: IMPORT SUBSTITUTION

India's **industrial policy** was closely linked to its **trade policy** during the early years of planning. In the **first seven Five Year Plans**, the country followed an **inward-looking trade strategy**, technically referred to as **import substitution**.

What is Import Substitution?

Import substitution refers to a policy aimed at **replacing imports with domestic production**.

- For example: Instead of **importing foreign vehicles**, the government encouraged setting up industries to **produce such vehicles within India**.

Protection of Domestic Industries

To implement this strategy, the government **protected Indian industries** from foreign competition through two main tools:

1. **Tariffs**:
    - These are **taxes on imported goods**.
    - They make foreign goods **more expensive**, discouraging imports.
2. **Quotas**:
    - These place a **limit on the quantity** of goods that can be imported.
    - They directly **restrict the availability** of foreign products.

The **combined effect** of tariffs and quotas was to **reduce imports** and allow **domestic industries to grow** in a sheltered environment.

Rationale Behind Protectionism

- Indian planners believed that **industries in developing countries** like India were **not ready to compete** with the well-established industries of **developed nations**.
- Protection was seen as a **temporary measure** to give Indian industries time to:
    - **Develop capacity**
    - **Gain experience**
    - Eventually become **globally competitive**

Concerns About Foreign Exchange and Luxury Imports

- There was also a **fear** that **precious foreign exchange** would be wasted on importing **luxury goods**.
- Therefore, **import restrictions** were imposed to:

- Conserve foreign exchange.
- Focus spending on **essential imports** like capital goods and machinery.

Limited Focus on Exports

- During this period, **export promotion was neglected**.
- The focus remained on **self-sufficiency** and import replacement until the **mid-1980s**, when export-oriented thinking began to emerge.

Conclusion

India's early trade policy of **import substitution** aimed to protect and nurture domestic industries by **restricting foreign competition.** While it helped build industrial capacity, the lack of export focus and excessive protection eventually led to **inefficiencies and limited global competitiveness.**

Effect of Policies on Industrial Development (1950–1990)

India's industrial policies in the first **seven Five Year Plans** brought notable achievements and challenges.

Achievements of Industrial Policy

6. **Growth in Industrial Contribution to GDP**:
    - Industry's share in GDP increased from **13% in 1950–51** to **24.6% in 1990–91**.
    - The **6% annual growth rate** in the industrial sector was significant.
7. **Diversification**:
    - Indian industry expanded **beyond cotton textiles and jute**.
    - By 1990, the sector had become **well-diversified**, largely due to the **public sector**.
8. **Promotion of Small-Scale Industries**:
    - Encouraged entrepreneurship among those without large capital.
    - Generated **employment and regional development**.
9. **Import Substitution and Protection**:

  - Enabled growth of **indigenous industries**, e.g., **automobiles** and **electronics**, which would not have developed without protection from foreign competition.
  - **Criticism and Limitations**

*A. **Inefficiencies in Public Sector Enterprises (PSEs)***

- Many **public enterprises underperformed** or continued to function **despite heavy losses.**
- **Monopolies** were maintained unnecessarily, such as:
  - **Telecommunication services** (long waiting time for phone connections).
  - **Modern Bread** (a basic bread-manufacturing firm).
- The **public sector expanded** into areas where the **private sector was capable** (e.g., **hotels**), creating **resource misallocation.**

Scholars argue the state should focus only on **essential services** that **private firms cannot** provide, such as **national defence**.

*B. **License Raj and Regulatory Misuse***

- A license was required for:
  - Starting a new industry.
  - Expanding production or introducing new products.
- This system was **misused**:
  - Big industrialists acquired licenses **to block competitors**, not to expand.
  - More effort went into **lobbying than innovation**, stifling competitiveness.

*C. **Drawbacks of Protectionism***

- **Prolonged protection from imports** reduced the **incentive to improve quality**.
- Consumers had **no choice** but to buy **low-quality domestic goods at high prices**.
- Lack of competition led to **inefficiency and complacency** among producers.

Differing Views Among Economists

- **Pro-public sector economists**: Emphasize that **profit is not the main goal** of PSEs—**social welfare is.**
- **Protectionists**: Argue that protection is still needed as **developed nations themselves protect** their industries.
- Others call for:
    - **Privatisation**, where suitable.
    - **Reduction in protectionism** to encourage competitiveness.

While India's industrial policies from 1950 to 1990 led to **diversification**, **employment**, and **self-reliance**, they also caused **economic inefficiencies**, **overregulation**, and **low-quality production**. These challenges led to widespread calls for reform, eventually resulting in the **New Economic Policy of 1991**.

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2.6 CONCLUSION

The performance of the **Indian economy during the first seven Five Year Plans** (1951–1990) was a **mixed story of achievements and emerging challenges**.

Achievements (1950–1990)

1. **Industrial Diversification**:
    - India's industrial base **expanded significantly**, moving beyond cotton and jute to include sectors like steel, automobiles, and electronics.
2. **Agricultural Self-Sufficiency**:
    - The **Green Revolution** made India **self-sufficient in food production**, reducing dependency on food imports.
3. **Land Reforms**:
    - The **zamindari system**—an exploitative landlord-based system—was **abolished**, empowering farmers and rural communities.

Emerging Challenges and Criticism

1. **Underperformance of Public Sector Enterprises (PSEs)**:
    - While public sector enterprises were crucial in the early years, many failed to perform efficiently over time.
2. **Excessive Government Regulation**:

- The **license-permit-quota raj** led to **bureaucratic delays**, discouraged innovation, and **stifled entrepreneurship**.

3. **Lack of Competitive Incentives**:
    - In the name of **self-reliance**, Indian producers were protected from foreign competition.
    - This **reduced the motivation to improve quality** or innovate.
4. **Inward-Oriented Policies**:
    - The focus on **import substitution** and minimal export promotion meant India **did not develop a strong export sector**.

Need for Reform

By the late 1980s, it became clear that India's **inward-looking and highly regulated economic model** was **unsustainable** in a rapidly globalising world.

- The **changing global economic scenario** and internal inefficiencies led to a **widespread demand for economic reform**.
- This marked the beginning of a new chapter in India's economic journey: the **New Economic Policy of 1991**, aimed at:
    - **Improving efficiency**
    - **Encouraging competition**
    - **Opening up the economy to global markets**