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THE ORIGINS OF IMPORT SUBSTITUTING INDUSTRIALIZATION IN INDIA

Tirthankar Roy¹

ABSTRACT

In the post-war world, India was one of the most protectionist countries. Protectionism originated in British colonial measures to design an industrialization policy in the 1920s. Whereas in the 1920s, protection was applied with discrimination, after independence in 1947, protection was offered without discrimination. The paper explains how this transformation came into being. It rejects the hypothesis now current that discriminating protection was dropped because it was a weak policy, and suggests instead that the aspirations of nationalistic businesses played a role.

Keywords: industrialization, colonialism, protection, import substitution, economic nationalism

JEL Codes: N15, N35, N65, N75, O14, O20

During much of the late twentieth century, a number of countries in the developing world pursued a policy of import-substituting industrialization (ISI). The contents of the policy were not similar. The common ingredient was protective tariff afforded to domestic industry, whereas on nontariff barriers, foreign investment, state ownership of assets, and state regulation of private investment, policy differed substantially. India represented one of the more emphatic versions of ISI. Just before the economic reforms of 1992, unweighted average tariff rate in India, at over 100%, was likely the highest among large countries in the developing world. And it had been reinforced by nontariff barriers, restraints on foreign investment,

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nationalization of financial services, and regulation of private investment. The paper seeks to establish the reasons why India went for an extreme version of ISI.

From the second half of the nineteenth century, the idea that tariff autonomy could be used to reinforce a process of state-led late industrialization became known to economists and politicians (Waterbury 1999). Most countries did not give up on free trade between 1860 and 1914. Late industrialization in the developing world, therefore, was characterized by diversity in the application of ISI. India started from a free-trader position in the nineteenth century, no doubt owing to its status as a colony of Britain. If India was a case of free trade with little state intervention, imperial Russia and Japan were examples of free trade with significant state intervention, and Brazil, Mexico, and Argentina, cases of significant protection from mid-to-late-nineteenth century.² These choices were guided by political situations, and sometimes, corporate power and corporatism.

Between 1920 and 1950, the average level of tariffs increased worldwide, though considerable cross-country variation has been discovered behind this tendency (Clemens & Williamson 2002).³ Towards the end of this time span, and especially after 1950, Latin America and India began to serve as models for the rest of the developing world. This was so because, in one view, ‘the most coherent formulation’ of ISI emerged in the Economic Commission for Latin America soon after it was established in 1948 (Waterbury 1999, 323). Other experts hold that ‘ISI was primarily a South Asian invention’ (John P. Lewis, cited in Waterbury 1999, 336). ‘The Indian effort’, one author claims, ‘was widely regarded as a model by other developing countries in the 1950s’ (Bruton 1998, 906). Interestingly, between these two regions the historical roots of ISI were quite different.

The Latin American ISI was ‘induced from abroad’ (Baer 1972, 97). ‘Continued reliance on the export of food and primary products was thought to be precarious because of the instability of such exports.’ (Baer 1972, 97). ISI was seen as the long-term solution to this problem. The prior experience of the large Latin American countries with protective tariff may also have been a factor in the choice. The significance of export shocks behind the choice of this pathway has been reassessed recently.⁴ But the message that ISI in Latin America emerged in order to reduce dependence on unstable commodity markets, remains intact.

2 In the presence of such diversity, we can ask if the trade regime mattered to the pace of industrialization in the periphery. A negative view holds that nineteenth century free trade locked-in countries into a pattern of specialization that they found hard to break out of. See Lewis (1978). A positive view holds that market integration fostered transmission of knowledge and capability. The former position is compatible with trade pessimism, which lent support to post-war ISI, see Rodriguez & Rodrik (2000). The latter view is compatible with new growth theory and the analysis of technology diffusion in the modern times. See Edwards (1998); Mody & Yilmaz (2002).

3 On variation, see Eichengreen & Irwin (2009).

4 Thorp (1992) shows that the export sector was resilient, Gupta (1997) stresses the effects of trade shocks on reallocation of investment.

From the 1920s, average tariff rates increased in India too. After 1950 there was a further and sharper increase. But India's choice had nothing to do with the factors that operated in Latin America. India was not nearly as trade-dependent as the larger countries in Latin America were. Whereas the export composition in the latter was dominated by one or two primary products, less than half of India's exports in the 1920s consisted of primary products, and the proportion had been falling from before the War. India, therefore, did not suffer commodity price shock on a comparable level. Furthermore, the effect of the Great Depression was differentiated according to whether commercial crops were export-oriented (cotton) or sold in the home-market (groundnut, sugar) (Charlesworth 1985). This was so because India's real GDP was more stable than that of its main trading partners in these years. The effect also varied by region and by the destination of exports. For example, the Japanese market, the main destination of raw cotton, was less affected than markets in the West. The fall in domestic prices caused considerable distress to debtors and the banks. These adversities were not mainly a result of the world economic collapse, but of conservative monetary policy.⁵ No doubt in both Latin America and India there was disillusionment with openness. Whereas the origin of that sentiment in Latin America may have been commodity price shocks, in India the origin was different and political, as this paper will show.

Indian ISI evolved in two stages, emergence and consolidation. The average tariff rate in India turned upward several years *before* the Great Depression (see Figure 1). The historiography of Indian industrialization explains the emergence of protection with reference to India's changed position within the Empire after World War I (Bagchi 1972, 43–47; Ray 1979; Morris 1983; Chatterji 1992; Mukherjee 2002). The contribution of Indian industry to the war effort was seen as sufficiently valuable to the Empire, for state aid to industry to be considered. Colonial protectionism, however, was a qualified form of protectionism. The policy recommended its application on a case-by-case basis, subject to assessments of comparative advantage of an industry, and potential cost to consumers. The protectionism that came into being after 1947 was by contrast, indiscriminate, and set at a much higher level.

An explanation of the post-war ISI in India needs to show why the change from discriminating to indiscriminate protection happened and what it meant. The received view suggests that the colonial policy was too weak to deliver industrialization. It failed to act as a 'general policy of industrialization', and was 'ineffective', 'rigid', and 'piecemeal'.⁶ Behind the 'apparently "technical" exercise' of the Tariff Board enquiries, colonial protection was a tool 'to reconcile imperial interests' (Chatterji 1983). It did not serve Indian interests (Mukherjee 2002, 191–95).⁷ By

5 On interpretations of the effect, see Rothermund (1992); Roy (2012), 210–23.

6 Cited texts from Bagchi (1972, 45). See also Ray (1979).

7 One point of criticism was that the Tariff Board had too many technocrats and lacked members possessing a 'nationalist outlook' (Mukherjee 2002, 195).

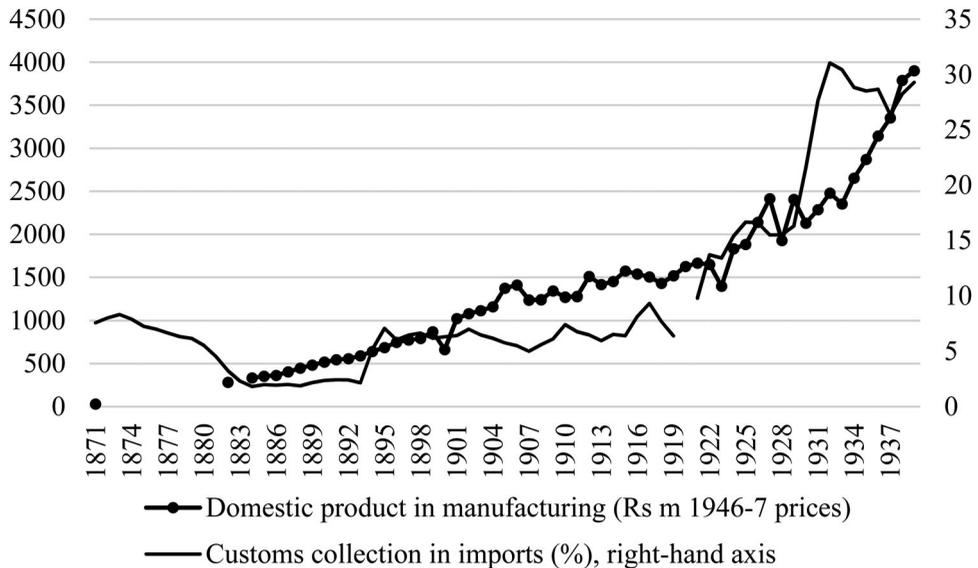


Figure 1: Industrialization and Customs collection 1871–1939 (Data from Statistical Abstracts for British India, various years)

implication, independence in 1947 supplied the political will to redesign ISI such that it could deliver real industrialization. The present paper disputes the received view on two points. First, the argument overlooks the fact that Indian industry grew quite rapidly before World War I, without almost any protection. If free trade did not obstruct industrialization, why should some protection be seen as obstruction? Second, the historiography misreads the difference between colonial and postcolonial policies. The difference was one between discriminating and indiscriminate – not between weak and strong or between imperialist and nationalist – protectionism. In order to see why discrimination was rejected, we need to know what it had aimed to achieve and why that aim was disputed.

This paper rereads contemporary political and intellectual discourses, and Tariff Board proceedings on specific industries, mainly steel and cotton textiles, to find an answer to the question. Colonial protectionism tried to design an efficiency-constrained ISI. India's open economy could be seen to serve efficiency in two particular ways. First, monetary integration with Britain reduced certain types of macroeconomic and business risks. This argument was long under attack, and the crisis of the Gold Standard and the Depression experience destroyed it. Second, open markets ensured continued easy access to machinery and intermediate goods, as well as capital and skilled labour, which resources were expensive in India. This second argument was never seriously in question. In the 1920s, the prevailing sentiment was that protection was inevitable, but protection needed to mind the advantages of openness. In other words, ISI entailed a trade-off between domestic production and efficiency of production, and needed to limit the scope of the policy to those cases where the efficiency costs of domestic

production would be modest and temporary. The paper shows that this accent on efficiency became a target of attack, mainly from a group of Indian industrialists. Economists and publicists joined them in the 1940s. They shared a belief that the charge of inefficiency attached to Indian producers in particular, and therefore, a clause on efficiency harmed the Indian industrial class. They criticized the clause by suggesting that ISI was more than a tool of industrialization, it was a tool to nurture *indigenous* capital. The indiscriminate protection model emerged from that ethnic nationalist political tendency.

The rest of the paper contains five sections. The next three sections discuss the formation of colonial ISI; import substitution in government purchases, which was the earliest field of application of colonial ISI; and tariff policy. In each case, we see concern over a trade-off between efficiency and protection influence the operation of ISI. The fourth section shows how an emergent nationalism attacked the trade-off. The last and concluding section restates the main arguments and suggests revisions of the historiography of Indian development policy.

COLONIAL ISI: PROTECTION VS EFFICIENCY

Modern industry began in India in the 1850s. When World War I ended, about one-and-a-half million people worked in factories in British India and the princely states together. The majority of these workers were employed in the two textile industries, cotton and jute, and in tea plantations. A substantial and growing number worked also in engineering, repairs, bricks and tiles, grain processing, paper, sugar, wool and silk textiles. The industrialization had occurred without significant protective tariffs. Lancashire textile interests put pressure upon the Indian government to keep import duty to a low level. The government did impose a nominal duty but neutralized its effects with a countervailing excise duty in the 1890s. Despite lack of fiscal support, however, factories continued to grow in numbers, thanks in part to the ease of access of entrepreneurs to British capital and skilled labour. By 1920, manufacturing industry was still a small segment of the economy (accounting for about 7% of GDP), but belonged in an increasingly assertive capitalist sector that included trading firms, banks, and insurance companies. Because the group was so diverse and globally connected, ISI was not the preferred option for all. In fact, the only serious campaign for protection came from the cotton mill owners of Bombay and Ahmedabad, and it was a relatively minor movement in political terms until the 1920s.

In India, ISI started in the 1920s due to shifts in British colonial policy. Within the colonial administration, support for policies to develop India had grown after World War I, because Indian resources had contributed significantly to the allied war effort. That stance led to three commissions of enquiry. The Indian Industrial Commission (1916–18) had a mainly fact-finding mission. But the other two – the Fiscal Commission (1922), and Stores Purchase Committee (1920) – had immediate effects on government policy. One of these recommended protection to selected industries of domestic origin, and another recommended that the government

buy manufactured articles for its own use from Indian sources as far as possible. Fiscally, protection helped Indian finances when older sources of revenue were failing. And politically, protection was helped by the decline in the influence of British manufacturing interests upon colonial policy, and by the idea of a customs union within the Empire, which had been proposed in order to shelter British industry from non-British competition in the markets of the Empire.

The practical rule was called ‘discriminating’ protection. On the face of it discrimination meant that an applicant for protection needed to establish a case for it. The case was deliberated on by a committee. Some of these deliberations ran into thousands of pages. Surely the rule was taken seriously. But why was it taken seriously? What was the rule aiming to achieve? A quick glance through the proceedings of the Tariff Board, the Fiscal Commission, and the Stores Purchase committee would show that these enquiries became complicated affairs because they were less interested in the ethnicity of ownership of businesses to be protected and more interested in the efficiency of the firms. They were microeconomic in scope. And as such they wanted to resolve a potential conflict between the interests of producers and consumers.

Sources discussed in the next three sections show that discrimination reflected an anxiety about the institutional context in which an industrial promotion policy was to be implemented. In principle, infant industry protection derived justification from a belief that protected firms would gain in efficiency by using economies of scale. In India, this belief was tempered by a sense that key resources that were needed for capturing the economies of scale, especially skilled labour, were limited in supply and expensive. Skills commanded a high premium and frequently had to be hired in Britain, Germany or the United States. The Tariff Board proceedings contained valuable discussion on the challenges of building competitive firms in a milieu in which capital and labour markets needed improvements. Specifically, the deliberations of these enquiries centred on the question, which firms would be able to deal with the constraint of *quality of labour*, and sometimes, whether or not the constraint ought to be overlooked.⁸ It is possible that the opportunity cost of protection was so prominent a part of the discussions because the perceived advantage of free trade was prominently in the minds of the committee members. The historiography of interwar industrialization overlooks this opportunity cost and interwar debates on the issue.

The relatively minor field in which state intervention to promote domestic industry was pursued was government purchase, the major field being protection. These two areas of action will be discussed in the two sections that follow.

8 Morris (1983) mentions that the Tariff Board deliberations involved conflicts between the interests of producers and consumers, but does not develop the point. Efficiency and training have received considerable attention in works on factory labour, especially in cotton and jute mills. See Chandavarkar (1994, 378–89 in particular); Chakrabarty (2000, 72). This scholarship does not draw a link between efficiency and industrial policy.

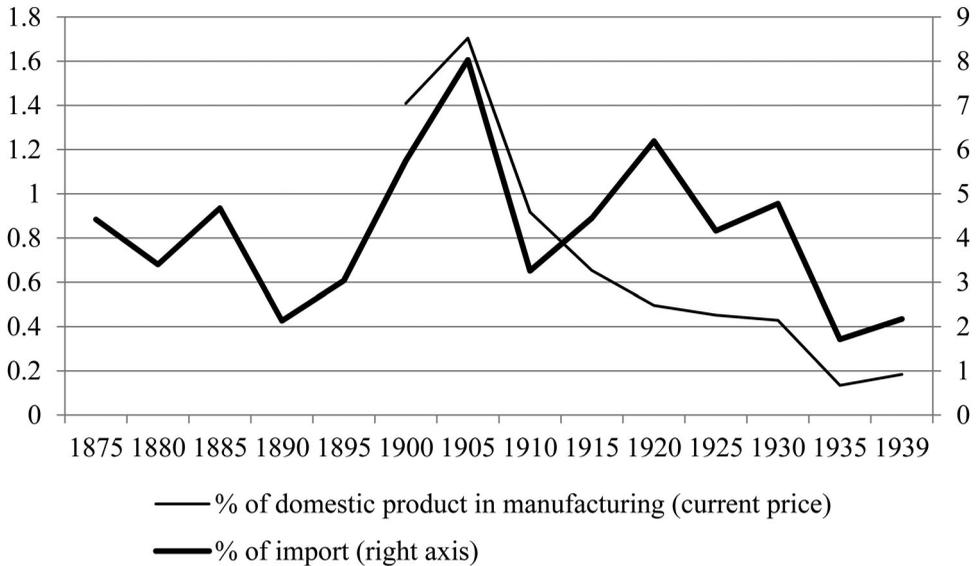


Figure 2: Stores Purchase 1875–1939

COLONIAL ISI: GOVERNMENT CONSUMPTION

This section discusses import-substitution in resourcing goods required by the state. Interestingly, the firms that were pushing for import substitution in this field were not domestic firms hoping to expand their business, but (mainly British) firms importing manufactured goods from Britain into India. A number of these were engineering firms. They wanted more freedom to resource goods. The Stores Purchase Committee became a platform for a debate and discussion of their demand.

With government expenditure at 3–5% of GDP in 1900, and the import value of stores not exceeding 2% of GDP (Figure 2) and 10% of total import, it might seem that the decision by the government to procure manufactured articles from India rather than Britain would make little difference. But, in fact, the government accounted for nearly half of net capital formation and a third of gross capital formation in 1900, though both proportions were falling in the interwar years. With natural resources and semi-processed goods like leather, the government had already been buying from India. In the two main large-scale industries – cotton and jute textiles – the government was an insignificant buyer because it did not need these goods in big quantities. With manufactured goods other than textiles, the government was not only a large buyer, but had also followed a consistently buy-British policy. The government and the railways were the main buyers of steel until World War I, the government was officially the exclusive buyer of arsenal, telegraph and telephone material, and a significant buyer of paper, medical material, and scientific instruments. Until the Stores Purchase Committee changed the rules, most articles for the government were purchased by a Stores Department of the India Office in London. The Government of India tried from

time to time to reduce the role of the India Office, but succeeded marginally. This was inconvenient for the consumers, discriminated against the local suppliers, and faced constant criticism in India. [Figure 2](#) shows that under corporate influence, procurement policy was moving away from foreign import at least 15 years before the official policy to do so was announced.

The critics of London procurement were trading firms and government departments. It took an enormous amount of time for indents to be declared, fulfilled, and goods inspected and shipped into India. In turn, for critical departments like ordnance or the state railways, the situation necessitated keeping six months' stock in hand, which locked up money. An engineer of a state railway complained that communication between local engineers and the India Office consultant engineers was far from perfect (India 1920, 238). Others expressed the view that large capital-intensive projects in the public works or railways required close and sustained service contract between the supplier and the consumer, something that the present system could not ensure. In short, consumers and merchants favoured a system of private contracts, which would make purchases more flexible and the post-purchase service more efficient.

To some critics, the railways represented an improved system. Railways began in the 1850s as private enterprise, but between 1880 and 1924 had come under full government ownership with traces of private management still left in.⁹ Given the number of railway companies that operated, the significantly different conditions in which they worked, as well as the mix of public-private management, a single policy of purchase would have been impossible to devise. The companies procured parts and stock in a variety of ways, from contractors, directly from firms, and from the workshops they themselves owned. By 1920, most railways bought all of their requirements of paints, bricks, ceramic material, small metal products like locks, and a considerable part of their requirement of pig iron from Indian sources. What they did not buy was finished steel such as plates. Other than the railways, the dockyards were a major consumer of finished steel.

World War I had forced upon London an acceptance of greater flexibility from before. At the end of the war, the proportion of goods procured from the agents of foreign firms stationed in India and from Indian firms had increased sharply in relation to goods centrally supplied (data from printing: India 1920, 10; on ordnance factories, 37). It had also at the same time increased the size, capability, and diversity of Indian-origin manufacturing firms supplying government stores. Both trends were in evidence in the paper industry, for one example. In the proceedings of the Stores Purchase Committee, even consultants to the India Office agreed that more purchase from India was an accomplished fact (India 1920, 119).

It was easy to read London's insistence on controlling procurement as a favour extended to British industry, and there may well have been an element of bias as long as London had a say in the matter. But this would be an exaggeration. For

9 For an outline of shifts in ownership and management, see Bogart & Chaudhary (2015).

one thing, British trading firms fought to gain more freedom in this case. For another, the capacity of Indian firms raised particular obstacles to reducing London's role in procurement. There were three types of problem.

First, in the nineteenth century, Indian costs were high and capability low in a number of fields. There were almost no Indian manufacturers of most qualities of paper, arsenal, medical supplies, and finished steel. In scientific instruments in healthcare, research, mineral prospecting or cartographic surveys, consumers did not think sourcing goods from India should be tried at all (India 1920, 41). Even when some of these goods began to be made in India, transaction costs were high. As the secretary to the Public Works department explained, for many engineering goods, British articles were cheaper than their counterparts, even when these were locally available (India 1920, 187). Engineers, even though nearly all of them favoured local purchase, stated that industrial intelligence was easier to obtain in Britain, whereas information on price and quality of specific goods did not circulate in India (India 1920, 245).

Second, the quality of goods was in question, largely because standardization procedures had not developed in India at the same pace as industrialization progressed. India did not possess adequate inspection facilities to ascertain the quality of privately procured goods, especially goods made and sourced in India. Both trading firms and manufacturing firms based in India agreed that quality control was weak and poorly understood. The Consulting Engineer to the India Office, while agreeing that manufacturing in India was in principle able to supply a number of goods now bought in London, cautioned that 'India must not be allowed to get the reputation of manufacturing shoddy articles' (India 1920, 120).

Even as the War increased the quantity of purchase, it made the old complaint about quality of goods more acute than before. In manufactured goods that came in from large firms, which dealt with inspection offices daily, there was an improvement of quality. The quality of shells produced in India was an example (India 1920, 48). In some cases, such as paper, pencil and ink purchased as government stationery, there was regular contact between the inspectors and the manufacturers, though the effects of this on quality cannot be ascertained (India 1920, 34). But in general, over-expansion had forced a deterioration of quality of goods, especially in businesses where the new entrants were small in size and too numerous to be regulated.

Third, the inspection and standardization bureaucracy created its own particular problems, partly stemming from the hierarchical nature of a colonial administrative office. The office was sufficiently low priority to be filled with Indian officers, and these officers tended to be nervous about exercising their judgment. The traders and manufacturers insisted that the few inspectors who worked in India were 'not real experts', and therefore afraid of using discretion of any kind (quote from manager of a textile mill: India 1920, 127). One example of this problem was cited by the Calcutta engineering firm Martin Burn. The 'quality' of steel products included both strength and finish. Inspection, according to the representative, should be less fussy on finish and concentrate on strength instead.

But the mentality of the officers ensured that they were more exacting than their counterparts in Britain on both counts (India 1920, 5).

In an indirect way, labour quality was the issue at stake. A ‘real expert’, at any rate an officer who would not be afraid of using own opinion, would typically be a European receiving Rs. 4–5,000 (£270–£330 in 1900) a year as salary in a large private firm. In 1920, the figure might amount to 100 times the per capita income. That type of person the cash-strapped provincial governments could not afford. Instead, in their recommended design of an expanded inspection system, they wanted to hire ‘foremen inspectors’, that is, people with basic training in testing rather than an engineering degree and available at one-tenth the salary (India 1920, 143). That course of action would not necessarily inspire confidence among the departments buying goods.

What could be the solution, if not hiring expensive European officers? Foreign direct investment was an alternative. In an open economy, the ethnicity of the firm making things was not a big issue. For many officers who had some say in the making of industrial policy, Indianization of procurement amounted to ‘inducing British manufacturers to establish branches here’ (Assistant Director of Industries, Madras: India 1920, 75). An interesting twist to this argument was presented by D.B. Meek, the Director of Industries in Bengal. Meek did not advocate any restrictions on foreign firms. But he believed that most foreign engineering firms charged too high a mark-up for selling goods in India. In order to induce them to establish manufacturing in India, a mild protection offered to Indian firms would be a good idea (India 1920, 253). The tariff wall would act as an encouragement to jump the wall, and it would act as a threat to those firms already trading in India that they might lose their hold in Indian markets.

By 1920, there were in fact a string of British engineering firms looking to expand operations in India. One example was the Calcutta firm Alfred Herbert dealing in machine tools. Alfred Herbert was the branch of a Coventry machine tool maker, and as such obtained goods from the parent firm. They also manufactured in India on a small scale. The British counterpart could bid for tenders invited by the London office, but with their eyes on expansion in India, they sided with the move for an India-based and decentralized purchase system. They were not the only ones. Among similar firms, mention should be made of Marshall, Sons (agricultural machinery and traction engine maker and trader, based in Lincolnshire), Stewarts and Lloyds (Birmingham firm making iron and steel tubes), Westinghouse Electric (London firm with presence in South America and Asia, dealing in electrical installations), Thornycroft (shipbuilders), George Cradock (wire rope manufacturers of Wakefield), Campbell Gas Engine (oil engine manufacturers and traders of Halifax), General Electric (formed of a merger between Thomas Edison’s company and Thomson-Houston, both electric light equipment manufacturers and traders), Saxby and Farmer (railway equipment manufacturer, of Kilburn and later Chippenham), British Thomson-Houston (branch of an American company), and Mather and Platt (Manchester engineering firm). All had established branches in India between 1900 and 1930. ‘The establishment of such

branches is the first step towards the actual manufacture of the goods in India and doubtless in time will lead to it' (India 1920, 143). Most of the aforementioned trading firms also started manufacturing in India.

The main protagonist in the battle for import substitution in government procurement – British-Indian trading firms – had no problem with that solution. Richardson and Cruddas, a Bombay-based trading firm dealing in steel for public works launched the first unsuccessful attack on London-based procurement in the 1870s. After 1919, manufacturing firms joined the battle. The latter included the cluster of British engineering firms trying to expand their Indian operations, and large Indian-origin manufacturing firms like Tata Steel and Martin Burn. The group was too large and almost near unanimous in their demands for London to resist any more. Nearly all of them who appeared before the 1920 Committee stated that while import substitution was needed to reduce transaction cost, purchases also needed to ensure standardization and quality, implicitly arguing for discrimination. Only occasionally was import substitution in this sphere linked to developmental aims such as industrialization.

In the Committee's proceedings, the Indian trading firms did not express a different view either. The Marwari Chamber of Commerce, and the United Provinces Chamber of Commerce, both composed of traders, were emphatically in favour of Indian procurement, but did not think that such a measure could be part of an industrialization policy. They seemed to think that reducing the cost of trade was one thing and industrialization was another, mixing the two would be a wrong thing to do. Commerce came before industry. Allowing trading firms to grow would take care of industrialization in due course. Promoting commerce amounted to the grant of full freedom 'to purchase imported stores in India', the shift of the axis of purchase from Britain to India, and from government procurement to the use of private contracts (India 1920, 131). Interestingly, the Marwari representatives raised the fear that too much departmental authority would lead to corruption. Likewise, Indian engineers in the employment of provincial governments wanted freedom of choice and their own authority to obtain material (India 1920, 300). But they did not express any opinion on the ethnicity of the source.

Politicians, economists, and industrialists who were close to the nationalist movement for self-government in the 1920s held import substitution in quite a different light. If we exclude traders, foreign investors, and engineers, the non-official Indian opinion was insistent that any policy of Indianization should mind the ethnicity of source above other considerations. In the view of the Indian member of the Imperial Legislative Council, it was not enough to offer freedom to the traders or invite foreign capital, but necessary to have foreign firms register in India, so that the Indian public could share in the profit (India 1920, 216). The member admitted that quality was an issue and that openness to trade better ensured quality; 'India must be able to purchase in the best market in which *the right quality* was obtainable' (India 1920, 216, emphasis added). A stronger support for indigeneity was expressed by the representative of the Associated Press, an Indian body of journalists. 'British firms were welcome to start industries in India, provided they afforded

employment to Indian labour, worked on rupee capital, and gave Indians an opportunity of accepting partnership' (India 1920, 247).

Among Indian manufacturing firms, the most powerful lobbyists for import substitution were not the same people who had an interest in the stores purchase policy. Cotton mill owners dominated the lobby for ISI. Engineering firms dominated the lobby for deregulation of state purchase. The Committee interviewed Ambalal Sarabhai, the representative of the Ahmedabad Millowners' Association and a textile mill-owner. He had no opinion on foreign capital or existing industries, but 'strongly' suggested that with Indian enterprise in new industries, 'indulgence [be] shown with regard to quality and price' (India 1920, 231). A newspaper editor in Allahabad went further. Making an implicit reference to the 'drain' theory of Indian underdevelopment, the editor said that foreign firms brought no benefit to India because they repatriated profits. Government purchase must favour Indian origin and Indian-owned firms. Purchase policy needed to be part of an industrial promotion policy. Foreign firms should be forced to train Indians rather than hire managers and skilled workers from abroad (India 1920, 150). Foreign firms should also be forced by law to register in Indian share markets and mandatorily sell 50% of shares to Indians. The origin of that idea (which was in fact implemented after 1947) was a 1906 speech by Vithaldas Thackersey, a Bombay-based textile mill owner. It thus seems that the more extreme view on the ethnicity of the source of goods tended to be expressed by individuals connected with the textile industry, who wanted to take leadership role in the postcolonial regime.

The new position was characterized by explicit trade pessimism. The representative of the Associated Press spoke against something he called 'spurious trade' (India 1920, 214). He seemed to mean a trade regime where traders had the freedom to choose whom they would buy from. Rather than having Indian traders enjoy such freedom, it was preferable that the India Office, a trusted body, should carry on doing what it was doing. We cannot know how prevalent the anti-merchant feeling was among the nationalists, but that it was an element of nationalism was revealed in the numerous restrictions imposed on private trade after 1947.

In 1922, the prevailing view was in favour of balance between promoting trade and promotion of Indian industrial capacity. Most insiders agreed that procurement from India would serve freedom of choice, but the move needed to mind quality. As an engineer in the employment of a provincial government put it:

Too much of a fetish was made of having Indian stores exactly to English pattern but it would have to be the duty of the inspection agency to combat the opposite tendency, which was to accept an article far below the English standard simply because it was made in India. (India 1920, 147)

In the tariff protection debate that started soon after, the same concern was present. But compared with the stores purchase discussion, in this case the attack on qualified import substitution was much fiercer.

COLONIAL ISI: DISCRIMINATING PROTECTION

Friedrich List was introduced to Indian readers by the publicist M.G. Ranade. Ranade was against state regulation of business but saw a role for the state protecting private enterprise. The theoretical position for which he was better known was that development policy could not flow from invariant first principles because it needed to adapt to geographical conditions. That position led him to advocate an activist agricultural strategy and more investment in public goods. It also made him a proponent of protection.¹⁰

When Ranade wrote, in the last decades of the nineteenth century, protection had plenty of critics who suggested, in good or bad faith, that it would encourage corruption, monopolistic combination, and perpetuation of inefficiency. When the idea was adopted for implementation, a young economist of the Bombay school wrote that ‘hope is held out that, the supervision of the Tariff Board, which the Commission recommends, will mitigate the effects of these disadvantages’ of tariffs (Vakil 1922, 125). In order to safeguard against these distortions, protection needed to be ‘discriminating’. The Indian Fiscal Commission explained what the term meant. Two rules were to be followed when granting protection. One of these was the rule of tariff equality, where protection was allowed to a firm that made a convincing case that the customs duty paid on imported raw materials made it uncompetitive. The second of the two rules was substantive protection, which employed the infant industry argument. This was the context where safeguards were needed the most. The Fiscal Commission stated the case for discrimination with reference to the ‘burden’ of inefficiency or a tax on consumers. Discrimination would favour industries that had a realistic chance of reducing the burden over time.

If the industries to be protected are selected with due discrimination, the burden [on consumers] should gradually diminish. ... as ... prices. ... become regulated more and more by internal competition. ... the consumer will then begin to derive the benefit from the increased efficiency of the local industry. (Quoted in Indian Tariff Board 1926a, 17)

How gradual was gradual? How long would the period, called ‘probation’ by the Tata Steel application for tariff protection, last? No one knew the answers for sure. In the case of steel, the time sought was 10 years, though the level of protection had to be revised before the 10 years were over. This point was as difficult to settle as the other point, what did a firm need to do to reduce the burden of inefficiency over time? Could some firms ever become competitive?

The condition behind the grant of substantive protection was that an industry that was (a) deemed to possess a natural advantage, (b) unable to grow without protection, and (c) expected to become competitive with protection, deserved tariff protection. Establishing the three conditions together was a difficult task in almost

10 Some aspects of his large corpus is analysed in Adams (1971).

every case. The history of cotton textile mills showed that the industry did not quite fit the second condition; it satisfied the first condition, and given the old machinery and restless labour that Bombay's cotton mills were burdened with in the 1930s, it was anybody's guess if it met the third condition or not. The demand for steel tariffs came from one firm, Tata, and both the tariff authority and non-official opinion were initially unsure if the first condition had been fulfilled or not. Was India ready for such a capital-intensive and skill-intensive industry as an integrated steel plant?

In nearly every other case, condition (a) was uncertain, because Indian start-ups were found to be producing goods inferior in quality and higher in price. This was so in sugar, attributed to inferior cane by the defenders of protection and to inefficient machines by the detractors of protection; in paper, attributed to the inferior quality of the pulp by pro-protection lobbyists; in salt; coal; plate and sheet glass; finished steel; and polished rice. In matches, the Swedish firm Western Indian Match Company happily advertised the inferiority of Indian products, drawing an irritated response from the Tariff Board (Indian Tariff Board 1926a, 292). On this occasion, raw materials could not possibly be blamed. In cement, consumers preferred imported cement on the point of quality, though no one could fault Indian limestone, and the fact of a quality difference was disputed by the Government Test House (Adarkar 1941, 333).

Where competing goods differed in quality, the enquiry needed to decide whether the goods were substitutes or not, and if they were substitutes, how close substitutes they were. On this task, the Tariff Board enquiries spent a long time. There were not enough detailed consumer reports available, and there was repeated failure to find foreign costs of production to ascertain what sorts of materials were used in a product. The only practicable course was to proceed as if there was equivalence in quality when an applicant said there was. More controversially the Board sometimes used country of origin as quality markers.

In the two main industries to receive protection – finished steel and cotton textiles – the issue was efficiency rather than quality. Both cases offer important lessons on state and business relationship in the interwar period. But the lessons are somewhat different. The common factor was that, in both, British industrial interests were less at stake if protection to Indian firms was allowed. In steel, the main competition came from the European continent, and in textiles, from Japan. The difference was that in steel, the prospect of becoming world competitive depended on how well one firm modernized itself, whereas in textiles, the prospect depended on how well a whole industry, which was very diverse within, modernized itself. The kind of data collected on these two cases, therefore, was quite different.

At the end of World War I there were four large-scale steel producers in India, Tata Iron and Steel, the Indian Iron and Steel, the Mysore Iron Works, and the Bengal Iron Company. Of these works, only Tata produced finished steel on a large scale. Indian Iron and Steel did not produce finished steel, and the Bengal Iron had stopped doing so before the war. Mysore Iron Works produced alloy and special steels on a small scale, and made charcoal pig iron. In 1921, Tata

Steel had erected a blast furnace. In 1924, only the Tata plant could produce steel rails and mild steel structural meeting the British Standard Specification for use in buildings, bridges, wagons and the railways.

The Tata factory had a relatively sheltered market during the war. When the war ended, the factory was left with a large work-force that was under-utilized. Expenses on skilled labour were a special burden. Although the expansion had brought down costs, the industry had to deal with a worldwide overproduction between 1925 and 1932. Japan, a large buyer of Indian pig iron, started to procure pig iron from Manchuria and Chosen. With finished steel, therefore, the Tariff Board dealt with one large and unusual firm that had, since its start, delivered a costlier product than continental steel. The firm could be left to fend for itself and might survive as a competitive producer of pig iron. But it was not.

As a single firm, Tata Steel could negotiate better, and its problems were precisely identifiable and therefore more easily addressed. In 1924 it made the case that the unfinished expansion plan had imposed a burden on the firm, that things could only get better, and made a promise to lower cost of production within seven years. The domestic steel industry was adversely affected by the overvalued currency. The firm, however, had to come back for more protection in the next two years. These too were granted it, in the shape of a bounty rather than a higher tariff. In 1926, practically 70 to 80% of the customs revenue from imported steel was handed back to Tata.

Non-official opinion was not always sympathetic to the level of support extended. A particularly embarrassing attack on Tata's case for protection was launched by Maneck Homi, a former employee who had left the Tata plant to work in the USA and returned to lead a strike. In his witness testimony, he gave a scathing report of Tata's record on housekeeping, using confidential documents apparently leaked to him by other employees. The Tariff Board had found that their furnace consumed too much coal and produced too little output. Among other areas of failure, Homi highlighted 'wanton extravagance' in the employment of labour. Wages of semi-skilled workers being low, this was an affordable burden. But a heavier burden was imposed by the 'top heavy administration', which enjoyed greater parity of wages among competing producers of steel (Indian Tariff Board 1924, 813).

Very few plants in America of the size and capacity as the Tata Iron and Steel Company Works would go in for a General Manager and his establishment charged over and above a General Superintendent and his staff. No plants, however big, keep half a dozen General Master Mechanics, floating Engineers of all sorts and conditions. There are three personal assistants to the General Manager, three for the Chief Accountants, two for the General Superintendent, besides a veritable army corps of clerks. (Indian Tariff Board 1924, 813)

Of all Indian industrial firms, Tata had relied on foreign technicians most heavily and persistently. The expansion plan apparently lacked expert technicians after the German experts initially hired had left the firm (Slater 1925). Their American replacements cost the firm a lot of money. Members of the Tariff Board tried to

diffuse Homi's attack. Tata's own statement challenging it did little to dispute the presence of inefficiency, but attributed the fact to 'the comparative efficiency of the Indian workman due to such well-known causes as physical stamina, climatic conditions, training' (Indian Tariff Board 1924, 845). Whether the managers liked Homi's words or not Tata Steel followed his remedy. Between 1925 and 1932, Tata Steel reduced its workforce from 32,500 to 25,000, and achieved

installation of more modern machinery, the 'Indianization' of the plants with the subsequent releasing of many highly paid foreigners, and also the greater efficiency of the Indian workmen as they become familiar with steel-works practice. (US Department of Commerce 1933, 7)

The government had strategic and political reasons to back the firm. The fact that Tata had accepted preferential treatment of British steel in Indian markets helped. But the Tariff Board also had a technical problem to solve; how the different categories of finished steel were to be treated. A series of separate negotiations followed for bars, rods, plates, rails, wire rods, billets, and galvanized sheets. The government induced the railways to buy the entire requirement of rails from Tata. On the other hand, little direct help was offered on wire rods and galvanized sheets. Between 1928 and 1933, Tata's share of Indian consumption increased sharply. By 1935, the firm had delivered on its promise, and could foresee that by 1940 it would not need protection any more. More than the success of the firm, this was an example of a negotiated and conditional support, the very idea behind discrimination.¹¹

During World War I, the cotton mills of Bombay and Ahmedabad had improved the quality of the cloth they produced. But labour productivity was another matter. The labour–equipment ratio was consistently higher in Bombay than its competitors elsewhere in the world. Thanks to growing wage differential, the city had a cost advantage over mills in Britain and North America. In the inter-war period, Japan emerged as a competitor and Japan was not only a low-wage producer but also a more efficient one. The production of cloth per weaver was three-and-a-half times higher in Japan, and the difference in the spindle-worker ratio was almost as great. Initially when Indian cotton mills were granted protection, their main competition still came from Lancashire. In 1932, when a second round of protection was sought by the mill-owners, and was granted, Japan was the main competitor. India being a cotton exporter to Japan, the two countries had a stake in continuing to trade, and a market share agreement was reached. The agreement condition was that protection would stay.

11 Standard histories on industrialization describe this period of transition in greater depth than I have been able to do in this section. More specialized research focuses on particular dimensions of the adaptation process, for example, on marketing systems, Nomura (2011); on labour–management relations and industrial disputes, Simeon (1995) and Bahl (1997); and on Tata's approach to preferential duties, Wagle (1981). The literature has not drawn the lesson that I draw here, which is that the negotiated adaptation represented a model of how discrimination was supposed to work.

As for the Tariff Board, the first enquiry on textiles in 1927 urged the mills to rationalize and improve efficiency. Many Bombay firms responded to the call and there was a distinct improvement on the operational side of the business. But unlike steel, on this occasion, the Board was dealing with an industry consisting of 200-odd firms. Sheer diversity in technological practice would make any sensible industry-wide policy on modernization almost impossible. In Bombay, an industry-wide rationalization was blocked by militant trade unions. Not surprisingly, therefore, in the second enquiry conducted in 1932, efficiency was of marginal interest.

Still, both textiles and steel foregrounded the issue of labour productivity. For many contemporaries, the optimum design of industrial policy depended on how quality of labour was addressed in the shop floor. That labour productivity was relatively low in India was widely acknowledged by contemporaries even outside the context of the protection debate. It was well established in agriculture; and was also present in mines, plantations, and factories. In 1921–25, the average production per person of a coal mine in India was 40% of that in the USA, and the average production per person in a cotton mill in India was 37% of that in a British mill (Das 1930, 50). A report by the glass industry stated that ‘we do not get same efficiency in production as in Belgium or Czechoslovakia’, mainly on account of lack of experience of the workers. The industry used the quality of work-force as the main ground for asking protection (Indian Tariff Board 1938, 35). In sugar manufacture, which was a major beneficiary of protection, India’s main competitor was Java. India had plenty of cane, but the manufacturing work in Java was superior on a number of points. Among other differences, the peasant family farms in India failed to raise the yield of land, whereas in Java,

cane crop is raised by capitalists, and factory owners. ... their research reached a stage where the cultivation of sugarcane is done on most business-like methods. The preparation of land, the system of seed selection and the methods of manuring. ... are very perfect. They therefore get an average yield of over 60 tons per acre whereas we are getting less than 20 tons in most places. (Chief Agricultural Officer, Krishna District, Indian Tariff Board 1938, 434)

In shipping, the building of small steamers for inland navigation was cheaper in India because of the availability of Burma teak, but the shipping companies still preferred to import boats above 100 feet in length from England because of the workmanship (Indian Tariff Board 1926b, 53). Taking all employees of the firm together, in 1914 to 1922, on average each employee of Tata Steel produced less than 5 tons of finished steel per year. The corresponding average for USA was 53 tons (Indian Tariff Board 1924, 811). These figures, supplied by the aforementioned Homi, were probably exaggerated but a significant difference was likely to remain after appropriate adjustments. In woollen textile industry, ‘the relative

inefficiency of the Indian workmen in finer work' was a known fact and attributable to 'lack of experience' (Indian Tariff Board 1935, 42).¹²

The proximate cause of low efficiency was shortage of factory skills. A 1930 book on industrial efficiency estimated that 'out of over 2.5 million workers engaged in organised industries employing 20 persons or more in 1921, only 28 per cent were skilled workers' (Das 1930, 71). The Tariff Board did not 'regard [this factor] as one which should debar the Indian industry from claiming protection' (Das 1930, 43). The appropriate stance would depend on how skill shortage was explained. It was said (in the case of woollen textiles) that inefficient labour was a symptom of small and seasonal market for finer work. Protection in that case would enlarge the market, offer skilled workers more regular employment, enable an efficiency wage mechanism, and reinforce the incentive to work harder and become better. More often, however, inefficiency was seen as a symptom of inadequate learning on the job. With proper effort, training would improve. What was necessary was that protection be made conditional on improvement in efficiency.

The glass industry submission made this link explicit, and even made training the aim, protection the means. 'Lack of trained and expert labour is admitted on all hands and, the case for protection has been made on this as one of the important grounds.' Protection was a precondition for training. 'Protection is necessary till our experts are able to train local labour and gain efficiency' (Indian Tariff Board 1934, 16). Protection, in short, was a process of creating dexterity and knowledge, and was to be granted on condition that the employers instituted mechanisms of acquiring both.

There was another solution, of course, which the Bombay cotton mills had relied on when they first started operating in the mid-nineteenth century. This was an open border to skilled labour. In most modern industries such as steel, engineering, cement, sugar and paper, the posts of managers, chemists, and technical supervisors were filled by Europeans and later by Americans. The proportion varied. In a highly material intensive industry like cement, neither equipment nor labour was a constraint. 'The employment of expensive skilled labourers imported from abroad is therefore necessary only to a small extent' (Indian Tariff Board 1925, 3, 5). The situation was quite different with metallurgy. Tata Steel relied heavily on foreign engineers working in all departments of the factory. In most engineering industries, such as steel rolling, wires and cables, and tinplate, specific tasks required foreign workers.

What did the foreigners do that their Indian counterparts could not? In the most studied example, cotton textiles, the foreign engineers came as machine operators and often represented the firms that made and supplied the machines. While

12 A set of papers draws attention to the labour quality syndrome that characterized Indian industrialization, for example, Wolcott & Clark 1999. The cotton mill case is particularly well known and generates a debate on the institutional and cultural roots of low labour quality. See Gupta (2011); Roy (2008).

their presence filled a need in the shop-floor, it also created a path dependence in choice of technology, which could be dysfunctional when more flexibility was needed (Kiyokawa 1983). The evidence of the tinsplate industry suggests that beyond heavy structural work, installing equipment was not enough to raise technical efficiency. The engineering industry needed to rely on artisanal methods, deft use of tools more than machines. In tinsplate, almost the entire engineering workforce came from Wales, because the particular process of rolling thin sheets of steel for tin containers had been developed in Wales (Indian Tariff Board 1926a, 385). In glass making from sheet glass, high artisanal skill was required in such tasks as cutting. Cutters were in short supply in India because the process was a new one, and a poorly trained cutter could damage material. To save money, the industry was forced to employ mainly Indian cutters, but the best cutters still came from Europe (Indian Tariff Board 1938, 35).

The alternative to employing expensive foreigners was in-house training. Who would supply the training? Some nationalist writers took it for granted that the government should do this. One of them accused the colonial government of failing to train industrial workers (Adarkar 1941, 59). But Tata did it in-house. Others, therefore, stressed private initiative. Thomas Holland, who had led the Indian Industrial Commission, discussed at length the experience with training workers in the Tata Steel plant.

Initially, in the Tariff Board debates, Indian political opinion took on board the quality of labour issue. But then, while asking the government to provide more training, some economists also wanted the whole issue of labour productivity to drop lower in priority. Quality was neither a static thing nor a precondition for industrialization. Instead, efficiency improved with industrialization itself, and in 'new enterprises efficiency should be expected to be relatively low. If the Indian industry were to hold its own against foreign competition, there must be some allowance for quality' (Adarkar 1941, 285). Between 1935 and 1945, a new discourse on protection emerged more or less on the back of this recommendation. The new approach deliberately dropped the efficiency constraint from the preferred model of ISI, as we see next.

NATIONALIST TRANSFORMATION OF ISI: 1935–45

During these 10 years, statements about protection moved from the technocratic circles of the Tariff Board to the political arena, and the political view responded to the quality issue differently. The Tariff Board was not too active in the late 1930s, and the voices heard on tariff policy were those of Congress politicians and nationalist economists. 'The conditions for the grant of protection. ... are difficult of fulfilment', the All India Congress Committee declared in a report on tariff policy (AICC 1935, 33). When Japanese competition was at its peak, a report prepared by the Indian National Congress attributed Japanese efficiency to 'inferior conditions of labour' in Japan, thus absolving Bombay's mill owners of any

responsibility in the matter (AICC 1935, 13). This was a popular view also with the communist trade unions of Bombay.

In the 1940s, Congress leadership projected a vision for India defined by three elements; that industrialization was necessary, industrialization must make use of import substitution, and import substitution needed to be unconditional. The Bombay Plan, drafted by business leaders of the city, and published in 1944, anticipated the vision, though judged from subsequent criticism and further developments, Bombay's capitalists had perhaps failed to anticipate the role of the state in the new industrial world (Kudaisiya 2014). These initiatives invited criticisms, mainly from the left. But neither the architects of industrial policy and planning, nor the critics, raised the issue of quality, choice, and consumer welfare. The Bombay Plan (Part II) did mention efficiency, advocated technical education and expressed admiration for Soviet 'Stakhanovite' strategy to inspire workers to work harder, but did not cite in-house training or competition as a driver of efficiency (Thakurdas et al. 1944, 4).

Two things had hardened political opinion, the push for Imperial Preference, and the rising voice of aspiring industrialists in nationalist politics. Between 1926 and 1932, another level of selection – preference – had been added to discrimination. The Imperial Preference treaty protected British industry in India while protecting Indian industry against non-British competition. A section of Indian business, and especially the group that closely allied with M.K. Gandhi's leadership, contended that the imperial government was trying to protect British trading interest in India. Homi Mody, representative of Bombay's mill owners and signatory to the treaty, was said to agree to it with the hope of securing the support of Lancashire for stronger protection against Japan, and became very unpopular in the process (Markovits 1985, 88–89). Interestingly, this group did not include the biggest single-firm beneficiary of discriminating protection, Tata. Tata's agreement to preferential tariffs was a controversial move, taken at the risk of isolation, and provoked a strong reaction from the leading nationalist, G.D. Birla.

After Imperial Preference, discriminating protection quickly lost support. Indian industry had meekly accepted the little protection it received, as much as the concessions that Imperial Preference offered to British industry, 'following the policy of half a loaf is better than none' (AICC 1935, 29). The full loaf must 'serve the true national interests of the country' (AICC 1935, 34). Industry-specific duties had created an unnecessarily complex system, which needed to be simplified if tariffs were to act as 'an effective instrument of a properly worked out national economic policy' (AICC 1935, 32). The implication was that India needed generalized protection unburdened by efficiency conditions.

During World War II that prospect came closer. Indian industrial capacity diversified, and the new industrialists were strident in their demand for unconditional protection. The discussion on policy had left discrimination behind, and had taken a turn from protection against trade to protection against foreign capital and labour. In the All India Manufacturers' Conference of 1941,

representing mainly small-scale industrial interests of Bombay, the president brought in a motion in favour of investment regulation.

The argument that in Indian Concerns. ... there may be inefficiency of methods of production or management, cannot hold water. May I ask those who argue this way, whether they really expect our industries in their early state of development, to be superefficient..?

India's industrialization, the motion explained, was for the exclusive benefit of 'the sons of the soil' and therefore must regulate 'non-nationals' not only from owning industry but also from participating in management. Neither consumer welfare nor labour productivity were arguments mentioned in the 100-page document charting out a policy framework for industrialization (All India Manufacturers' Conference 1935, 49).

Economists now joined the attack on efficiency and discrimination. The 1929 Arthur Balfour Committee report on British industry and trade had pointed out structural inefficiency in British industry. In an interesting twist, the Indian economist used the report to turn the efficiency debate on its head. Exit from Imperial Preference was necessary because Indians needed to be free of inefficient British industry. 'To expect India to subsidise this [British] inefficiency', B.N. Adarkar (1941, 530) wrote in the best-known contemporary book on tariffs, 'and that too at the expense of her own industrial development is so selfish a procedure that only political power can make it feasible'. The argument did not explain why Indian industry needed protection from the rest of the world, but succeeded in projecting efficiency as an imperial ploy, one which, like the countervailing excise duties on cotton textiles from an earlier time, delayed 'the rapid development of the Indian industry by reserving the Indian market to the British producers' (Adarkar 1941, 76). Imperial Britain had lost the moral ground to insist on efficiency.

A number of other works by eminent economists and public intellectuals around 1940 strengthened the case for rejecting discriminating protection. M. Visvesvaraya, the former Prime Minister of Mysore, blamed the weak protection policy for India's underdevelopment in a plan published in 1944 (Visvesvaraya 1944, 30). In a series of radio speeches delivered in 1938, V.K.R.V. Rao, the Cambridge-educated economist soon to play a large role in Indian economic administration, called for 'unqualified' protection, that is, for the tariff wall to be raised as high as needed for Indian concerns to survive, and somewhat paradoxically, raised the fear that 'behind the tariff wall, giant foreign concerns are erecting their factories, and, threatening to wipe out the financially and technically less equipped Indian concerns' (Rao 1938, 76). Shriman Narayan Agarwal (1944, 97), a prominent Congress politician and intellectual, later a member of the Planning Commission, and the author of a book on Gandhi's economic principles, declared that 'the doctrine of free trade is now dead as dodo', before endorsing unqualified tariff protection for Indian industry, while at the same time advocating protection for small industry from large-scale industry. Left-leaning economists saw the efficiency issue as an apology for capitalism (Wadia & Merchant 1944).

After this turn, the political mainstream did not revert to the efficiency costs of protection. When postcolonial India, or the ‘Nehruvian’ regime, raised the tariff wall, the issue of safeguards played no central role. Economists recently have tried to reconstruct the policy environment of the Nehruvian regime. There is a difference of views over whether the transition into a closed economy was gradual or abrupt (Panagariya 2008; McCartney 2010). The debate is about the number of years that enjoyed relatively moderate levels of protection. In the most generous estimate, the number would not exceed eight (1948–56). By 1963, average tariff rates on manufactured consumer goods in India were among the highest in the world, above 70%, and while average tariff rates on capital and intermediate goods were relatively low, their imports were regulated by the state procurement and licensing system (Panchamukhi 1977: the averages do not account for the *ad valorem* duties). State procurement did not apply only to government-consumed products as before, but almost all mineral and agricultural material as well. Within broad categories, the inter-industry difference in average tariff rates was smaller than before. The convergence reveals that discrimination played little role in the new regime of ISI.

Tariffs were reinforced by measures that directly and indirectly hurt foreign firms by making their access to capital, labour, and machinery from the world market increasingly difficult. The mainly foreign-owned tea industry and the jute industry faced restrictions on equipment import, which had to be vetted by appropriate government authorities. Although the late 1960s saw some counteracting measures, such as export incentives, the basic parameters of policy did not change. What the Indian trading firms thought of ISI is not well researched. It is highly unlikely that would support a trade regime that repressed and nationalized trade. Protection was universal. But we know little about the divisions because industrial interests dominated the subsequent discussions on economic policy.

CONCLUSION

The paper explores the changing discourse of ISI in India between 1920 and 1940, which transformed a colonial efficiency-constrained protectionist industrialization policy into an entitlement for indigenous capitalists and an instrument to serve the ‘national interest’. In the process, discriminating protection changed into indiscriminate protection. I reject the hypothesis now current in the literature that discriminating protection was dropped because it was weak, poorly designed, or introduced in bad faith – and suggest instead that the aspirations of a class of Indian industrialists played a large role in this transformation. Their interests conflicted with the interests of trading firms, who had campaigned to free government purchase from a buy-British bias, and thus served ISI in a manner that protected the interests of foreign capital in India. In the final stages of the debate, the voice of trading firms and foreign capital was weak.

The argument of the paper has a relevance for interpretations of the postcolonial pattern of industrialization in India. It is well known in the literature that the

strong version of ISI became unsustainable in India because it delivered little productivity growth.¹³ In standard accounts, the design of the postcolonial ISI is held responsible for the failing. Politicians and economists desiring to industrialize quickly designed the policy. Their intention was right; their method was wrong. The paper revises that story, by suggesting that the intention was wrong too. The disregard for productivity and efficiency stemmed from a political battle fought in the 1930s and 1940s, from which a small section of the Indian capitalist class emerged as winners, at the expense of a larger section consisting of traders and foreign investors who relied on the open economy to do business.

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13 On the evidence on relatively low factor productivity in India during 1978–2004, see Bosworth & Collins (2008). See Virmani (2004) showing both low and falling total factor productivity between 1950 and 1971. Trend in productivity after 1970 is a controversial subject in India. There is a large literature exploring the link between openness, capital accumulation, and output growth across countries. One of the key ideas is that protection can have different implications depending on whether consumer goods or capital goods are protected more.

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