

Reflections on the Future of Punjab's Economy: Arrested Development

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Punjab remains one of India's better-off states, but it has slipped dramatically in the states' league table of income and development. How can we understand the state's recent trajectory and find clues to its possible future? Here, I offer some impressionistic reflections, informed by discussions, observation and economic analysis, but without any formal empirical backing. Hence, what I say here should be taken as a starting point for further investigation.

I want to begin with the "standard" model of economic development, based on widespread historical experience. This postulates growth through modernization and industrialization, with modernization being taken somewhat narrowly to mean technological progress. On the other hand, the role of social and individual attitudes, encapsulated in "culture," is less well understood or subject to consensus.

Despite some extreme views, there is more of a consensus on the roles of State and market, with each having a positive part to play in development: the State provides public goods such as law and order (including security of property rights) and physical infrastructure, corrects for positive and negative externalities (respective examples including primary education and pollution), while the market harnesses private ingenuity, innovation, enterprise and risk-taking to make and trade goods and services in increasing abundance.

The typical path of development involves first industry and then services becoming more important in the economy, and absorbing labor from agriculture. As productivity in each sector rises, outputs per worker go up as the basis for higher standards of living. Along the way, there can be unevenness in sharing the fruits of growth, and politics plays a role in redistribution to manage possible social conflict, in addition to being a vehicle for reaching agreement on how to channel resources to public investment.

To summarize the Punjab experience after independence, what the state possessed in relative abundance was human capital. Political institutions were less developed, but by the mid-1950s, public investment was taking place in dams, canals, electric power, rural roads and market towns. This laid the foundation for the green revolution of the 1960s, fueled by technological innovation. In addition to the previous public investments, agricultural extension as a public good played a role as well. Public procurement reduced the market risks faced by farmers. Developments in agriculture had implications for ancillary light manufacturing and services, which also developed. Other light manufacturing such as woolen textiles and bicycles also grew.

Of course, private enterprise and initiative, whether on or off the farm, played a role in this economic progress. But the underlying drivers of change were technological and political. On the positive side, Partition had provided somewhat of a clean slate in terms of the influence of vested interests versus ordinary individuals. Furthermore, the green revolution in Punjab was of great importance to the national government, seeking to avoid the political embarrassment of emergency food imports. Even though the local economy was not absorbing enough labor from agriculture, emigration and armed services recruitment provided safety valves.

These factors began to change in the 1970s. The green revolution did not bring further innovation to Punjab, so that the gains began to be second order in magnitude, subject to diminishing returns. Energy prices rose. Domestic and international politics became less favorable. There was a negative reaction to the social change that economic growth and the project of national integration (stressing Hindi or English in the language dimension, and “secularism” or Hinduism in the religious sphere) were wreaking. The 1970s saw two oil shocks, the Emergency, and the Soviet invasion of Afghanistan. The two safety valves for excess labor began to be choked off. Interestingly, the 1966 division of Punjab, which carved out Haryana, only served to sharpen regional distributional conflicts.

In this scenario, the political responses in Punjab were myopic at best, and contributed to the damage that was to come. A focus on trying to preserve access to adequate water to extend the fruits of the green revolution contributed to political conflict. Meanwhile, subsidies for water, electric power and fertilizer created huge distortions in input use and cropping decisions. Water intensive crops such as rice and sugar cane expanded in acreage, and created new lock-in effects for farmers to go with those for wheat under the PDS. Sugar mill owners, providers of inputs on credit, and middlemen in the *mandis* all gained in power and influence. Groundwater began to be pumped at alarming and unsustainable rates. All this went with political and social chaos, State repression, and a complete suspension of normal politics.

As a result of what happened in the 1980s, when the Indian government liberalized in the 1990s, Punjab was among the worst placed of the richer states to benefit from this change. Instead, Punjab politics was about rent-seeking and straight corruption. In 2001-02, when I tried to understand Punjab's prospects as an information technology or IT-enabled services hub, one of the main barriers seemed to be pervasive corruption in the state government. Punjab has been a case of arrested development, with the prison partly being created by the politics generated by the state's path of economic development.

What I am arguing is that, for a combination of reasons, Punjab after the green revolution became locked into an equilibrium that involved squeezing economic rents out of the system by intermediaries and the government, and this equilibrium persists to date. New national policies such as the food security bill will only prolong this situation. Meanwhile, the groundwater level

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is close to irreversible collapse. That is one possible future for Punjab's economy, a slow death based on the current pattern of production, which mostly benefits the rest of India and local intermediaries.

To avoid this future, Punjab's leaders across the political and social spectrum have to realize the mistakes of the past. But changing course will be more difficult than it would have been 40 years ago, when a more far-sighted state government would have looked for ways to begin a new cycle of investment and innovation both within agriculture and in manufacturing. Now, some vested interests are more powerful and more entrenched. More positively, however, the end of industrial licensing has removed a major former impediment to leveraging structural change in the economy. There are small and large entrepreneurs and business people in Punjab, or with Punjab connections, who still see potential in the state.

What needs to be done, and can it happen? The first step has to be to control corruption and improve governance. My examination of attempts to build an IT and ITES sector in Punjab over a decade ago convinces me that corruption in Punjab is the single biggest barrier now to economic progress. Whether this can be done is perhaps the biggest question mark with respect to the future of Punjab's economy. Political competition in Punjab does not seem to be robust enough to support good governance instead of populism and rent-seeking.

A second step has to be investment in human capital. Punjab's human capital has suffered a relative decline. It is no longer what the state needs. The investments required are across a range of sectors, not just engineering and IT. Agricultural science, biological and life sciences, and manufacturing technology are examples of areas where Punjab can build human capital capabilities, by expanding and upgrading higher education in the state. Efforts have to be made at a large enough scale to attract high-quality faculty, and international standards have to be used to judge performance. The recent ranking of Panjab University in a global survey of universities is an encouraging example of what is possible. The ISB campus in Mohali also has potential, with its specialized institutes for different aspects of management.

I have two suggestions with respect to strategy on the human capital and higher education front. One is to proactively involve foreign universities with good brands (they do not have to be the very top ranked ones), to bring in individual and organizational expertise. Another is to develop Patiala and Nabha as an educational hub, to avoid further over-concentration of development around Chandigarh. Of course, Amritsar, Ludhiana and Jalandhar all have a role to play in the education sector, building on various existing strengths and local industry needs.

Investing in human capital is a complement and precursor to the third and final step I would like to suggest, which might be termed "industrial policy." The term is an old one, and can mean many different things, but the essence of what it signifies is that the government cannot be a

passive bystander in the process of structural change. Structural change is driven by changes in comparative advantage, but the equilibrium dictated by an existing pattern of comparative advantage may require explicit disruption by government policy, in order to change the economy's comparative advantage to one that is consistent with higher productivity and living standards. At the same time, the evidence suggests that the government cannot be the direct implementer of structural change, instead providing the right incentives to the private sector. Ideally, these incentives are not ongoing, but help reduce setup and entry costs: an example would be investment tax credits. Providing a supporting education infrastructure can have similar effects.

The famous example of Japan's strategic intent from 1950 of building a world class automobile industry is useful to recall: the idea was to develop expertise in a product and process that maximized knowledge spillovers and would grow in demand over time. In a different, more recent context, China's latest five-year plan emphasizes the support of seven "Strategic Emerging Industries," including biotechnology, new materials, and energy conservation and environmental protection. The Chinese list is not an appropriate one for Punjab, but one can brainstorm about what might make sense.

For example, if one uses health care as a thematic sector, one could think of electronic medical devices, prosthetics, generic pharmaceuticals, certain classes of surgical procedures, and ayurvedic health products. I have no idea if this is the right list, but the choice of health care is suggested by the increasing world demand for health products and services, in an analogy to the Japanese case. My list is not too ambitious, and does not involve substantial leapfrogging, but it will still require difficult changes in Punjab's environment for doing business. The right focus will emerge from soliciting a range of inputs from business and academia, but what will be important is not to allow current business interests to determine what the future can be. Industrial policy cannot be successful if it is just another version of crony capitalism.

To recapitulate, I have suggested three key changes to support a more positive future for Punjab's economy: more honest and effective leadership and governance, a massive upgrading of higher education, and a strategic vision of Punjab's dynamic comparative advantage. There are many things I have not touched on directly, including the tax system and structure of government revenues, urban planning and governance, and a reorientation of agriculture away from a doomed role as India's breadbasket. The last of these is connected to issues of credit markets, agricultural extension, cold chain infrastructure, water-saving technologies and much more. These are all necessary defensive measures, but they will not be the basis for sustained economic growth in the 21st century.

I have also not provided a solution to the social challenges of economic change. The green revolution helped to create a set of social challenges that contributed to subsequent political and

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social turmoil. But change will happen, whether one wishes it or not. Economic development is better than no development. Productive and interesting employment is better than no employment or mindless labor. Whether economic development undermines cherished social values and ethical principles depends on societal structures that are not within the narrow confines of economic policy. How to align economic progress with broader ethical principles is *the* major global challenge of the coming decades. But maintaining ethical principles does not have to mean stagnation. I may even be so bold as to suggest that my three-pronged approach for Punjab's economy – honest and conscientious governance, better education, and strategic vision – is perfectly consistent with the cherished values of the state of Punjab.