

**LONG-RUN EFFECTS OF FDI IN INDIA'S MULTI-BRAND
RETAIL TRADE: LESSONS FROM CROSS-COUNTRY
ECONOMIC HISTORY**

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Abstract

In view of the recent debate on the entry of FDI in India's multi-brand trade, this article seeks to analyse the long-run effects of this policy-options on the formation of industrial capital and entrepreneurs. To do so, we look into the economic history of two of the presently developed countries, the United Kingdom in Europe and Japan in Asia. Their historical sequences suggest that the industrialisation process in an economy should obtain capital and entrepreneurs from the agricultural and tertiary sectors, and that a congenial policy-environment is imperative to these ends. Also, we deal with the economic history of India during the early colonial period, and learn that, owing to hostile governance, the period witnessed a reverse flow of those critical factors of production from industries and trade to agriculture. This article, therefore, concludes that FDI in multi-brand trade, which is expected to hard-bit tiny and small traders in the long run, may jeopardise India's prospect of domestic capital formation and entrepreneurs for industries. This will be very harmful for our future course of industrialisation.

Keyword: *Economic History, Domestic Capital, Entrepreneur, DFI*

A great debate has been brewing for some time past on India's policy option in favour of foreign direct investment (FDI) in multi-brand retail trade.¹ While the Marxian/neo-Marxian writers² always raise strong voices against such a policy option, there is a mixed

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bag of opinions from the mainstream economists. Notwithstanding a broad unanimity about FDI's blissful effects on Third World economies, many economists are not ready to accept such a hypothesis unconditionally in the context of multi-brand retail trade. The central thesis of this genre of writings is based on three basic questions: (a) what will be the effect of this policy on market organization? (b) does the consumer-surplus go up? and (c) what will be the nature of income re-distribution? These issues are discussed both in short- and long-run dimensions. In the short run, the entry of FDI in the multi-brand trade is expected to underpin competition, so that the retail prices plummet down, augmenting the consumer surplus. But authors like Guruswamy³ and Marjit⁴ believe in its reverse spree of causation in the long run. On the basis of supply-chain paradox modelling⁵, they argue that since such FDI-players always belong to large corporate houses, they can eventually monopolise the market by way of taking over relatively efficient competitors, compelling others to quit. Also, the long-run income re-distribution effect is no more encouraging. Given that a few giant enterprises would occupy an once competitive scenario of myriad small and tiny retailers⁶, and also that the retail technology in multinational enterprises are highly labour-saving, employing urban-educated youths in the place of illiterate/neo-literate ruralites, an income re-distribution against the have-not's is inevitable. These issues are highly mute, and are often discussed on theoretical planes without much empirical ado, especially in the Indian context.

Refraining ourselves from these debates we take up an altogether different issue. We concentrate on how FDI in multi-brand trade will affect the domestic capital formation and the growth of entrepreneurial class in the country. It is widely acknowledged that the colonial rule dried up much of India's entrepreneurial talent. That was the reason why, *a la* Andre Gunder Frank and Samir Amin⁷, the independent India developed a chain of development finance institution (DFIs) to nurture industrial entrepreneurs in the society

from the early years of her five-year plans. The central thesis of this article is that a reverse gear has once again been pushed in this respect by allowing FDI in multi-brand retail trade.

The plan of this study is this. Section I discusses the concept of entrepreneur, as used in economics, with a view to indentifying the political and economic environment where entrepreneurship flourishes. Attempts here are largely theoretical in nature. These deliberations act as a motivation in Section II to search for historical evidences on the factors underlying the growth of entrepreneurs in an industrialising country like India. We focus here exclusively on the United Kingdom in Europe and Japan in Asia. India's historical experiences are discussed in Section III. Finally, Section IV delivers a judgement in brief about the effects of FDI in multi-brand retail trade on the generation of domestic entrepreneurial talent in India.

I

The literature on economics assigns a crucial role to entrepreneurs since they unify other factors like land, labour and capital in the production process, contributing thereby their own foresight and risk-bearing attributes. But often do we encounter two related questions on this: (a) who is the entrepreneur? and (b) which factors do promote (or destroy!) the entrepreneurial talent in a society?

In common parlance, entrepreneurship is defined as a factor of production that organises the factors like land, labour and capital for the creation of utility. Possibly recognising this broad concept of entrepreneurship, many countries run the school of entrepreneurship development on the basis of a theoretical underpinning that entrepreneurship can be imparted among individuals by way of proper training and selective exposures to experiences. But these ideas are widely criticised in the literature. A more acceptable hypothesis in the academics is that entrepreneurship is a facet of human quality which can be acquired only by birth. Therefore, the quest of entrepreneurship development is only a futile

exercise. According to Schumpeter, 'Inheritance of pecuniary results and of personal qualities may then both keep up this position for more than one generation and make further enterprise easier for descendants, but the function of the entrepreneur itself cannot be inherited⁸.'

The divergence between these schools of thought may be explained by the difference in the definition of the term they employ. In contrast to what is commonly held, Schumpeter does not believe that entrepreneurs are referred to all persons who organise land, labour and capital in the production process. To him, there are two classes of people who organise production. To the first rung belong those people who adapt new technology in production or a new product, risking a great deal of monetary loss. Only do their foresight and organising acumen ensure a high rate of return from investment. People belonging to the second stratum only imitate the forerunners, surely at a lower monetary margin. Schumpeter does not recognise these 'imitators' as a class of entrepreneurs who ignite a rapid economic growth. Their quality is much less acclaimed than what is needed for championing the cause of industrialisation. Regarding this class of production organisers, Schumpeter writes, '[T]he deficiency makes itself felt by poverty of their moral personality, and they play a wretched part in the smallest affairs of private and professional life in which this element is called for. We recognize this type and know that many of the best clerks distinguished by devotion to duty, expert knowledge and exactitude, belong to it.' But 'entrepreneurs' in the Schumpeterian sense of the word are quite superior to them. He continues, 'From there, rising in the scale we come finally into the highest quarter, to people who are a type characterized by super-normal qualities of intellect and will. Within this type there are not only many varieties (merchants, manufacturers and financiers, etc.) but also a continuous variety of degrees of intensity in 'initiative'.... Many a one can steer a safe course, where no one has yet been; others follow where first another

went before; still others only in the crowd, but in this among the first'.⁹

Without disputing this Schumpeterian definition, however, this study adopts the commonly held broad concept of the term, since the 'imitators' do contribute to the process of industrialisation, once it is ignited.

Turning to our next question (i.e. the factors that promote entrepreneurial talent), we assert that the capital base of a society should bear a high degree of correlation with the growth of entrepreneurs. *Ceteris paribus*, a society with a large base of capital is expected to generate more entrepreneurs than a capital-deficient society. This may be explained by the fact that a person in the possession of money-capital should always seek, under his instinct of self interest, to invest it in productive ventures. This is so obvious that often is the factor capital taken together with entrepreneurship. Such an impression perhaps influenced the classical economists to work on three factors of production: land, labour and capital. We, however, retain here the flavour of the modern literature, and recognise entrepreneurship and capital as separate factors of production. By this, we do not, however, intend to reject a scenario where a successful entrepreneur may not have some amount of capital to start with. There are, indeed, many evidences to this end. But, in majority cases, entrepreneurship grows in a society in tandem with the formation of capital. We emphasize that, while it holds good in a macro-economic perspective, there may be two alternative scenarios in a micro case: (a) a given individual might be increasingly involved in entrepreneurial activities as his capital grows; and (b) there is a division of labour between the classes of entrepreneurs and savers, and the former flourishes along with the latter in the presence of a developed financial intermediation. While recognizing the latter line of argument, we believe that the former is by far a more frequent event, at least in the initial phase of economic development, when the division of labour is weak.

Another important factor contributing to the entrepreneurial expansion is surely the nature of governance in a society. The policy environment that prevails in a country determines to a good extent the budding rate of entrepreneurs, and also whether the existing entrepreneurs will flourish or perish. Much in a spirit of List's Infant Industry Argument¹⁰, many capitalist countries protect the entrepreneurial class in the domestic economy, and promote their interest internationally by way of suitable fiscal devices. Corn Law and Navigation Acts are glaring examples in European economic history.¹¹ Government efforts to impart entrepreneurship education are also a case in point. Among other promotional policies, we may cite the reservation for industries belonging to small and micro enterprises. However, counter policies are also evident in that, for the sake of augmenting competition, domestic entrepreneurs, both existing and prospective, are exposed to international competitors, or competitors from a particular country.

II

Our analysis in the previous section motivates us to probe into the economic history of two of the presently developed countries in the world, the United Kingdom and Japan, to understand the mysteries behind the formation of their rich class of entrepreneurs. We note here that the dawn of economic development in both these countries was herald with a high rate of capital formation, suggesting that it should have a high degree of correlation with the emergence of industrial entrepreneurs in the society. The growth-propelling significance of capital formation was, indeed, a 'classical' proposition that T.S. Ashton¹² revived in the post-war period. While stressing it as crucial for unleashing the Industrial Revolution, he argues that rapid capital formation led to a 'substantial fall in interest rate which occurred in the early decades of the eighteenth century which had made it very much easier to invest.'¹³ This proposition was further advanced, courtesy to Lewis in 1954 and 1955¹⁴ and by Rostow in 1956¹⁵. Notwithstanding disputes over its scale of expansion in the

pre-Revolution period, there is a broad consensus that capital formation was significantly accelerated on the eve of modern economic development. Thus, Phyllis Deane tells that capital formation in Great Britain, which, in no way, exceeded 3 per cent per annum towards the end of the seventeenth century, became 5-6 per cent per annum on the eve of the War of American Independence¹⁶.

Thus recognising the significance of capital formation towards economic progress, let us proceed to discuss in a nutshell how a high rate of capital formation was called for in Great Britain and Japan. We surmise here that, in both these countries, industrial capital came initially from trade and agriculture. In the classical tradition, Karl Marx, indeed, underscores the importance of capital and develops the thesis of 'primitive accumulation of capital' underlying industrial capitalism, which composed of mercantile capital and colonial 'lootings'.¹⁷ While the mercantile capital referred largely to accumulation through overseas trade, the internal trade was not insignificant. The history of shop-keeping in Europe¹⁸ reveals that though, in the Middle Ages, the craftsman were often involved in retail trading, it became a specialized job in Europe by the end of the seventeenth century. Later on, a reverse scenario was unfolded, where we get many examples of traders involved in manufacturing. There are many stories like that of grocer Pottin in France who 'established branches [of grocery shop] in the capital and the provinces; and began to manufacture the goods'¹⁹. Birnie writes, 'The success of these methods provoked imitation and now multiple grocery firm is a familiar feature in all European countries'. The domestic traders thus very often turned as industrial entrepreneurs and their trading accumulation served as the initial stock of industrial capital. To quote Birnie, again, 'In the later Middle Ages industrial and commercial functions were frequently combined'.²⁰ These historical experiences corroborate that internal trade endowed industrialisation with capital as well as the much-

needed entrepreneurs.

Turning to Asia we find that Japan's take-off stage during the Meiji period got sizeable funds from its own trading sector. During the early nineteenth century, the country was dotted with a large number of retail traders, who subscribed their accumulated capital to the industrial process. Available sources indicate that the number of such traders stood at a lofty figure of 1.1 million during 1872-1882. It rose further to 2.9 million in 1908-12. Much akin to the British experiences, Japan's industrialisation received a flow of entrepreneurship from internal trade.²¹

As a source of industrial capital and entrepreneurs, agriculture stands next to tertiary in importance. Experiences from both the countries under review vouch for this. The Agricultural Revolution in the United Kingdom, which followed its Second Enclosure Movement, compelled the small farmers to sell off their holdings to larger units, and later landed in and around Lancashire. Those erstwhile farmers evidently set up small-scale and tiny units in textile manufacturing, investing whatever they acquired by selling lands. They became the first band of cotton textile entrepreneurs at the debut of Industrial Revolution. Because of these contributions²², however, historians often identify the British Agricultural Revolution as an explanation for hers being the pioneer in the Industrial Revolution. These small and tiny firms, very large in number, gave rise to the concept of perfect competition in economics.

Similar story was witnessed in the nineteenth century Japan. Her Meiji era was started with the demise of the feudal system, and the feudal lords of the society (the so called *samurai*) gradually involved themselves in industrial ventures. Japan's industrialisation process was thus endowed with capital and entrepreneurship from the agricultural sector. The Government also played an important role in the transfer of capital between these sectors. The fiscal history of the country indicates that the government revenue predominantly

came from the land tax, constituting about 80 per cent of it in 1879-80.²³ With the revenue from agriculture, the contemporary government evidently undertook various industrial ventures. To cite a few, the government took over many undertakings belonging to the *Shogunate* and *daimyo*, and re-equipped and re-organised them; it built and operated many cotton-spinning mills of western type; and set up many manufacturing units in silk, cement and woollen-ware²⁴. In 1880, the government-owned industrial undertakings were enumerated as: 3 shipbuilding yards, 51 merchant shipbuilding, 5 munition works, 52 other factories, 10 mines, 75 miles of railways, and a telegraph system which linked all the towns.²⁵ These were largely financed out of the proceeds of the land tax.

We should also note here that the government budget in the initial Meiji period was largely deficit in nature, financed by the printing press. Price inflation was thus inevitable. In the wake of violent inflation, as Allen notes, ‘The landlords, in particular, received windfall..... They applied their capital gains partly to purchase of more lands and partly to investment in trade and industry in which many of them already participated’. He confirms, ‘It was from the landlords that many new industrial entrepreneurs were recruited at that time.’²⁶

Fortunately enough, the policy environment in these countries was also very conducive to the development of entrepreneurship. Towards the close of the Middle Ages, the idea of nationality became increasingly dominant, which gave rise to economic nationalism, or what is usually described as mercantilism. It represents a set of protective economic policies under which domestic entrepreneurs were nurtured. While describing mercantilism as a system of power, William Cunningham notes, ‘The politicians of the sixteenth, seventeenth and a greater part of eighteenth century were agreed in trying to regulate all commerce and industry, so that the power of England relatively to other nations might be promoted’.²⁷ A policy environment was thus created in

this period whereby the nation's economic interest, so also that of her citizens, were highly protected. It is only expected that such an environment should breed a larger number of entrepreneurs, and protect the budding ones more carefully.

Similar policy environment was also created in Japan during the Meiji era. Apart from setting up a series of model industrial units, the Meiji government supported the domestic private entrepreneurs to set up new industrial ventures. Among various protective measures, Allen points out that 'in order to encourage private enterprises, it [the government] imported and sold foreign spinning machinery to entrepreneurs on the instalment plan.'²⁸ He further notes elsewhere, 'Under the stimulus of government and of new opportunities caused by the freeing of trade and the opening of the country, industry and commerce began to advance.'²⁹

III

Lessons from the economic history of Great Britain and Japan thus suggest that industrialisation in an economy must initially obtain the inflow of capital and entrepreneurs from other sectors like agriculture and trade, where capital might have accumulated earlier, and also that the policy environment must be conducive to these ends. This section, however, argues that the policy environment in India during her colonial period was just opposite to what Great Britain and Japan enjoyed. As a result, there was a reverse flow of those critical factors from industries and trade to agriculture.

It is a well-accepted hypothesis in economic historiography that India, especially Bengal, excelled in various industrial arts and long-distance trade prior to her colonial era from about the mid-eighteenth century. A note in the Industrial Commission (1916 – 19) thus underlines, 'At a time when the west of Europe, the birthplace of the modern industrial system was inhabited by uncivilised tribes, India was famous for the wealth of her rulers and for high artistic skill of her craftsmen' and that 'even at a much

later period when the traders from the West made their first appearance in India, the industrial development of this country was at any rate not inferior to that of the more advanced European Nations'.³⁰ Among various industries that flourished in the province of Bengal (fondly called the 'Paradise of Nations' in view of the richness of her economic products), we should cite cotton textile, silk textile, indigo-dye, boat making, salt manufacturing, sugar manufacturing and so forth.³¹ Production of these industrial goods, *pari passu* with a host of agricultural articles, gave rise to vibrant internal trade where domestic businessmen largely dominated. Apart from Bengali traders, there were domestic traders from other provinces also, especially from Gujarat, Kashmir, Sindh and Upper Province, who permanently settled in her port-towns such as Satgaon, Hooghly, Tamralipti, Dacca, Gour and Balasore. Indeed, the foreign traders started flocking in from the early seventeenth century - the Portuguese at the beginning, followed by the Dutch and the English. These European traders were, however, involved largely in the long-distance trade, leaving the internal trade under the domain of domestic traders.³² The trading items, according to Nawab Mir Kasim's list to Lord Vansittart, ran over such varieties as oil, fish, straw, bamboo, rice, paddy, beetle-nut, salt, ghee, gunnies, ginger, sugar, opium and 'many other things'.³³

The first jolt of the colonial era, however, fell on the internal trade. After the Battle of Plassey in 1757, the English 'free traders' very quickly took away this branch of business from the domain of domestic traders. It is well documented in the historiography how Nawab Mir Kasim entered into battle with the English East India Company, once he stood to the interest of the domestic traders, and finally lost the throne.³⁴

After domestic traders had declined under extra-economic forces, the British capital slowly encroached into the industrial sector. The series of industries that had long been the fiefdom of the domestic capital were either under the threat of extinction, or

came under the control of the British capital. It was, indeed, not a historical accident that deindustrialisation followed the collapse of internal trade from the control of domestic traders. As the English traders began to push foreign articles into India's domestic markets – surely, Lancashire's cotton textile, Spitalfields' silk textiles, and Liverpool's salt were the examples in point - it hard-hit the domestic entrepreneurs. The domestic enterprises were either to give up to the British capital in India – as in the case of cotton and silk textiles – or else, to ruin altogether, as in the case of salt manufacturing.³⁵ It was needless to say that the colonial governance was largely responsible to all these ends. However, the domestic capital that was to quit from industries and domestic trade, found its outlet in agriculture.

At that critical turn of events, the colonial government promulgated the Permanent Settlement Act in 1793 to ensure a relatively risk-free return from agriculture. Benoy Chaudhuri³⁶ documents how the elites of the contemporary urban society in Bengal were attracted to invest in agriculture, and became zamindars. Our analysis disagrees with the wisdom, held by some historians, that the domestic capitalists in India were risk-averse, shunting themselves off from industrial and tertiary activities. We are rather in favour of the hypothesis that under the compulsion of hostile governance, the domestic capital was confined to agriculture.

IV

What light do these cross-country stories of economic history shed on the ongoing debate regarding FDI in India's multi-brand trade? The analysis of historical data and information induces us to believe that an economy's industrialisation process should initially be fed with capital and entrepreneurship from domestic, tertiary and agriculture sectors. In view of such an important role of the tertiary sector, especially internal trade, the government should promote internal trade under domestic capital so that domestic entrepreneurs

in these activities are graduated to industrial entrepreneurs, and to invest their accumulated funds in industries. On the other hand, if the domestic trading class is marginalised owing to the entry of foreign capital, and subsequent monopolisation of internal trade, the generation of domestic industrial entrepreneurship will greatly suffer. Being discriminated in trade they will, in all probability, fall in agricultural activities, which is already over crowded. We are, therefore, inclined to believe that FDI in India's multi-brand trade will seriously hamper the formation of domestic capital and entrepreneurship in industries. One may not subscribe to the neo-Marxian philosophy that the involvement of foreign capital and entrepreneurs leads to 'lumpen' economic development³⁷. But it must be acknowledged as a lesson from economic history that none of the presently developed countries achieved industrialisation based on foreign capital and entrepreneurs. The latter could only play a supportive role.

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Notes

- 1 Vijay, 'Debate: Should FDI be allowed in retail branding?' The financial Express, Dec 6, 2004.
- 2 See, for example, Amin, Accumulation on a world scale.
- 3 Gurusawmy, Sharma, Mohanty and Korah, 'FDI in India's Retail Sector: More Bad then Good?', pp. 619-623.
- 4 Marjit, 'Foreign Direct Investment in Multi-brand Retail Trade'. This issue.
- 5 Marjit *op.cit.* p. 4
- 6 Guruswamy *op.cit.* p. 621
- 7 For a detailed analysis of these views, see Bandhyopadhyay and Ray, 'Genesis of development finance institutions in India', pp. 89-100
- 8 Schumpeter, The theory of Economic Development, p.79
- 9 Schumpeter, *op.cit.* p.82
- 10 List, The National system of Political Economy

- 11 Habakkuk, Cambridge Economic History of Europe.
- 12 Ashton, The Industrial Revolution 1760 -1830, p.7-11
- 13 Crouzet, thus, notes 'Economic historians in post 1945 period paid more importance to capital formation. There was also a consensus respecting a very simple model inspired by that of Harrod and Domar which presupposes that increasing capital formation in England had led quite naturally to Industrial Revolution; the plentiful supply of capital was thus seen as the crucial advantage which accounted Britain's early start.' Crouzet, Britain Ascendant: comparative studies in Franco-British Economic History, p. 152.
- 14 Lewis, Economic Development with unlimited supply of labour, pp. 201-202, 207-208, 225-26, 235
- 15 Rostow, 'The Stages of Economic Growth', pp.1-16
- 16 Feinstein also reveals a rising share of gross investment in GNP before the most rapid industrialisation i.e. before 1790's; see his, 'Capital Accumulation and the Industrial Revolution' in Floud and McCloskey, eds., The Economic History of Britain since 1700, vol. 1, p.136.
- 17 Marx, Capital, Vol 1 part VIII
- 18 For the emergence of shop -keeping business see Birnie, Economic History of Europe, 1760–1939, pp. 48-60
- 19 Birnie, *op.cit.* p.56
- 20 Birnie, *op.cit.* p.58
- 21 Lockwood, Trade and Trade rivalry between the United States and Japan,1936
- 22 For the contribution of British Agriculture to Industrial Revolution see, Rosenberg and Bridzell, How the West grew rich, pp. 168-169
- 23 Allen, A Short Economic History of Modern Japan, London, p.42
- 24 Allen, *op.cit.* p.33
- 25 Allen, *op.cit.* p.34
- 26 Allen, *op.cit.* p.45
- 27 Cunningham, The Growth of English Industry and Commerce 1882... referred, p.26
- 28 Allen, *op.cit.* p.33
- 29 Allen, *op.cit.* p.35
- 30 Government of India, Indian Industrial Commission, p. 204
- 31 Ray, Bengal industries and the British Industrial Revolution (1757-1857)

- 32 See Arasartnam, *Maritime India in the 17th Century*, p 108, and Dasgupta, A, *Indian Merchants and the decline of Surat*, Weisbaden Frajsteeiner Verlag, 1979, p. 16
- 33 Dutt, *Economic history of India*, p. 23
- 34 Dutt, *op.cit.* p. 24
- 35 Ray, *op.cit.*
- 36 Chaudhuri, 'Agrarian relations: Eastern India', pp. 93-118.
- 37 Frank, *Lumpen-bourgeoisie and lumpen-development*.