Economic Reforms Since 1991

The long-term constraints that were building up over a few decades and debilitating the Indian economy combined with certain more recent and immediate factors led to a massive fiscal and balance of payments crisis that climaxed in 1991. The crisis pushed India into initiating a process of economic reforms and structural adjustment. The reforms, which in the Indian context were almost revolutionary in nature, were ironically started by a minority government led by Narasimha Rao, and guided by one of the most distinguished economists of post-independence India, Manmohan Singh, as finance minister.

Reform of the dirigiste, controls-ridden and inward-looking Indian economy was long overdue. As early as the early 1960s, Manmohan Singh had argued (quite bravely, given the intellectual climate of the period) that India's export pessimism at that time was unjustified. He advised more openness and a less controlled economy.[1] Other eminent Indian economists such as Jagdish Bhagwati were among those who urged reform in the early stages. An attempt at reform was made in the mid-1960s but it got stymied for a variety of reasons discussed elsewhere leading to a further recoiling into restrictionist policies. The 1970s witnessed some, what has been described as, 'reform by stealth', with the rupee being allowed to depreciate in response to market conditions not by an outright devaluation, which was then politically unviable, but by pegging it to a depreciating sterling. Indira Gandhi, particularly after her return to power in 1980, tried to bring in liberalization measures, mainly in the area of deregulation of industrial licensing and reduction of restrictions on large 'monopoly' enterprises. Though by the standards of the post-1991 reforms these efforts would appear puny, a glance at the newspapers of the 1980s would suggest that they were seen as quite path-breaking (particularly by the critics) at that time. Rajiv Gandhi, when he took over in 1984, attempted reform at a relatively quicker pace towards industrial deregulation, exchange rate flexibility and partial lifting of import controls. The major issue of the emerging macroeconomic imbalance, calling for stabilization of the fiscal and balance of payments deficits, was, however, left unattended, despite the express intentions to the contrary. Reforms of the financial and labour markets and the public sector also essentially remained untouched. Even these piecemeal attempts at reforms made by Rajiv Gandhi got abandoned after some time mainly due to the political crisis centred on the Bofors allegations and the desertion of V.P. Singh and others.

Though the need for reform had been recognized early enough, its comprehensive implementation could not occur for various reasons. Governments, especially when in a vulnerable situation (e.g., Rajiv Gandhi after the Bofors scandal, Indira Gandhi with the Punjab crisis, and later even Narasimha Rao following the destruction of the Babri Masjid), were extremely wary of initiating or sustaining reforms which would involve introducing unpopular measures like attempts to regain fiscal discipline, change in labour laws, steps which in the initial phase were bound to be painful. Also, there was (and still remains) persistent opposition to reform from vested interests such as the bureaucracy and even sections of business who benefited from the existing system of controls, using them to earn a sort of ‘rent’. Last, and certainly not the least, a strong ideological opposition from the orthodox left, strangely oblivious to the changing global reality, continued to play a role in obstructing reform.

The crisis in 1991, with the country at the edge of default, enabled the Narasimha Rao government to break through the traditional mindset and attempt an unprecedented, comprehensive change at a time when both the ideological opposition and the resistance of the vested interests was at a weak point. Thus, though late, nearly thirteen years after China changed course, a programme of economic reform was initiated in 1991. One reason why the shift took so long and, even when it took place, was not as sharp a turnaround as it was in China in 1978 or the Soviet Union after the mid-1980s was that in a democracy the change from one kind of societal consensus (such as the Nehruvian consensus) to a new consensus (say around reforms) had to be a process and not an event, which had its own dynamic, very different from that operating in a non-democratic or totalitarian society.

The process of reforms started in 1991, involved, *inter alia*, an immediate fiscal correction: making the exchange rate more realistically linked to the market (the rupee underwent about a 20 per cent devaluation at the very outset); liberalization of trade and industrial controls like freer access to imports; a considerable dismantling of the industrial licensing system and the abolition of the MRTP Act; reform of the public sector including gradual privatization; reform of the capital markets and the financial sector; removing a large number of the restrictions on multinational corporations and foreign investment and welcoming them, particularly foreign direct investment, and so on. In short, it was an attempt to free the economy from stifling internal controls as well as equip it to participate in the worldwide globalization process to its advantage.

The record of the first few years of reform was creditable by any standards, though a lot of problems and challenges still remained. India performed one of the fastest recoveries from a deep macroeconomic crisis. Moreover, the process of structural adjustment, particularly the fiscal reining in (done initially), was achieved with relatively minimal pain—without it setting off a prolonged recessionary cycle leading to massive unemployment and deterioration of the condition of the poor as was feared and as occurred in the case of several other economies in a similar situation attempting structural adjustment.

For example, the growth rate of India’s GDP which had fallen to a paltry 0.8 per cent in the crisis year of 1991–92 recovered quickly to 5.3 per cent by 1992–93 and rose further to 6.2 per cent in 1993–94 despite the major disturbances in 1992–93 triggered by the Ayodhya crisis. More important, over the next three years, the Indian economy averaged an unprecedented growth rate of over 7.5 per cent, a rate closer to the high performers of East Asia. Despite the crisis and the necessary structural adjustment, the Eighth Plan (1992–97) averaged a growth rate of nearly 7 per cent (6.94), higher, and on a more sustainable basis, than the Seventh Plan (1985–90) average of 6 per cent. Gross Domestic Savings averaged over 23 per cent between 1991 and 1997, higher than the Seventh Plan average of 20.6 per cent. Gross Domestic Capital Formation (Investment) and Gross Domestic Fixed Capital Formation between 1992 and 1997 also maintained a respectable average of 25.2 per cent and 22.3 per cent of GDP respectively, considerably higher than the Seventh Plan average of 21.8 and 19.8 per cent.

Industrial production, which showed a dismal, less than 1 per cent, growth rate in 1991–92 (it was negative in manufacturing), picked up to 2.3 per cent in 1992–93 and 6 per cent in 1993–94, peaking at an unprecedented 12.8 per cent during 1995–96. The capital goods sector, which had demonstrated negative growth rates for a few years, bounced back to nearly 25 per cent growth in 1994–95, allaying early fears that import liberalization would hit the domestic capital goods industry adversely. The small-scale sector too grew faster than overall industrial growth, suggesting that abolition of the MRTP Act did not have an adverse effect on it and perhaps encouraged its growth. Agriculture, too, after recording a fall in 1991–92, picked up the following year and by and large maintained till 1996–97 the high rate of growth of over 3 per cent which it had been experiencing for some years.

The central government's fiscal deficit, which had reached 8.3 per cent of GDP in 1990–91, was reduced and averaged roughly 6 per cent between 1992–97. The important thing was that out of the total fiscal deficit of 5.2 per cent in 1996–97, 4.7 per cent was accounted for by interest payments which was a liability emanating from past fiscal laxity. The primary deficit, that is, fiscal deficit net of interest payments, which represents current fiscal pressures or overspending, was only 0.6 per cent in 1996–97; it was systematically brought down from 4.3 per cent of GDP in 1990– 91 and 2.9 per cent in 1993–94.

The external sector also showed considerable improvement. Exports, which registered a decline of 1.5 per cent in dollar terms during 1991–92, recovered quickly and maintained an average growth rate of nearly 20 per cent between 1993–96. Very significantly, India's self-reliance was increasing to the extent that a considerably larger proportion of imports were now paid for by exports, with the ratio of export earnings to import payments rising from an average of 60 per cent in the 1980s to nearly 90 per cent by the mid-1990s. The current account deficit in balance of payments, which had reached an unsustainable 3.2 per cent of GDP in 1990–91, was brought down to 0.4 per cent in 1993–94 and rose to 1.6 per cent in 1995–96. Yet the average deficit between 1991–92 and 1997–98 was about 1.1 per cent, significantly lower than the Seventh Plan (1985–90) average of about 2.3 per cent. The foreign exchange reserves (including gold and SDRs) had grown to a respectable $30.4 billion at the end of January 1999, providing cover for about seven months of imports as compared to a mere two weeks in July 1991.

The debt situation had also started moving away from a crisis point. The overall external debt–GDP ratio for India fell from a peak of 41 per cent in 1991–92 to 28.7 per cent in 1995–96. The debt service ratio also fell from the peak of 35.3 per cent in 1990– 91 to 19.5 per cent in 1997–98. It is, however, still quite high compared to China, Malaysia and South Korea, which all had (till 1997) debt service ratios below 10 per cent.

Reforms and liberalization of the stock market since the 1980s and particularly after 1991 produced dramatic results. The total market capitalization on the Indian stock markets as a proportion of GDP rose from a mere 5 per cent in 1980 to 13 per cent in 1990 and, following further reforms in 1991, it rose rapidly to 60 per cent of GDP by the end of 1993. By 1995, the Indian stock market was the largest in the world in terms of the number of listed companies—larger even than the US. Measures such as the repeal of the Capital Issues Control Act of 1947 (through which the government used to control new issues and their prices) and the external liberalization (which, *inter alia*, allowed foreign institutional investors to buy Indian corporate shares and enabled Indian companies to raise funds from foreign markets) considerably increased the Indian companies' ability to raise funds from the stock market (including in foreign exchange) to finance their development and growth. The amount of capital Indian companies could raise in the primary market in India increased from Rs 929 million in 1980 to Rs 2.5 billion in 1985 and Rs 123 billion in 1990. By 1993–4 the figure had reached Rs 225 billion—a nearly 250 times increase since 1980.[2] A substantial 12.8 per cent of the country's Gross Domestic Savings was accounted for by new corporate securities in 1993–94, up from about 1 per cent in 1981. Also, permission to access the international market enabled Indian companies, during 1994–95, to raise $2.03 billion through 29 Euro issues of Global Depository Receipts (GDRs) and Foreign Currency Convertible Bonds (FCCBs). Up to December 1995, Indian firms had raised $5.18 billion through 64 issues of GDRs and FCCBs.

The encouragement to foreign investment bore fruit with FDI increasing at nearly 100 per cent per year between 1991 and 1996, it being $129 million in 1991–92 and $2.1 billion in 1995– 96. Total foreign investment including portfolio investment increased from $102 million in 1990–91 to $4.9 billion in 1995–96. Considerable improvement, no doubt, but yet a far cry from what was being achieved by the East Asian countries. China alone had been absorbing more than $30 billion of FDI every year for some years, the figure for 1996 being $40.8 billion. One positive sign, however, was that one of the most stubborn mindsets—the xenophobia about foreign capital—seemed to have eroded, with the Common Minimum Programme (CMP) of the coalition government (following the defeat of the Congress in 1996), to which even the Communists were a party, desiring that the FDI in India should rise to $10 billion per year. However, the danger emanating from the relatively volatile nature of foreign portfolio investments, with the possibility of their sudden withdrawal (as happened in Mexico and more recently, in the late 1990s, Southeast Asia) due to often unpredictable extraneous factors, was understood by successive governments and efforts made to control short-term capital inflows and capital flight.

Critics of reform, mainly from the orthodox left, made the charge that reform was anti-poor, a major (and perhaps the only somewhat credible) plank of their arguments. However, studies of a large number of countries have shown that barring a few exceptions, rapid economic growth has been associated with fall in poverty levels. India too witnessed significant fall in poverty levels with the relatively faster economic growth of the 1980s. The proportion of population below the poverty line (the poverty ratio) fell from 51.3 per cent in 1977–78 to 38.9 per cent in 1987–88. Countries like China and Indonesia, which had much higher poverty ratios of 59.5 and 64.3 in 1975 compared to India's 54.9 in 1973– 74, were able to reduce their poverty levels to much below India's in the span of twenty years. These countries maintained a much higher rate of growth than India during this period and their poverty ratios fell dramatically to 22.2 and 11.4 respectively by 1995, while India's had fallen only to 36 by 1993–94.[3]

To the extent, therefore, that the economic reforms were designed to put India on a higher-growth path, it would be expected that poverty levels would decline as well. The key question remaining was what would be the impact on poverty in the transitional phase, especially when the necessary stabilization had to take place with the attempts to improve the balance of payments position and reduce the fiscal deficit, leading to a possible fall in government expenditure. India's initial stabilization programme was said to be 'extraordinarily successful' causing 'remarkably little suffering' when 'compared with most other countries which were forced to effect a large and rapid reduction in their current external account deficits'.[4] Calculations based on several different indicators of poverty show that poverty, mainly rural poverty, marked a significant rise only in 1992–93 and its causation was linked mainly to a drought and fall in foodgrain output in 1991–92, leading to a rise in food prices, and very weakly to the stabilization programme. Even this was perhaps avoidable to a great extent. The government's failure in not anticipating the situation and maintaining expenditure on rural employment programmes, its not refraining from making any cuts (in real terms, there being a nominal increase) in the anti-poverty Social Services and Rural Development (SSRD) expenditure in 1991–92 to achieve fiscal stabilization, was criticized even by the supporters of reform. However, all the poverty indicators showed that by 1993–94 there was much improvement in the poverty situation. The poverty levels, both rural and urban, were significantly lower in 1993–94 than in 1992, by nearly six percentage points, and were lower than the pre-reform average of the five years 1986–87 to 1990– 91.[5] Thus, it may be noted that the stabilization under the reforms had little negative impact, if any, on poverty levels. Other aspects of structural reform, it is generally agreed, do not threaten the poor and in fact would improve their condition by releasing the full growth potential of the economy.

The improvement in the poverty situation was helped by the fact that the government increased the overall Social Services and Rural Development expenditure from 1993–94. It rose from 7.8 per cent of total government (Central) expenditure in 1992–93 to an average of nearly 10 per cent between 1993 and 1998. Real agricultural wages, which had decreased by 6.2 per cent in 1991– 92, grew in the next two years at over 5 per cent per year and by 1993–94 surpassed the pre-reform level. After the low of 1991– 92, additional employment generated in the total economy rose to 7.2 million in 1994–95, averaging about 6.3 million jobs every year between 1992–93 and 1994–95, considerably higher than the average annual increase of 4.8 million in the 1980s. Moreover, inflation, which hurts the poor the most, was kept under control. The annual rate of inflation, which touched a high of 17 per cent in August 1991, was brought down to below 5 per cent in February 1996.

But this does not complete the picture. Though on the whole the reform initiatives looked quite successful, there was still a long way to go. Continued political instability, aggravated by no clear majority emerging in parliament of any political party, made it difficult for any government to move away from populist measures and take tough but necessary decisions.

That is why no serious efforts were made to increase public savings and reduce government expenditure and the problem of high fiscal deficits continued. The public savings–investment gap remained at a very high average of 7.1 per cent of GDP between 1992 and 1996. The foodgrain subsidy actually increased from Rs 28.5 billion in 1991–92 to Rs 61.14 billion in 1996–97 (revised estimate). The fertilizer subsidy also increased from Rs 32.01 billion in 1988–89 to Rs 45.42 billion in 1989–90 and Rs 62.35 billion in 1995–96. The huge subsidies contributed towards a tendency for real investment in agriculture to fall because of lack of resources. C.H. Hanumantha Rao, eminent agricultural economist, noted in 1992, 'the annual subsidy on fertiliser alone amounts to nearly as much as the annual outlay on agriculture by the Centre and states put together'.[6] A similar example was the government subsidy on diesel, kerosene and cooking gas amounting to Rs 93.6 billion in 1995–96. The oil pool deficit (dues owed to oil companies by government which partly enabled the huge subsidy) in 1996–97 was Rs 98 billion making the cumulative deficit in that year about Rs 155 billion. The result was that the oil companies were unable to make the absolutely necessary investments in the oil sector.

Similarly, little was achieved with regard to reform of the public sector, particularly of state-owned utilities like electricity boards, transport corporations, etc. While the Punjab government went to the absurd limit of actually distributing electricity and water free to the farmers, several other states were not much better as they charged rates which covered only a small fraction of the costs. Therefore, state electricity boards and transport corporations ran at huge losses at a time when availability of power and proper transport infrastructure threatened to be critical bottlenecks, slowing down the projected rate of growth of the economy.

Also, there was no significant move towards reform of the labour market and creating possibilities of exit for loss-making enterprises. After the few years of initial success, the tempo of economic reform in India seemed to be waning. Moreover, the economy began witnessing a slowdown, from 1997. The GDP growth rate had decelerated significantly to 5 per cent in 1997–98, down from 7.8 per cent in 1996–97. Exports, which were growing at over 20 per cent, slowed down for the third year in succession since 1996 and were negative in 1998–99 (April-December). There was a slowdown in industry after 1995–96 and it was growing at less than half the rate achieved that year over the next three years. Very importantly, there was been a slowdown in the critical infrastructure sector, which was emerging as a major bottleneck. Flows of external capital, both FDI and portfolio investment, declined sharply, the latter turning negative in 1998–99 (April–December).

One of the most dangerous reversals was in the sphere of fiscal deficit, where the primary deficit which had been brought down to 0.6 per cent of GDP in 1996–97 (0.5 per cent in the new series data used in the Economic Survey of 1998-99) more than doubled to 1.3 per cent in 1997–98 and for the Centre and states together it was estimated to be 2.4 per cent (revised estimate). The selective acceptance of the Fifth Pay Commission recommendations by the United Front (Gujral) government in 1997, whereby the government expenditure on salaries was to increase very sharply without any compensatory savings, as the measures suggested by the Commission to achieve such savings were not accepted, put further pressure on the fiscal deficit. The situation reached a point where, 'given the serious fiscal slippage', even the Economic Survey of the Government of India of 1998–99 was constrained to argue, 'the time has perhaps come to reconsider the issue of *constitutional limits* on the deficit'.[7]

The slowing down of the economy from 1996–97 was partly because of the East Asian crisis, with Japan in recession and South Korea, Indonesia, Thailand and others showing negative growth rates. Other parts of the world such as Russia and Brazil were also facing crisis situations. There was a slowing down of world growth and particularly world trade growth in 1998. The crisis adversely affected world flows of capital, and exports, partially explaining the fall in Indian receipts of foreign investment and Indian exports. However, the fact that the deceleration in Indian exports was greater than that of the 'developing countries' as a whole is indicative of the failure of the reform process in addressing some structural factors which inhibited Indian exports such as poor infrastructure (power, transport, port facilities, etc.), archaic labour laws, continued trade restrictions and so on. It is this which enabled China and not India to occupy the space vacated by Korea, Taiwan, Hong Kong, etc., in the sphere of exports of labour-intensive goods, as labour costs in the latter countries rose.

Also, the economic sanctions imposed on India because of the nuclear tests (which the BJP government hurried into clearly with an eye on the domestic political scene) had a dampening effect on the economy. Political instability, opportunistic coalition governments with partners having widely divergent world-views, the BJP's 'double face' in economic matters, as in politics, with the RSS, their mother organization, talking of 'Swadeshi' which inhibited India's reforms and participation in the globalization process, while the BJP continued to swear by reform, all partially explain the tardy progress of reform.

Yet, it was a positive development of enormous significance in a democracy, that there was a broad consensus among all political parties from the right to the left (barring the extremists at both ends) that the reform process had to continue, a consensus reminiscent of the one around the Nehruvian programme at independence.

The consensus was suggestive of the fact that economic reforms or liberalization did not mean a change of goals set at independence by the Indian people, such as rapid growth, industrialization, self-reliance, removal of poverty and so on. Liberalization and participation in the globalization process was not the 'final surrender' to international capital or imperialism or the IMF– World Bank combine as has been argued *ad infinitum* by sections of the orthodox left. On the basis of the experience with various controls and state intervention at home, of changes occurring in the world such as the collapse of the Socialist bloc, the new globalization process after the Second World War and the experience of various fast-growing economies in the recent past, the aspiration towards the same goals set out at independence required an altering of strategy.

However, this is not to say that the earlier 'Nehruvian' strategy was wrong. That strategy had its historical significance. As we saw, it gave the Indian economy a certain depth and spread, increased its bargaining power and independence, and lent the Indian economy and society the dignity it did not possess after the colonial experience. But, over time, certain negative features developed. That, and the response to the changed world conditions, required a shift in strategy for the achievement of the same goals. To give just one example, if self-reliance and rapid growth in the 1950s, required import substitution, today capital and technology flows, and through that, keeping up efficiency or productivity levels was the route to self-reliance and rapid growth.

It was no accident that so many of the very people who created, outlined or subscribed to the earlier strategy over time saw the necessity of reform. We have, for example, apart from Indira Gandhi herself, the radical economist of the Nehruvian era, K.N. Raj, the Marxist economist Lord Meghnad Desai, the Nehruvian Narasimha Rao, left economists like Sukhamoy Chakravarty, C.H. Hanumantha Rao, Arjun Sengupta and Nobel laureate Amartya Sen, and practising Communist and chief minister for the longest tenure since independence, Jyoti Basu, all implementing or arguing for economic reforms involving liberalization and participation in the globalization process, though with different approaches and in varying degrees. Even the BJP, despite the strong resistance of the RSS-supported Swadeshi Jagran Manch, was essentially committed to pressing on with reforms.

There was, in other words, a growing recognition in India of the imperative to be responsive to the external changes and internal experience and change strategy so that this great country could come into its own and realize its enormous potential rather than fritter away the considerable achievements made since independence. It is this which gave hope that India would enter the new millennium ready for her 'tryst with destiny', strengthened by the journey since independence so dramatically started by the people of India with Nehru in the lead.