CHAPTER

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ECONOMIC REFORMS

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*An important feature of India's reform programme, when compared with reforms underway in many other countries, is that it has emphasised gradualism and evolutionary transition rather than rapid restructuring or 'shock therapy'. This gradualism has often been the subject of unfavourable comment by the more impatient advocates of reform both inside and outside the country.**

** Montek S. Ahluwalia addressing the inaugurating of the Seminar on 'India's Economic Reforms' at Merton College, Oxford University, London, June 1993.*

INTRODUCTION

The economic reforms initiated in 1991 is now into the 25th year. In this period there was hardly a day that some news, news analysis, write up or article did not appear in the newspapers regarding the reform process. Several highly acclaimed books have been authored on India's economic reforms by some of the best experts of economics from India and abroad. Still students, especially coming from non-economics background, are generally at a loss on the 'pros' and 'cons' of the reform process.

ECONOMIC REFORMS

Popularly, economic reforms denote the process in which a government prescribes declining role for state and expanding role for the private sector in an economy. So let's unravel the reform process based on the author's classroom interaction with students. It is safer to see economic reform as a policy shift in an economy from one to another or ***'alternative development strategies'***. Economists attribute the differences in the performance of economies to the differences in the 'strategies' they follow. The different strategies of development evolved through a long period of trial and error by different countries under the influence of different sets of ideologies. But the process has been like an educational trip. To understand the term 'economic reform' and more so to clarify the confusion concerning it in the Indian context, we must see the different 'alternative development strategies' which evolved through time. A brief description is given below:

1. PLANNING MODEL

Till the rise of the Soviet Union, the prevalent development strategy in the Euro-American countries was the capitalist system of economy, which promoted the principles of laissez-faire and dominant role for private capital in the economy. Once the Soviet Union went for the planning model (including the East European countries and finally China in 1949) most of the developing countries after their independence were influenced by socialism and the governments there took a central role in planned development. As these economies were dominated by foreign colonisers, they worried that opening themselves to foreign investment would lead to a new form of domination, the domination by large multinationals. That is why most of these countries went for 'protectionist' economic policy with ***import substitution*** as one method, side by side. But by the 1970s, the world was having convincing proofs that the socialist as well as the planned economies[1] were inclined to follow their kind of development strategy—because either they had very slow and lower growth rates or were stagnating. The experiences of these economies gave rise to a new ideology which is popular as the ***'Washington Consensus'***.

2. WASHINGTON CONSENSUS

By the early 1980s, a new development strategy emerged. Though it was not new, it was like the old idea getting vindicated after failure of a comparatively newer idea. After the world recognised the limits of a state-dominated economy, arguments in favour of the market, i.e., the private sector, was promoted emphatically. Many countries shifted their economic policy just to the other extreme arguing for a minimal role of the government in the economy. Governments of the socialist or the planned economies were urged/suggested to privatise and liberalise, to sell off state-owned companies and eliminate government

1. There were many developing non-socialist countries which also accepted the economic planning as their development strategy (France should not be counted among them as it was a developed economy by then). These countries were following the 'mixed economy' but their form was closer to the command economy, i.e., the state economy or the socialist economy.

intervention in the economy. These governments were also suggested to take the measures which could boost the aggregate demand in the economy (***i.e., macroeconomic stability measures***). The broad outlines of such a development strategy were called as the ***Washington Consensus.***[2]

This consensus is broadly termed as the popular meaning of the 'economic reform' followed by almost all the socialist, communist and planned developing economies during the 1980s in one form or the other[3]—the term economic reform got currency around the world during this period. The term was usually seen as a corollary of promoting 'naked capitalism', openness in the economy and an open attitude towards foreign investments, etc. The governments of the developing economies were criticised by the political parties in the opposition and the critiques for being soft to the dictates of the IMF and the WB, and becoming a party to promote 'neo-imperialism'.

But these policies, in many cases proved little better than the previous policies in promoting growth over an extended period of time. But somehow a mood in favour of the market economy had gained ground. The United Kindom under Mrs. Thatcher had gone for politically most vocal privatisation moves without any political debates (the only such example of privatisation moves among the democracies, till date).[4] It should be noted here that after the Great Depression of 1929 a 'strong state intervention' was suggested (by J.M. Keynes) and such a policy did really help the Euro-American countries to mitigate the crisis. The favour for the state intervention in the economy was being reversed by the Washington Consensus. But soon this consensus was also to be replaced by another development strategy. More detailed discusstion on the Washington Concensus is given in the *Chapter 1*.

3. Mixed Economy

By the mid-1990s, it had become increasingly clear that neither of the extremes—the Washington Consensus or the state-led planned economy—were the ultimate strategies of development.[5] The success achieved by the East Asian economies even if we take into account their setback due to the financial crisis of 1997–98, stands out in marked contrast to the experiences of the other economies of the time who were following the Washington Concensus strategy of the planning model.[6] The East Asian economies have not only been able to propel higher growth rates but they have been greatly successful in reducing poverty, promoting education and healthcare, too.

The East Asian economies had promoted a development strategy which had its most distinctive feature as the balance they were able to strike between the roles of the state/ government and the market/the private sector in their economies. This was really a new kind of mixed economy which was never permanently inclined towards either state intervention or the free market, but always a balanced mix of the state and the market according to the requirement of the socio—economic situation of the economy. The East Asian countries had pursued market-oriented policies that encouraged development of the private sector—augmenting and governing the market, not replacing it.[7]

2. As the strategy was advocated by the IMF, the WB and the US Treasury (i.e., US Ministry of Finance) all located in Washington, therefore it got such a name.
3. Without changing the broad contours of economic policy, the Government in India had also come under the influence of this consensus and a great many ***liberal*** policies were followed by the country (during Rajiv Gandhi's regime) in the 1980s.
4. ***Collins Dictionary of Economics,*** Glasgow, 2006, pp. 417–18.
5. WB, ***The East Asia Miracle,*** Washington, 1993.
6. ***Ibid***.
7. As is concluded by Stiglitz and Walsh, p. 800, op. cit.

Technically speaking, shifting of economic policy of a country from one to the other above-given three 'alternative development strategies' is economic reform. But in the history of world economy, it was inclination of the economies towards the market economy, which have been referred as economic reforms. In the Indian case, economic reform has been always used in this sense. Here, one should note that when India started the programme of economic reforms in the early 1990s, the world view was in favour of privatisation, liberalisation, de-nationalisation, etc., as the main plank of economic reforms. But by the mid-1990s, not only the world view has polarised in favour of 'mixed economy', but one another change was about to sweep the world economies, i.e., the favour for globalisation sponsored by the World Trade Organisation (WTO). Now, the developing economies (mixed economies with planning as their development strategy) as well as the transition economies (Russia and the whole Eastern Europe, China)—who were already promoting the market-oriented reform process were faced with a dilemma. To prosper and compete in the globalising environment while they needed immediate liberation from their state-dominated mode of economies at one hand they also needed to strike a balance between the state and the market on the other. Each one of them tried to strike the balance in their own way with mixed results. In India, the governments have not been able to convince the masses that the economy needs reforms and the attempted reforms will benefit all. In every election since the reforms of 1991, the voters have not supported a pro-reform government. Though the process of economic reforms started in India with the slogan ***'reforms with human face'***—the slogan has utterly failed to garner the empathy of the masses. We may hope that in coming times the masses will start connecting to the reforms and are able to get the message clear, i.e., reforms are to benefit all.

ECONOMIC REFORMS IN INDIA

On July 23, 1991, India launched a process of economic reforms in response to a fiscal and balance-of-payment (BoP) crisis. The reforms were historic and were going to change the very face and the nature of the economy in the coming times. The reforms and the related programmes are still going on with changing emphasis and dimensions, but they are criticised as being slow ever since the UPA Government came to power in May 2004. Back in the mid-1980s, the governments had taken its first steps to economic reforms. While the reforms of the 1980s witnessed rather limited nature of deregulation and 'partial liberalisation of only a few aspects of the existing control regime, the reforms started in early 1990s in the fields of industries, trade, investment and later to include agriculture, were much 'wider and deeper'.[8] Though liberal policies were announced by the governments during the reforms of the 1980s itself, with the slogan of 'economic reforms', it was only launched with full conviction in the early 1990s. But the reforms of the 1980s, which were under the influence of the famous ***'Washington Consensus'*** ideology had a crippling impact on the economy. The whole Seventh Plan (1985–90) promoted further relaxation of market regulations with heavy external borrowings to increase exports (as the thrust of the policy reform). Though the thrust increased the growth rate led by higher industrial growth rate (riding on costly imports supported by foreign borrowings, which the industries would not be able to pay back and service) it also led to a substantial increase in

8. Jeffrey D. Sachs, Ashutosh Varshney and Nirupan Bajpai, ***India in the Era of Economic Reforms,*** Oxford University Press, N. Delhi, 1999, p. 1.

foreign indebtness that played a major role in the BoP crisis of 1991.[9] The crisis was immediated by the First Gulf War (1991) which had two-pronged negative impact on the Indian foreign exchange (forex) reserves. First, the war led the oil prices to go upward forcing India to use its forex reserves in comparatively shorter period and second, the private remittances from Indians working in the Gulf region fell down fast (due to their emergency evacuation)—both the crises were induced by a single cause, i.e., the Gulf War. But the balance of payments crisis also reflected deeper problems of rising foreign debt, a fiscal deficit of over 8 per cent of the GDP and a hyper-inflation (over 13 per cent) situations.[10]

The minority government of the time had taken a highly bold and controversial step in the form of economic reforms criticised throughout the 1990s by one and all—right from the opposition in the Parliament, to the communist parties, to the industrial houses, the business houses, media, experts and by the masses also. By now as the benefits of the reforms have accrued to many, the criticism has somewhat calmed down, but still the reform process is considered as 'anti-poor' and 'pro-rich' by at least the masses—the people who decide the political mandate for the country to rule. At least one belief is followed by everybody, i.e., the benefits of reforms are not tickling to the masses (the ***'aam aadami'***) with the desirable pace.[11] The need of the hour is to go for 'distributive growth' though the reform has led the economy to a higher growth path.

OBLIGATORY REFORM

Similar reform process started by some other economies since the 1980s were voluntary decisions of the concerned countries. But in the case of India it was an involuntary decision taken by the government of the time in the wake of the BoP crisis. Under the Extended Fund Facility (EFF) programme of the IMF, countries get external currency support from the fund to mitigate their BoP crisis, but such supports have some obligatory conditionalities put on the economy to be fulfilled. There are no set rules of such conditions already available with the IMF though they are devised and prescribed to the BoP-crisis-ridden economy at the time of need. A point needs to be referred here is that the conditionalities put upon India were of the nature which required all the economic measures to be formulated by them. It means that the reforms India carried or is carrying out at present were neither formulated by India nor mandated by the public. Yes, there was a large section of experts inside and outside the government who believed in similar economic measures to bring the economy on the right path. Some of them were arguing the same since 1970s itself, while many other experts believed in them since the mid-1980s.[12] But why after all was the Rao-Manmohan Government credited to start the reform process in India? It is because they thought it suitable to follow and make it politically possible in India. Imagine, a government proposing to sell the state-owned companies to the private sector or closing them down in a country which

9. J. Barkley Rosser, Jr. and Marina V. Rosser, ***Comparative Economics in a Transforming World Economy,*** Prentice Hall of India, N. Delhi, 2nd Ed., 2005, p. 469.
10. Vijay Joshi and I.M.D. Little, ***India's Economic Reforms, 1991–2001,*** Oxford, Clarendon Press, 1996, p. 17.
11. The feeling is even shared by the government of the present time. One may refer to the similar open acceptance by India's Minister of Commerce at the Davos Summit of the World Economic Forum (2007). In an interview to the ***CNN-IBN*** programme, the Cabinet Minister for Panchayat Raj, and the North East (Mani Shankar Aiyar) on 20 May 2007 opined that benefits of higher growth are going to the selected 'classes' and not to the 'masses'.
12. The Seventh and the Eight Plans have many such suggestions to give to the governments of the time, especially the latter Plan has called for the same nature of the reform process, very clearly.

has been convinced that these companies will be the 'temples of modern India'. The masses were convinced that the government has bowed down to the dictats of the IMF, the imperialist forces, the multinationals, etc. Even today such feelings are there in several quarters of the economy. The politics of economic reforms damaged India more than the reform has benefitted the country. It would not be an exaggeration if we conclude that economic reforms had no political consensus. Political parties in India are divided on the issue of reforms—the parties together with the masses lack the level of political maturity required for the success of the reforms programme. It is right, democratic maturity comes to a multi-party political system, but it takes time. It takes even more time where masses are unaware and ignorant. The emotional issues of religion, caste, etc., play their own roles in such situations.

The **IMF conditions** put forth for India were as under:

(i) Devaluation of the rupee by 22 per cent (which was effected in two phases and the Indian rupee fell down from Rs. 21 to Rs. 27 per US dollar).

(ii) Drastic reduction in the peak import tariff from the prevailing level of 130 per cent to 30 per cent (India completed it by 2000–01 itself and now it is voluntarily cut to the level of 15 per cent).

(iii) Excise duties (i.e., CENVAT now) to be hiked by 20 per cent to neutralise the revenue short falls due to the custom cut (a major tax reform programme was launched to streamline, simplify and modernise the Indian tax structure which is still going on).

(iv) All government expenditure to be cut down by 10 per cent, annually (i.e., cutting the cost of running the government and denotes, interests; pays, pension and PF; subsidies. A pressure on the government to consolidate the fiscal deficit and go for fiscal prudence).

Though India was able to pay back its IMF dues in time, the structural reform of the economy was launched to fulfil the above-given conditions of the IMF. The ultimate goal of the IMF was to help India bring about equilibirium in its BoP situation in the short-term and go for macroeconomic and structural adjustments so that in future the economy faces no such crisis.

There was enough scope for the critics to take India's economic reforms as prescribed and dictated by the IMF. The process of economic reforms in India had to face severe criticism from almost every quarter of the economy concerned, although the reforms were aimed to boost growth and deliver competitiveness to the economy.[13]

REFORM MEASURES

The economic reform programme, that India launched, consisted of ***two*** categories of measures:

1. MACROECONOMIC STABILISATION MEASURES

It includes all those economic policies which intend to boost the aggregate ***demand*** in the economy—be it domestic or external. For the enhanced domestic demand, the focus has to be on increasing the purchasing power of the masses which entails an emphasis on the creation of gainful and quality employment opportunities.

2. STRUCTURAL REFORM MEASURES

It includes all the policy reforms which have been initiated by the government to boost the aggregate supply of goods and services in the economy. It naturally entails unshackling the economy so that it may search for its own potential of enhanced

13. ***Economic Survey, 1991–92 & New Industrial Policy, 1991***, GoI, New Delhi.

productivity and production. For the purchasing capacity of the people to be increased, the economy needs increased income which comes from increased levels of activities. Income so increased is later distributed among the people whose purchasing power has to be increased—this will take place by properly initiating a suitable set of macroeconomic policies. For the income to get distributed among the target population, it takes time, but the efforts a government initiates to increase the supply, i.e., increasing production becomes visible soon. As production is done by the producers (i.e., the capitalists), *prima facie* the structural reform measures look 'pro-rich' and 'pro-industrialist' or 'pro-capitalist', known with different names. Ignorant people easily get swayed by the logic that everything which is 'pro-rich' has to be necessarily 'anti-poor'. But it was not the case with the process of economic reforms. Unless the economy is able to achieve higher growth (i.e., income) wherefrom the purchasing power of the masses will be enhanced? And increased income takes time to reach everybody. If the economy lacks political stability, this process takes even more time due to short-term goals set by the unstable and frequently changing governments—the exact case is with India.

THE LPG

The process of reforms in India has to be completed via three other processes namely, liberalisation, privatisation and globalisation, known popularly by their short-form—the LPG. These three processes specify the characteristics of the reform process India initiated. Precisely seen, liberalisation shows the ***direction*** of reform, privatisation shows the ***path*** of reform and globalisation shows the ultimate ***goal*** of the reform. However, it would be useful to see the real meanings of these terms and the exact sense in which they are being used worldwide and particularly in India.

LIBERALISATION

The term liberalisation has its origin in the political ideology 'liberalism' which took its form by early nineteenth century (it developed basically in the previous three centuries). The term is sometimes protrayed as a ***meta-ideology*** capable of embracing a broad range of rival values and beliefs. The ideology was the product of the breakdown of feudalism and the growth of a ***market*** or ***capitalist*** society[14] in its place which became popular in economics via the writings of Adam Smith (its founding father in the USA) and got identified as a principle of ***laissez-faire.***[15]

The term liberalisation will have the same connotation in economics as its root word liberalism has. Pro-market or pro-capitalistic inclination in the economic policies of an economy is the process of liberalisation. We see it taking place in the whole Euro-America in the 1970s and particularly in the 1980s.[16] The most suitable example of this process could be China of the mid-1980s when it announced its ***'open door policy'.*** Though China lacks (even today) some trademark traits of liberalism, as for example individualism, liberty, democratic system, etc., still China was called a liberalising economy.

We may take an example from the history of the world economy—putting the USA of the early 20th century and the communist China on the two poles of the scale—thus representing the best historical example of the liberal economy and China being the best example of the 'illiberal' economy. With the USA on the south pole and China on the north any policy movement towards 'the south' is 'liberalisation'. The movement

14. Andrew Heywood, ***Politics,*** Palgrave, New York, 2002, p. 43.
15. Robert Nisbet, ***Prejudices: A Philosophical Dictionary,*** Harvard University Press, Massachusetts, 1982, p. 211.
16. **'Economics: Making Sense of the Modern Economy'** ***The Economist,*** London, 1999, pp. 225–26.

from the south to the north will be known as 'illiberalisation'.

It means that the process of decreasing traits of a state economy and increasing traits of a market economy is liberalisation. Similarly, the opposite will be the process of illiberalisation. Technically speaking, both the processes will be known as the processes of economic reforms, since 'reform' as a term does not say anything about the 'direction'. All the economic reforms in the world have been from the 'north to the south'. Similar is the case with the process of liberalisation.

It means, in the Indian case the term liberalisation is used to show the direction of the economic reforms—with decreasing influence of the state or the planned or the command economy and increasing influence of free market or the capitalistic economy. It is a move towards capitalism. India is attempting to strike its own balance of the 'state-market mix'. It means, even if the economic reforms have the direction towards market economy it can never be branded a blind-run to capitalism. Since the economy was more like the state economy in the former years, it has to go for a greater degree of mix of the market. But in the long run, Liberalism curtails the powers of Parliaments.[17]

PRIVATISATION

The decades of the 1980s and 1990s witnessed a 'rolling back' of the state by the governments, especially in the USA and UK under the inspiration of the New Right priorities and beliefs.[18] The policies through which the 'roll back' of the state was done included deregulation, **privatisation** and introduction of market reforms in public services. Privatisation at that time was used as a process under which the state assets were transferred to the private sector.[19] The root of the term privatisation goes to this period which got more and more currency around the world once the East European nations and later the developing democratic nations went for it. But during the period several connotations and meanings of the term 'privatisation' have developed. We may see them as follows:

(i) Privatisation in its purest sense and lexically means **de-nationalisation,**[20] i.e., transfer of the state ownership of the assets to the private sector to the tune of 100 per cent. Such bold moves took place only once anywhere in the world without any political fallouts—in the early 1980s of the UK under the Thatcher regime. This route of privatisation has been avoided by almost all democratic systems. In the mid-1990s some West European nations—Italy, Spain and France—besides the USA went for such moves.[21] India never ventured into any such privatisation move.

(ii) The sense in which privatisation has been used is the process of **disinvestment** all over the world. This process includes selling of the shares of the state-owned enterprises to the private sector. Disinvestment is de-nationalisation of less than 100 per cent ownership transfer from the state to the private sector. If an asset has been sold out by the government to the tune of only 49 per cent the ownership remains with the state though it is considered privatisation. If the sale of

17. J.K. Galbraith, ***A History of Economics,*** Penguin Books, London, pp. 123,178.
18. Andrew Heywood, ***Politics,*** p.100.
19. Stiglitz and Walsh, ***Economics,*** p. 802–3.
20. Collins, Oxford, Penguin, ***Dictionary of Economics,*** relevent pages.
21. Samuelson and Nordhaus, ***Economics,*** p.199.

shares of the state-owned assets has been to the tune of 51 per cent, the ownership is really transferred to the private sector even then it is termed as privatisation.

(iii) The third and the last sense in which the term privatisation has been used around the world, is very wide. Basically, all the economic policies which directly or indirectly seem to promote the expansion of the private sector or the market (economy) have been termed by experts and the governments as the process of privatisation. We may cite a few examples from India—de-licencing and de-reservation of the industries, even cuts in the subsidies, permission to foreign investment, etc.[22]

Here we may connect liberalisation to privatisation in India. Liberalisation shows the direction of reform in India, i.e., inclination towards the dominance of market. But how will it be achieved? Basically, privatisation will be ***the path*** to reform. It means, everything which includes promotion to the 'market' will be the path of the reform process in India.

GLOBALISATION

The process of Globalisation has always been used in economic terms though it has always taken the political and cultural dimensions. Once economic changes occur it has several socio-political manifestations.[23] Globalisation is generally termed as 'an increase in economic integration among nations'.[24] Even before several nation-states were not even born, the countries around the world had gone for globalisation, i.e., 'a closer integration of their economies'.[25] This globalisation lasted from 1800 to almost 1930, interrupted by the Great Depression and the two Wars which led to retrenchment and several trade barriers were erected since early 1930s.[26]

The concept was popularised by the Organisation of Economic Cooperation and Development (OECD) in the mid-1980s again after the Wars. In its earlier deliberation, the organisation had defined globalisation in a very narrow and business-like sense—***'any cross-border investment by an OECD company outside its country of origin for its benefit is globalisation'.*** After this summit of the OECD, proposals for replacing the GATT by the WTO were pushed by the developed economies of the world, better known as the starting of the Uruguay Round of GATT deliberations which ends in Marrakesh (1994) with the birth of WTO. In the meantime, the OECD had defined (1995) globalisation officially, too— "a shift from a world of distinct national economies to a global economy in which production is internationalised and financial capital flows freely and instantly between countries."[27]

The official meaning of globalisation for the WTO is movement of the economies of the world towards ***"unrestricted cross border movements of goods and services, capital and the labour force".*** It simply means that the economies who are signatories to the process of globalisation (i.e., signatories to the WTO) for them there will be nothing like foreign or indigenous goods and services, capital and labour. The world becoming

22. New Industrial Policy, 1991 & several documents of GoI since then.
23. Talcott Parsons, ***The Structure of Social Action***, McGraw-Hill, New York, 1937.
24. Samuelson and Nordhaus, ***Economics,*** p. 32.
25. Stiglitz and Walsh, ***Economics,*** p. 804.
26. Thomas L. Friedman, ***The World is Flat,*** Penguin Books, London, 2006, p. 9; Stiglitz & Walsh, ***Economics,*** p. 804.
27. As quoted in Andrew Heywood, ***Politics,*** p. 139.

a flat and level-playing field emerging in the due process of time.[28]

For many political scientists (which is today a very dominant force in the world), globalisation is the emergence of a situation when our lives are increasingly shaped by the events that occur at a great distance from us about which the decisions are not taken by our conscious self. One section of experts believe that globalisation subordinates the state while the other section argues that the local, national and global events constantly interact under it without any subordination of one by the other. Rather, globalisation highlights the deepening as well as broadening of the political process in this sense.[29]

India became one of the founding members of the WTO and was obliged to promote the process of globalisation, though its economic reforms started with no such obligation. It is a different thing that India started the process of globalisation right after the reforms were started in 1991, itself.[30]

Now we may connect the three simultaneous processes—the LPG with which India launched its reform programme. The process of liberalisation shows movement of the economy towards the market economy, privatisation is the path/route through which it will travel to realise the ultimate 'goal', i.e., globalisation.

It should be noted here that the Indian idea of globalisation is deeply and frequently inclined towards the concept of the welfare state, which keeps coming in the day to day public policy as an emphatic reference. The world, including the IMF, the WB and the developed nations have now increasingly shown their recognition to the fact that the official goal of globalisation of the world economies would not take place without giving the poor of the world a better standard of living. Even if globalisation is complete without including almost one-fifth of the world population, the poor, will it be called development of the world?

GENERATIONS OF ECONOMIC REFORMS

Though there were no such announcements or proposals while India launched its reforms in 1991, in the coming times, many 'generations' of reforms were announced by the governments.[31] A total of ***three*** generations of reforms have been announced till date while experts have gone to suggest the ***fourth*** generation, too. We may substantiate the components of the various generations of reforms to properly understand the very characteristics and the very nature of the reform process in India, as given below:

First Generation Reforms (1991–2000)[32]

It was in the year 2000–01 that the government, for the first time, announced the need for the Second Generation of economic reforms and it was launched the same year. The ones which had been initiated by then (i.e., from 1991 to 2000) were called by the government as the reforms of

28. As Friedman shows in his best-seller, ***The World is Flat,*** op.cit.
29. As put by the ***Oxford's Dictionary of Politics,*** N. Delhi, 24 pp. 222–25 & Andrew Heywood, ***Politics,*** p.138.
30. It should be noted here that the whole Euro-America has already started promoting globalisation by the mid-1980s as the WTO deliberations at Uruguay started. The formation of the WTO only gave globalisation an official mandate in 1995 once it started its functions. It means, for India, globalisation was a reality by 1991 itself–one has to move as the dominant forces move
31. It should be noted here that many economists believe the economic reforms of the mid-1980s as the First Generation. But the governments of the time have not said anything like that. It was only in the year 2000–01 that India officially talks about the generations of reform for the first time.
32. Based on the ***New Industrial Policy, 1991*** & several ***Economic Surveys*** as well as many announcements by the governments.

the First Generation. The broad coordinates of the First Generation of reforms may be seen as under:

(I) Promotion to Private Sector

This included various important and liberalising policy decisions, i.e., 'de-reservation' and 'de-licencing' of the industries, abolition of the MRTP limit, abolition of the compulsion of the phased-production and conversion of loans into shares, simplifying environmental laws for the establishment of the industries, etc.

(II) Public Sector Reforms

The steps taken to make the public sector undertakings profitable, efficient, their disinvestment (*token*), their corporatisation, etc., were the major parts of it.

(III) External Sector Reforms

They consisted of policies like—abolishing quantitative restrictions on import, switching to the floating currency regime of exchange rate, announcing full current account convertibility, reforms in the capital account, permission to foreign investment (direct as well as indirect), promulgation of a liberal Foreign Exchange Management Act (the FEMA replacing the FERA), etc.

(IV) Financial Sector Reforms

Several reform initiatives were taken up in the areas of the banking sector, capital market, insurance, mutual funds, etc.

(V) Tax Reforms

This consisted of all the policy initiatives directed towards simplifying, broadbasing, modernising, checking evasion, etc.

A major re-direction was ensued by this generation of reforms in the economy—the 'command' type of the economy moved strongly towards a market-driven economy, private sector (domestic as well as foreign) to have greater participation in the future.

Second Generation Reforms (2000–01 onwards)[33]

The government launched this generation of the reforms in the year 2000-01. Basically, the reforms India launched in the early 1990s were not taking place as desired and a need for another set of reforms was felt by the government which were initiated with the title of the Second Generation of economic reforms. The reforms of this generation were not only deeper and delicate but required a higher political will power from the governments. The major components of the reform are as given below:

(I) Factor Market Reforms

Considered as the 'backbone' for the success of the reform process in India itself, it consists of dismantling of the Administered Price Mechanism (APM). There were many products in the economy whose prices were fixed/regulated by the government, viz., petroleum, sugar, fertilizers, drugs, etc. Though a major section of the products under the APM were produced by the private sector, they were not sold on market principles which hindered the profitability of the manufacturers as well as the sellers and ultimately the expansion of the concerned industries leading to a demand-supply gap. Under market reforms these products were to be brought into the market fold.

In the petroleum segment now only kerosene oil and the LPG remained under the APM while

33. Based on the ***Economic Survey, 2000–01*** **and** ***Union Budget, 2001–02*** especially besides other official announcements by the GoI in the coming years.

petrol, diesel (by March, 2014), lubricants have been phased out. Similarly, the income tax paying families don't get sugar from the TPS on subsidies; only urea, among the fertilizers, remain under APM, while many drugs have also been phased out of the mechanism. Opening the petroleum sector for private investment, cutting down the burden of levy on sugar (levy obligation was abolished by mid-2013), etc., are now giving dividends to the economy. But we cannot say that the Factor Market Reforms (FMRs) are complete in India. It is still going on. Cutting down subsidies on essential goods is a socio-political question in India. Till market-based purchasing power is not delivered to all the consumers, it would not be possible to complete the FMRs.

(II) Public Sector Reforms

The second generation of reforms in the public sector especially emphasises on the areas like greater functional autonomy, freer leverage to the capital market, international tie-ups and greenfield ventures, disinvestment[34] (*strategic*), etc.

(III) Reforms in the Government and Public Institutions

This involves all those moves which really go to convert the role of the government from the 'controller' to the 'facilitator' or the administrative reform, as it may be called.

(IV) Legal Sector Reforms

Though reforms in the legal sector were started in the first generation itself, now it was to be deepened and newer areas were to be included—abolishing outdated and contradictory laws, reforms in the Indian Penal Code (CrPC), Labour Laws, Company Laws and enacting suitable legal provisions for new areas like Cyber Law, etc.

(V) Reforms in the Critical Areas

The second generation reforms also commit to suitable reforms in the infrastructure sector (i.e., power, roads, especially as the telecom has been encouraging), agriculture, agricultural extension, education and the healthcare, etc. These areas have been called by the government as the ***'critical areas'***.[35]

These reforms have two segments. The first segment is similar to the FRMs, while the second segment provides a broader dimension to the reforms, viz., corporate farming, research and development in the agriculture sector (which was till now basically taken care of by the government and needs active participation of the private sector), irrigation, inclusive education and healthcare.

Other than the above-given focus of this generation of reforms, some other important areas were also emphasised:

(a) **State's Role in the Reform:** For the first time, an important role to the state was designed, in the process of economic reforms. All new steps of the reforms were now to be started by the state with the centre playing a supportive role.

(b) **Fiscal Consolidation:** The area of fiscal consolidation, though it was a major co-ordinate of reform in India since 1991 itself, gets a constitutional commitment and responsibility. The FRBM Act is passed by the Centre and the Fiscal

34. Basically 'disinvestment' started in India in its 'token' form which is selling of the minority shares of the PSUs in its symbolic form. While in the Second Generation the government went for the 'strategic' kind of it which basically involved the transfer of ownership of the PSUs from the state to the private sector—MFI2, BALCO, etc., being the firsts of such disinvestments. Once the UPA Government came to power in May 2004, the latter form of disinvestment was put on hold. We will discuss it in detail in the chapter ***Indian Industry.***

35. ***Ministry of Finance Economic Survey, 2000–01,*** GoI, N. Delhi, 2001.

Responsibility Act (FRAs) is followed by the states as an era of new commitments to the fiscal prudence starts in the country.

(c) **Greater Tax Devolution to the States:** Though there was such a political tendency[36] by the mid-1990s itself, after the second generation reforms started, we see a visible change in the central policies favouring greater fiscal leverage to the states. Even the process of tax reforms takes the same dimension. Similarly, the Finance Commissions as well as the Planning Commission start taking greater fiscal care of the states. And for the first time the states had a net revenue surplus collections in the fiscal 2007–08.[37]

(d) **Focussing on the Social Sector:** The social sector (especially the healthcare and education) gets increased attention by the government with manifold increases in the allocations as well as show of a greater compliance to the performance of the development programmes.

We see mixed results of the second generation reforms though the reforms continue.

Third Generation Reforms

Announcement of the third generation of reforms were made on the margins of the launching of the Tenth Plan (2002–07). This generation of reforms commits to the cause of a fully functional Panchayati Raj Institution (PRIs), so that the benefits of the economic reforms, in general, can reach to the grassroots.

Though the constitutional arrangements for a decentralised developmental process was already effected in the early 1990s, it was in the early 2000s that the government gets convinced of the need of 'inclusive growth and development'. Till the masses are not involved in the process of development, the development will lack the 'inclusion' factor, it was concluded by the government of the time. The Eleventh Plan goes on to ratify the same sentiments (though the political combination at the centre has changed) and views regarding the need for the third generation of reforms in India.

Fourth Generation Reforms

This is not an official 'generation' of reform in India. Basically, in early 2002, some experts coined this generation of reforms which entail a fully 'information technology-enabled' India. They hypothesised a 'two-way' connection between the economic reforms and the information technology (IT), with each one reinforcing the other.

Note

The different generations of economic reforms in India should not be seen as the completion/ending of the former and commencement of the later generations of reforms. Basically, all of the generations are going on at present simultaneously, so that the goal of reforming the economy is objectified. The various generations of reforms in India also verify the fact that 'reform' is a continuous process which needs 'fine-tuning' in accordance with the changing situation. Reform is not the aim of the economy, but reforming the economy is the aim. Reform is a means to an end.

We saw a general decline in the government's eagerness towards furthering the cause of economic reforms once the UPA came to power in 2004 — largely due to the nature of the coalition which included the Left Front supporting it from outside

36. We see it, especially, when the Coalition Government (i.e., the UF Government) goes to amend the constitution so that the Alternative Method of Devolution (AMD) of the tax suggested by the Tenth Finance Commission becomes a law before the recommendations of the Eleventh Finance Commission. It should be noted that the AMD has increased the gross tax devolution to the states by a hefty 5 per cent.
37. The Comptroller and Auditor General, ***Provisional Report***, May 2007.

(outside support is considered the weakest and the most delicate thing for a government by the world political thinkers and analysts). The returning of the UPA to power in 2009, with a bit different coalition partners could not ensue any new pace regarding furthering the reform process. Almost everyone, including the major industrial houses remarked the policy-paralysis of the government as the cause of hurting the pace of growth in the economy. The government document,[38] *Economic Survey 2011–12*, says that though it is hard to quantify and for that reason is contestable, there has been seen a slackening in the pace of reforms—one consequence of increased awareness of high-profile corruption scandals in different parts of India and welcome civil-society activism has been a sense of caution among civil servants in taking crucial decisions. Since one way to avoid the charge of an ill-considered or, worse, bad-intentioned decision is to take no decision, it is arguable that some civil servants have resorted to precisely this strategy, concludes the *Survey*. This would cause a slowdown in the decision making process. In addition, coalition politics and federal considerations played their role in holding up economic reforms on several fronts, ranging from diesel and LPG pricing and taxation reform like the goods and services tax (GST) and direct taxes code (DTC), to FDI in retail and reform of the APMC Act, says the document.

Other than the above-discussed reasons the recent financial developments in the global economy, especially, the US and European economies which followed in the aftermath of the *US Sub-prime Crisis* also placed an ideological dilemma in front of India. This fact has been given no attention by the contemporary Indian media or the intelligentia, probably due to its academic nature (which can hardly be understood by the masses, the voters, who had already numerous reservations regarding the economic reform process followed by the government.[39] The so-called affinity to the idea of the ***Washington Consensus*** among the Euro-American nations has now almost lost ground in the region where it was proposed, cemented and propagated around the world through the IMF/WB. What should be the course of action in future towards greater dependence on the private capital is still to be decided by the world financial body in clear terms. Meanwhile, a certain degree of liberal attitude towards promoting the process of economic reforms has been suggested by the IMF/WB to India.[40]

CURRENT SCENARIO

The process of economic reforms decelerated during the 2009–2014 due to several factors. The 'gradualist' reform (already having a slower pace in comparison to the other emerging economies) of the Indian economy had almost reached a point of halt. Experts, together with corporate India cited this as a situation of 'policy paralysis' (to which the government of the time remained in clear 'denial mode') – but the new Government officially accepted this situation (in the *Full Union Budget 2014–15*). Since the new government assumed office, 'a slew of economic reforms has led to a partial revival of investor sentiment'.[41] Tentative signs that the worst is over are evident, for example, in data that shows that the rate of stalled projects has begun to decline and that the rate of their revival is inching up. But increasing capital flows are yet to translate into a durable pick-up of real investment,

38. Ministry of Finance ***Economic Survey 2011-12,*** GoI, N. Delhi, p. 30.
39. Various issues of ***The Economist*** and the ***Economic & Political Weekly*** between July, 2007 and May, 2012.
40. ***An IMF/WB Release*** dated 28th April, 2012, Washington DC, USA.
41. **Economic Survey 2014-15**, MoF, GoI, N. Delhi, Vol 1, p. 25.

especially in the private sector. This owes to at least **five interrelated factors** (challenges) that lead to what the *Mid-Year Economic Analysis* called the "*balance sheet syndrome with Indian characteristics*". As per the *Economic Survey 2014–15*, these factors are:

(i) Weak profitability and over-indebtedness have eroded the investment capability of the Indian corporate sector. One key indicator of profitability—the interest cover ratio, which if less than one implies firms' cash flows are not sufficient to pay their interest costs—has also worsened in recent years. Further, the debt-equity ratio of the top 500 non-financial firms have been steadily increasing, and their level now is amongst the highest in the emerging market world.

(ii) Weak institutions relating to bankruptcy means that the over-indebtedness problem cannot be easily resolved (the stock and 'difficulty-of-exit' challenge). This is reflected in the persistence of *stalled projects*, which have been consistently around 7 to 8 per cent of the GDP in the last four years.

(iii) Even if some of these problems were solved, the PPP model at least in infrastructure need to be re-fashioned to become more viable and forward looking (the institutional challenge).

(iv) Since a significant portion of the infrastructure was financed by the banking system, especially the public sector banks (PSBs), their balance sheets have deteriorated.[42] For example, the sum of non-performing and stressed assets has risen sharply, for the PSBs for over 12 per cent of the total assets.[43] Uncertainty about accounting and valuation, and indeed the history of banking difficulties across time and space, counsel in favour of over-rather than under recognising the severity of the problem. When banks' balance sheets are stressed they are less able to lend, leading to reduced credit for the private sector (the financing challenge).[44]

(v) In a peculiarly Indian twist, this financing problem is aggravated by generalised risk-aversion (the challenge of inertial decision-making).[45] For the public sector banks in particular, which are exposed to governmental accountability and oversight, lending in a situation of NPAs is not easy because of a generic problem of caution, afflicting bureaucratic decision-making.

42. According to RBI's **Financial Stability Report**, December 2014, the contribution of mining, iron and steel, textiles, aviation and other infrastructure to total advances stands at 28 percent whereas their contribution in stressed assets is 54 percent.

43. **Economic Survey 2014-15**, MoF, GoI, N. Delhi, Vol 1, p. 28.

44. Suggestions on how capital markets can play a greater role in infrastructure financing are elaborated in the **Economic Survey 2013-14** in detail.

45. **Economic Survey 2014-15**, MoF, GoI, N. Delhi, Vol 1, p. 26.