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Introduction

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India launched a programme of economic policy reforms in response to a fiscal and balance-of-payments crisis in July 1991. The programme consisted of measures for attaining macroeconomic stabilization and structural reforms in order to put the Indian economy on a higher growth path. While the 1980s witnessed rather limited deregulation and halting liberalization of only a few aspects of the pre-existing control regime, by contrast, the reforms of the 1990s in the industrial, trade, and investment regimes, among others, are much wider and deeper.

The papers in this volume assess the progress of India's reforms, and discuss both their political and economic aspects. We start below with an overview of the economic issues, comparing India's reforms with China's and drawing, in addition, lessons from the East Asian financial meltdown for India. We will then, in the second half of the introduction, move to the political aspects of reforms.

The Economic Issues

Like most other developing countries, India's reforms were also preceded by an economic crisis. In 1990–1, the gross fiscal deficit of the central government reached 8.4 per cent of GDP, and the annual rate of inflation peaked at nearly 17 per cent (Government of India, 1993: 6). During the 1980s, the growth rate was accelerated by borrowing, but without any drastic restructuring of the economy. This, in turn, aggravated the problem of external indebtedness. The external debt rose from 12 per cent of GDP in

1980–1 to 23 per cent of GDP in 1990–1. India borrowed heavily from abroad, particularly in the late 1980s. Much of the borrowing was from commercial banks and a large part was in the form of Non-Resident Indian (NRI) deposits, which were short-term capital inflows at high interest rates. Consequently, the debt service burden rose from 10 per cent of current account receipts and 15 per cent of export earnings in 1980–1 to 22 per cent of current account receipts and 30 per cent of export earnings in 1990–1.

In 1990 and 1991, increased political risk, overly expansionary macroeconomic policies, and a sharp decline in remittances from overseas Indian workers in the wake of the Gulf War led to outflows of short-term capital, putting extreme pressure on India's foreign exchange reserves. By mid-1991, India's foreign exchange reserves had declined to just two weeks of import coverage. This near miss with a serious balance-of-payments crisis was the proximate cause that started India's market liberalization measures in 1991, led by then Finance Minister Manmohan Singh. The reforms in India followed a gradualist approach. Being crisis induced, the initial phase of reforms had to focus on macroeconomic stabilization. Simultaneously, reforms of industrial policy, trade and exchange rate policies, and foreign investment policy were initiated along with tax reforms, financial sector reforms, and public sector reform.

India's reform strategy of stabilization-cum-structural adjustment measures has produced some satisfactory results, both in the area of macroeconomic stabilization and growth. The annual rate of inflation, which was placed around 17 per cent in August 1991 (Government of India, 1993) came down steadily, and except for periodic phases of rise has by and large been contained. The annual average inflation rate (based on the wholesale price index for all commodities) was 5.0 per cent in 1997–8, and the same based on the consumer price index for industrial workers was 8.3 per cent. GDP growth, which had dipped to 0.8 per cent in 1991–2, recovered to 5.3 per cent during the very next year, thereby representing one of the fastest recoveries from a macroeconomic crisis. More importantly, average GDP growth during the period 1994–5 and 1996–7 was placed at 7 per cent. However, for a variety of reasons, GDP growth dropped to 5 per cent in 1997–8; the agricultural sector registered a negative 2 per cent growth. Industrial growth, which had fallen to 0.6 per cent in 1991–2 showed significant

recovery and was 11.8 per cent in 1995–6, but fell to 7.1 per cent in 1996–7, and was placed at 4.2 per cent in 1997–8.

Foreign currency reserves, which had fallen to almost $ 1 billion in mid-1991 recovered swiftly and stood at $ 6.4 billion in March 1993 and were placed at $ 27.4 billion in January 1999. On the trade front, the export–import ratio averaged nearly 90 per cent during 1991–4 as compared to an average of about 65 per cent for the preceding three years. Exports in the financial years 1994–5 and 1995–6 increased by 18.4 and 20.8 per cent respectively. During the same period, imports also surged by 22.9 and 28.0 per cent respectively. The current account deficit remained at less than one percentage point of GDP. This occurred partly because the deficit in the invisible account has been converted into a surplus as a market-determined exchange rate of the rupee has encouraged inward remittances through legal channels. On the down side, however, since 1996–7, growth performance of both exports and imports has been far from satisfactory. During 1997–8, exports and imports merely grew at the rate of 2.6 and 5.8 per cent respectively. Among the causes of poor export performance are high cost of export finance; slow growth in industrial output; infrastructural bottlenecks; sluggishness in international trade; and the East Asian currency crisis.

The sharp decline in current account deficit in the 1990s, and large capital inflows are reflected in the build-up of foreign currency reserves of the Reserve Bank of India (RBI). The composition of foreign capital inflows is fast changing towards equity as against debt. While on the one hand, external assistance, external commercial borrowings, IMF loans, and NRI deposits have been declining since the initiation of India's reforms, on the other, inflows of foreign investment in the form of global depository receipts (GDR), foreign institutional investment (FII), off-shore funds, and foreign direct investment (FDI) have been rising. The total FDI approved between 1991–2 and 1997–8 amounted to $ 44.4 billion; against just under $ 1 billion approved during the previous decade (1980–90). The actual FDI inflows increased from $ 135 million in 1991–2 to $ 3 billion in 1997–8.

In sum, the year 1991–2 witnessed a stabilization-induced recession, but growth picked up soon thereafter. At that time, the authorities in India recognized the fact that in order to achieve rapid growth, efficient use of resources was essential and competition,

both domestic and foreign, was the best means of ensuring efficiency. Keeping these broad objectives in view, reforms have been undertaken in the areas of industry, trade and exchange rate, foreign investment, tax policy, and the financial sector. These reforms, slow moving as they are, are gradually aligning domestic industries with India's factor endowments, and leading them towards becoming globally competitive. Put simply, India's reform strategy has been to dismantle four decades of central economic control. Among other things, this included controlling fiscal deficit, cutting and rationalizing corporate and personal income taxes, abolishing industrial licensing, encouraging foreign investment, liberalizing import rules and cutting import duties, encouraging exports, and deregulating India's archaic capital markets. Be that as it may, despite more than seven years of reforms in India, sustaining a GDP growth of 7 per cent per year has not been feasible. To a large extent this is due to the fact that India's reform process is very slow moving, and has yet to commence in several critical areas.

A China–India Comparison[1]

From a comparative perspective, one can draw several lessons for India from China's economic performance over the past two decades. China has attained and sustained high overall growth on the basis of rapid export growth, while India has managed only moderate success in exports and overall GDP growth. India could have achieved what China has in export growth, but failed in basic policy strategy. While in China, exports of goods and services went up from 6 per cent of GDP in 1980 to 21 per cent of GDP in 1995, by contrast, they went up from 7 per cent of GDP to merely 12 per cent in the case of India. Of course, there has been some opening up of the economy, but the results have been much more modest in terms of export-led growth. If one were to look at the figures in dollar terms, the comparison is much more striking. China's merchandise exports (excluding services) rose from $ 18.1 billion in 1980 to $ 148.8 billion in 1995. India's merchandise exports rose from $ 8.6 billion to a mere $ 30.8 billion. In per capita terms, China exported $ 123 per person in 1995, while India managed only $ 33 per person. Nothing more clearly accounts for

[1] The discussion here is based on Bajpai, Jian and Sachs (1997).

the difference in growth performance of the two countries—8.3 per cent average annual growth per capita in China during 1985–95 compared to just 3.2 per cent in India—than the difference in export growth.

Export growth in China was based on core policy and economic management decisions carried out in the early 1980s. These can be summarized as follows. First, China understood that the root of export growth would be diversification away from traditional sectors, especially raw materials, into non-traditional sectors, especially manufactured goods. But China lacked by itself the technology to be competitive in manufactured goods. Therefore, it invited foreign direct investors to provide the capital and expertise to achieve export competitiveness in a wide range of sectors, including electronics, apparel, plastic toys, stuffed animals, ceramics, and many other labour-intensive sectors. In each sector, the key was to link foreign investors, capital and expertise with a large and low-cost Chinese labour force. The foreign investors brought in product design, specialized machine tools and capital goods, key intermediate products, and knowledge of world marketing channels. The Chinese assured these foreign investors certain key conditions for profitability, such as low taxes, reliable infrastructure, physical security, adequate power, decent logistics for the import and export of goods, and so forth.

In China, urban export-oriented enterprises were encouraged by the designation of a growing number of special economic zones (SEZs), coastal open cities, and economic and technological development zones (EDTZs), all designed to encourage manufacturing exports. These special areas received various kinds of favourable tax and regulatory treatment, such as tax holidays, and duty-free access to imported inputs and capital goods needed for export production. Thus the SEZs and other special areas were akin to the export processing zones (EPZs) that had been used in other parts of Asia as part of their initial export-led growth.

India too has established these special zones, called export-processing zones. In fact, the first EPZ in India was established as early as 1965 in Kandla. Indian EPZs have not performed as well as Chinese SEZs for many reasons which include limited scale and overcrowding of the EPZs; insufficient logistical links with airports and seaports; poor infrastructure in areas surrounding the zones (e.g. unpaved roads and poor physical security); government

ambivalence and red-tape regarding inward foreign direct investment; unclear incentive packages governing inward investment; lack of interest on the part of state and local governments and the private sector, when compared with the central government, in the design, set-up and functioning of the zones. In China, the major responsibility for the SEZs rests with local and provincial governments, whereas in India, the responsibility remains largely with New Delhi. Under the present circumstances, many state governments have actually been averse to the idea of EPZs in their states.

India's export environment suffers from several other institutional weaknesses. First, workers in large firms in the formal sector have a virtual guarantee of continued employment according to the Industrial Disputes Act. For firms of 100 employees or more, reductions in workforce must only be with the permission of state government, which is almost never granted. In fact, these guarantees are extensive, applying not just to industry but to virtually any undertaking that employs 100 or more people, including non-profit activities such as universities, hospitals, and charitable organizations. The results of India's highly regulated labour markets have been devastating. Formal-sector employment in India is shockingly low, in large part because so much urban employment is carried on outside of formal registration.

Second, removal of exit barriers is one area in which the Indian reforms have yet to commence. In the absence of an exit policy even loss-making firms are not allowed to close their operations without government approval. An exit policy is a set of measures concerning industrial decline, retrenchment, restructuring of ailing firms, and liquidation of closed units. Although the government took swift action in removing the entry barriers that were present for decades in such forms as licensing and exclusion of domestic and foreign investors from many industries, a liberalization of exit barriers has yet to take place. In 1993, the government formed a Committee on Industrial Sickness and Corporate Restructuring (CISCR) to re-examine the regulatory framework of restructuring and liquidation of corporate firms. However, no concrete action has so far been taken. A large number of firms in the private and public sectors continue to incur losses, yet stay in operation through public subsidies, or remain in a state of suspended animation (as sick industrial units) by closing down indefinitely

without seeking formal liquidation. In the process, workers of closed units lose their jobs without any compensation, and owners of such units lose their locked-in capital. Creditors, mainly public sector banks, always end up losing money.

Third, equally remarkably, India's legislation continues to restrict the entry of large firms, or the growth of small firms into large firms, in several areas of potential comparative advantage. Thus garments, toys, shoes and leather products continue to be reserved, to a varying extent, for small-scale producers. Such restrictions virtually assure China's dominance in these sectors when compared with India's performance.

Fourth, India's tax and tariff structures remain anti-export biased. India's high overall tariff rates, especially tariffs on intermediate products that are used by exporters, impose a heavy indirect tax on export competitiveness. The union budget for 1998–9 imposed an additional non-modvatable levy of 8 per cent (later reduced to 4 per cent) on imports.

Finally, the government's attitude towards foreign direct investors, who could be the fuel for India's export drive, continues to be ambivalent. The government promotes FDI on the one hand, but then maintains regulations against full foreign ownership, or insists on lengthy approval processes, on the other hand.

Given these constraints, both the hardware and software of export-led growth in India need revamping. On the hardware side, the development of industrial parks for exports should be greatly intensified and enhanced. Private developers need the freedom to acquire urban and semi-urban land, as also to develop privately financed infrastructure in support of exports. The government must take urgent measures to reduce export costs, including private-sector provision of port services; zero tariff ratings on capital and intermediate goods imports used for export (based on an effective duty exemption scheme); ensure enhanced export-oriented infrastructure, especially of roads to the ports, reliable power supply, and telecommunications facilities to support export zones. Labour legislation should be revised to allow managerial flexibility in the hire and dismissal of workers in export- oriented sectors. The reservation of labour-intensive sectors to small-scale enterprises should simply be scrapped. The government should actively encourage inward investment in export-oriented sectors, allowing 100 per cent foreign ownership

without administrative interference, and with the provision of generous tax holidays as necessary to attract internationally mobile capital from other locations.

The East Asian Crisis and Lessons[2]

In order to outline the macroeconomic policy challenges facing India, we must first understand the East Asian crisis. The East Asian countries that are now in crisis are suffering from an abrupt reversal of capital flows that began in mid-1997. Consider the five hardest hit countries: Indonesia, Korea, Malaysia, the Philippines, and Thailand. These five countries received $ 230 billion of net private capital flows during the period 1994–6. In 1996 alone, they received $ 93 billion of net flows. When the Thai baht was devalued in mid-1997, however, the euphoria in world markets that had led to the massive inflows, suddenly turned to panic and massive capital outflows. An estimated $ 12 billion of net outflows occurred in 1997 as a whole, all concentrated in the second half of the year. The net reversal of flows of $ 105 billion represented approximately 11 per cent of the pre-crisis GDPs of the five countries, in other words, an absolutely massive and sudden shock.

Much of the panic resulted from the form of the original lending. A huge proportion of the capital inflow came in the form of short-term loans from international banks. The international banking system had lent the five Asian countries roughly $ 230 billion in total loans as of mid-1997, of which around $ 150 billion had a maturity of under one year. These short-term debts were larger than the combined foreign exchange reserves of the five countries, which totalled approximately $ 120 billion as of mid-1997. Because the short-term liabilities exceeded short-term assets, the Asian-5 countries were subject to financial panic. Each investor posed himself a question. 'Suppose all the other investors decide to withdraw their short-term loans. Will there be enough foreign exchange available to make good on my loan as well, when it comes due?' Clearly, if each investor comes to believe that *all other* investors will withdraw their loans, it becomes rational to call in one's own loans as well, indeed ahead of other creditors. A 'rational panic' ensues, in which every investor scrambles to be the first one out of the country. The Thai baht devaluation provided the impetus for the panic.

[2] The discussion that follows is based on Radelat and Sachs (1998).

Interestingly, certain kinds of money fled, while other kinds did not. This gives guidance for macroeconomic policy management. The hottest money was short-term loans from international banks. Indeed, the reversal of short-term bank lending constituted a very large proportion of the overall $ 105 billion reversal in capital flows. The banks put in $ 56 billion in net lending in 1996, and then withdrew an estimated $ 21 billion in net loans in 1997, for a swing of $ 77 billion (or 73 per cent of the overall reversal). Portfolio equity investors (e.g. country equity funds) also reversed gear, to the extent of $ 24 billion. Foreign direct investors, by contrast, were very stable. It is estimated that net foreign direct investment remained roughly unchanged between 1996 and 1997, at around $ 7 billion in net flows each year (Radelet and Sachs, 1998).

Here are some of the pertinent lessons for macroeconomic management. First, beware of reliance on short-term inflows. Such short-term capital is fickle. India has benefited since the early 1990s in keeping a regulatory restraint on short-term borrowing from abroad, after a brush with financial disaster in 1991 (which involved the reversal of short-term capital flows of so-called non-resident Indian accounts). There is simply no good case for allowing domestic banks to expose themselves to large amounts of foreign debt, especially short-term debt.

Second, policy makers should keep an eye on the crucial ratio of short-term debt to foreign exchange reserves. Markets will be subject to panic when short-term reserves dip below short-term debts. Again, India has looked rather good on this score in the recent past. With reserves around $ 25–27 billion, and short-term debts to international banks around $ 8 billion, and therefore a ratio of short-term debt of reserves around 30 per cent (as opposed to the greater than 100 per cent in the East Asian crisis countries), India has been able to avoid a self-fulfilling panic.

Third, India should act with considerable care in the liberalization of financial markets. This is not an argument to avoid needed reforms, but to sequence them in an appropriate manner. Certain reforms should come early. Currency convertibility on current account transactions can be introduced immediately (as was done successfully in Poland, for example, in 1990) since this merely

establishes the financial mechanism for free trade. Similarly, the doors should be thrown wide open to foreign direct investment. FDI brings huge advantages (new capital, technology, managerial expertise, and access to foreign markets) with little or no downside. FDI flows tend to be acyclical, or sometimes even counter-cyclical. Financial institutions should be pressed to raise capital in order to put a larger cushion in the financial system against the kind of banking calamities hitting the East Asian countries. Under-capitalized banks are simply an invitation to banking misbehaviour and a heightened risk of banking collapse. State banks should be privatized, with the explicit aim of bringing in long-term foreign investors into the banking sector. Another lesson from East Asia is that there are significant advantages to a large presence of foreign owners in the banking system. Foreign capital in the banks provides another cushion against banking collapse. For example, when the Indonesian banking sector unravelled in November 1997, the only banks that remained functional were branches of international banks.

Fourth, India should avoid another of the serious mistakes of several East Asian countries, most notably Korea, the Philippines, and Thailand. These countries pegged their currencies to the US dollar in the early 1990s; then experienced inadvertent and sharp currency appreciation *vis-à-vis* Europe and Japan when the dollar strengthened after 1995; and then ran down foreign exchange reserves vainly trying to defend the overvalued exchange rate when market sentiment turned against the currencies in late 1996 and in the first half of 1997. By spending reserves in a failed attempt to defend the currency, the central banks also left their economies exposed to subsequent financial panic when short-term debts came to exceed the dwindling level of foreign exchange reserves. In the end, the currencies collapsed in any case, but only after a deep financial crisis had already gotten under way. Fortunately, the Reserve Bank of India has been more circumspect in exchange rate policy, letting the rupee weaken in the face of the Asian crisis. There is probably more currency weakness to come, if only because India competes with Indonesia and Thailand in several product lines, and will thus face pressures on cost competitiveness now that the competitors' currencies have been deeply depreciated.

In short, we stress on the following aspects: (a) the dangers of high levels of short-term foreign debt; (b) the need to keep flexibility in the exchange rate; (c) the need for strong capital adequacy standards of banks; (d) the need for caution in opening up short-term capital inflows into India for fear of a boom–bust cycle; and (e) the strong advantages of foreign direct investment over short-term loans (and the absolute need for FDI, to raise technology, improve infrastructure, etc.).

ECONOMIC PAPERS: A SUMMARY

Ahluwalia's chapter in this volume undertakes an appraisal of the economic reforms undertaken so far. He divides the post-reform period into two phases—1991–2 to 1993–4 essentially being the stabilization phase, and the period from 1994–5 onwards being the time frame to evaluate the longer-term objective of attaining and sustaining high rates of economic growth—the author emphatically argues that the first phase was exceptionally successful. Current account deficit was brought down substantially along with inflation, foreign exchange reserves were rebuilt, and growth resumed at 5 plus per cent within a year. However, controlling fiscal deficit in the later years has proved to be difficult. In the author's view, high levels of fiscal deficit have surfaced due to lack of buoyancy in revenues and the inability of the government to raise substantial resources from public sector disinvestment rather than lack of control over expenditures. As for the second phase, the author observes that reform measures have provided the necessary growth impetus such that despite a slowdown in 1997–8, the average growth rate in the four years 1994–5 to 1997–8 is almost 7 per cent. Among other things, Ahluwalia suggests rationalization of labour laws as a critical domestic restriction that impedes efficiency.

Bajpai and Sachs, in their chapter on fiscal policy in India's economic reforms, argue for expenditure reduction in the areas of government subsidies and employment; grants to states; and interest payments on domestic debt. As for state governments, the authors suggest that their budgetary losses could be reduced significantly if they were to raise user charges for water and electricity in accordance with their costs. With regard to the issue of tax reforms, the authors suggest simplification of the tax system so as to permit a competitive tax structure based on moderate tax rates with a broad base of tax collection. For the central government, the required reforms include further reductions in import

tariffs and corporate taxes, a minimum alternate tax based on gross assets of companies, and the transformation of the existing Modvat system into a national-level value added tax. For the state governments replacing sales tax with a shared portion of the national value added tax, and the extension of income tax to agricultural income among other currently untaxed areas is recommended.

Kotwal and Ramaswami argue for liberalization of some specific policies relating to agriculture in order to stimulate growth. The authors highlight numerous controls and instruments of state intervention in the area of domestic marketing and processing of agricultural produce that could be removed. Some of these are procurement levies on rice and sugar, the monopoly procurement scheme, such as in cotton, and controls on the movement of commodities. Further, in the case of many agro-processing activities, production is permitted in the small-scale sector only. The authors suggest that a process of rural growth based on outside market opportunities, urban–rural linkages, through the use of producer services and diffusion of new activities and technologies is most likely to succeed in rural India.

Roberto Zagha's paper on labour and economic reforms focuses on the labour market implications of the reforms implemented in India. The author is of the view that the effects of labour regulations are strongly influenced by the conditions under which product markets operate. While intensive use of voluntary retirement schemes, lockouts, use of contract labour, subcontracting, etc. may have rendered existing job security regulations ineffectual, this does not imply that the regulations have become benign. Labour market policies have failed to protect workers' interests and have not had a significant effect on either employment or wages. According to the author, the interests of India's labour would be best served by: (a) improvements in the economy's micro and macro fundamentals which would accelerate growth and expand labour demand; and (b) less constraining labour regulations that can be implemented more effectively.

Ghemawat and Patibandla look at India's exports since the reforms in three specific industries. These are successful export industries—diamond cutting and polishing, garments, and the software industry. The authors examine these industries with a view to determining the effects of the economic reforms undertaken in 1991 and discussing further reforms that still need to be implemented. While analysing each industry's recent performance and future prospects since the reforms, they find that these have enhanced India's competitiveness in the labour and skill-intensive industries; helped to reduce the dependence of competitive industries on inefficient domestic suppliers and infrastructure; and enhanced domestic competitive conditions. Nonetheless, they find causes for concern about each industry's ability to sustain growth, pointing out the need to continue to extend and deepen the reform process.

THE POLITICS OF ECONOMIC REFORMS: CONTINGENCIES, INTERESTS, AND MINDSETS

As we examine the evolution of economic reforms in India since July 1991, four political issues stand out. First, very few people had anticipated that India's economy, infamous by the late 1970s and 1980s for its self-defeating central planning, stifling regulations, and inward-looking policies, would be transformed in its basic orientation in a matter of a few years. Though economic arguments against central planning had been raised and had become increasingly plausible by the late 1970s, political recognition of the necessity of change was on the whole missing in India. Rajiv Gandhi did try to break free of a control-oriented mindset, but did not succeed in changing India's economic direction decisively. What political factors, then, can one identify that made a transition—from central planning to markets—possible after 1991?

Second, while reforms have clearly been substantial in some areas, they have stalled, or barely begun, in others. Liberalization of investment rules, capital markets and the trade and exchange rate regime has, by and large, gone farther than the reform of agricultural trade, public finance or labour markets, and the privatization of public sector firms. Why have Indian governments been more successful with the former, less (or not at all) with the latter? Is the reason for such divergence a lack of ideas, or a fear of powerful interests?

Third, the norms for how state governments deal with the central government have changed. Much of investment as well as budgetary support in the pre-1991 era used to come routinely from Delhi. Since 1991, budgetary constraints are no longer as soft as they used to be, and reliance on central planning for investment

has dramatically decreased. In the changed environment, state governments must compete for *private* investment and put their fiscal houses in order. Have the state governments responded? If not, why? If some state governments have, not others, what explains the variance?

Fourth, though Indian governments since 1991 have demonstrated a pragmatic, 'one-step-here and two-steps-there' approach towards economic reforms, a full-blown, systematic rationale for why India needs reforms has not been boldly articulated *in politics*. Reforms have been debated in the English-language press, in parliament, and in elite forums of discussion, but even though India has had two parliamentary elections since 1991, reforms have not been thrust into electoral politics as a major issue by any political party, including the Congress party that initiated reforms in 1991 and could, in principle, have taken credit for the considerable economic success India has already achieved since then. Instead, the electoral agenda has been dominated by secular versus religious politics, affirmative action, corruption, and personalities. Why is it that politicians, including those who approved reforms, are unable, or unwilling, to make a clear ideological statement in favour of market-oriented reforms in electoral or mass politics? Do they lack ideological boldness even though they understand that reforms are needed, or are they still not convinced that a market-oriented economic shift is both necessary and desirable in India? Or do they feel that there exists anyway an effective consensus that is best not disturbed by further debate?

The two political chapters in this volume, by Varshney and Weiner respectively, take up the first three themes. Their arguments are summarized below. The question of ideology versus pragmatism, an increasingly important matter, is taken up at some length subsequently.

POLITICAL PAPERS: A SUMMARY

Why did the Rao government succeed in pushing reforms, but only in some economic areas, not others? In answering both questions, Varshney draws a distinction between elite politics and mass politics. Although most reforms can be shown, ultimately or indirectly, to have relevance for mass welfare, some policies—for example capital market reforms—directly concern only the upper and upper middle classes in India whereas others—such as labour

market and agricultural reforms—touch upon mass welfare *directly and in the short run*. The latter can be politically risky in an adversarial democracy, as opposition parties organize to confront the government on behalf of the short-run losers. Indian governments since 1991 have gone for the less risky and relatively safer reforms, reforms that primarily affect elite welfare, while leaving reforms more relevant to the masses relatively untouched.

Varshney comes to this conclusion by comparing the stillborn reforms of the Rajiv Gandhi government (1985–9) and the more successful reforms of the Narasimha Rao government (1991–6). The success of the latter is, politically speaking, a puzzle, for Rajiv Gandhi had close to three-fourths support in parliament, whereas the Rao government did not even have a simple majority in parliament until 1993, by which time India's reforms were already two years old. Varshney resolves the puzzle by arguing that identities, rather than reform, drove India's mass politics and electoral agenda after the emergence of two highly passionate and divisive issues in politics in 1990: job reservations, or affirmative action, for the 'lower' castes upon the reopening of the Mandal Commission Report by the V. P. Singh government; and the escalation of Hindu–Muslim tensions in the wake of the BJP-led Rath Yatra in 1990 and the subsequent worsening of the mosque–temple controversy. Paradoxically, however, mass passions aroused by identity politics, he argues, facilitated economic reforms in India. How to stop the Hindu nationalists from advancing politically and coming to power was a key objective of most mainstream political parties between 1990–1 and 1997–8. New alignments of political interests were thus born. Whether or not politicians in the past were opposed to a market-oriented liberalization, they began to support reforms once it became clear that it was more important to fight the Hindu nationalists on questions of religious politics versus secularism than oppose the government of the day on economic reforms. The political logic induced by explosions of communal passions gave the reformers room to push reforms.

The same logic, Varshney suggests, has also come to define the limits of economic reforms. Afraid that the masses and their own party cadres or supporters might turn against them, India's reformers have so far failed to privatize public sector, restructure labour laws, introduce agricultural reforms, and reduce fiscal deficits adequately. By affecting very large numbers of people

directly, these policy initiatives can potentially focus opposition effort on the entire reform programme, bringing it in mass politics. *Ex ante,* without adequate ideological campaigns and preparation, insertion of reforms in mass politics can have radically uncertain political consequences. Hence the inability or unwillingness of reformers to move in these areas so far. In comparison, though more can still be done, considerable progress has been made on liberalizing the investment, trade, and exchange rate regimes and reforming capital markets. These policy areas, while hugely important, are of *direct and immediate* concern to very few people in India. They have been an elite concern, generating lively debate in upper and upper middle class forums, but not beyond.

The evidence supporting the argument that economic reforms, on the whole, have not entered mass politics comes from some recent surveys. A large-scale survey of political attitudes in India conducted between April–July 1996 found that only 19 per cent of the electorate reported any knowledge of economic reforms, even though reforms had been in existence since July 1991 (Yadav and Singh, 1996). In the countryside, only about 14 per cent knew of reforms, as opposed to 32 per cent in the cities. Further, about 66 per cent of college graduates were aware of the post-1991 changes in economic policy, compared to only 7 per cent of the poor. In contrast, consider the mass awareness of issues in India's identity politics. Nearly three-fourths of the electorate knew of the 1992 mosque demolition in Ayodhya; 80 per cent took a stand on whether the country should have a uniform civil code, or religiously prescribed separate laws, for marriage, divorce and property inheritance; and 87 per cent had clear views on caste-based affirmative action.

Thus the debate over economic reforms in India, Varshney concludes, is 'confined to the English-language newspapers, the country's graduates, the discourse on the Internet, the Bombay stock market, and New Delhi's India International Center and the economic ministries. That is the circle of India's elite politics'. Economic reforms were a non-issue in the 1996 and 1998 elections (Yadav and Macmillan, 1998; Yadav and Singh, 1996). Ethnic and religious disputes, secularism, caste-based affirmative action and social justice have been driving India's mass politics, and have led to large-scale mobilization, insurgencies, riots, assassinations, desecrations and destruction, of holy places. In comparison, economic reforms have aroused very little passion, and to the extent that they have done so, it has been confined to India's upper middle classes.

Weiner, in his chapter, focuses on the implications of federalism and state-level politics for economic reforms. He notes, first of all, that with the decline of the Congress party, regional forces have become very powerful in India. The formation and continuance of governments in Delhi increasingly depend on the bargains struck between national and regional political parties. No national party has been strong enough to make a government on its own since 1989.

The rise of regional forces has important implications for reforms. Many policies that have a critical bearing on the progress of economic reforms are on the 'state list' in India's constitution. Especially important are state electricity boards (SEBs) and elementary education. By constraining the development of the power sector, unreformed and loss-making SEBs are already slowing down reforms, and by creating a large army of illiterates, low investments in education are likely to have a detrimental effect on the progress of reforms in the long run. Other policy areas falling under state governments can also be listed, but these two should suffice to illustrate how important state governments have become to the further evolution of economic reforms.

Have state governments shown sensitivity to the political, economic and bureaucratic requirements of a reform era? The answer, by and large, is no, argues Weiner. The realization that the rules of the economic game have changed has dawned with a remarkable lag. The Orissa government may have reformed its SEBs, and the Gujarat, Maharashtra, Tamil Nadu, Andhra Pradesh and Karnataka governments may have succeeded in providing some incentives to private investors, but the bulk of India's state governments remain stuck with a pre-reform mindset, still unable to gear up for a time when lobbying Delhi for more money is not the primary way to obtain resources. State finances are also in a veritable mess. The expenditures of state governments, given their penchant for subsidies and bloated bureaucracies, far outstrip their revenues. Declining educational investments at the state level are in part a consequence of the resource crunch.

Politically speaking, argues Weiner, federalism in India has been a great success for it has allowed India's diversity to express itself

politically, keeping national integrity intact. The linguistic reorganization of Indian states, he contends, was a brilliant policy move in the 1950s and 1960s when threats to national unity were quite serious. But economically speaking, he argues, state governments have shown remarkably little inclination for policy innovation, with the exception of some non-Congress governments. He points to three reasons for the absence of thinking on economic policy.

First, a dependence on Delhi for policy leadership, given the pre-1991 importance of central planning, has undermined policy initiative, and the bureaucratic capacity for it, at the state level. For all practical purposes, state governments simply used to follow the instructions from Delhi. If they did fight, it was over shares of planned investment and revenue, not on a fundamental redirection of policy. Second, short-run considerations have tended to dominate the political horizons of state governments. Since 1967 state governments have been in office for an average of 2.65 years only, not 5 years, which greater political stability would have made possible. Such short tenures have put a premium on patronage for survival, and devalued the political importance of policy deliberation and innovation. Finally, organized interests—businessmen, farmers, NGOs, and trade unions—opposed to one or the other aspect of economic reform have a great deal of clout at the state level, more so than at the centre.

Can state governments work better as agents of economic reform? The solutions follow from the diagnosis of the problem above. To quote Weiner:

> The pursuit of market-friendly policies by state governments requires a change in the mindset of state politicians, new skills within the state bureaucracies, and a different kind of politics. Most fundamentally, it requires rethinking on the part of state politicians, activists in non-governmental organizations, journalists and politically engaged citizens as to what is the proper role of government, and how and to what end limited resources should be used.

As reforms evolve further and some state governments steal a march over others in reducing bureaucracy, restructuring SEBs, providing investment-friendly facilities, restoring fiscal health, redirecting state resources towards health and education, it will be interesting to study what differentiates reforming state governments from those still wistfully longing for the older and more familiar times of central planning.

IDEOLOGY VERSUS PRAGMATISM

There has been an absence of ideological thrust in India's reform programme, which is arguably one of the causes behind the moderate speed of post-1991 reforms. To be sure, there is consensus on reforms across the political spectrum, but the nature of that consensus is somewhat odd and should be noted. Political leaders and parties are implementing reforms, but not making clear ideological arguments in favour of reforms. If ideological arguments are made, they are made with great tentativeness. Economic reforms are yet to be boldly presented on the ideological platform of political parties. They are yet to be made into the centrepiece of electoral campaigns.

Consider some examples. Neither in 1996 nor in 1998 did the Congress party, which initiated reforms in India, turn its policy breakthrough into a theme for electoral campaigns. Nor, for that matter, did the BJP ever explain to the electorate, though it has historically been in favour of freer internal business and trade (not freer external trade and foreign investment), why a more market-driven economy would be a better economy for all. The fact that the trading and small business community has traditionally supported the BJP in northern and western India has always made the party oppose the bureaucratic regulation of trade and business, but BJP leaders have never clearly articulated why a less regulated economy is not only in the interest of traders and businessmen, but also the masses in general. In the 1998 election manifestos of the BJP and Congress, considerable space was given to economic policy, but the electoral battle was over whether Sonia Gandhi, the ace campaigner of the Congress party, was an Italian or an Indian, whether her entry into politics was an example of dynastic hold over Indian democracy, and whether the BJP would moderate its anti-Muslim stance. Economic policy, as in the elections before, was hardly debated.

This raises a serious political question. Why do economic reforms have such low electoral salience in India? Or, why are they so perceived by politicians? No clear explanation is yet available. Further research can be structured around three hypotheses.

First, the contingencies of India's political economy in the last two decades are partly responsible for why economic reforms are not a matter of high electoral importance. India's economic crisis

in 1991 was not as deep as that of Latin America or the Communist bloc before they started reforming their economies. Ranging between 3.5 to 5 per cent per annum, India's economic growth rate since 1950 has been below the nation's potential but, unlike Latin America in the 1980s, the Indian economy never lost a whole decade to zero growth. Government regulations and policies did create a gap between India's economic possibilities and actual performance but, unlike Eastern Europe or China, India's government did not throttle its citizenry or economy. A vast private sector was allowed to exist in India, along with supporting institutions like a stock market and a court system implementing corporate laws. In the aggregate, growth performance below the nation's potential for four decades did add up to a big economic loss, but India's economic failure was not concentrated in any particular period of the nation's post-1947 history. It was a slow but steady accumulation of welfare losses (Bhagwati, 1993).

Does such a difference in background matter *for politics*? Consider for a moment what awful failures of the past can do to current political and economic postures. 'To get rich is glorious', argued Deng Xiao Ping, justifying market-oriented reforms in China in the late 1970s and early 1980s. Such an economic motto was inconceivable under Mao. In seeking to achieve egalitarianism, Mao's China went through the unspeakable terrors of the Great Leap Forward and the Cultural Revolution—millions of deaths, incarcerations, and forced migrations to the countryside. Such horrors, at least those of the Cultural Revolution, were far too fresh in people's minds when China's economic shift to the market began. Maoist excesses, ironically, became China's advantage after Mao's death. A market economy is emerging in China from the ruins of a discredited ideology. Because of the abject failures of the latter, getting rich could be officially and publicly termed glorious.

A democratic India did not have to go through the excesses of a Cultural Revolution or a Great Leap Forward. In its search for a better political and economic future, India successfully avoided 'excessive misery'—famines and cultural revolutions—but it failed to obliterate 'regular misery'—malnourishment, illiteracy, hunger (Sen, 1982). When India's economic reforms began in 1991, there was considerable mass dissatisfaction with Indian polity and

economy, but the whole system had not been rendered illegitimate in the eyes of the masses. An absence of excessive misery made a radical change in economic rhetoric harder. As a result, not even the ace reformers of India—Manmohan Singh or P. Chidambaram and their respective parties, the Congress or TMC—have found a large ideological space in politics for a market-oriented rhetoric. Slow deterioration simply does not focus mass energies the same way as a blitzkrieg of failure does.

This contingent reasoning, though quite plausible at first sight, does not go far enough. If we probe deeper into India's political culture, a second hypothesis presents itself. Constrained though they may have been by myriad regulations, India's industrialists and businessmen, unlike those in the United States, have never enjoyed popular legitimacy, except in 'business states' like Gujarat and Maharashtra. Few businessmen win elections outside these states. Of all the occupations from which elected legislators have come, business ranks among the lowest in India's parliament since 1952 (Varshney, 1995). Businessmen's riches may have been envied but, in popular perceptions, their endowments and gains have always been suspected to be a consequence of connections, bribery, or foul play, not of hard work or imaginative business strategies. The extent to which the state in India intervened in economic life, of course, made much of this inevitable, for it was hard for most businessmen to thrive without pleasing the bureaucrat and the politician. But suspicion of businessmen and traders may not simply be an artifact of state regulation. A deeper reason is worth exploring in further research.

India's traditional folklore is full of stories that view the business castes—the Vaishyas—with suspicion. Businessmen and traders, in these stories, are blamed for creating and exploiting scarcities, for fleecing the poor, and for usury while lending money to the needy. The transference of this cultural image from pre-industrial times, when it might well have been correct, to an industrial age, when competition in the marketplace can make unprincipled rent-seeking difficult, is utter folly, but cultural constructs are sticky and not prone to quick disappearance. A whole host of bureaucrats and politicians in India have routinely been heard by researchers to argue that unless regulated and disciplined by the state, the market would only hurt the poor, and the businessmen would

'squeeze' the consumer and the poor, as there would be no checks on their profit-making instinct (Weiner, 1962).

Though not exactly laden with explicit suspicions of wrongdoing, a famous passage from *The Discovery of India* gives some clues about the anti-business attitudes at the highest levels of Indian polity. Nehru argued:

> It would be absurd to say that the profit motive does not appeal to the average Indian, but it is nevertheless true that there is no such admiration for it as there is in the West. The possessor of money may be envied but he is not particularly respected or admired. Respect and admiration still go... especially to those who sacrifice themselves... for the public good [p. 554].

By now, of course, cultural values are beginning to change substantially. Instead of aiming for jobs in the bureaucracy, more and more young men and women have set up businesses, or worked as managers, in the 1980s and 1990s. But such changes are by and large confined to metropolitan India.

If the reasoning above is right and further research can confirm it, then we potentially have an answer to one of the puzzles of India's reform politics: viz., that even the reformers are afraid to turn their successes into election rhetoric. To put it simply, *freer business environment does not yet have mass political constituency in India*. In an era when 'lower' castes, who have often viewed the Vaishyas as exploiters and also aired that sentiment openly, have risen in politics, politicians find it hard to make a case for freer business and trade.

Thus India's reforms did not result from an ideological conversion of politicians. They simply began as a consequence of a serious macroeconomic imbalance. The foreign exchange crisis of July 1991 gave not only the IMF and World Bank an opportunity to insist on policy change, but also reform-oriented bureaucrats inside the government to pursue their long-cherished agenda. A possibility of financial collapse led to a new resolve at the governmental level. Once the opening was provided, a political consensus on reforms began to emerge simply because reforms worked, even though moderately. Since 1991, economic growth rates have gone up, many of the consumer goods that the burgeoning middle classes need are cheaper, and considerable international attention has been paid to India's economy. It is, of course, a different matter that if the reforms were deeper and wider, growth rates would arguably

be still higher, goods even cheaper, employment larger, and international attention greater.

The policy dynamic of post-1991 reforms is roughly the same as that in the mid-1960s, when India's agricultural policy was changed in a more market-oriented direction. A green revolution took place as a result of the policy change, overpowering the many ideological objections raised initially (Varshney, 1995). Analogously, if India's economic reforms had failed to push up growth rates after 1991, their survival in the absence of ideological convictions would have been highly unlikely. Success, even if moderate, has sustained reforms in India.

This reasoning leads us to the third big question about the interaction of ideology and pragmatism in India's reform politics. If the success of reforms can undermine ideological objections to them, why can the success not be turned more fervently into a political asset? What will finally bury the suspicion in India—lessening on the whole but still lingering—that the reforms are meant for the rich and the upper middle classes, not for the masses?

It is at this point that the role played by economists in the political process needs to be more fully examined. In a country where decent work, income, education, and health are still seen by millions as a distant goal, the ultimate *political* rationale for reforms is, and would have to be, not easing rules for business, but creating more jobs and incomes and providing better education and health for the many. The former may be the means to the latter, but it can not be the principal political end.

This inevitable political truth about reforms in a poor democracy needs to be better understood in India's elite politics. India's business press, its business intellectuals, and its reform-oriented economists have continued vociferously to argue in favour of greater economic efficiency, better business environment, and greater economic integration with world markets. It is clear however, that while all of it is indeed economically desirable, it cannot be a strategy of political mobilization, or constitute the main theme of political rhetoric in a poor democracy. A preoccupation with economic efficiency cannot motivate India's politicians in their political campaigns.

Deeper and quicker reforms in India will require not only assuming, but also demonstrating, that they are positively linked

to *mass welfare*. One may have to create a 'popular intellectual' climate, and build political coalitions, in favour of the argument that privatization and restructured labour laws are aimed at creating jobs, alleviating poverty, making more education and better health available to the masses.

The role of economists will be absolutely central to this process. It is generally hard for politicians, and many intelligent people, to understand how privatization or trade reform, for example, will lead to higher mass welfare. Economists must continue to emphasize that the privatization of infrastructure, for example, can not only attack fiscal deficits by allowing the sale of loss-making public sector firms, but it can also release resources for public investments in primary education and basic health, both of which will create jobs and add to mass welfare. Reforms need to be more clearly linked to the elimination of poverty.

A discourse and language that can turn ideas about the economic consequences of markets into a political rhetoric of mass welfare are crying out for serious attention in India. If India's politicians can be convinced that their constituency will be better served by economic reforms, there is a good chance that political rhetoric and ideology will also change. A better alignment of elite and mass politics will almost certainly quicken the speed of economic reforms in the coming years.

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