# Making Reforms Work for the Common People

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The reforms of 1991 and 1996 were branded pro-rich as people with better initial endowments benefited disproportionately from the significant positive impacts, thus exacerbating both income and regional inequalities. This must change. Therefore, rather than minimising the role of the state as per the Washington Consensus, the presence of a development state is a necessary condition for implementing structural reforms in India.

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That the 1991 reforms marked a major watershed in India's economic history is surely beyond argument. No waiting lists for cars or scooters, no special licences for securing foreign exchange for studying abroad, no gold smuggling and no more the dread of the customs officer at airports with long queues that took hours to be cleared as each case was opened and rummaged to look for the "banned item."

It would have been simply inconceivable prior to 1991 that 10 million Indians would voluntarily give up the subsidy on cooking gas. The Indian reality has changed and life has become less Kafkaesque. And thankfully, scarcities are no longer the driver of human endeavour in present-day India as it was prior to 1991. One must acknowledge the paradigm shift that was initiated in 1991 and which 25 short years later has resulted in a post-reform generation that is perhaps totally oblivious to the days when one had to wait for three to five years to buy a Vespa or 10 years to get hold of a Padmini.

The credit for this must be given to P V Narasimha Rao, who as the Prime Minister heading a minority government after the horrendous assassination of Rajiv Gandhi in May 1991, was able to establish the necessary political coalitions in support of the reforms. Rao was successful in putting across to his political opponents and to the people at large, that India was faced not only with an unprecedented economic crisis but also a potentially severe political crisis in case the population did not come together as one in supporting the reforms. His principal secretary A N Verma marshalled a highly sceptical bureaucracy to support the effort.

This unity of purpose among the political class and senior bureaucracy provided the necessary condition for the Rao government to successfully reverse the three decades of steadily rising state intervention in all aspects of economic activity that expanded the scope of state capitalism, central planning and bureaucratic over-regulation. Therein lies a lesson for the present government: in a country as diverse as India, leaderships of ruling parties will have to constantly build coalitions both within and outside the Parliament if it is serious about implementing the critically necessary structural reforms. Neither an abdication of reforms nor an attempt to railroad them through the legislatures or even the bureaucracy will yield the necessary growth momentum.

The second necessary condition for the 1991 reforms was the significant amount of academic and intellectual churning that preceded them. Throughout the 1980s, there was a constant battle of ideas between the "liberalisers" and "status-quoists and regulators." The latter would employ the age-old trick of creating a scare about India becoming a "neo-colony" and the demise of domestic industrial capacities if the Indian industry was confronted with global competition.

There were a number of studies undertaken by leading think tanks to refute this vicious argument on the basis of empirical evidence. Some major studies were also published to quantify the benefits that would potentially result from economic liberalisation. For reforms to succeed in India, the intellectual battle has to be won in the public domain. With media explosion and greater openness and participation in public discourse, this is now even more essential than ever. It is a misplaced perception that reforms in India were or can be stealthily undertaken by ministers and bureaucrats acting covertly in the expectation that positive results that are expected to accrue from these reforms will suffice to convert the general public opinion in their favour. Given our vibrant and fiercely competitive democracy, reforms in India will be successful if and only if, sufficient groundwork has been done in advance to mould the public opinion in their support.

It is perhaps redundant after 25 years to argue that reforms cannot be imposed from abroad or by any group of externally oriented experts. India has traversed a long distance and appreciably reinforced its sovereign credentials. But it should also be recognised that even the 1991 reforms had a very large dose of indigenous inputs and were a result of rigorous research and active advocacy domestically. Researchers well versed in the Indian ground realities and its political economy presented these reform measures in a form readily comprehensible to the political leadership, bureaucracy and the political class in general.[1] In the present context, it will be even more critical to demonstrate that reforms are rooted in the Indian reality and are of an Indian origin.

## Major Achievements

A lot has been already written about the positive impact of 1991 reforms (Ninan 2015). Summarily, the best testimony to the success of the 1991 reforms arises from comparing the rate of growth of per capita incomes in the 25 years preceding the reforms and those succeeding it. Between 1965 and 1990, India's average[2] annual gross domestic product (GDP) growth was a mere 4.1%, which translated to a per capita income growth of 1.9% per annum. In the subsequent period (1990 to 2015), this increased to 6.3% and 4.6% respectively. The reforms allowed India to firmly jettison the so-called Hindu rate of growth. It would not be misplaced to assert that without these reforms, the country could have faced acute social and political problems that would have arisen as a result of the economy's inability to generate enough wealth and employment, had the economic growth remained at pre-1991 levels.

A related achievement of the reforms, characterised by making the Indian economy more open to foreign flows and markets, was to integrate the Indian economy more deeply with the global economy. In the 25 years prior to the reforms, the share of the trade (export and imports of goods and services) in the total GDP was a low 11.5% on an average. This increased four times to become 48.7% in 2015. This was a direct outcome of policy reform measures being focused largely on the "tradable sectors" of the economy.

Average applied import tariffs have been brought down from about 82% in 1990 to less than 10% in 2014, giving Indian consumers and producers the benefit of lower prices prevailing in global markets. Exports of goods and services (taken together) have increased from a mere \$2.0 billion in 1965 and \$22.6 billion in 1990 to \$522 billion in 2014. The higher level of integration has allowed India to benefit not only from easier access to foreign markets and relatively cheaper intermediate inputs but also from higher inflows of foreign direct investment (FDI) and portfolio investments and technology. This has enhanced the investment capability and raised productivity levels in the economy.

In summary, the 1991 reforms put India on a higher trajectory of economic growth by removing some of the dysfunctional controls and regulations, facilitating imports of intermediate inputs, technology and financial flows thereby moving the economy towards greater integration with the world economy and de-reserving some key sectors from exclusive public sector ownership.

## The Pro-rich Perception

It is generally agreed that policy advance of the early 1990s initiated the programme of structural reforms but left them far from complete. The Rao government lost its reformist elan prior to reaching its mid-term mark, that is, by the beginning of 1994. This was reflected most sharply in two separate incidents.

The first was when the government did not accept the second tranche of the Asian Development Bank's industrial structural adjustment loan that required the completion of a slew of deeper structural reforms, including changes in the labour market and privatisation of public sector enterprises. Having completed some far-reaching reforms like the abolition of the Monopolies and Restrictive Trade Practices (MRTP) Act and Directorate General of Technical Development (DGTD), and sharply reducing the number of sectors reserved for public sector operations (including commercial banks and insurance), the Rao government lost its appetite for further reforms that would have involved taking on both the well-entrenched trade unions and vested interests supporting the continuation of "state capitalism" in the country. This was despite the strong demonstration of the positive impact of denationalisation in the telecom sector, in which public sector monopoly was breached and private investment was actively invited.

The second manifestation of the loss of reformist verve was the extreme reluctance of the government to privatise even the loss-making public sector enterprises. Privatisation became a derogatory term and was replaced by disinvestment or denationalisation. It was clear early on that the Rao government was not prepared to take on the public sector trade unions or roll back the dysfunctional expansion of the government in commercial activities. This has persisted with successive governments, except for a brief interlude under Atal Bihari Vajpayee, to reform the public sector enterprises either through strategic privatisation or more accountable governance and efficient operations.

The reform effort was sustained and actually given a fresh momentum during the Vajpayee government (1999–2004) especially under Yashwant Sinha as finance minister and Arun Shourie as minister in charge of disinvestment (Sinha 2007). Murasoli Maran, the minister of industry and commerce in that government was, however, not a reformist and spent his energies largely in defending India's position in the Doha Development Round.

However, the rather bitter truth was that the 1991 reforms or those undertaken subsequently by the Vajpayee National Democratic Alliance (NDA) government, despite their success in pushing the GDP growth rate higher, were surely not seen as guaranteeing electoral victories. If anything, the unfortunate fate of the Vajpayee government in Delhi and of Chandrababu Naidu government in undivided Andhra Pradesh made clear the political lesson that was to be drawn: economic reforms for liberalising the economy were to be left well alone if the political fray had to be won. This was a result of the palpable inability of successive governments and assorted political formations in building a case in support of these reforms in the public domain.

The liberal, open economic policy regime continued to be seen as being pro-rich and not serving the interests of the poor. This is in complete denial of the reality that during the 25 years after reforms, India has been successful in reducing the share of population living in abject poverty from 56% of the total population in 1973 and 46% in 1993 to (a still unacceptable) 22% in 2011. This implies bringing more than 150 million people out of rank poverty as compared to an increase in the number of poor from around 326 million to 416 million, between 1973 and 1993, that is, in the period prior to the 1991 reforms. This negative public perception about the reforms that is reflected rather widely also in the political classes, despite the positive economic outcomes, needs explanation.

Therefore, in its bid to wrest power back from the NDA, the Sonia Gandhi-led United Progressive Alliance (UPA) government that succeeded the Vajpayee government in office for 10 years (2004–14) gave up the reform effort and instead tried to maximise its longevity in office by pursuing populist policies that were focused on improving distribution and entitlements. The Sonia Gandhi-led National Advisory Committee, that ironically called the shots on economic policy, despite the government being led by a professional economist, worked on the assumption that economic growth of 7% to 8% had been assured by the reforms already undertaken in the past and so did not need further reform push to be sustained. Instead, the focus was principally, if not exclusively, on establishing higher entitlements and expanding the social security net in the firm belief that this would yield successive electoral victories. The disappointing result was a marked loss of reform momentum and concomitantly of growth momentum as well. The economy is still struggling to emerge out of that slowdown.

The strategy having been successful both in 2004 and 2009 was repeated again in 2014, however, with disastrous results for the Congress, whose appeal based on further enhancing entitlements fell far short of a young electorate's rising aspirations (Kumar 2014). The Congress leadership perhaps overlooked the fact that by 2014, a very large cohort of the post-1991 generation had entered the workforce and acquired voting rights. This generation was not aware of the scarcities and deprivations of the pre-1991 period; the number of poor had also declined precipitously to less than 20% by 2014.

## Changing the Pro-rich Perception

There are to my mind two principal reasons of 1991 reforms being not only perceived as pro-rich but also having produced an inequitable outcome. First, the growing income inequality in the country since 1991 as compared to the first four decades after independence. The second factor has been the widespread incidence of large-scale corruption that threatened to become systemic as a result of an ever-strengthening nexus of the political classes with crony capitalists. Both anecdotal and empirical examples (rising values of Gini coefficients in the post-reform period) point unmistakably to the rising inequality in the society during the last 25 years. This has happened across both interpersonal and interregional space with some of the poorer states being left behind unmistakably. This trend is counter-intuitive. An open and liberal economic regime should theoretically promote convergence and close the income gaps, especially across regions.

The reason is not far to seek. The reforms of 1991 and those which succeeded them during the Vajpayee regime, opened up new opportunities for those already better endowed with financial and human capital. They did so by providing expanded opportunities both in terms of greater access to foreign markets and by facilitating imports of technology, finance and intermediate inputs to those already poised for expanding capacities. By unleashing massive export opportunities for software firms, and at the same time, encouraging supply response from the private sector which was allowed entry into the telecom sector, these reforms exponentially increased returns on education and vocational training. Thus, they strongly favoured those who were already in possession of the required human capital. Thus, the reforms accelerated incomes for those individuals, firms and regions already well endowed by connecting them more intimately with global flows and markets.

However, the 1991 reforms did practically nothing for those whose initial conditions or given endowments were poor or non-existing as is the case for those who live in abject poverty. This lack of focus on improving the delivery of essential public services like primary education, basic health and mobility has been the major failure of India's structural reform efforts. The state simply abdicated its responsibility in these crucial areas by not even attempting to restructure the social sectors and bring about a modicum of improvement in these two crucial areas of education and health.

In infrastructure too, except for the Pradhan Mantri Gram Sadak Yojana (PMGSY) which sought to connect villages (even remote ones) to state highways and nearby towns, the dominant effort was focused principally on facilitating the mobility of the well-off by developing a network of national highways under the Golden Quadrilateral programme. There has been a notable lack of effort on modernising the railways, and inner-city public transportation, which would have been more accessible to the poor and lower middle classes. In short, the 1991 and subsequent reforms have favoured the middle and rich classes and therefore, by definition, excluded the poorer segments of the population from their coverage.

This is reinforced by the near complete lack of attention to modernising agriculture and raising yields and productivity of Indian crops. Public investment in agriculture has continued to decline in the last 25 years, reaching an abysmal level of 0.4% of the GDP in 2015. At the same time, the quantum of subsidies on account of fertilisers and electricity have risen many times from around ₹9,000 crore in 1991 to over ₹83,000 crore in 2015. Unlike public infrastructure that would be more accessible and help the poor and marginal farmers, these subsidies which seem to have pushed out public investment are largely usurped by the middle and rich farmers. Lack of public irrigation, inability of the public sector agencies to supply reasonably priced seeds, and the near complete breakdown of agro-extension services have implied that agriculture, supporting nearly 50% of the population, remains trapped in backwardness and contributes to rising income inequalities in the country. This has also reinforced the public perception that reforms favour the rich.

There was a major effort during the 1990s and subsequently to reform and simplify the indirect tax structure. This saw the lowering and rationalisation of both import tariffs and excise duty structures. The modified valued added tax was successfully introduced and the grounds laid for the much awaited Goods and Services Tax (GST). With the GST, the entire country would be covered by a single uniform tax imposed equally on goods and services.

Unfortunately, however, the same cannot be said for the system of direct (personal income and corporate) taxes. Rather than being simplified and rationalised (for example, by removing the surfeit of exemptions), these have been made more complicated and draconian with the introduction of, for example, "retrospective taxation." The result is that the personal income tax net is confined to 37 million taxpayers. Even if we assume that each income taxpayer represents one household (a liberal assumption because there are a large number of double income taxpaying households), it represents merely 15% of the total number of 250 million households in the country. Surely the tax net can be widened.

Similarly, the effective corporate income tax (total tax divided by taxable corporate income) is estimated at 22% while the nominal rate is nearly 34%. Removing the exemptions, that will help the micro, small and medium enterprises (MSMEs) by simplifying the tax process, would surely remove this bias in favour of richer corporates.

Finally, according to the Central Board of Direct Taxes (CBDT), the number of taxpayers with incomes above ₹1 crore is only 17,515. This number can be and should be increased manifold in the present-day economy which boasts of a very large number of billionaires and multimillionaires. The inequity in the direct tax system further reinforces the perception of unfairness and deepens inequality. The inability to collect taxes from the rich, who also inherit wealth without paying any estate duty on inheritance, implies a greater dependence on the relatively more regressive indirect taxes. By not tackling the direct tax system over these 25 years, the reformists have opened themselves to charges of being strongly biased in favour of the rich, rentiers and the prosperous. This must change.

The second weakness referred to above has been the overt emergence of a "politician–crony capitalist" nexus that has seen a manifold expansion of corruption throughout the system even at times endangering the country's security. This has been one of the negative fallouts of the push for public–private participation in infrastructure and other sectors. The basic, though faulty premise underlying this phenomenon was to accept one of the tenets of the Washington Consensus that sought to minimise the presence of the government (or the state) in both undertaking, and effectively regulating economic activity.

Under the convenient garb of pushing back the state from even its legitimate and critical activity in support of development, political leaders and bureaucrats have sought to replace the state with a coalition in which the distinction between the public and private interests is largely blurred if not eliminated. Thus, in the education sector, politicians can beat or circumvent the plethora of regulations because of their proximity to the regulator.

In the health sector, private hospitals with their rampant commercialisation can get away with minimal oversight on meeting their mandated social goals. The growing nexus of those "within the establishment" with private sector providers has promoted a widespread culture of "finding private solutions to public problems." This breeds regulatory corruption at all levels and at the same time weakens the state's capacity to deliver on its development agenda.

The poor, who are by definition, excluded from this private provision of services are often the victims of this unholy nexus. For example, the breakdown in public education at all levels implies that increasing recourse is taken to private tuitions and crammers. The poor cannot afford these. Similarly, the replacement of government security machinery by private security providers (reportedly one of the fastest growing industries in India) has implied that the poor are left vulnerable to the vagaries of thugs and unscrupulous local political and official goons often with unacceptably dehumanising consequences.

The above two weaknesses taken together are symptomatic of a more deep-rooted malaise that has remained untackled over these 25 years and represents to my mind the biggest weakness of the reform effort. This refers to the lack of even the effort to improve governance and implement the critically required reforms in the administrative and judicial systems. This has stymied overall economic progress and has resulted in a growing delegitimisation of the state. India would not be only emerging country where the state has effectively withdrawn and become discredited over time (Sud 2012). This phenomenon can be noticed in an increasing number of emerging economies across all continents. The Indian state too has become increasingly characterised by rampant corruption within the executive and political establishments, policy paralysis at all levels, and an unimaginably long pendency of legal cases which does not seem to bother the judiciary in which corruption is rife, especially among the lower echelons. Governance has badly broken down across the country.

Reforming the governance system and making it more accountable and transparent was not on the reform agenda until Narendra Modi brought it right in the centre of his electoral campaign and subsequently followed it up in practice since taking office (Kumar 2016). Reforming governance is the necessary condition for improving delivery of public services that will make economic growth less exclusionary. Better (accountable, consistent and transparent) governance is also at the heart of improving the conditions for doing business and making India a more investor-friendly environment.

Better project execution capabilities in the public sector would also result in a more rapid expansion of physical infrastructure capacities that also help the poor by enhancing their mobility, connectivity and productivity. More accountable governance also reduces the distance between the governors and the governed, thereby deepening our democracy and liberating it from the feudal overtones that currently characterise it. While the present government's rhetorical emphasis on better governance is most welcome, it will have to be translated into actual practice for it to have a positive impact on general welfare. This is not yet in evidence.

## Concluding Remarks

The last 25 years, though representing a period of significant economic achievements, have also brought forth several important lessons for the future.

First, India is not suited to the application of the Washington Consensus, which, if at all, may be suited to advanced economies. Given India's conditions, the state, far from being withdrawn, will have to lead the effort in ensuring that growth is inclusive by ensuring that the delivery of public services is efficient and subsidies are effectively targeted and not usurped by the non-deserving. However, this certainly does not imply that the government continues to own and manage commercial undertakings that are best run by the private sector in a competitive market framework. A development state, as in East Asian economies, is the need of the hour.

Second, necessary administrative reforms and those needed desperately in the judicial sector must be expeditiously undertaken. These are essential for establishing a development state.

Third, apart from governance, policy attention now needs to be focused on other non-tradable sectors like education, health, direct taxation and infrastructure as these are key to making Indian industry globally competitive and economic growth more inclusive.

Finally, a wider and more engaged public discourse on the effectiveness of structural economic reforms in raising the welfare of the general population is now urgently required. The outcome of such an engaged and sustained public discussion on the need for reforms will hopefully result in their wider acceptance. This will ensure that all stakeholders pull together in the same direction for ensuring India's successful emergence as one of the three leading economies in the world by 2046, the centenary year of our independence.

### NOTES

1 A particular example was the study prepared by Kelkar, Kumar and Nangia for the Asian Development Bank in 1989. This study not only rigorously analysed the weaknesses in India's macroeconomy, but also laid out a plan of action for structural reforms. It is noteworthy that many of these measures were replicated in the structural reform matrix presented by the International Monetary Fund as the set of its conditionality while extending the structural adjustment facility to India to help overcome its external finance crisis that had engulfed it in 1990 and 1991 (Kumar and Kelkar 1990).

2 Compound Annual Average Growth Rate (CAGR) at constant prices of 2004–05.

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