

# Indian Reforms: Yesterday and Today

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**Honourable Speaker of the Lok Sabha Smt. Meira Kumar,  
Honourable Prime Minister Dr. Manmohan Singh, and  
Honourable Vice-President of India Shri Muhammad Hamid  
Ansari:**

I am honoured by the invitation to give this prestigious lecture. I am also delighted to see many of our distinguished leaders in the audience, from all political parties and from several walks of life: among them, Smt. Sonia Gandhi, Smt. Gursharan Kaur, Shri L K Advani, Shri Karan Singh, Shri Shashi Tharoor and Shri N K Singh.

It is a great privilege to be lecturing here today on our reforms. But it is also presumptuous to do so in the presence of the Prime Minister who has not merely thought about these reforms for as long a period as I have, but has also initiated and overseen them. But, perhaps, I can add a few shades to the portrait he has been painting since 1991, while adding to the ongoing debate on the shape of Indian reforms to date, where they are going next, and where they should.

Yet, perhaps the most appropriate way to start my tribute to the memory of the eminent parliamentarian, Professor Hiren Mukerjee, would be by celebrating Indian democracy of which

the Lok Sabha itself is the chief symbol. India was for decades unique in her democracy among the post-colonial countries that had gained Independence. Today, that uniqueness has thankfully disappeared as several countries around the world have followed in India's footsteps and transited from authoritarianism, even military dictatorships, to democratic forms of governance. But our embrace of democracy from the outset does set us apart from, and puts us in a higher pecking order relative to, China whose egregious denial of democratic and other human rights detracts hugely from admiration for its stellar economic performance.

India has not just the Lok Sabha and elections; it also has all the elements of what we now call a "liberal democracy". We have an independent judiciary that has also advanced the cause of our poor and the underprivileged with Public Interest Litigation that, I am happy to claim, my brother, the former Chief Justice of India, pioneered. We have a free and lively press. Most of all, we have innumerable and growing number of non-governmental organisations (NGOs), the social action groups, that make up our civil society.

Many NGOs today are led by women who generally prefer doing good to doing well. This is so manifestly true that there is now a joke that, whereas in the old days if you were looking for a good daughter-in-law, you had to offer her a flat or a green card to go to the United States so that she could escape from having to live with her mother-in-law, today you have to offer her money so she can start her own NGO!

The NGOs are a critical part of a well-functioning democracy because they facilitate the implementation of the important social legislation that governments like ours pass. You can have all the fine legislation you want at the Centre; but it will not be implemented if the NGOs do not bring the transgressions and omissions to governmental attention. They are the eyes and ears of good governance from the Center.

We have, therefore, what Naipaul called a multitude of mutinies. Many years ago, when I met with Prime Minister Lee Kuan Yew of Singapore where political freedoms are more muted, he contrasted Singapore's orderly regime favourably with our chaotic, undisciplined one. I remarked: Mr. Prime Minister, what you call the noise of democracy is in fact its music.

And we now increasingly realise how wisely our leaders since Independence managed to use democracy and its accommodating ways to hold a multi-religious, multi-language, multi-ethnic country together, creating unity without denying diversity. When Prime Minister Nehru wished to turn Bombay into a city state like Delhi, denying it to Maharashtra, he soon yielded to democratic agitation that could have been long suppressed by a dictatorship. It is no secret that reorganisation of states along linguistic lines was considered unwise in New Delhi; yet this was allowed in the end since democracy requires that voices from below must be heard at the top.

Minorities were given representation in public life: in the judiciary, in the legislatures, in the executive, even in the Foreign Service, thus giving them a sense of belonging. Our leaders had the wisdom to choose Muslim and Dalit Presidents long before the United States elected an African-American, Barack Obama, as its Head of State.

The same goes for women. We have had a woman Prime Minister in Mrs. Indira Gandhi while Mrs. Hillary Clinton still waits in the wings, hoping to return to the White House, where she was the First Lady, instead as the first female President of the United States. But few realise today that we owe this to Mahatma Gandhi, the Father of our Nation, who used the cultural, religious idiom of our mythology to advance women to the front ranks in Indian life. After all, our mythology is full of women goddesses slaying male demons! So, Gandhiji got us used to seeing women marching in the front ranks alongside men.

This came home to me when I was going for the year to New York from New Delhi and a voluble woman, who turned out to be the great American feminist Betty Friedan, was sitting next to me on the plane. She had been going around the country with Mrs. Gandhi after her assuming the Prime Ministership. She told me that she had asked every man she met: What do you think of Indira Gandhi as a woman Prime Minister? She had been astonished that every man replied: We think of her as the Prime Minister, not as a woman Prime Minister.

It is easy for us to forget today that many feared then that India's diversity would cause it to disintegrate. In fact, the distinguished American journalist Selig Harrison published in 1960 his alarming book, *India: The Most Dangerous Decades*, speculating how India could fragment. When this had not happened, my friend Sanjeevi Guhan, who had a sardonic wit, went to him and said: "Selig, I am sorry that we could not implement your agenda; you know how inefficient we are."

I must also add that our democracy has been a source of immense gratification, not just to elites, but also to the common man. It is easy to slip into the fallacy that the masses yearn for economic gains, not for political rights. I have long argued that economic betterment, in a country with an immense backlog of poverty, inevitably takes time.

On the other hand, democracy gives the poor and the underprivileged instant affirmation of what Americans call their "personhood", a sense of equality with the castes and classes above you in a strongly hierarchical society. The elections are preceded by the elite politicians courting your vote and not ordering you around; and the election day is when you have the sense that you can turn the "bums" out.

I wrote about this when Prime Minister Indira Gandhi returned to power in 1980 after the Emergency in 1975 and the electoral disaster that tuned her out in 1977. I did not have the vote as Indians abroad could not vote. But I,

nonetheless, went with our family cook, who was from the Hills, to the election booth to observe what was going on. I was pleasantly surprised that, normally deferential, he stood in front of me in the line, not behind, and when I asked him if he was going to vote for Mrs. Gandhi, he said that he did not have to tell me. That was *his* day. So I reflected on this and wrote at the time that democracy matters more to the poor than to the rich: a proposition that the celebrated political scientist Al Stepan endorses and calls the “Bhagwati Law”!

But permit me to turn now to the central question that I wish to address today: the question of economic reforms, what they have accomplished, and where we are and should be headed. On what we have accomplished so far, what I call the Reforms Yesterday, there are two conflicting “narratives” that we find currently, one adoringly celebratory and the other hypercritical and condemning.

Perhaps the most dramatic, optimistic view of India has come from the once skeptical magazine, *The Economist*, which famously wrote nearly twenty years ago that India was a tiger that was crouched for long but unable to leap; the danger was that *rigor mortis* had set in. But the magazine wrote a raving cover page story on 10<sup>th</sup> September 2010, abandoning its reservations and arguing that India’s steadily accelerating growth rate since the 1991 pro-market, liberal (or “neoliberal” if you wish to make them sound sinister) reforms was not a flash in the pan. Apparently throwing caution to the wind, it speculated that India’s growth rate “could overtake China’s by 2013, if not before”.

But then, the naysayers, among them the socialists in the currently ruling Congress Party, have rejected the “miracle” produced by the reforms by asserting darkly that the growth “lacks a human face”, that it is not “inclusive”, that the gains have accrued to the rich while the poor have been immiserised, that inequality has increased, and that India stands condemned

before the world. Perhaps the most articulate critics are the “progressive” novelists of India, chief among them Pankaj Mishra whom the op.ed. page editors of *The New York Times* regularly and almost exclusively invite to write about the Indian economy, a privilege they do not seem to extend symmetrically to American novelists to give us their profound thoughts on the US economy.

Mishra’s latest *Times* op.ed. on October 02, 2010, writes of the “alarmingly deep and growing inequalities of income and resources in India”, “the waves of suicides of tens of thousands of overburdened farmers over the last two decades”, “a full-blown insurgency ...in central India” to defend tribals against depredations by multinationals, “the pitiless exploitations of the new business-minded India”, and much else that is allegedly wrong with India.

While economic analysis can often produce a yawning indifference, and Mishra’s narrative is by contrast eloquent and captivating, the latter is really fiction masquerading as non-fiction. The fact is that several analyses show that the enhanced growth rate has been good for reducing poverty while it has not increased inequality measured meaningfully, and that large majorities of virtually all underprivileged groups polled say that their financial situation has not worsened and significant numbers say that it has improved.

### **Abysmal Growth Prior to Reforms**

The enhanced, and increasing, growth rate since the reforms followed a period of abysmal growth rates in the range of 3.5 to 4.00 percent annually for over a quarter of a century, starting in the 1960s. The cause of the low growth had to do, not with our efforts at raising our investment rate, but with the fact that we got very little out of the investment we undertook. The reason was that we had a counterproductive policy framework whose principal elements were:

- Knee-jerk intervention by the government through a maze of Kafkaesque licensing and regulations concerning investment, production and imports, prompting the witticism that Adam Smith's Invisible Hand was nowhere to be seen;
- Massive expansion of the public sector into many areas other than utilities, with occasional monopoly granted to public enterprises by excluding entry by the private sector, with predictable inefficiencies that multiplied through the economy; and
- Autarky in trade and inflow of equity investment which was so extreme that the Indian share of trade to GNP had fallen while it had increased in most countries whereas the inward flow of equity investment had been reduced to minuscule levels.

This policy framework had been questioned, and its total overhaul advocated, by me and Padma Desai in writings through the late 1960s which culminated in our book, *India: Planning for Industrialization* (Oxford University Press: 1970) with a huge blowback at the time from virtually all the other leading economists and policymakers who were unable to think outside the box. In the end, our views prevailed and the changes which would transform the economy began, after an external payments crisis in 1991, under the forceful leadership of Prime Minister Manmohan Singh who was the Finance Minister at the time.

It is often suggested by populist anti-reformers in India and their ideological friends abroad, that the policy changes were imposed from outside, reflecting what has come to be known as the Washington Consensus – a phrase that has the advantage of harnessing anti-Americanism in your cause – in favour of liberal reforms at the Bretton Woods institutions. But that is no more true than to argue that the Soviet *perestroika* under President Gorbachev and the Chinese economic reforms

starting in the late 1970s were imposed by Washington. In all three cases, the driving force was endogenous, a realisation by the leadership that the old, counterproductive policy model had run their economies into the ground and that a change of course had to be undertaken. In fact, if the contention of the populists was correct, one would have expected the reforms to be reversed once the 1991 payments crisis was over. Instead, successive governments have only intensified the reforms: no serious analyst wanted to turn the clock back and back into the future, embracing a failed policy model.

The early reforms were primarily focused on dismantling the licensing regime (known popularly as the “permit Raj”) which freed up the animal spirits of the private sector. The economy was also steadily opened up: the average import tariff on manufactures, at virtually 113 percent in 1990-91, was reduced steadily, avoiding the folly of “shock therapy”, and now stands at 12 percent.

While privatisation would prove politically difficult, its intended effects in terms of efficiency of management were sometimes achieved by opening up entry by private firms into the sectors that had been reserved for public sector enterprises: the entry of these firms, plus unwillingness to provide ever more subsidies to absorb losses, was like a pincer movement that meant: shape up or ship out.

I remember how, on a flight of Indian Airlines from Bombay to Delhi, the stewardess had brought breakfast with the tea already made Indian-style: one part tea, four parts milk, and countless spoonfuls of sugar. When I complained, she answered: that is the way we serve tea (and, under her breath: if you do not like it, lump it). After the growth of splendid new private-sector airlines such as Jet Airways and Kingfisher Airlines, Indian Airlines changed: competition mattered.

The old policy architecture could not be demolished in one fell swoop. The leadership had to negotiate minefields of

ideological opposition, bureaucratic intransigence, and the lobbies (called “interests” by political scientists) that had fattened on the rents (*i.e.* monopoly profits) attending sheltered markets that they were earning. The three I’s – ideas, institutions and interests – of the old regime had to be confronted. Then, again, the post-1991 reformers felt that their task was akin to cleaning up after a tsunami. Hastening slowly was their only choice.

### **Substantially Enhanced Growth after the Reforms**

Still, as the reforms gathered steam, the effects on the growth rate were palpable. The growth rate, rising to roughly 6 percent, nearly doubled in the 1990s and increased still further in the next decade and has recently been close to 9 percent. The sense that India was now an “emerging superpower” was a heady experience for Indian elites who had seen their country marginalised by policies that had become a laughing stock in the world while smaller nations in the Far East had emerged as the much-admired star performers.

### **The Poor and the Underprivileged Have also Benefited**

But are the opponents of the reforms right to complain that the reformers have been focused on growth to the neglect of the underprivileged; and that the latter have been bypassed or immiserised?

It has become fashionable to say that this must be so because the Human Development Index, produced by the UNDP, puts India at the bottom, at 135<sup>th</sup> rank, in 1994. But this is a nonsensical index which reduces, without scientifically plausible weights, several non-commensurate elements like literacy and diverse health measures to a single number. It is a fine example of how bad science gains traction because of endless repetition by the media: it must be dismissed as rubbish.

There is no substitute for hard, scientific answers to the questions concerning what has happened, during the period of reforms and enhanced growth, to the poor and the underprivileged: and these answers, as I will presently sketch, are more benign.

To begin with, however, let me remind you that the common criticism that Indian policy was interested in growth for itself is not even true if we go back to the early 1950s when planning took formal shape. In fact, my first job in the Indian Planning Commission half a century ago was to devise a strategy to bring the bottom 30 percent of India's poor above the poverty line so they would enjoy a "minimum standard of living"; and I came to the view, often expressed by the leaders of the Independence movement, that we had to grow the pie to do so: redistributing wealth in a country with "many exploited and few exploiters" as the visiting Marxist economist Kalecki put it graphically to me in 1962, was not a strategy that could produce sustained impact on poverty.

Growth was, therefore, regarded as a principal "instrument", a strategy, for pulling the poor out of poverty through gainful employment, not as an end in itself. Growth was seen as what I have called an activist, radical "pull up" strategy to reduce poverty. In no way was it viewed as a passive, conservative "trickle down" strategy to reduce poverty, illustrated by the film of Robin Hood where the Earl of Nottingham and his vassals are eating legs of lamb and venison at the high table and crumbs fall below to the dogs and serfs underneath the table.

The growth strategy to pull the poor up from poverty, however, did not work because growth itself did not materialise because of the counterproductive policy framework that I sketched above. But now that growth has actually been produced by the post-1991 reforms, what can

we say about the wisdom of the growth strategy? Let me sketch some of the studies that suggest an affirmative answer.

After a considerable debate, it is now generally accepted that the enhanced growth over nearly 25 years was associated with lifting nearly 200 million of the extreme poor above the poverty line. By contrast, consistent with commonsense, the preceding quarter century with abysmal growth rate witnessed no perceptible, beneficial impact on poverty.

Then again, at a narrower level, the political scientist Devesh Kapur and associates have studied the fortune of the *Dalits* (untouchables) in India's most populous state, Uttar Pradesh, between 1990 and 2008, to find that 61 percent of those surveyed in the east and 38 percent in the west said that their food and clothing situation was "much better".

Most striking is the finding of the political scientists Al Stepan and Yogendra Yadav, drawing on polling data produced by the Center for the Study of Developing Societies in Delhi, that for every disadvantaged group, including women, the response to the question "Has your financial situation improved, worsened, or has remained the same" posed in 1996 and again in 2004, shows that every group has overwhelmingly remained the same or improved: those who claim to have worsened are invariably less than 25 percent of the respondents.

As for the relative economic outcomes of the disadvantaged groups, the economist Amartya Lahiri and associates have studied India's "scheduled castes" and "scheduled tribes", two particularly disadvantaged categories, and conclude that the last twenty years of major reforms "have seen a sharp improvement in [their] relative economic fortunes". Then again, using household expenditure data for 1988 and 2004, the Johns Hopkins economists Pravin Krishna and Guru Sethupathy conclude that inequality, using a well-known

measure invented by the Dutch econometrician Henri Theil, while showing initial rise, had fallen by 2004 back to the 1988 levels: a straight rise in inequality cannot be asserted.

I should also add that many reforms help the poor more than the rich because the rich can cope with the results of inefficient policies better than the poor. If the public sector generation and distribution of electricity is inefficient, and the electricity goes off in the middle of the night in Delhi's summer, the rich turn on their private generators and their air-conditioners continue working. But the poor man on his charpoy swelters as his small *Usha* fan is not working. Those who object to letting in Coke and Pepsi forget that the common man derives his caffeine from these drinks while the well-off critics get theirs from the Espresso and Cappuccino coffee in the cafes.

The most interesting political implication of the success in finally denting poverty significantly, though nowhere enough, is that poverty is now seen by India's poor and underprivileged to be removable. India is witness finally to what I have called the *Revolution of Perceived Possibilities*. Aroused economic aspirations for betterment have led to political demands for the politicians to deliver yet more. This suggests, as my Columbia University colleague Arvind Panagariya and I have hypothesised, that voters will look to vote for the politicians who can deliver growth, so that we would expect growth before the vote to be correlated with vote now.

In an important paper, Poonam Gupta and Panagariya have recently tested for this hypothesis and indeed found that it works. So, this implies that politicians should be looking to augment reforms, not reverse them as misguided anti-reform critics urge. In fact, the recent dramatic success of Chief Minister Nitish Kumar, who had successfully delivered on prosperity, only underlines the lesson that the electorate will

reward the politicians who have delivered and, therefore, are credible when they promise more.

So, politicians would do well to strengthen the conventional reforms, which I call Stage 1 reforms, by extending them to the unfinished reform agenda of the early 1990s. In particular, further liberalisation of trade in all sectors, substantial freeing up of the retail sector, and virtually all labour market reforms are still pending. Such intensification and broadening of Stage 1 reforms can only add to the good that these reforms do for the poor and the underprivileged.

But these conventional reforms have also generated revenues which can finally be spent on targeted health and education so as to *additionally* improve the well-being of the poor: these are what I call Stage 2 reforms which were, let me remind you, in the minds of our earliest planners (as demonstrated by their inclusion in our Five Year Plans since 1951 and Programme Evaluation reports at the time) but had been handicapped principally by revenue constraints.

When “progressive” critics argue that Stage 2 reforms must replace Stage 1 reforms, because they appear superficially to be more pro-poor, they forget that Stage 2 reforms have been made possible only because Stage 1 reforms have been undertaken and have produced the necessary revenues.

How to get the most bang for the buck from programs under Stage 2 reforms is where we have to be turning our attention as well. As it happens, Stage 2 reforms involve “social engineering” and are inherently more difficult than Stage 1 reforms. Thus, except for political difficulties, it is easy to reduce trade barriers: you just slash them. But if you want to improve education, for example, you have to worry about the best classroom size, the issue of teacher absenteeism, the question of how to get poor children to the school when their parents might want to have them work instead, whether you want to use school vouchers, and so on. There is little doubt,

however, that, once we have put our minds to work and our shoulders to the wheel, we will move ahead on both Stage 1 and Stage 2 reforms.

Many of the reforms require good governance and indeed necessitate a role for the government in some areas (in the appropriate provision of health, for instance) even as they require withdrawal of the government from others (as with inappropriate labour laws). Can we do this?

It is easy to get despondent today about the deterioration in governance because many seem to surrender much too easily to the notion that we have become hugely corrupt and that this is irretrievably so. Thus, Transparency International's index of corruption ranks us high on corruption. However, this index is wholly arbitrary, depending on subjective evaluation of the chosen respondents. Besides, in India, public figures are considered to be corrupt unless they prove to you otherwise. A blind man will tell you how he saw "with his own eyes" a bribe being given and accepted. A most distinguished Indian bureaucrat once told me that his mother said to him: "I believe you are not corrupt only because you are my son".

The abolition of the permit raj, of course, eliminated that important source of corruption. But that also means that we have removed from our system the way in which politicians could raise money for their campaigns which, while not as expensive as in America, are still large enough to matter. This means that other forms of corrupt ways of raising political funds have proliferated. We need, therefore, legal ways to raise campaign finance. Americans have done this; we need to do so as well.

Then again, we can use science to get at corruption in several areas. Thus, Nandan Nilekani is engaged in arguably the most important innovative reform in recent years by creating a national database of identity details of Indian citizens.

This should take the political corruption out of the Public Distribution System and in the Employment Guarantee Scheme, for instance, and will also reduce bureaucratic corruption by bypassing the low-level bureaucrats who refuse to give you what you need unless you grease their palms.

In fact, what Nilekani is doing additionally is demonstrating anew how science is integral to our assault on poverty and other ills in our society. The enormous potential of science is variously manifested. To take just three examples:

- The invention of the cheap laptop by Media Lab at MIT and later by Intel, has almost made it possible financially to put a laptop into every lap;
- The invention of Embrace baby warmers for the millions of premature and low-birth-weight babies born each year is an important breakthrough, which will make it possible for them to sell at a price that is one percent of the traditional incubator; and
- The invention of BT Brinjal and other GM crops makes it possible to have a second round of the Green Revolution that we need so badly if we are to increase productivity in agriculture; but the government has to deploy scientific evidence and argumentation against the naysayers who have objected to these as Frankenstein foods and instead have been allowed to halt their use on flimsy, virtually unscientific grounds, including assertions of “agricultural suicides” that have been exposed often as unrelated deaths.

Perhaps we need to recall what Prime Minister Nehru said eloquently: “It is science alone that can solve the problems of hunger and poverty, of insanitation and illiteracy, of superstition and deadening of custom and tradition, of vast resources running to waste, of a rich country inhabited by starving poor...Who indeed can afford to ignore science today? At every turn, we have to seek its aid...The future belongs to science and those who make friends with science.”

Reflection on what I have said today should provide the agenda that the impressive young Members of the Lok Sabha, who clearly seek new perspectives and aim to accept fresh challenges, can embrace to take India to what Jawaharlal Nehru called our “tryst with destiny”. After 60 years of Independence, surely it is high time for his vision to turn into reality.

*This is the full, augmented text of the Hiren Mukerjee Lecture delivered in the Lok Sabha on December 02, 2010. The oral presentation is available on the Lok Sabha website (<http://164.100.47.132/inputprogram/Module/part2.pdf>).*