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**India Today and Yesterday**

**By**

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**The Prime Minister's visit in Washington at the end of November was spectacular, with the Obamas and the Singhs taking the center stage in the media. For those who have forgotten, similar attention came the way of Prime Minister Vajpayee when he came to Washington and was given the added honour of addressing the US Congress. Indeed, India and her leaders have become a major factor on the US scene since the days of the Clinton administration and, even more dramatically, under the younger President Bush. The assertion that we heard from President Obama that we are the world's leading democracies and therefore "natural allies", which sounded like a pious assertion with no political salience when intellectuals like me began to use it some time ago, has now become a cliché because it has come to be appreciated ever more widely.**

### **Two Decades of Reforms: The Turning Point**

**But this turn of events, reflecting our changed status in the world economy and therefore in the world polity, did not happen fortuitously like with a turn of the kaleidoscope. The change occurred as a result of our own policies.**

**As we contemplate the last decade, indeed the last two decades, it is impossible not to remember that India had slipped earlier into obscurity on the world stage, as its economy registered abysmal performance at near-3.5 % over nearly a quarter of a century, while the super-performers in the Far East grew at nearly double digits. India (along with China) was widely believed to be the "sleeping giant" that would wake up in the postwar period. But it had continued**

snoring as the smaller players such as the Lilliputian Far Eastern economies, with very different economic models, sprinted past India whose disastrous policy framework had seriously undermined India's economic performance. The "liberal" reforms that began in earnest under Prime Minister Rao and then Finance Minister Manmohan Singh after the 1991 balance of payments crisis, were the turning point.

The crisis itself was only the immediate cause; the real cause was that India's elite had come to realize that the old model, the inherited policy framework, was not working. For, if this conviction had not taken root, we could have reversed the reforms as soon as we had recovered from the payments crisis. Instead, we reinforced them in one way or another, under the Congress, then under the BJP, and then again under the Congress.

#### From Anti-Market Fundamentalism to Pragmatic Reforms

This is an important thing to remember as, with the current crisis in the world economy, which is a double crisis interacting between Wall Street (the financial sector) and the Main Street (the real economy) and hence very potent, the ever-hopeful anti-reform intellectuals in India seek to find new reasons to discount and denounce the reforms. So, they turn to financiers like George Soros, and populist economists like Joe Stiglitz, who assert that the crisis shows that "market fundamentalism" is dead, as is the "Washington Consensus" for the developing countries. But these are absurd arguments, coming from ignorance. The proper answer to these people and their ilk is: "go home and ruin your own countries".

India (as did many other developing countries in the postwar period since decolonization), for reasons which were explored by me in my Radhakrishnan Lectures at Oxford (India in Transition, Clarendon Press, 1993), had wound up embracing a policy framework that consisted of three counterproductive elements. First, there was knee-jerk interventionism to a degree that only those of us who looked closely could appreciate. Second, the public sector had expanded hugely, not just in public utilities but in every industrial activity, often with monopoly positions created by preventing entry of private sector firms at home or from abroad. These two policy approaches were tantamount to what we should call “anti-market fundamentalism”. Their ill-effects were compounded by a third element: the fear that integration into the world economy would lead to the disintegration of the Indian economy, so inward-looking policies had steadily reduced our trade share in world trade and decimated the inward flow of equity investment by foreign firms, and had cut us off from the gains from trade and equity investment which, in varying combinations, had produced the East Asian miracle.

That we were in a critical stage where we had to change our policies or become totally marginal players on the world stage was a perception which had become widespread when the reforms began. But there was also the added element that a slow-growing economy had failed to lift our masses out of abysmal poverty. While a growing economy may have an inadequate effect on pulling people out of poverty through creation of opportunity, it is surely commonsense that a stagnant economy will certainly be worse: just as businesses making losses cannot finance Corporate Social Responsibility. I should also add that, as I argue in depth in my

book, In Defense of Globalization (Oxford, 2004), growth will also facilitate social improvements by making progressive legislation meaningful: for instance, one can reform the Divorce laws so a woman can walk out of a bad marriage, but that is no help if she cannot find a way to support herself as is more likely to happen when the economy is growing rather than stagnant.

So, we had shot ourselves in the foot, even in both feet and above, by following a policy framework, a model or template, that produced little growth and hence little impact on poverty and social improvement of the many poor. That was not merely bad in itself, for it undermined the shared objective of Gandhiji and Pandit Nehru and other leaders of India after Independence that we eliminate poverty in India and modernize our social legislation as with the Hindu Code Bill. But it also further reduced our influence on the world stage. How could we command attention when the world could see the massive poverty and our failure to make a serious dent on it?

### Two Stages of Reforms: Then and Now

There is little doubt that these reforms, which I call Stage 1 reforms (following the distinction I drew between direct and indirect effects of growth on poverty almost a quarter century ago in my 1987 Vikram Sarabhai Lecture in Ahmedabad on “Poverty and Public Policy”), which started dismantling the crippling policy framework of the pre-reforms period, have produced since the 1990s the economic growth that we had hoped for. They have also led to a significant impact on poverty. By conventional definitions of poverty, nearly all observers are agreed that the acceleration of the growth rate over nearly two

decades, a near doubling of our average growth rate, has lifted over 200 millions of the poor above the poverty line ( though, before you break out the champagne bottle, remember that they are still poor and there are many more who are still below the poverty line).

The fact still is that we still have a long way to go in completing these Stage 1 reforms. The old policy framework was so extensive that dismantling it is like cleaning up after a tsunami: it cannot be done in one fell sweep. So, the Prime Minister has to reform the labour legislation where both rights and obligations must be recognized. Little privatization has occurred; though, the fact that imports have become more liberal, the entry of private sector firms like the new airlines has been allowed, and the licensing machinery has been virtually dismantled, has made the public sector more efficient through competition. Agriculture and services need to be progressively subjected to more import competition just as we exposed the manufacturing sector to progressively greater import competition, with good rather than bad results for our industry. We can produce yet greater and sustained prosperity, and therefore yet greater impact on poverty reduction, by completing more Stage 1 reforms. The Prime Minister needs to keep on this path instead of being diverted into inaction or misdirected anti-reforms policies by calls for “social justice” from the people whose advocacy of the disastrous pre-reforms policy framework accentuated the very poverty they now accuse us of having ignored. Calls for social justice ring hollow when the policies one espoused led to its denial in practice by undermining the economic prospects of the poor!

**But the success of the Stage 1 reforms, with its direct impact on poverty, can be supplemented by what I call Stage 2 reforms now that a growing economy has finally begun to provide the revenues that can be spent on additionally helping the poor. The Prime Minister has remarked that, without revenues, he was handicapped from doing so. This is no longer so. The Stage 2 reforms are in fact particularly difficult because they involve “social engineering”. Thus, if we are going to provide more effective access of the poor on primary and secondary education, we have to worry about absentee teachers, about the optimal size of classes, about the role of school vouchers for the poor, and other issues where there is a lot of controversy in most countries and not just in India. For higher education, we have the problem of reservations, an issue that raises questions about the best form of affirmative action. The Employment Guarantee Scheme is yet another way to spend the new moneys on Stage 2 reforms. But here, there is even more controversy since there is the not-groundless fear that the moneys will disappear into the pockets of the politicians at the ground level, and that such schemes will produce more graft and corruption instead of helping the poor.**

**These are the areas where we will see more research and then informed action. But it is surely the way ahead. Stage 2 reforms are sometimes presented as an alternative to Stage 1 reforms: a noted economist, whose embrace of the pre-reforms policy framework put us back by a generation in our efforts at reducing poverty, is fond of saying that we should worry about poverty and not about whether Coca Cola should be allowed to invest in India. He could not be more wrong. It is not just that we are not like President Ford who could not do two things**

at one time. It is also that we need to do both. Stage 2 reforms are dependent on the success of Stage 1 reforms.

Fortunately, the Prime Minister understands this; but he needs to articulate it better. Just as he taught President Obama why India was on a better economic and political path than China, whom the President seemed to be in awe of, he can also learn from the President's eloquence and how to translate his profound grasp of what India needs in its economic policy framework into a bold vision to be put before the country.

### Poverty, Inequality and Democracy

He also needs to confront the easy assertion of the anti-reformers that Stage 1 reforms have brought about increased inequality and therefore need to be reversed or moderated. I believe, as does the noted economist Arvind Panagariya who is busy with a project analyzing these hypotheses empirically in depth, that the reforms, by finally helping to reduce poverty, have led to a Revolution of Perceived Possibilities. As long as we were stagnant, there was fatalism: as we would say in Hindi: "aise hee chalta hai". But now, aspirations have been aroused. The masses know that, while Oliver Twist asked for more and got less, they can ask for more and translate that into political demands at the voting booth. So, Stage 1 reforms have meant that the poor are finally awake and want more results: the Stage 1 reforms therefore have to be accentuated and supplemented with the Stage 2 reforms that they make possible.

On the other hand, if you believe that people are responding with anger to changing Gini coefficients measuring inequality, or to urban-rural disparities in



**average incomes, or to what is the share of income in India going to the top 5% and the bottom 5%, and that they believe that reforms are the cause of increasing disparities, then they would be voting against the reforms. Then, the Prime Minister would be inhibited from proceeding with the reforms if this view gains ascendancy.**

**I believe that the inequality-view is mistaken and the poverty-view is the correct one. Some of the polling data by political scientists such as Al Stepan and his associates strongly suggest that a majority of the poor in the rural areas believe that they improved their well-being in the past few years; the majority also expects that to carry into the future. If this result is robust, and confirmed by further analysis by Professor Panagariya's research team, then the Prime Minister needs to stick to an intensification of the incomplete Stage 1 reforms and then to choose carefully from the Stage 2 reforms that he would then be able to build on the success of the Stage 1 reforms.**