

## **This is how economic reforms have transformed India**

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*Jagdish Bhagwati, University Professor, Economics and Law, Columbia University, delivered the Third Hiren Mukerjee Memorial Annual Parliamentary Lecture in the Central Hall of Parliament House on December 2, 2010. Here are the edited excerpts of his excellent analysis of how the economic reforms have benefited India:*

Perhaps the most appropriate tribute to the memory of the illustrious parliamentarian, Professor Hiren Mukerjee, would consist in the celebration of 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.

**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'. I must 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.

### **Even bitter critics praise India's boom**

But let 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 sceptical 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 September 10th, 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'.**

### **Some 'non-fiction' on India's growth**

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 immiserized, 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 2, 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 follow a period of abysmal growth rates in the range of 3.5 to 4.00 per cent annually for over a quarter of a century, starting in the 1960s. The cause 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:

1. 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;
2. 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

3. 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.

### **Policy changes not imposed by US**

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 that the Indian policy changes were imposed from outside, reflecting what has come to be known by ill-informed observers as the Washington Consensus 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.

### **Why the transformation came about**

In all three cases, the driving force was endogenous, a realization 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.

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 per cent in 1990-91, was reduced steadily, avoiding the folly of 'shock therapy', and now stands at 12 per cent.

While privatization would prove politically difficult, its intended effects in terms of efficiency of management were often achieved by opening up entry by private firms into sectors hitherto 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.

### **Competition mattered**

I remember how, on a flight of Indian Airlines from Mumbai to Delhi, the stewardess had brought breakfast with the tea already made Indian-style: one part tea, four parts milk, and 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 per cent, nearly doubled in the 1990s and increased still further in the next decade and has recently been close to 9 per cent.

The sense that India was now an 'emerging superpower' was a heady experience for Indian elites who had seen their country marginalized 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 immiserized?**

**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 135th rank, in 1994.**

**But this is a nonsensical index which reduces, without scientifically plausible weights, several non-commensurate elements like literacy and health measures to a single number.**

### **Media helps bad science gain traction**

**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 per cent of India's poor above the poverty line so they would enjoy a 'minimum standard of living'; and we 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 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, not as a passive, conservative 'trickle down' strategy, to reduce poverty.**

The growth strategy to pull the poor up from poverty, however, did not work because growth itself did not materialize 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 year 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 per cent of those surveyed in the east and 38 per cent 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 per cent 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 hypothesized, 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.**

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 liberalization 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.

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.

How to get the most bang for the buck from programmes under Stage 2 reforms is where we have to turn 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.**

**But 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'.**

**Equally, it is wrong to think that we cannot think of institutional reforms that can reduce the corruption we do have. 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:

1. 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;
2. The latest invention of Embrace baby warmers for the millions of premature and low-birth-weight babies born each year; these are slated to sell at a price that is 1% of the traditional incubator; and
3. **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 sixty years of Independence, surely it is high time for his vision to turn into reality.