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1991: economic liberalization and political process

The reality in the national context and conjuncture in the international context enabled a minority government to introduce far-reaching changes

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Over the past three months, 1991 has received much attention in newspapers. This is no surprise. It is 25 years since July 1991, when economic liberalization began life in India. For some, those who lived through the times as adults, it is etched in memories as a watershed. For most, particularly those who were young, or at school, or not yet born, it is essentially folklore. The focus has been on the economy and the dramatis personae at the time.

Until not so long ago, the common perception was that Manmohan Singh, finance minister (FM) at the time, and prime minister (PM) later for a decade, was the architect of economic liberalization in India. The recent reportage, analyses and interviews have corrected that belief. P.V. Narasimha Rao, PM then, has received some recognition and credit, even though the Congress party had sought to minimize, if not erase, his role from memory. These correctives have also been made explicit in two books, published recently, by Vinay Sitapati and Sanjaya Baru.

I lived through that era as chief economic adviser to three successive governments in a span of two years marked by economic crises and political uncertainties. As a witness to, and participant in, the process, there are three propositions I wish to stress in this article. First, the story of July 1991 began much earlier, although it surfaced in late 1990. Second, there were many actors, in leading or supporting roles, in this drama. Third, it was the largely ignored political process, driven by the economic compulsions of the time, which made liberalization possible.

History fosters understanding by tracing origins. During the 1980s, the competitive politics of populism, reinforced by the cynical politics of soft options, led governments into a spending spree. But it was not possible for the government, or the economy, to live beyond its means year after year. Government finances became progressively unsustainable. The inevitable crunch did come in the form of an acute economic crisis that was waiting to happen.

It was triggered by an increase in world crude oil prices, following Iraq's invasion of Kuwait in August 1990. The balance of payments situation became almost unmanageable. The fear of acceleration in the rate of inflation loomed large. The underlying fiscal crisis was acute.

The V.P. Singh government that assumed office in December 1989 inherited the problem. But it did not act soon enough, probably lulled into false comfort by the same advisers who had assured Rajiv Gandhi that the situation could be managed. However, the minor oil shock did strengthen a growing cognition of the impending crisis. Alas, the political situation became more complicated. There were mounting strains in the coalition supported by the Bharatiya Janata Party (BJP) and the left from outside but not in government. Growing agitations on reservations for Other Backward Classes compounded problems. Even so, in early October 1990, Singh authorized initiating negotiations with the International Monetary Fund (IMF). This was in sharp contrast with Gandhi's decision in September 1989 to reject a proposal that suggested approaching the IMF.

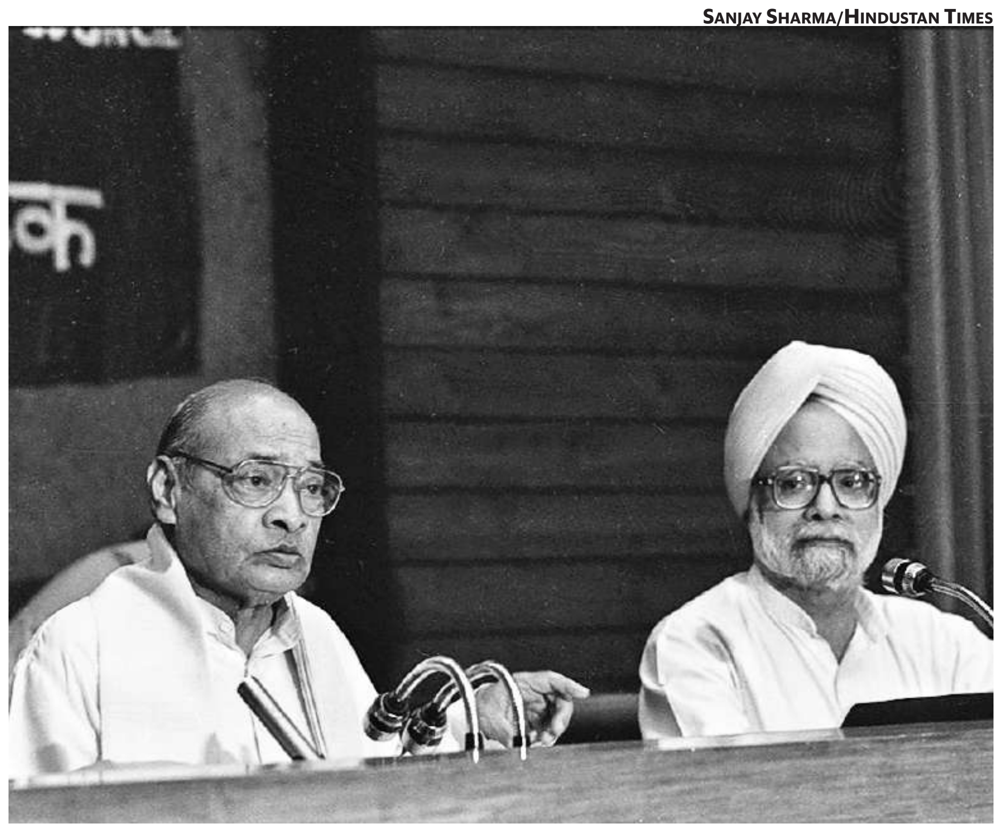
In November 1990, Singh lost the vote of confidence in Parliament and was succeeded by Chandra Shekhar as PM. To begin with, the PM was hostile to the IMF. A cabinet minister, who promised to bring $2 billion from the Sultan of Brunei and super-rich non-resident Indians, was given two weeks' time. It was no surprise that he failed to deliver. A fortnight later, Chandra Shekhar authorized resumption of negotiations with the IMF. The resistance was transformed into an acceptance based on the realization that India was close to default on its international payment obligations and that the IMF was needed not simply as a lender of last resort but also for its imprimatur, essential to restore international confidence.

Our negotiations with the IMF had the complete support of Yashwant Sinha, then FM, and the PM. We managed to get $1.8 billion under the first credit tranche and the compensatory and contingency financing facility (to help meet the increased cost of petroleum imports) in January 1991 after tough bargaining, almost without conditions. The Union budget exercise began in right earnest and was completed. The broad contours of this budget, which Sinha could not present to Parliament as scheduled in February 1991 because the Congress party withdrew support, were broadly the same as what was ultimately presented in July 1991.

We had a caretaker government and a general election to come. The assassination of Gandhi in May 1991 in the midst of the election campaign prolonged the interregnum. Foreign exchange reserves were perilously low. There was capital flight from non-resident deposits. The prospect of default hung over our heads like the sword of Damocles. In April 1991, the caretaker government decided to ship 20 tonnes of gold, confiscated from smugglers, to raise $200 million. In a society where only a bankrupt household would mortgage its gold, and Chandra Shekhar said so in chaste Hindi when he approved, it was a brave decision that was also high-risk.

It was fire-fighting day-by-day and surviving month-by-month, while working at solutions, and strategizing for what needed to be done when a government was in place. These events do highlight the resilience of the political process despite all its flaws and warts. Two short-lived governments that inherited an economic crisis made tough decisions instead of postponing the day of reckoning. The governmental system and its institutions did everything possible to avert default even when there was no elected government that could make policy decisions.

Rao assumed office as PM on 21 June 1991, and appointed his cabinet, with Manmohan Singh as FM, three days later. Critical decisions were made within one month. Exchange rate adjustments were announced on 1 and 3 July. Gold from the reserve assets of Reserve Bank of India (RBI), to raise $400 million, was shipped out soon thereafter. On 24 July 1991, the statement on industrial policy announced dramatic changes in the morning, while the Union budget presented to Parliament announced far-reaching decisions, way beyond the remit of conventional budgets, in the evening. It must be said that any government that had come to power in mid-1991 would have done roughly the same. The blueprints existed. There was little choice. However, it was possible only for an elected government with a mandate from the people.



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Even so, there is a political question that arises. How were such far-reaching changes introduced by what was then a minority government (some were announced even before it had established its majority in Parliament), while Gandhi with an overwhelming majority was unable to do so despite stated intentions of liberalizing.

The answer is provided by reality in the national context and conjuncture in the international context. For one, the changes were dictated by the immediate economic compulsions of crisis management, combined with a political realization that the outside world was no longer willing to lend to India and that governments could become insolvent even if countries did not go bankrupt. For another, the collapse of communism and the break-up of the erstwhile USSR removed the countervailing force that had always been a prop for India, to replace competing ideologies with a dominant ideology.

There were three other supportive factors. The emerging concerns about efficiency and productivity had led to rethinking about the economic policies, through the late 1980s, so that the manifesto of every political party for the 1991 election, across the ideological spectrum, talked about the need for restructuring the economy. There was also a consciousness among politicians across parties, which did not necessarily mean an understanding, about the crisis in the economy. Above all, the political system was somewhat tired of conflict, so that opposition parties were simply not willing to bring down the government and force another round of elections.

There is nothing better than a crisis to focus minds. Yet, debates might have continued and laws of inertia—characteristic of economy and polity in India—might have prevailed. It was Rao, the consummate politician, who made a difference. In sharp contrast with his own political past, he was most decisive in this incarnation. The decisions about the exchange rate adjustments, the shipping of gold from RBI vaults, the tough measures incorporated in the Union budget designed to sharply reduce the fiscal deficit, including the increase in prices of petroleum products, the slashing of subsidies on fertilizers and food, turned out to be possible because Rao was so decisive, whether in the cabinet committees or in discussions with the ministers and officers concerned. He could have kept a plaque on his table that read "the buck stops here".

Rao was just as deft in political management. He saw that political support for economic reforms was minimal. There was no consensus even in the ruling party, let alone across the political spectrum, about what needed to be done. But he recognized the political value of the reality in the national context and the conjuncture in the international context. And he exploited to the fullest the three other supportive factors mentioned above. Even if silence did not mean consent, he treated it as acceptance. There were a few trade-offs, but he did not waver.

This determination was highlighted in a striking manner 10 years later. The occasion was the release of a book by my friend Arjun Sengupta titled *Reforms, Equity And The IMF: An Economist's World* at the India International Centre, New Delhi, in early January 2001. The panellists invited for the discussion were Rao, Manmohan Singh and me. In keeping with protocol, I spoke first, mostly about Sengupta and his work. Manmohan Singh spoke next, largely about economic liberalization and economic reforms during his tenure as FM from 1991-96. Rao spoke last. After the preliminaries, his opening sentence was: "Finance Ministers are much like zeros. Their value depends on what you put before them. The digit on the left is provided by the PM." Clearly, in 1991, politics was in command.

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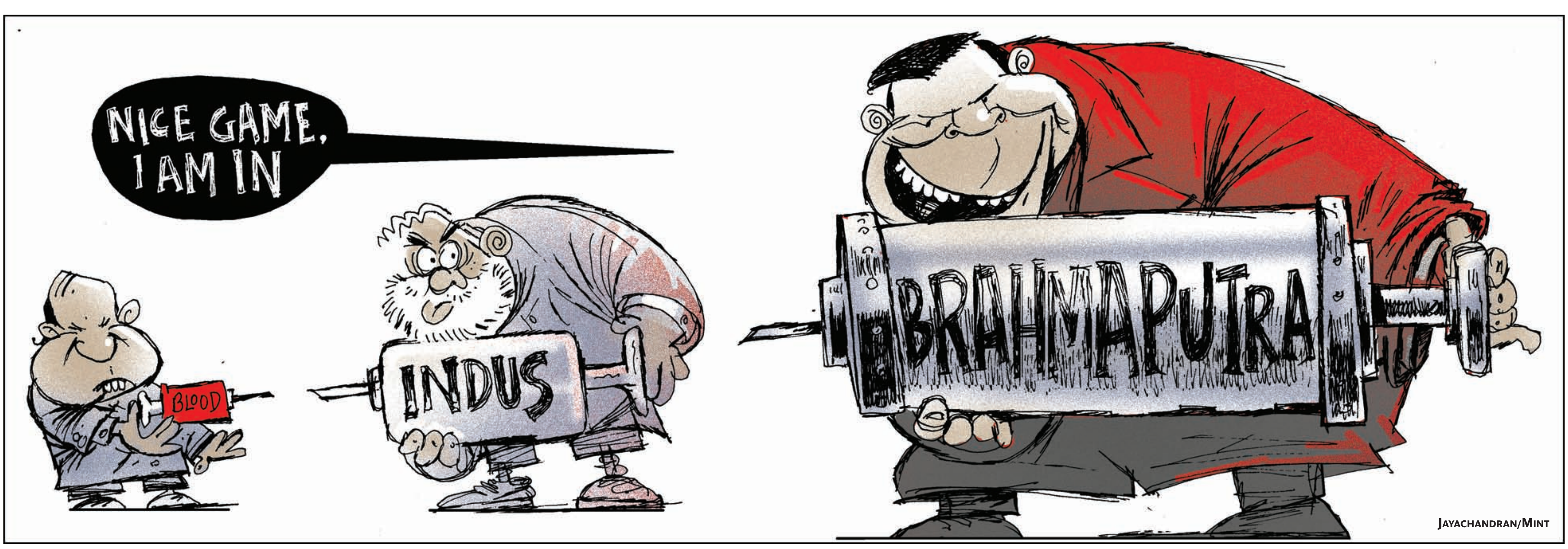

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