Economic Liberalisation in India
Then and Now

DEEPAK NAYYAR

Even if adjustment and reform in 1991 were driven by economic compulsions, it was the political process that made these possible. However, liberalisation was shaped largely by the economic problems of the government rather than by the economic priorities of the people or by long-term development objectives. Thus, there were limitations in conception and design which have been subsequently validated by experience. Jobless growth, persistent poverty and rising inequality have mounted as problems since economic liberalisation began. And, 25 years later, four quiet crises confront the economy, in agriculture, infrastructure, industrialisation and education as constraints on the country's future prospects. These problems must be resolved if economic growth has to be sustained and transformed into meaningful development. In this quest, India needs a developmental state for its market economy to improve the living conditions of her people.

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Deepak Nayyar (*nayyar.deepak@gmail.com*) is Professor Emeritus at the Centre for Economic Studies and Planning, School of Social Sciences, Jawaharlal Nehru University, New Delhi.

For the economy of independent India, 1991 was a tumultuous and momentous year that witnessed radical departures from the past. Over the past six months, it has been the focus of much discussion not only in the media, but also among scholars in economics and politics. This is no surprise. It is 25 years since July 1991, when economic liberalisation began life in India. For those who lived through the times as adults, it is etched in memories as a watershed. For those who were young, or at school, or not yet born, it is essentially folklore.

The object of this article is to analyse economic liberalisation in India during the past quarter century. In doing so, it traces its origins and examines its limitations, to discuss the implications of outcomes that have unfolded, and problems that have surfaced for economic development in India. The article is divided into three parts. The first part outlines the story of 1991 to focus on how liberalisation began life, to consider not only the economics but also the politics of the process. The second part sets out the economic rationale of reforms and changes introduced then to examine the limitations that were discernible at the time and have been subsequently validated by experience. The third part shifts attention to the present to highlight some outcomes and some problems, visible now, that might constrain future development prospects, and suggests what needs to be done. In conclusion, the article argues that it is absolutely essential to rethink and redefine the economic role of the state in the quest for development.

The Story of 1991

At the outset, before starting my narrative of those times, there is a disclosure to be made. 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 here. 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 liberalisation possible.

It is essential to trace the origins of what transpired then, simply because history fosters our understanding of reality. 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 (Nayyar 1996). It was triggered by an increase in world crude oil prices, following Iraq's invasion of Kuwait in August 1990. This minor oil shock was the proverbial last straw that broke the camel's back (Bhaduri and Nayyar 1996). 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 uncertain political situation, which was superimposed on an economy already under severe strain, exacerbated problems.

The V P Singh government that assumed office in December 1989 inherited the problem as legacy. 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 authorised initiating negotiations with the International Monetary Fund (IMF). This was in sharp contrast with Rajiv 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 Prime Minister. To begin with, the then Prime Minister 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 (NRIs), was given two weeks' time. It was no surprise that he failed to deliver. A fortnight later, as it became clear that there was no such miracle on the horizon, Shekhar authorised a resumption of negotiations with the IMF. The resistance was transformed into an acceptance based on the realisation that India was close to defaulting on its international payments obligations and an understanding that the IMF was needed not simply as a lender of the last resort but also for its imprimatur essential to restore international confidence.

Achilles Heel of Economy

The external debt crisis and payments situation was the Achilles heel of the economy. It was particularly vulnerable for three reasons: short-term debt was about $6 billion, of which $2 billion was rolled-over every 24 hours with overnight borrowing in international capital markets; outstanding NRI deposits, more than $10 billion, were prone to capital flight, while foreign exchange reserves were a mere $1 billion that were not enough to finance imports even for a fortnight, let alone debt service payments (Nayyar 1996). The prospect of default hung over our heads like the sword of Damocles.

The negotiations with the IMF, which I led, had the complete support of Yashwant Sinha, then Finance Minister, and Shekhar. The use of the first credit tranche and the Compensatory and Contingency Financing Facility (to help meet the increased cost of petroleum imports) at the IMF helped raise $1.8 billion 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 could not be presented to Parliament by Sinha as scheduled in February 1991 because the Congress party withdrew support, were broadly the same as what was ultimately presented in July 1991.

The accentuated political uncertainties that surfaced were juxtaposed with an already formidable macroeconomic crisis. The challenge was to manage the crisis in the short term and return the economy to a path of sustained growth with price stability in the medium term. It was fire-fighting day-by-day, surviving month-by-month, while working at solutions, and strategising for what needed to be done when a government was in place. This was an exercise in multitasking. The IMF loan provided some breathing time, but not for long, as the relentless pressure of the liquidity crunch persisted. Cash margins on imports were raised from a substantial 50% to a whopping 200% in March 1991. Some debt service payments, on earlier defence purchases, were deferred through discussion and mutual agreement. As events unfolded, it seemed that all these efforts might not be enough.

There was a caretaker government and a general election to come. The assassination of Rajiv Gandhi in May 1991 in the midst of the elections prolonged the interregnum. Foreign exchange reserves were perilously low. There was capital flight from non-resident deposits. In April 1991, the caretaker government decided to ship 20 tonnes of gold, confiscated from smugglers, to raise $200 million from the Union Bank of Switzerland through a sale with a repurchase option. In a society where only a bankrupt household would mortgage its gold, and Shekhar said so in chaste Hindi when he approved, it was a brave decision that was also high risk.

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.

P V Narasimha Rao assumed office as Prime Minister on 21 June 1991, and appointed his Cabinet, with Manmohan Singh as Finance Minister, three days later. Critical decisions were made within one month. Exchange rate adjustments, which were announced in two steps on 1 and 3 July, led to a depreciation of the rupee by 23.3% vis-à-vis the US dollar. Gold from the reserve assets of the Reserve Bank of India (RBI), 47 tonnes, was shipped out soon thereafter to raise $405 million from the Bank of England and the Bank of Japan. 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. Around then, I was also tasked to negotiate a Stand-By Arrangement with the

IMF and a Structural Adjustment Loan with the World Bank, both of which were concluded in September 1991. 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. And the room for manoeuvre was negligible. However, it was possible only for a government elected by the people to make these decisions.

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

The answer is provided by reality in the national context and conjuncture in the international context (Bhaduri and Nayyar 1996). For one, the changes were dictated by the immediate economic compulsions of crisis management, combined with a political realisation that the outside world was no longer willing to lend to India and that governments can become insolvent even if countries do not go bankrupt. For another, the collapse of communism and the break-up of the erstwhile Union of Soviet Socialist Republics (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 elections, 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.

Obviously, there is nothing better than a crisis to focus minds. Yet, debates might have continued and laws of inertia—characteristic of the economy and the polity in India—might have prevailed. It was a minority government that had not yet won its vote of confidence, which acted promptly and decisively. There can be little doubt that its actions were largely crisis-driven, which would simply not have been possible to conceive or design, in the short span of one month, without plans-in-place put together by many individuals and institutions in the governmental system over the preceding six months, if not longer. Yet, it would be reasonable to ask who the decisive factor among the dramatis personae was at the time. Until not so long ago, the common perception was that Manmohan Singh, the then Finance Minister, and Prime Minister later for a decade, was the architect of economic liberalisation. This was not so. In fact, recent reportage, interviews and analyses have corrected that popular belief. And, Rao, Prime Minister then, has received some recognition and credit, even though the Congress party has sought to minimise, if not erase, his role from memories. These correctives have also been made explicit in two recently published books (Sitapati 2016; Baru 2016).

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, particularly on the economy. 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 substantial increase in the prices of petroleum products, the slashing of subsidies on fertilisers and food, turned out to be possible essentially because Rao was so decisive, whether in the cabinet committees or in discussions with concerned ministers and officers. He could indeed have kept a plaque on his table that read "the buck stops here."

Prime Minister Narasimha 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 recognised 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, or compromises, but he did not waver.

Rationale and Limitations

Beyond the narrative, it is necessary to set out the rationale for the changes introduced in mid-1991, in the wider context of the economy. This would help highlight the striking differences with the past, which would also help examine the limitations in conception and design that were discernible at the time, and have been subsequently validated by experience.

There were earlier episodes of liberalisation in the late 1970s and the mid-1980s, which were perceived as correctives for an industrialising economy, but did not contemplate any fundamental changes in the objectives or strategy of development (Nayyar 1994). The changes in 1991 were significant enough to be characterised as a shift of paradigm. It is worth highlighting three dimensions (Nayyar 1996). First, the essential objective was economic growth combined with economic efficiency. The earlier concerns about equity were subsumed in the pursuit of growth on the premise that it would reduce poverty. Second, there was a conscious decision to substantively reduce the role of the state in the process of development and rely far more on the market. In doing so, the large share of the public sector in investment and output would be reduced, while the government would no longer guide the allocation of scarce investible resources in the private sector. Third, the degree of openness of the economy in trade, investment and technology was sought to be increased significantly and rapidly. The idea was to enforce a cost-discipline on the supply side, and the hope was that foreign investment and foreign technology would perform a strategic role in industrialisation.

The economic reforms introduced in July 1991 had two components: macroeconomic stabilisation and structural reform. The object of the former was to manage the fragile balance of payments situation by reducing the current account deficit and curb inflationary expectations by reducing the rate of inflation. The focus was on the demand side. The time horizon was the short-run. Once the economy in crisis had stabilised, this adjustment at the macro level was expected to return the economy to a path of sustained growth. The object of the latter was to raise the rate of growth of output. The focus was on the supply side. The time-horizon was the medium-term and beyond. Structural reform was meant to shift resources from the non-traded goods sector to the traded goods sector (within it from import-competing activities to export activities) and from the government sector to the private sector, to improve resource allocation. It was also meant to improve resource utilisation by increasing the degree of openness of the economy and by changing the structure of incentives which would reduce the role of the government to rely more on the market, dismantle controls to rely more on prices, and wind down the public sector to rely more on the private sector.

Prudent Macroeconomic Management

For an economy in crisis, a return to prudent macro-management of the economy was both necessary and desirable. The fiscal adjustment in the union budget for 1991–92 was sorely needed. The exchange rate adjustment was necessary to stem destabilising expectations, dampen imports and stimulate exports. Even the sale and pledge of gold was an important symbolic gesture that helped restore confidence in international capital markets. There was no default on international payments obligations. The economy in crisis was stabilised. In the short-run, the contraction in demand led to a sharp slowdown in growth. But the current account deficit was reduced to manageable proportions within three years. It took a little longer for the rate of inflation to drop below double-digit levels. Growth in gross domestic product (GDP) returned to pre-crisis levels in five years (Nayyar 2001). In this transition from crisis to stabilisation, India did far better than most developing countries.

The limitation was that the idea of prudent macro-management was reduced to a fetishism about the gross fiscal deficit of the government (Nayyar 1996). The size of the fiscal deficit, or the amount of government borrowing is the symptom and not the disease. And there is nothing in macroeconomics which stipulates an optimum level to which the fiscal deficit must be reduced as a proportion of GDP. Indeed, it is possible that a fiscal deficit at 6% of GDP is sustainable in one situation, while a fiscal deficit at 3% of GDP is unsustainable in another situation. The real issue is the use to which government borrowing is put in relation to the cost of borrowing by the government. Thus, government borrowing is always sustainable if it is used to finance investment and if the rate of return on such investment is higher than the interest rate payable (Bhaduri and Nayyar 1996). The misplaced emphasis on the gross fiscal deficit led to a neglect of the revenue deficit (revenue receipts plus non-tax revenues minus consumption expenditure) which shows whether the fiscal situation is sustainable, or the primary deficit (gross fiscal deficit minus interest payments) which shows whether the fiscal situation is getting better or worse.

The focus of structural reforms was on the industrial sector, the trade regime, foreign investment, foreign technology, the public sector and the financial sector.

Industrial policy reform removed barriers-to-entry for new firms and limits on growth in the size of existing firms. The dismantling of the complex regime of controls on investment decisions embedded in the licence–permit raj was both necessary and desirable. But there was no symmetrical removal of barriers-to-exit. And no anti-trust legislation was put in place (Nayyar 1996). The competition law came more than a decade later. It is a watchdog mostly without teeth, so that it does not effectively regulate the market to ensure necessary competition among domestic firms.

Trade policy reform abolished the complex import-licensing system, slashed import tariffs and eliminated export subsidies. Some of this was much needed. But import liberalisation hurt the manufacturing sector and the problem was exacerbated by the absence of effective anti-dumping laws. Exposure to international competition was meant to force domestic firms to become more efficient but the pace of change could have enforced closures rather than efficiency at a micro level. In terms of speed and sequence, increased openness in trade should have been compatible with initial conditions and consistent with each other (Nayyar 1996, 2004).

Similarly, the policy regime for foreign investment and foreign technology was liberalised at a rapid pace, in the hope of stimulating non-debt-creating capital inflows and enhancing international competitiveness. There was nothing selective or strategic about this approach, which was necessary to foster industrialisation. It also failed to recognise that imports of technology cannot substitute for domestic technological capabilities. There was a clear and present danger that such non-discriminatory openness could simply replace domestic firms by foreign firms, instead of making domestic firms more competitive with foreign firms, in the manufacturing sector.

Public sector reform sought to reduce the activities of the public sector, facilitate the closure of loss-making units and ease the burden on the exchequer on account of the public sector. It was long on words and short on substance. In fact, it was mostly about asset-sales or closures, which meant selling the flagships and keeping the tramp-ships, or sending a few white elephants to the slaughter house. The dire need to restructure public sector firms or increase their efficiency was simply neglected (Nayyar 1996, 2004).

Financial sector reform sought to improve the profitability of government-owned commercial banks and the functioning of the domestic capital market, assuming that the discipline of market forces alone will achieve both objectives. Reform dispensed with over-regulation but did nothing to address the problem of under-governance by creating institutional structures and legal frameworks for governance. The short-term outcome was that scams proliferated (Bhaduri and Nayyar 1996). The deregulation and liberalisation of the financial sector also carried the risk of changing incentives and rewards in its favour at the expense of the real sector of the economy.

Apart from these specific limitations in each sphere, there are some general analytical limitations in the economic logic underlying structural reforms. First, resources are neither as mobile nor as substitutable in use across sectors as orthodoxy believes. In fact, economies are characterised by structural rigidities rather than structural flexibilities. Second, the belief that getting-prices-right makes an elementary but commonplace error in the design of policies. It confuses *comparison* (of equilibrium positions) with *change* (from one equilibrium position to another). In the real world, economic policy must be concerned not only with comparison but how to direct the process of change. Third, the presumption that policy regimes that are necessary are also sufficient is wrong. Policy regimes can allow things to happen but cannot cause things to happen. And there is nothing automatic about competition. The creation of competitive markets that enforce efficiency may, in fact, require strategic interventions through policies, just as it may require the creation of institutions.

It is clear enough that both macroeconomic adjustment and structural reforms were driven by economic problems confronting the government in mid-1991. The immediate short-term compulsions were managing the critical balance of payments situation, manifest in the external debt crisis, and controlling inflation to restrain inflationary expectations. The medium-term needs were finding a sustainable solution to the fiscal crisis, through fiscal adjustment, and returning the economy to a path of sustained growth, through structural reforms that would increase in the productivity of investment and make the economy more efficient in its use of resources. The economic priorities of the people and long-run national development objectives were not part of either the conception or the design of economic liberalisation at the time.

The problems of management of the economy are largely the concern of the government and, with the exception of inflation, do not concern the people of India. Economic priorities, however, are a different matter, for these are determined by the needs and aspirations of people. Those who live in absolute poverty do not have the incomes to meet their basic human needs in terms of food, clothing and shelter, leave alone healthcare and education. For the poor, who do not have any assets and have nothing to sell but their labour, employment is the only means of improving their living conditions and eradicating their poverty. Yet, poverty and employment were simply not part of the discourse on economic liberalisation. There was an unstated presumption that economic growth would reduce poverty and create employment.

Similarly, the debate on economic liberalisation proceeded as if the agricultural sector or rural India does not exist or, if it exists, it does not matter. This was incredible for an economy in which two-thirds of the workforce was directly or indirectly employed in agriculture, while rural India was home to a larger proportion of the total population and to more than three-fourths of the poor. Obviously, no sensible restructuring of the economy is even thinkable without a clear perspective on agriculture. For ordinary people in India, their well-being is also shaped by the infrastructural facilities, whether physical infrastructure such as roads, electricity, public transport and railways, or social infrastructure such as drinking water, sanitation facilities, health services and schools. The high-priests of economic liberalisation were more concerned with expenditure cuts for fiscal adjustment and believed that, the private sector would provide what the government could not.

The focus of economic liberalisation, then, was so much on the short-run or the medium-term, that national development objectives in the long-run were largely neglected. It is ironical that so little was said or done about social sectors—education and health—in an economy where improving the quality of human resources was the only means of mobilising our most abundant resource, people, for development. There was a similar neglect of managerial and technological capabilities among firms and technological development in the economy at the macro level (Nayyar 2011).

Outcomes and Problems

It is not possible to provide a systematic assessment of economic liberalisation over the past 25 years. This would need another article. However, it is possible to highlight some outcomes that have unfolded and some problems that have surfaced, particularly those which have implications for the future.

The rapid economic growth in India is often attributed to economic liberalisation but this is not quite correct. If we consider the 20th century in its entirety, the turning point in economic performance, or the structural break in economic growth, is 1951–52. If we consider the period 1950–51 to 2000–01, the turning point in economic growth is 1980–81 (Nayyar 2006). During the 20th century, the most significant structural break, or departure from the long-term trend in economic growth, was 1951–52, followed by 1980–81. In either case, 1991 was not a turning point (Nayyar 2006; Rodrik and Subramanian 2005). And even if we consider period 1980–81 to 2010–11 (since growth slowed down starting 2011–12), the turning point is 2003–04. Therefore, it is not possible to attribute the significant jump in India's growth performance to economic liberalisation even on a post hoc, ergo propter hoc basis. Of course, it is likely that economic liberalisation contributed to sustaining rapid growth rates from the mid-1990s, just as the boom in the world economy contributed to the further acceleration in growth rates during 2003–04 to 2007–08.

It is just as important to recognise that India has met with more success than most developing countries and transition economies following economic liberalisation. This success is, to a significant extent, attributable to institutional capacities which existed at the time that the reforms were introduced. And the essential foundations were provided by the preceding four decades of economic development in India. The entrepreneurial abilities were created. A system of higher education was developed. The social institutions and the legal frameworks necessary for a market economy were in place. In this milieu, it was possible to create new institutional capacities with relative ease. Given the importance of initial conditions, it must also be recognised that economic reforms in India yielded benefits in significant part because of the essential foundations that were laid in the preceding four decades. The politics of democracy was the other critical factor that sustained the process in India.

This performance is impressive in aggregates but conceals as much as it reveals, for growth is necessary but not sufficient. It is important to remember that per capita income is an arithmetic mean. Social indicators of development are also statistical averages. Neither captures the well-being of the poor or the common man, because the distribution is so unequal. And it is not as if all is well with the economy as a whole. There are three persistent, yet mounting, crises manifest in jobless growth, persisting poverty and rising inequality. A long-term view reveals the quiet, almost silent, crises in agriculture, infrastructure, industrialisation and education.

The persistent crises, which could worsen in the future, are discernible in retrospect through the era of economic liberalisation.

Jobless Growth, Persistent Poverty, Rising Inequality

The first persistent crisis is the phenomenon of jobless growth. The biggest failure of the past 25 years is that, despite such rapid economic growth, employment creation has simply not been commensurate. In fact, the employment elasticity of output declined steadily from reasonably high levels during 1972–73 to 1983 (0.60) through modest levels during 1983 to 1993–94 (0.41), to low levels during 1993–94 to 2004–05 (0.17) and 2004–05 to 2011–12 (0.04). In fact, between 2004–05 and 2011–12, employment elasticity of output in agriculture (-0.42) and in manufacturing (0.13) plummeted, as compared to the 1983 to 1993–94 period when it was much higher in both agriculture (0.49) and manufacturing (0.47) (IHD 2014).

The second persistent crisis is that poverty persists on a large scale even after three decades of the most rapid economic growth, faster than anywhere in the developing world, as also in history, except for China. Of course, growth has helped bring about a significant reduction in absolute poverty. Yet, its incidence remains high. In 2011–12, at least 25%, possibly 30%, of 1.2 billion people live in absolute poverty below the critical minimum in terms of food and clothing. These are the perennial poor. If we were to use a higher poverty line that allows for other basic needs such as appropriate shelter, adequate healthcare and education, it is estimated that about 75% of the population lives in absolute poverty. These are the vulnerable poor. The population between the two poverty lines, more than 40% of the total is vulnerable to any shock such as a bad harvest, high inflation, or an illness in the family which could push them deeper into poverty. In fact, in 2011, of the total number of poor in the world (below each of the two poverty lines), around one-third lived in India (Nayyar 2017).

The third persistent crisis, which has worsened in the era of economic liberalisation, is rising inequality. In fact, but for this, rapid growth in GDP would have reduced poverty far more. The evidence on trends in inequality is fragmented and incomplete. Even so, it is clear. Between 1990 and 2010, the Gini coefficient of consumption inequality in India (estimated from the National Sample Survey Office [NSSO] data) rose from 29.6 to 36.8 (Nayyar 2017). The increase in income inequality is bound to have been significantly greater because the poor save little or dis-save, while it is the rich who save. Atkinson (2015) estimates that the Gini coefficient of income inequality in India in 2010 was almost 50. The share of the super-rich, the top 1%, in national income rose from 5% in 1980 to 12% in 2000, while the share of the ultra-rich, the top 0.1%, in national income rose even more from 1% in 1980 to 5% in 2000 (Atkinson and Piketty 2012).

The four quiet, almost silent, crises in the economy, which loom large as potential constraints on future prospects, are at least in part a consequence of what was done and what was not done in the era of economic liberalisation.

The first is the almost silent crisis in agriculture that runs deep, perhaps much worse than it was in the mid-1960s. But there is little discernible cognition. Its near absence from the discourse on the economy, and the radar screen of the public domain, suggests that agriculture's long neglect has worsened in the era of economic liberalisation. Farmers' suicides are reported in the newspapers. Maoist movements are considered law and order problems. But neither of these are recognised as symptomatic of deeper crises in rural India. Between 1993–94 and 2011–12, the share of the agricultural sector in GDP dropped from 25% to 15%, while its share in total employment dropped from two-thirds to less than one-half. Thus, GDP per capita in the agricultural sector has been only one-tenth of GDP per capita in the non-agricultural sector for the past 25 years. Yet, its political significance shaped by its share of votes in a democracy is directly proportional to its share in the population. Its potential economic significance is also considerable since incomes from agriculture could drive economic growth from the demand side. Agriculture needs serious attention across a wide range. There is need to revive extension facilities, including credit for inputs that had been provided by state governments but were wound up progressively during the 1990s in the hope that markets would do it better. There is need to revive public investment in irrigation as private tube wells are rapidly depleting the groundwater potential. There is need to develop technologies for dry land farming. There is need to create transportation, storage and processing facilities for fruits and vegetables that perish without reaching consumers. There is need to develop rural infrastructure, whether roads or power, which would help promote non-agricultural rural employment.

The second quiet crisis is in infrastructure. The physical infrastructure—power, roads, transport, ports, and communications—is grossly inadequate. Some of it is creaking at the seams. Some of it is on the verge of collapse. The story is much the same for the social infrastructure—education and healthcare, or even sanitation facilities and safe drinking water. In this milieu, human development is at risk and economic growth is unsustainable. The ideological belief in the magic of markets has led to a premature withdrawal of the state from public investment in infrastructure, but private investment, whether domestic or foreign, has simply not been forthcoming. Faith in the much touted public–private–partnership model represents a triumph of hope over experience. It is almost a non-starter. Even where it has materialised, in a few places, there is a socialisation of costs and privatisation of benefits. The role of the state, and the importance of public action, in creating a physical and social infrastructure cannot be stressed enough. Without it, growth cannot be sustained, let alone be transformed into development.

The third quiet crisis in the economy, just about discernible, is its industrialisation that is not at par with emerging economies in the developing world. This suggests regress as compared with the past, as there was progress until 1990. Independent India created the initial conditions and laid the essential foundations for industrialisation during the period from the late-1940s to the mid-1960s. Its enormous industrial potential was unlocked by developing infrastructure and a capital goods sector, emphasising higher education, science and technology, designing intervention and support from the government, formulating industrial and trade policies, and nurturing managerial and technological capabilities. India did learn to industrialise (Lall 1987), although necessary changes in strategy or policies were not introduced in the 1970s to enhance competitiveness in price and quality. Even so, by the mid-1980s, some success was visible in pharmaceuticals, two-wheelers, auto components, and clothing, when the information technology sector was also born. The share of manufacturing in GDP reached its peak level of 17.3% in 1979–80 and fluctuated in the range of 16% until 1995–96 when it was 17.3% once again, to hover in the range of 15%–16% until 2007–08 but declined thereafter to 12.9% in 2013–14 (Nayyar 2017a). India's share in manufacturing value added in, and manufactured exports from, the developing world declined steadily in the two decades from 1990 to 2010 (Nayyar 2013). This was in sharp contrast with the steadily rising shares not only of China but also of Indonesia, Malaysia and Thailand (Nayyar 2013; ADB 2013).

Beginnings of De-industrialisation?

Between 1995–96 and 2013–14, the share of manufacturing in India's GDP dropped by more than four percentage points, to a level less than one-half of that in the aforesaid Asian countries. This does suggest the beginnings of de-industrialisation. In fact, during the past 25 years, India's progress in terms of industrialisation has been most disappointing. This outcome contradicts the claims of those who argued that economic liberalisation would increase efficiency and foster growth of the manufacturing sector. India needs to industrialise for obvious reasons. Manufacturing can utilise its most abundant resource, labour, through employment creation; drive productivity increase through linkages, spillovers or externalities in other sectors; and unleash India's enormous industrial potential embedded in its pool of entrepreneurs, just as it can mobilise its managerial and technological capabilities so much in evidence among migrants in industrialised countries. The revival of industrialisation in India, inter alia, requires radical changes in monetary policy, correctives in exchange rate policy, calibration of trade policy, and a rebirth of industrial finance. Strategic coordination of these policies in a long-term perspective, often described as industrial policy, was at the foundations of success at industrialisation elsewhere in Asia. Without such a coordinated policy mix, "Make in India" will be no more than a fond hope.

The fourth quiet, almost silent, crisis is in education. But for those who know this world, it stares us in the face. The educational opportunities for our people are simply not enough and what exists is not good enough. This is true across the entire spectrum from primary education and secondary education, through vocational education, to higher education, and professional or technical education. Learning outcomes are often poor. The excellence in a few islands in each of these domains is deceptive. It is created by the enormous reservoir of talent and a Darwinian selection process. Institutions and individuals possibly excel despite the system, which is just not conducive to learning and does little for those with average abilities or without social opportunities. The comparative advantage that India had in a few segments of higher education is being slowly, yet surely, squandered. It would seem that the education sector is caught in a pincer movement.

At one level, there is a belief that markets can solve the problem through private players, which is leading to treating education as business, shutting the door on large numbers who do not have the means to finance themselves. At another level, governments that believe in the magic of markets are virtual control freaks with respect to public educational institutions. This is motivated by the desire to exercise political influence in education for patronage, rents and vested interests, as politicians are also in the business of education. It strangles autonomy and stifles creativity without creating any accountability. The quality of education is collateral damage. There is a desperate need for reform and change in education. It is not rocket science. And there are blueprints galore. It needs political will. This can only come from recognition that the spread of education in society is at the foundations of development everywhere, in which primary education is the base and higher education is the cutting edge.

In Conclusion

It would seem that economic liberalisation introduced in 1991 was shaped largely by the economic problems of the government rather than by economic priorities of the people and long-term development objectives of the nation. This needs correction. It is essential to attach the highest priority to the economic aspirations of ordinary people, the common man, so that liberalisation improves their well-being. This is not possible unless the role of the state in India's market economy is redefined with clarity. The real shortcoming, if not failure, is that this has not even been attempted over the past 25 years. It is now an imperative if we think of the next 25 years.

The second half of the 20th century witnessed a complete swing of the pendulum in thinking about the role of the state in economic development. We moved from a widespread belief, prevalent in the 1950s, that the state could do nothing wrong, to a gathering conviction, fashionable in the 1990s, that the state could do nothing right. The dramatic change in thinking was attributable to past experience (inappropriate or excessive intervention) and the conjuncture in time (collapse of communism), reinforced by the dominant political ideology of the times (markets and capitalism). This ideology is now subject to question everywhere, in the wake of the market-driven financial crisis and the persistent recession in the world economy. It is no longer dominant in the world outside. In India, however, the belief in markets remains strong among the literati and the influential, because of rapid economic growth and because of little faith in governments. Even if failures or limitations of markets are recognised, concerns about inept or corrupt governments are larger than life.

More-of-the-same or business-as-usual is obviously neither acceptable nor desirable. In India, it is time to rethink and redefine the role of the state in a market economy in a very different national context, 70 years after independence, and a profoundly changed international context. Such rethinking can be set out in terms of two simple propositions (Bhaduri and Nayyar 1996). First, the state and the market are, by and large, not substitutes; instead they must complement one another in many spheres. Second, the relationship between the state and the market cannot be specified once-and-for-all in any dogmatic manner; instead the two institutions must adapt to one another through cooperation, rather than conflict, as the economy develops. Given that the entrepreneurial talents of the private sector and the capabilities of the government sector, as also the needs of the economy, change over time, this relationship must be flexible and adaptive. In such a milieu, the state and the market can provide mutual checks and balances that function as institutionalised self-correcting mechanisms when things go wrong. Indeed, the history of capitalism suggests that success at economic development is observed mostly in countries where governments and markets complement one another and adapt to one another as circumstances and times change.

In the earlier stages of industrialisation, state intervention alone can create the initial conditions by building a physical infrastructure with government investment in energy, transport and communication, and by developing human resources through education and healthcare. These tasks remain unfinished in India. Clearly, the state must not only continue to perform this role in the economy but also do so much better than it has so far. In the later stages of industrialisation, both the degree and nature of state intervention in the economy must change to incorporate functional, institutional and strategic roles. Functional intervention is necessary to correct for market failures, both specific and general, as economic decisions are shaped more and more by the market. Institutional intervention is needed to govern the market by setting rules of the game for players in the market, to create frameworks for regulating markets and establish institutions to monitor its functioning, since a market economy requires rules of the game to ensure a level-playing field and to pre-empt a free-for-all. Strategic intervention is desirable to guide the market, interlinked across activities or sectors, to attain broader long-term objectives of development.

Those who emphasise the costs of state intervention in the past must also recognise the costs of state inaction in the present and its implications for the future of India's economic development and the well-being of our people. They would also do well to remember that a government which fails in intervention is also bound to fail in liberalisation. For the same reason, a state that cannot provide governance or run enterprises cannot regulate, let alone guide or govern, markets. Indeed, efficient markets need effective governments. In sum, India needs a developmental state for its market economy to improve the living conditions of her people.

The respective roles of the government or the public sector and the market or the private sector are bound to change over time at different stages of development. Even so, at every stage, there are many things that only markets can and should do. These are best left to markets and the private sector. However, at every stage, there are other things that only governments can and must do. If governments perform these tasks badly, it is not possible to dispense with governments and replace them with markets. Government must be made to perform better. This is easier said than done. Yet, it is feasible, for the government is accountable to people. In India's vibrant democracy, there is a growing political consciousness among citizens. The accountability of governments to their people is clearly visible at election time. Performance is rewarded when incumbent governments are re-elected. Non-performance is penalised when incumbent governments are kicked out. Even if democracy works slowly—and with time lags—the implicit incentives and disincentives for political leaders and political parties do provide checks and balances. A better world is possible, if only we can activate and realise the enormous potential of our political democracy.

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