INTERVIEW | MONTEK SINGH AHLUWALIA

India's 1991 liberalisation leap and lessons for today

The reforms were hugely successful but a lot remains to be done, says one of the architects of the transition

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Three decades after India embarked upon the path of economic liberalisation, **Montek Singh Ahluwalia**, *one of the key figures of the reform process, former Deputy Chairman of the erstwhile Planning Commission and currently Distinguished Fellow at the Centre for Social and Economic Progress (CSEP), discusses in an interview with* The Hindu *the transition of the Indian economy, what remains to be done, and the road ahead after recovery from the slowdown induced by the COVID-19 pandemic. Edited excerpts*:

How would you describe the evolution of the economy since 1991?

■ The reforms were aimed at unleashing the energies of the private sector to accelerate economic growth and to do so in a manner that ensured an adequate flow of benefits to the poor. They certainly succeeded in this objective.

The full benefits took time to materialise because a gradualist approach was adopted – entirely understandable in a democracy – but the results are dramatic if we look at a longer time frame. The GDP growth averaged 7% in the 25 years from 1992 to 2017, compared with an average of 5% in the preceding ten years and 4% in the preceding 20! And as growth accelerated, poverty declined. Between 2004-05 and 2011-12, the last year for which official data on poverty are available, about 140 million people were pulled above the poverty line. This is not to say that there were no shortcomings. Some of the reforms begun in 1991, especially in the financial sector, have yet to be completed. We have not done as much as we should have in the health and education sectors; environmental concerns have not been adequately built into our development strategy.

In his book, *Confessions of a Swadeshi Reformer*, former Union Finance Minister Yashwant Sinha has said that a lot of the blueprint for the liberalisation was already on the table when the Narasimha Rao government took charge. Could you give us a glimpse of that period and what were the key changes being worked out before the change of the regime?

■ I have written on this subject in my book *Backstage*, but let me attempt a brief encapsulation. To get a glimpse of the period, one should consider the main features of the control system before the reforms and see how it restricted entrepreneurship.

The private sector was not allowed to invest in a number of sectors thought to be critical for development. The so-called "commanding heights" were reserved for the public sector despite its lacklustre performance. Where the private sector was allowed, it could invest only after getting an industrial licence, and that was especially hard to get for "large" industrial houses. Over 860 items were reserved exclusively for small-scale producers, including many that had very high export potential. Imports were more strictly controlled than in almost any other developing country because it was felt necessary to conserve scarce foreign exchange. Consumer goods simply could not be imported so domestic producers faced no import competition. Producers could import capital goods and intermediates needed for production, but this generally required an import licence. This was given only if the government was satisfied that the import was essential and domestic substitutes were not available. Finally, the import of technology was controlled and Foreign Direct Investment (FDI) was discouraged.

It was clearly not a system geared to encourage enterprise or innovation. I am reminded of George Santayana's much-quoted words: "Those who forget history are doomed to repeat it." Since most of the population today has no recollection of the control system we had earlier, I hope it will serve to ensure that we never slip back to these absurdities.

Efforts were made in the 1980s to liberalise the system but these were incremental changes. The system itself remained in place. By 1990, it was clear that drastic change was needed. I had the opportunity to prepare a paper outlining a core set of industrial and trade policy reforms, combined with exchange rate reform and reforms in the public sector. This paper, dubbed by the media as the 'M Document', generated a great deal of controversy, but several people supported the need for these reforms. Around that time, the Ministry of Industry under Ajit Singh (newly returned from the United States) proposed bold liberalisation of industrial licencing, but he was opposed by the Finance Ministry under Madhu Dandavate, and only a watered-down version was announced.

> **The government's decision to stay out of the RCEP went against the Prime Minister's earlier positive signal of moving from "Look East" to "Act East"**

As Commerce Secretary in the Chandra Shekhar government, I started working on trade policy reforms along the lines suggested in the 'M Document', including bringing in Exim-scrips, as a first step in moving to a flexible exchange rate. In April 1991, Dr. Manmohan Singh, who was then Adviser to Prime Minister Chandra Shekhar, delivered the convocation address at the Indian Institute of Management Bangalore, where he outlined what he thought were the key reforms needed. It included many of the suggestions in the 'M Document' and went beyond them.

In other words, the ideas that finally went into the reforms were on the table before 1991. But they had not been approved politically. It was the P.V. Narasimha Rao-Manmohan Singh duo that implemented them in 1991. The fact that the economy was in a crisis helped, but their success is also due to the fact that there was a well-thought-out policy package to implement.

Even so, it was not easy. Both the Right and the Left opposed the reforms. The Congress party itself had many who were not convinced. Indian businesses were also conflicted. They liked domestic liberalisation, but were unhappy at the entry of foreign competition, both through imports and FDI.

Some pending factor market reforms, in areas such as labour and land, remain hanging. Are they not holding up investment?

■ Yes, these are key pending items. The need for labour market reforms was recognised, but it was thought that we should first get the industrial, trade and financial sector reforms to show positive results and take up labour market reforms later ... In a meeting with businessmen in 2006, PM Manmohan Singh was asked about labour market reforms. He said ... if we could get the economy to grow at 10%, it would be easier to persuade labour. We did grow at over 9% for a few years but persuading labour proved to be difficult.

On the land market, I must admit that it was not on our agenda. One reason is that land is a State subject and the Centre had enough on its plate. In the UPA [United Progressive Alliance] years, it did get involved in land acquisition because this was an area with a lot of agitation and allegations of heavy-handedness. Unfortunately, the resulting legislation introduced too many conditions, which could greatly delay the process.

India progressively lowered import tariffs from an estimated 57.5% in 1992 to 8.9% in 2008, but this trend has been reversed over the past few years. While this appears to be in line with rising protectionism globally, can India afford to do this if it wants to play a greater role in world trade?

■ I feel the reversal of a trend that was followed by several governments, including the NDA [National Democratic Alliance] government under former Prime Minister Atal Bihari Vajpayee, is unfortunate. It will hamper our stated ambition to become part of global supply chains. Indian industry has legitimate complaints about poor infrastructure, poor logistics and time-consuming trade procedures, which reduce its competitiveness. But the solution lies in addressing these problems directly, not in raising import duties, which will only raise costs in the economy.

I also fear that once the government signals a willingness to raise duties to help individual products, it will encourage a flood of demands that will be difficult to resist. The government should engage with Indian industry and other experts to come to an agreement on what the average level of duties should be and how it should be reduced over time. The NITI Aayog under its first Vice-Chairman, Arvind Panagariya, had recommended that we should move to an average duty rate of about 7%, gradually narrowing the range of variation across products and eliminating duty reversals. This is the right approach.

Should we revisit our stance on the RCEP [Regional Comprehensive Economic Partnership] even as we try to re-engage with markets such as the United States, the United Kingdom, the European Union and Australia for free-trade pacts?

■ I was surprised by the Centre's decision to stay out of the RCEP. It went against the Prime Minister's earlier positive signal of moving from "Look East" to "Act East". I assume that there was lobbying from those who fear that the Indian industry would not be able to compete against China, a member of the RCEP.

As I have already mentioned, the Indian industry has legitimate complaints about things that make India uncompetitive, and these must be addressed directly. The reduction in tariffs required under RCEP was to be accomplished over several years, giving ample time to take the steps needed to improve our competitiveness. As far as unfair competition from China is concerned, the solution lies in a faster method of imposing anti-dumping duties on China, not raising import duties across the board. We should note that geopolitics is forcing major countries to reduce dependence on China. India cannot expect to replace China, but it can reasonably expect to become a major player in non-China-dominated supply chains. RCEP membership would help as it will reassure partners that trade policy will not be arbitrarily changed.

As for Free Trade Agreements (FTAs) with the U.S., Europe and the U.K., we have traditionally preferred trade liberalisation in a multilateral forum, but major developed countries seem to be moving away from multilateral negotiations. Working on agreements with important groups bilaterally seems to be the only hope for assuring market access. However, such FTAs will involve more give and take, including on contentious issues such as intellectual property rights and bilateral investment protection, and we must be willing to accept that.

The spectre of jobless growth was a matter of great debate in the UPA years. Did the situation worsen post-UPA even before the pandemic, which of course has led to severe income and job losses?

■ Employment was a matter of concern during the UPA period, but it had some positive features. The period was the first time we saw a fall in employment in agriculture ... but it was accompanied by sufficient growth in total employment in non-agriculture sectors, so that the labour displaced from agriculture was absorbed in non-agriculture. Total employment actually increased...

The post-UPA period before the pandemic has been analysed in a recent study by Santosh Mehrotra and Jajati K. Parida. They find that the substantial slowdown in GDP growth after 2016-17 led to employment actually falling from 474 million in 2011-12 to 469 million in 2018-19. Employment in agriculture continued to decline, reflecting a normal structural change, but unlike the UPA years, non-agricultural employment grew much more slowly. So, open unemployment increased. The problem was most severe among the youth, who experienced unemployment of 18%.

The COVID-19 pandemic has of course triggered a collapse in employment. According to provisional National Income estimates, GDP contracted by 7.3% in 2020-21. Many analysts say this underestimates the contraction as the adverse impact on the informal sector is not captured. In any case, a sharp fall in the GDP is bound to lead to a contraction in total employment, and we are seeing that in the data from the Centre for Monitoring Indian Economy.

What do you think should be the priorities looking ahead?

■ The economy is clearly recovering from the contraction induced by the pandemic, but how quickly it will recover is uncertain. Much depends upon whether we are hit by a third wave, and more importantly on how severe it is. The priority now must be to get the vaccination coverage expanded as soon as possible. This will create conditions conducive to a return to normalcy.

However, recovery will only take us back to the 2019-20 level ... If we only go back to the pre-pandemic growth rate of around 4% to 5%, we will get little respite on the employment front or on reducing poverty. Past experience shows that we need to get back to 7% to 8% growth if we want to make progress on poverty reduction and provide enough jobs for our growing labour force.

Once the pandemic is brought under control and we are back to the 2019-20 level of production, the government would be well-advised to take a hard look at what caused the slowdown before the pandemic, and then come out with a clear statement of a set of mutually supportive policies that will counter these forces and lead to higher growth and higher employment. It should also come out with a target for post-pandemic growth.

(Read the full interview at https://bit.ly/MontekSingh)