The most pivotal year in India's post-independence history, 1991 saw the nation undergo a cataclysmic **balance of payments** crunch. Caused by trade and financial imbalances rooted in decades of economic mismanagement, the crisis was amplified by assassinations, political backstabbing, and covert airlifts of gold bars. Featuring an improbable hero in the form of a 70-year-old curmudgeon, the events of 1991 precipitated reforms that led to the transformation of a country once seen as "a bottomless pit for foreign aid" into the world's fastest-growing major economy.[1]

Note: This is **part two** of a two-part series on the roots and impact of India's **1991 crisis**; part one is here.

Cover of The Economist, *October 2, 2010.*[2]

This report is part two of a two-part series on the roots and impact of India's 1991 crisis. It provides **a recap of part one** *(see below)* before exploring: **the immediate lead-up to the 1991 crisis** *(see next page)*; **the chronology of the crisis itself** *(see page 6)*; **the ensuing reforms to India's economic policy** *(see page 11)*; and **the economic revitalization catalyzed by those reforms** *(see page 17)*.

An upcoming series of dispatches will address the impact of India's revamped approach to trade and financial policy on its macroeconomic stability, as well as the ways in which the liberalization unleashed in 1991 remains a work in progress.

Recap: India before 1991

Part one of this series *("India before 1991: tiger caged")* examined the highly statist economic strategy implemented by Nehru, India's first prime minister. Envisioned as a means of protecting the country from neo-colonial exploitation by industrialists and foreigners, Nehru's policies had the effect of limiting the opportunities available to India's poor while sheltering a handful of crony capitalists from both domestic and foreign competition. Indira Gandhi's decision to double down on those policies in the 1960s and 70s further stifled competition, deterred entrepreneurship, and incentivized corruption, while deepening India's isolation from the global economy.

The relatively minor changes Indira and Rajiv Gandhi managed to implement during the 1980s, such as loosening controls on capacity expansion and cutting taxes, are best described as "pro-business" rather than "pro-market". They helped improve the profitability of incumbent industrial producers and commercial establishments, but failed to dismantle barriers to competition and trade – postponing the kind of transformational liberalization that would benefit all Indians,[3] and making the economy increasingly dependent on unsustainable fiscal deficits underwritten by costly foreign financing.

By the end of the 1980s, India was lurching toward the edge of a financial precipice.[4] At the same time, the nation's politics began to descend into escalating turmoil, and the window of opportunity that Rajiv Gandhi had been granted to liberalize policy seemed "unlikely to be repeated." Nevertheless, the conclusion of *The Economist*'s May 1991 "tiger caged" report – which predicted that "[t]he tiger will not be freed for some yet" – was about to proven dramatically wrong.[5]

Eve of the crisis: war in the Gulf, turmoil at home

With **Rajiv Gandhi** bogged down in scandals and confidence in the economy badly damaged, the Congress party performed poorly in the 1989 election. Mr. Gandhi's former finance and defense minister, **V. P. Singh**, managed to piece together a weak coalition government (led by his short-lived Janata Dal party) "that was united only in its opposition to [Congress]".[6]

In the summer of 1990, V. P. Singh traveled to Kuala Lumpur for an international summit and was stunned by the rapid progress Malaysia had made since his previous visit to that country just five years earlier.[7] He asked his top advisor – the Oxford-educated economist Montek Ahluwalia – to examine what India needed to do in order to replicate the robust growth rates in Southeast Asia and China. The resulting internal study, which would later form the blueprint for India's post-1991 reforms, provided the most detailed and comprehensive outline to date of the policy changes India needed to undertake.[8] In July 1990, this report – dubbed the "**M document**" – was leaked to the press, sparking huge controversy.[9]

Even as V. P. Singh attempted to manage the political fallout from the "M document", the August 1990 **Iraqi invasion of Kuwait** suddenly exacerbated India's already worrisome trade and financial imbalances.[10] Conflict in the Gulf caused the price of crude oil and petroleum products – which accounted for over a quarter of India's import bill[11] – to double,[12] and contributed to **economic slowdowns** in both the **United States** and the **Soviet Union** – the first- and second-largest destinations for Indian exports, respectively.[13]

In what remains the largest air evacuation in history (and a source of great national pride), the Indian government airlifted home over 170,000 Indian citizens who had been working in Kuwait at the time of the invasion.[14] However, the combination of the subsequent sharp **decline in remittances** from overseas Indians, **costlier oil**, and a **slump in exports** was disastrous for India's current account.[15] Between the first six months of 1990 and the second half of the year, the nation's **current account deficit** jumped from $2 billion to over $5 billion.[16]

A **current account deficit** is principally a trade deficit, which implies a net flow of capital *out* of a country. A **financial account surplus** is the capital that must flow *into* a country to offset that trade deficit.

For a detailed primer on balance of payments terminology, please refer to the appendix on page 20 of part one of this series ("India before 1991: tiger caged").

Indian expatriate workers board a flight home from the war-torn Gulf, 1990.[17]

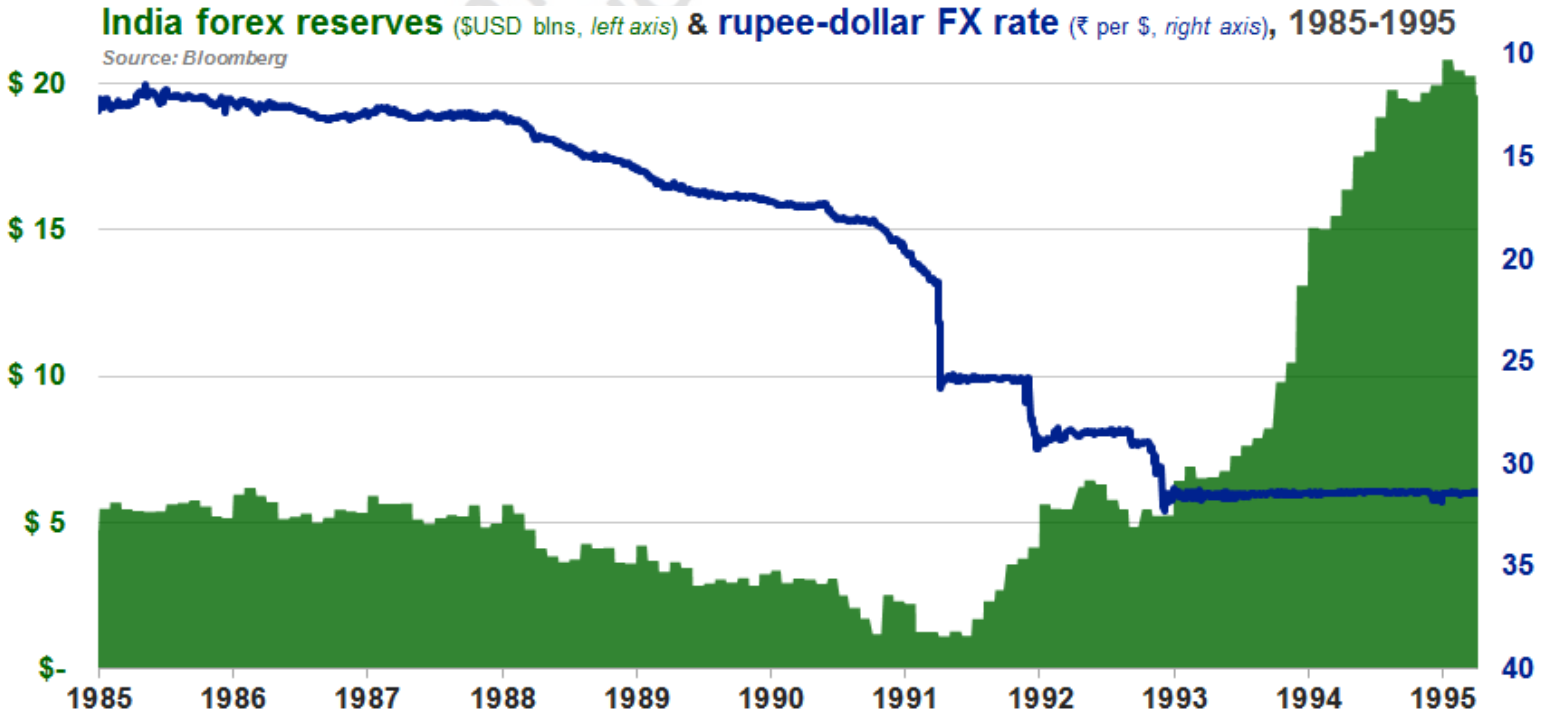
Within weeks of the invasion of Kuwait, V. P. Singh authorized his officials to reach out to the **International Monetary Fund** (**IMF**) – making his the first Indian administration in a decade to request a loan from the Fund. Despite India's increasingly precarious financial position, V. P. Singh knew that borrowing from the IMF remained politically contentious. As soon as it became public knowledge that a government was applying for assistance, its leaders "would be attacked in parliament and in the press for subjugating the country's interests to foreign domination." To reduce his political vulnerability, V.P Singh limited his request to $1.8 billion – equivalent to one-quarter of India's IMF quota, the maximum it could draw without promising specific policy reforms[18] – even as it became increasingly obvious that more would be needed to bridge the nation's financing gap.

The government tried to buy itself more time with various traditional crisis-fighting measures, including a tightening of import licensing and surcharges on bank finance for imports.[19] However, a series of sectarian disputes brought down V. P. Singh's administration in November 1990, when a breakaway faction of his party defected before a no-confidence vote. That splinter group installed its leader, **Chandra Shekhar**, as prime minister – though its survival was entirely dependent on the backing of the Rajiv Gandhi-led Congress party.[20] Immediately after Shekhar took office, his new government sent two top officials to Washington "on a secret mission" to seek a larger funding package from the IMF, and began preparing an emergency budget proposal.[21]

In January 1991, the start of the **Gulf War** destabilized Shekhar's already-weak administration. As U.S.-led coalition forces began a massive aerial bombing campaign in Iraq, his government struggled to preserve a neutral stance amid heated domestic opposition to the refueling of U.S. warplanes at Mumbai's international airport.[22] The public outcry forced Shekhar to delay the presentation of his emergency budget to parliament – "effectively [putting] discussions with the IMF on hold."[23] In March 1991, right as the plan was finally on track to be submitted to parliament, the Congress party pulled its support for the government[24] – toppling Shekhar's nascent administration (a "four-month comic interlude") and triggering yet another election.[25]

Increasingly wary foreign lenders saw India's trade and financial imbalances deteriorating, its borrowers (including the government) facing rating downgrades, and its politics in disarray. As the country's political turmoil deepened, the **Reserve Bank of India** (**RBI**) alerted the Ministry of Finance that Indian banks were losing their ability to access dollar funding from global lenders.[10] The RBI expended its foreign currency reserves in an attempt to defend the value of the **rupee** (which was pegged to a basket of the dollar, yen, pound sterling, and deutsche mark).[26]

By the time the Shekhar government fell, those reserves had dwindled to $2.2 billion – barely enough to cover a month's worth of imports.[27] Locked out of commercial funding and with no prospect of support from the teetering Soviet Union, India was on the brink of default – kept afloat only by a limited credit line from the IMF. It was increasingly clear that the nation was not going to get further aid without significant conditions attached.



India on the brink: "I didn't know it was this bad…"

The first thing Indians noticed about the official election manifesto released by the Congress party on April 16, 1991 was that it contained no mention of the word "socialism". Deviating from Congress's decades-old economic dogma, the platform promised to deepen the economic liberalization that the party's leader, Rajiv Gandhi, had partially implemented during the previous decade.

Opposition politicians accused Congress of "trying to take the country to the pre-1947 mentality". Critics heaped scorn on Mr. Gandhi for being "in a hurry […] to reverse his grandfather's [Jawaharlal Nehru's] belief in self-reliance", declaring that he had "outdone the former British Prime Minister, Mrs. Margaret Thatcher […] in his bid at economic liberalisation".[28] Barely a month later, on May 21, 1991 – one day after the first round of India's staggered, multi-phase election – Rajiv Gandhi was **assassinated**.

As confidence crumbled, authorities postponed the election and resorted to a desperate stopgap measure, raising $234 million from the Union Bank of Switzerland (UBS) by sending 20 tons of **gold** on a Swissair flight to Zurich.[29] For a nation with a deep-rooted reverence for gold as a traditional symbol of prosperity,[30] this humiliating news – much more so than S&P's subsequent downgrade of India's sovereign credit rating to junk[31] – "finally drove home the point that something drastic had to be done to save the Indian economy,"[32] which "was so wrecked that India was pawning its family jewelry."[33]

INDIAN EXPRESS

WITH BUSINESS EXPRESS

Bombay: Monday July 8 1991

EASY COMPUTERS BEGINNER SERIES

S. CHAND & COMPANY LTD

Secret sale of gold by RBI again

21,000 kg of metal airlifted to coded destination

By V. Shankar Aiyar

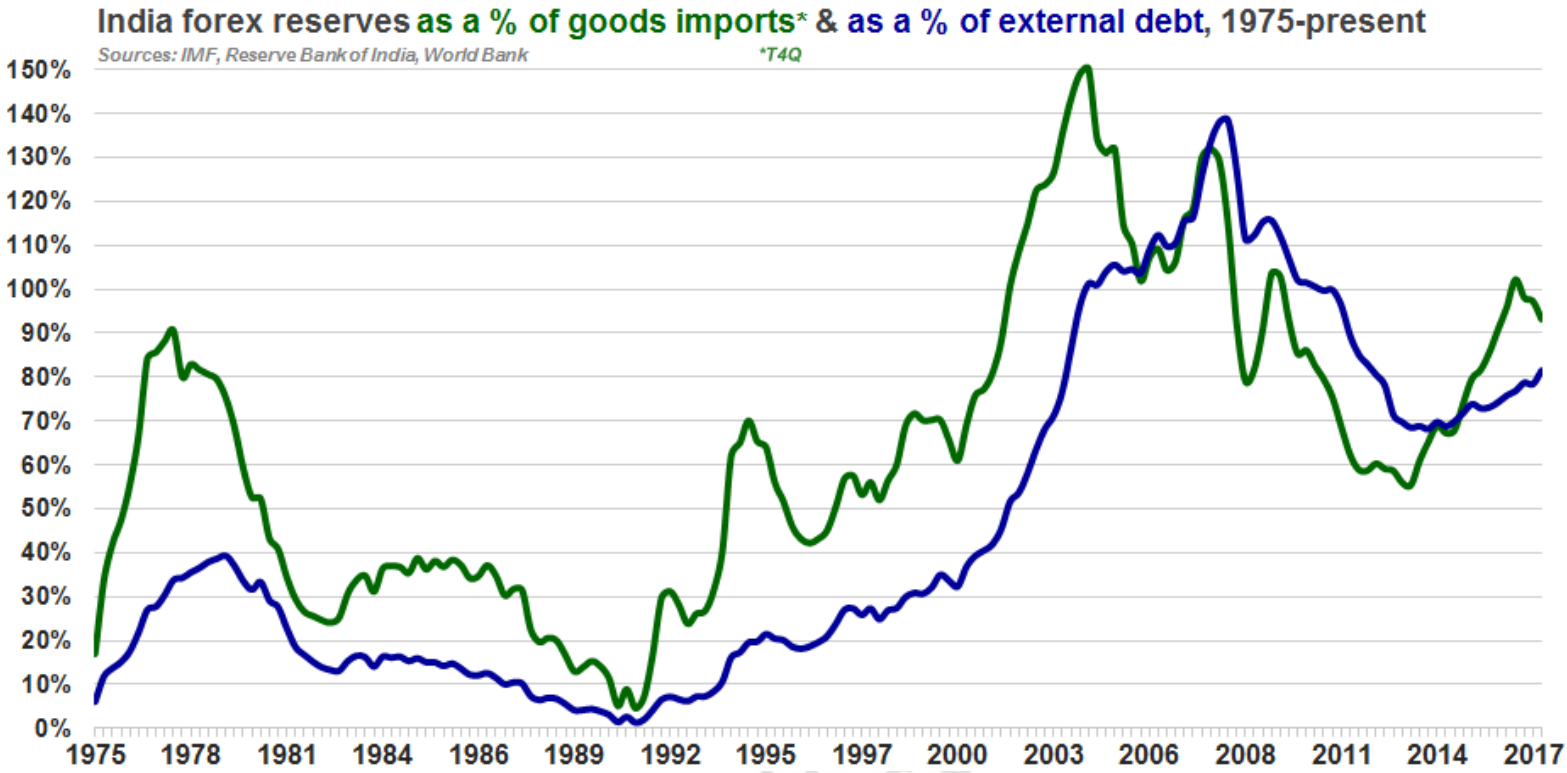
July 8, 1991 headline disclosing one of several airlifts of the central bank's gold reserves.[34]

Rajiv Gandhi's assassination in the middle of India's 1991 election suddenly left Congress without a leader. After **Sonia Gandhi**, Rajiv's Italian-born widow, declined to take the reins, the party was forced to turn to **P. V. Narasimha Rao** (prime minister 1991-96). A fixture of national politics for decades, the 70-year-old Rao had held ministerial positions in the administrations of both Indira and Rajiv Gandhi.

Sporting a plain *dhoti* (a traditional men's garment worn wrapped around the waist) and "the pout of an ageing uncle",[35] Rao had a "highly underwhelming appearance" and the "charisma of a dead fish".[36] With a secretive, taciturn personality that contrasted sharply with the charm and exuberance of his young predecessor,[37] Rao was widely seen as a frail, indecisive, and unambitious "fuddy-duddy".[38]

When polling resumed in mid-June, sympathy for the Gandhis ensured that Congress won the largest number of seats in parliament – though not an absolute majority.[39] Chosen "because he was seventy, quiet, dull, and […] threatened no one", the party's newly-installed leader, Narasimha Rao, proceeded to form a coalition government that nobody expected would last for very long.[40] Luckily for India, Rao's underwhelming exterior concealed a shrewd, ideologically flexible pragmatist who was about to defy all expectations.

Prime Minister P. V. Narasimha Rao and Sonia Gandhi.[41]



Late on June 20, 1991 – the eve of his swearing-in as India's tenth prime minister – Rao was briefed on India's balance of payments crisis, the previous government's secret discussions with the IMF, the pressure to devalue the rupee, and the mortgaging of the central bank's gold bullion. "I didn't know it was this bad…" was his reaction[42] upon being informed that the RBI's reserves had been depleted to just $1.1 billion – enough to cover only two weeks' worth of imports.[27] A protectionist "who confessed that he did not understand economics", Rao became an economic liberalizer that evening.[43]

A novelist and technology enthusiast who wrote fiction in multiple languages and taught himself computer code, Rao cut his teeth as a wartime propagandist during India's 1962 conflict with China.[41] While serving as foreign minister in the 1980s, he observed how Deng Xiaoping – whom he would later call his "philosophical mentor"[36] – was able to portray a wholesale reorientation of China's economy as a mere extension of Mao's vision.[44]

By the time Rao reached India's highest political office, he had learned how to harness a fast-moving narrative, sideline his adversaries, and push through unpopular policies – skills that were about to prove extraordinarily useful as he steered the world's largest democracy out of a desperate crisis and into a new economic era.[45]

Over the following 33 days, India overhauled its entire industrial, trade, and fiscal policy, kick-starting a transformation that would irreversibly alter the very nature of the country's economy.[46] On June 21, Rao made the first of several pivotal decisions – appointing as his finance minister Dr. **Manmohan Singh**, an economist and former governor of the RBI who happened to be familiar with the managing director of the IMF.[47] Decades earlier, while studying at Cambridge and Oxford, Singh had written about the flaws of India's import substitution policies.[48] Now, he and the rest of Rao's cabinet would be given free rein to implement tough reforms to the controls that had for so long stifled India's development.[49]

To avoid the perception that his government was acting under foreign pressure, Rao instructed his officials "to do whatever had to be done immediately" and preemptively, rather than wait for the IMF to lay out conditions. On the evening of June 21, the prime minister told his chief of staff "not to wait for formal orders and instead, [to] start working closely" with the newly-installed Singh.[50]

Finance Minister Manmohan Singh in 1991.[51]

In the decade leading up to 1991, much of India's political class continued to view economic liberalization – in particular, the softening of import controls – as the *cause* of India's problems, and saw re-regulation as the cure for the country's current account deficit.[52] Few recognized or acknowledged that the combination of protectionism and the License Raj had created a vicious circle of misguided policy – with scarcity triggering calls for more controls, which further inhibited production, resulting in even more scarcity, corruption, and hostility to the prospect of liberalizing reform.

Throughout the 1980s, however, a small but vocal faction within India's economic establishment had endorsed and outlined most of the liberalizing policies that would later come to comprise the post-1991 reforms. As a result, pro-liberalization technocrats "were already in place with papers and draft policy documents" when circumstances presented them with a historic opportunity to push through momentous changes.[53] Singh was one of several of these economic dissidents – many of them educated at or employed by U.S. universities and institutions such as MIT and the World Bank – whom Rao was able to draft into key roles overseeing and implementing the reforms.[54]

On June 22, Rao used his first nationally-televised address to notify Indians that his government intended to do more than simply resolve the immediate crisis. In contrast to his predecessors – who had responded to India's balance of payment crises of 1966 and 1981 with tentative, half-hearted tweaks to its statist economic system – Rao began to exploit India's brief dependence on the IMF "to direct policy attention towards the competitiveness of the Indian economy."[8] Declaring that "there [were] no soft options left," Rao announced that his administration was committed to "removing the cobwebs" obstructing India's path towards industrialization and international competiveness.[24] On July 9, he stated in another speech that the "bulk of government regulations and controls on our economic activity have outlived their utility."[55]

Without losing any time, Rao's officials began proactively implementing the reforms they anticipated would be demanded by the IMF, starting with a long-overdue exchange rate adjustment. In the first four days of July 1991, Singh **devalued the rupee** by 25% against the U.S. dollar.[56] Midway through the process, Rao reportedly lost his nerve and attempted to halt the devaluation. By the time he contacted his cabinet, however, the deed was done, and Singh had already announced it to the public. It was too late to turn back.[57]

"When 1991 happened, suddenly it felt like somebody opened the jail door, came in, and removed all the shackles, and said, 'You're free. You can go.'"[58]

Suresh Krishna, industrialist

The New Economic Policy

"We do not have time to postpone adjustment and stabilisation. We must act fast and act boldly […] I do not minimise the difficulties that lie ahead on the long and arduous journey on which we have embarked. **But as Victor Hugo once said, 'no power on earth can stop an idea whose time has come.'** I suggest that the emergence of India as a major economic power in the world happens to be one such idea. Let the whole world hear it loud and clear. India is now wide awake."[4]

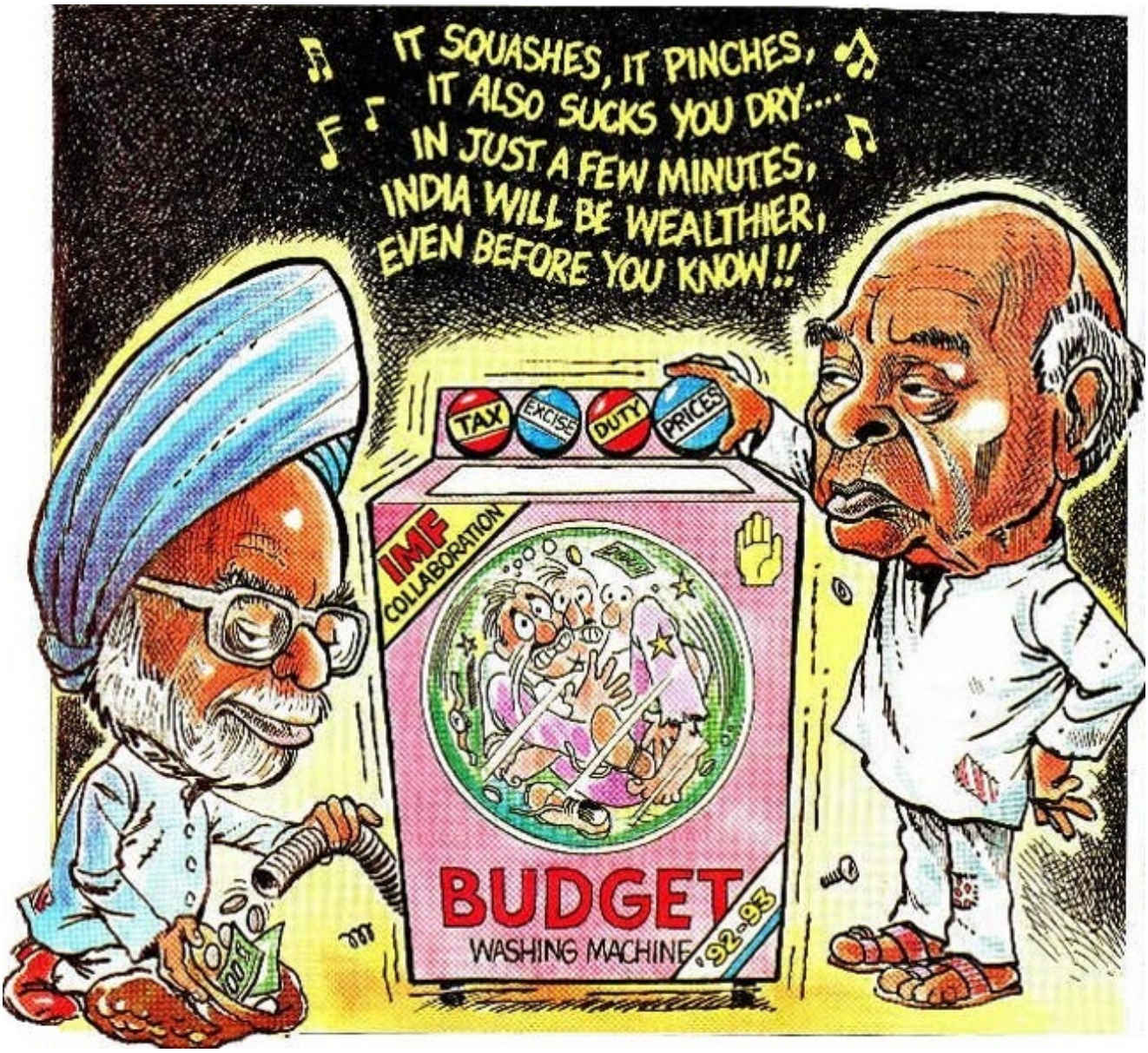
Manmohan Singh's speech to Parliament on July 24, 1991

The whirlwind of reforms that followed came to be known as the **New Economic Policy** (**NEP**).[59] At noon on July 24, 1991, the government announced plans to **dismantle the License Raj**, open most sectors to private-sector competition, and scrap the MRTP Act (the 1969 law that had prevented business expansion).[60]

Four hours later, Manmohan Singh presented to India's Parliament a budget that eliminated most price controls, did away with quantitative restrictions on production and imports, slashed import duties, liberalized interest rates, initiated a "disinvestment" policy for partially privatizing state-owned companies, instituted an automatic approval process for foreign ownership of up to 51% of direct investments in most industries (replacing the 40% ceiling that had been imposed back in 1973), and handed responsibility for capital markets regulation to a new, independent agency. Declaring that "[t]he room for maneuver, to live on borrowed money or time, does not exist anymore", Singh added that this would all be achieved concurrently with a significant reduction in the government's fiscal deficit.[4]

Manmohan Singh's pivotal 1991 and 1992 budget speeches are particularly memorable examples of an annual tradition known as "**Budget Day**". Each February, India's finance minister is expected to observe a series of quirky rituals – including serving a giant pan of *halwa* (a sugary dessert) to his officials and posing for photographs clutching a briefcase on the steps of parliament – before reading a speech (typically laden with literary references) that outlines the government's economic plans. In the weeks preceding Budget Day, business news channels do their best to build anticipation with sensationalist special programming in which talking heads breathlessly speculate about the budget's potential impacts on taxpayers, investors, and companies.[61]

The NEP initially faced tremendous resistance from a "divided parliament, nervous industrialists, shrill intellectuals, and a stodgy, statist Congress party".[36] Despite the slow-motion collapse of the U.S.S.R. and the by-then clear success of China's market-oriented policies, most of India's politicians seemed "unaware of how much of an anomaly" their country had become.[5] Opposition leaders denounced the "bitter pills" of currency devaluation, deregulation, and other previously-unthinkable reforms[62] as a surrender to the "dictates" of international financial institutions.[63] Senior officials from Rao's own party accused his government of compromising India's sovereignty and betraying Nehru's legacy, and "beseeched Sonia [Gandhi] to take over Congress and rescue the country."[64]



Singh (left) and Rao (right) depicted as accomplices of the IMF.[65]

Rao successfully neutralized these simplistic and predictable attacks – which had deterred previous administrations from even proposing contentious policy changes – with a slick combination of political browbeating and public relations. He jolted his opponents within Congress into submission by threatening to replace the party's system of patronage with competitive primaries.[64] Meanwhile, he and Singh nimbly recast the reform program from "a matter of compulsion" imposed by Western institutions to "a matter of conviction" borne out of Indians' own confidence in the value and necessity of tough changes.[50]

While acknowledging that the reforms had an external catalyst (i.e., the IMF), Rao and Singh were careful to present the NEP as an Indian-made package – built on the foundations laid by Nehru and the Gandhis, consisting largely of policies that the Congress party had publicly endorsed in its 1991 election manifesto, and implemented on India's own initiative (albeit with the understanding that it was a necessary precondition for assistance).[66]

Taking advantage of his reputation as an elder statesman unassociated with the Congress party's "pro-business" wing, Rao deliberately avoided championing free-market policies as an end unto themselves, instead deftly characterizing liberalization as being "of value to the nation".[50] Citing the need to "attain an adequate technological and competitive edge in a fast changing global economy",[4] Rao and Singh portrayed the NEP and subsequent reforms as a course correction en route to Nehru's vision of economic independence,[67] with access to foreign capital, technology, and export markets substituted for "self-reliance".[68]

> "Berlin Walls are collapsing all around us, and at such a time to stick to ideas and ideologies of the 1960s does not show us to be radical, but reactionary."[69]
>
> *Industrialist J.R.D. Tata writing in* The Times of India*, August 1, 1991*

Rao and Singh sustained a near-daily pace of policy announcements, speeches, and press conferences in a calculated attempt to keep the opposition "off balance."[70] Rao employed agents from the Intelligence Bureau (India's equivalent of the FBI) to spy on Sonia Gandhi and other senior Congress party members, and used the resulting scuttlebutt regarding their views on economic reforms to prioritize certain policies while quietly shelving other controversial proposals (e.g., full privatizations of government-owned firms) that risked provoking too much of a backlash from powerful constituencies.[36] Meanwhile, Singh slipped into the first package of reforms a provision – the removal of duties on newsprint – designed to keep India's rowdy media "on side".[71]

In the end, the root cause and severity of the circumstances in which India found itself in 1991 limited Rao's opponents' options for derailing the reform process. With airlifts of the central bank's gold still on the front pages, even critics of the government's specific reform plans were forced to acknowledge that the country's own past policy choices had left India with a binary choice between taking some form of corrective action and an alternative – an unprecedented default on its sovereign debt – that "would be a recipe for long-term disaster."[47]

> In the absence of exogenous shocks such as droughts, wars, or spikes in the price of oil, India could arguably have muddled through each its pre-1991 crises. Whereas misguided policy had *exacerbated* those emergencies, 1991 saw a "policy-induced crisis par excellence", in which the country had sunk into an unsustainable debt trap long before external developments cut short politicians' room for maneuver.[72]
>
> Although the Iraqi invasion of Kuwait and slowdowns in export markets hastened the day of reckoning, it is clear that policies pursued throughout the 1980s – in particular, increasingly reckless public spending – were untenable "and would have resulted in a crisis at some point, perhaps a little later in the 1990s."[73]

The "euphoric" response to the NEP from news outlets and the public convinced Rao that "the people were [...] ahead of the politicians in wanting reform."[40] The government proceeded to implement a sweeping set of transformative policies – from a restructuring of the telecommunications industry to an overhaul of capital markets regulation – that **went far beyond the boilerplate terms laid out by the IMF** and the World Bank (which joined the structural adjustment program in December 1991),[8] and continued even after the formal expiration (in late 1993) of India's arrangements with both institutions.[74]

In February 1992, Manmohan Singh used his next budget presentation – the first in India's history to be televised live – to unveil another round of dramatic changes. These included abolishing the Controller of Capital Issues (the Delhi-based bureaucracy that arbitrarily set the valuations at which companies could go public), establishing a roadmap for making the rupee fully convertible, permitting the entry of new private-sector banks, reducing the share of banks' deposits that had to be invested in government bonds, and directing the recently-formed **Securities and Exchange Board of India** (**SEBI**) to institute a set of rigorous regulations aimed at protecting investors and improving transparency.[75]

Proclaiming that "**[w]e must not remain permanent captives of a fear of the East India Company, as if nothing has changed in the past 300 years**", Singh announced that foreign institutions would be permitted to invest in Indian equities. Asserting that Indian industry was capable of going head-to-head against foreign competitors "on its own terms", he threw open India's doors to multinational companies.[76] Foreign investment surged from a meager $80 million in 1991 to $6.4 billion just three years later.[77] By mid-1993, the country was attracting enough private capital that it "had no further need to borrow" from the IMF or World Bank.[78]

In November 1992, the government backed the creation of a new equity exchange – the **National Stock Exchange** (**NSE**) – to compete with the Bombay Stock Exchange (BSE), a storied institution that had been reduced by decades of financial repression to an inefficient, high-cost monopoly.[79] Within a year of commencing operations in late 1994, turnover on the NSE's state-of-the-art, transparent platform surpassed that of the BSE. Along with a third government-promoted institution (the National Securities Depository, established in 1996 as the country's first electronic securities clearing house), the SEBI and the NSE facilitated the formation of dynamic, reliable capital markets capable of supporting the growth of Indian companies in the years ahead.[80]

Offices of the National Stock Exchange, Mumbai.[81]

In March 1993, the RBI shifted from pegging the rupee to a basket of currencies to the current **managed float** exchange rate system. By August 1994, the government made the rupee **fully convertible** for current account transactions – removing all remaining restrictions on importers' ability to convert rupees into foreign currencies, giving businesses free rein to pay for imports or fund expansions outside India, and enabling foreign investors to repatriate their capital on demand.[79]

A key common factor across every modern balance of payments crisis, from India (1991) to Mexico (1994) to the East Asian economies (1996), was a fixed exchange rate system that pegged each country's currency to the dollar (or a basket of reserve currencies) – thereby preventing exchange rate adjustments that might have corrected the mismatch between each country's current account deficit and its financial account surplus before it provoked a crisis.[82]

Under the managed float system it has employed since 1993, the Reserve Bank of India (RBI) continues to intervene in the foreign exchange market, but allows the rupee to fluctuate in response to market forces. Crucially, the RBI permits the currency to *depreciate* to help contain current account deficits; its intervention in the foreign exchange market has to date focused on curbing excessive rupee *appreciation*.

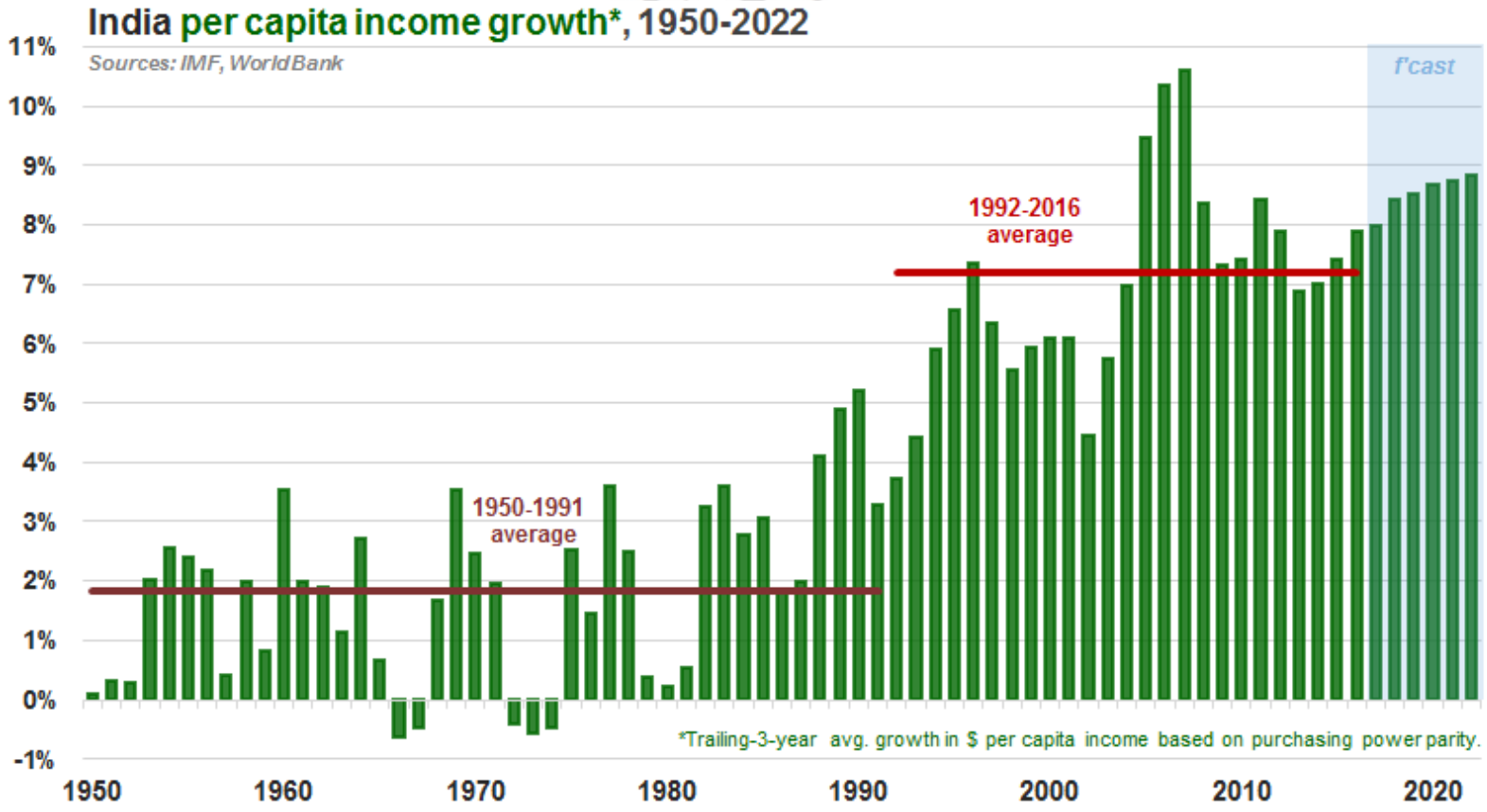
For more detail on the relationship between a country's balance of payments and its exchange rate system, as well as the process by which central banks such as the RBI intervene in forex markets, please refer to the appendix on page 20 of part one of this series ("India before 1991: tiger caged").

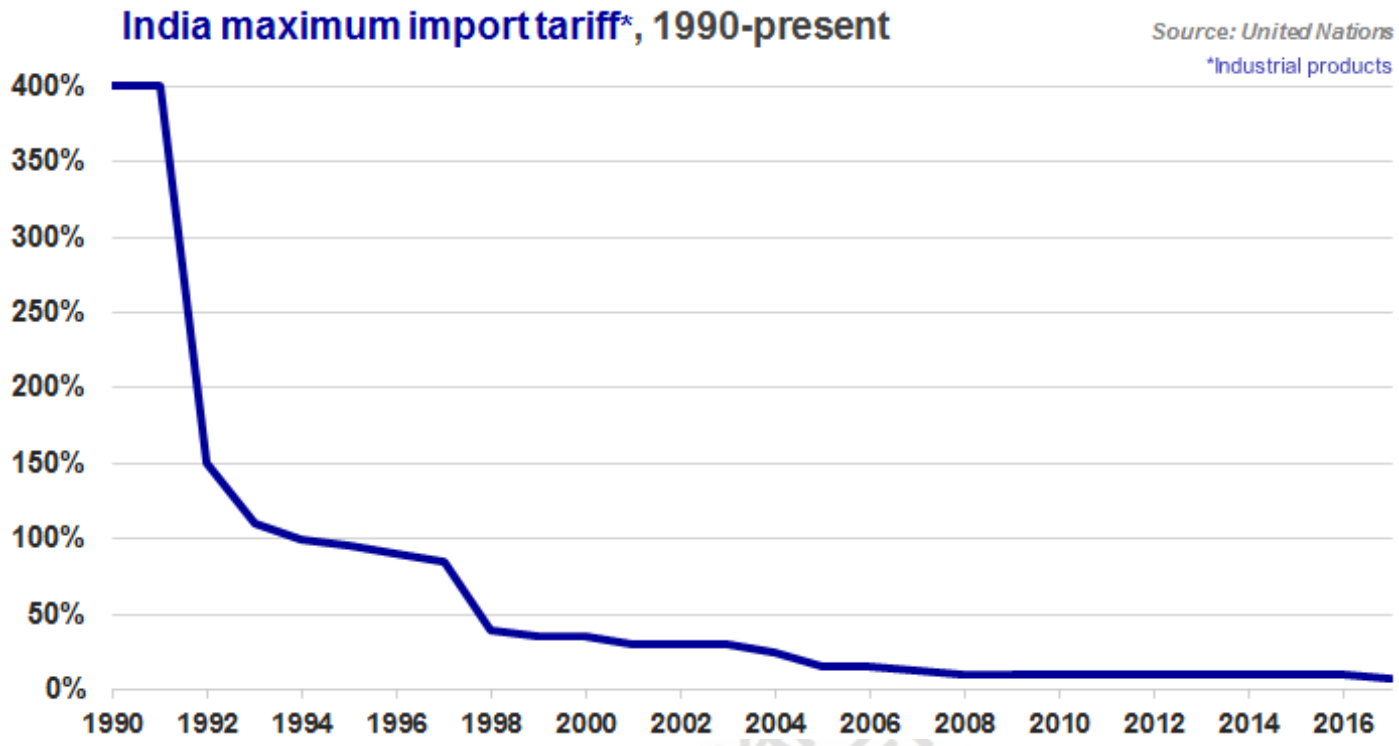
India's recovery from the crisis took less than two years – the **fastest turnaround in the history of IMF structural adjustment programs**.[83] As the efficacy of the NEP and subsequent reforms became increasingly apparent, they gained the backing of an overwhelming majority in parliament – winning approval not only from Rao's own party, but also from the BJP (the largest opposition party), which noisily qualified its support by declaring that the reforms were BJP ideas that Congress "had appropriated".[39] Bolstered by the economy's unexpectedly rapid resurgence, Rao became the first Indian prime minister outside of the Nehru-Gandhi dynasty to complete a full five-year term.[84]

India since 1991: a "caged tiger" let loose

The reforms galvanized by the 1991 crisis "unleashed an explosion of pent-up commercial energy",[85] transforming India's economy from an inward-looking laggard dominated by public-sector firms into a major beneficiary of globalization led by private enterprises, exports, and foreign investment. Though less dramatic than the collapse of communism in Europe, India's liberalization instantly reshaped the lives of nearly 900 million people – more than double the population of the entire Soviet bloc.[86]

The removal of red tape that had acted as a barrier to new entrants resulted in a flood of new competitors "across virtually all industries" following liberalization.[87] More new businesses were registered from 1992 through 1995 than during the entire preceding decade.[88] Over that same four-year period, the number of publicly-traded Indian companies more than doubled (to over 5,000),[89] driven in part by the availability of foreign capital – which allowed upstarts to raise the funds necessary to compete with the country's established, cash-rich conglomerates in capital-intensive sectors such as cellular telecoms.[8] Cumulatively over the first three *years* following the crisis (from 1992 through 1994), India attracted more foreign direct investment than it had over the preceding three *decades*.[90]





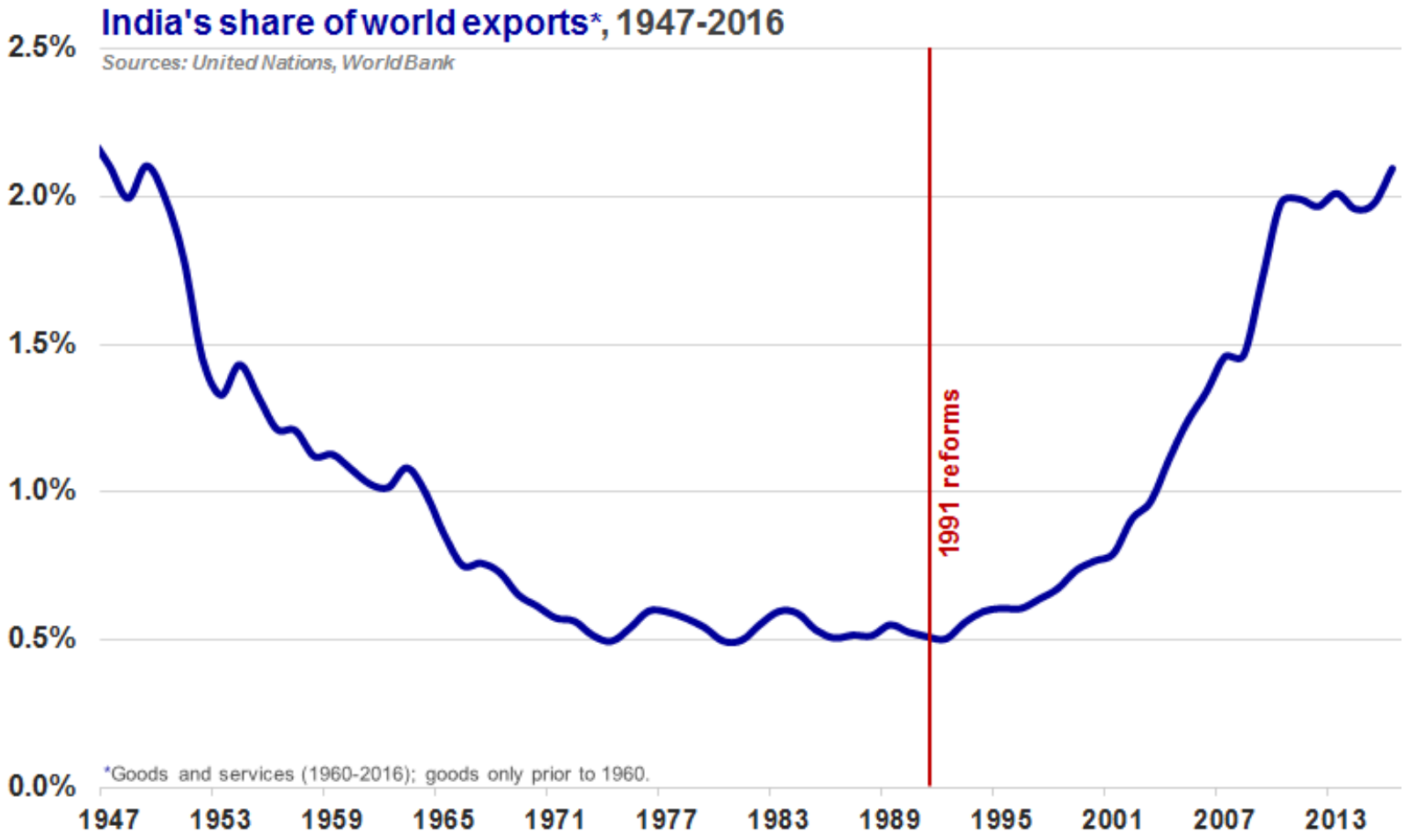
The sheltered monopolies and cartels that had dominated India's economy up until 1991 feared that they would lose out from reforms – particularly the Rao government's moves to slash tariffs, abolish the import licensing regime, and allow multinationals back into the country.[91] In 1993, a group of tycoons who came to be known as the "Bombay Club" wrote a letter to Manmohan Singh complaining, among other things, about the rapid reduction in import duties and the difficulty of competing with multinational corporations' production efficiencies and "marketing shenanigans".[92] The Bombay Club's unofficial spokesman, the head of Pune-based Bajaj Auto,[93] warned that Indian industry was at risk of being "wiped out".[63]

Dispelling such fears, Indian businesses have thrived since 1991. Forced to compete with the world's best, home-grown companies discovered that they could – not only in India, but in markets worldwide. Before liberalization, India manufactured fewer than 2 million motorbikes annually. Now it produces ten times that number, including over 2 million for export.[94] The domestic market, which had been dominated by Japanese imports, was rapidly taken over by none other than Bajaj Auto.[8]

India's auto industry comprises not only producers of cars and trucks, but also manufacturers of "two-wheelers" (motorbikes, scooters, and mopeds) and "three-wheelers" (auto rickshaws). There are over five times as many motorized two-wheelers on the country's roads as there are cars.[95]

Many Indian businesses have become multinationals themselves. In a post-colonial role reversal, the Tata Group is now the biggest private-sector employer in the United Kingdom.[96] Pune-based Bharat Forge has grown into the world's top supplier of metal forgings.[97] Indian-owned ArcelorMittal is the globe's leading steel producer.[85] Mumbai-based Sun Pharma is among the largest manufacturers of generic drugs. Delhi-based Bharti Airtel is the dominant wireless carrier across much of sub-Saharan Africa.[98]

Before liberalization, an over-valued rupee and counter-productive import-substitution policies held back the competitiveness of Indian exports. The 1991 currency adjustment and subsequent lowering of protectionist barriers allowed firms to make the most of India's plentiful comparative advantages – from its abundance of technically adept, English-speaking talent to its position as the lowest-cost producer of most cotton textiles.[99] During the 1990s, India's export volumes rose at almost double the highest rate achieved in any prior decade.[73] Over the past quarter-century, **India's exports have grown by a factor of twenty** – fully reversing the decline in the country's share of world exports between independence (1947) and 1991.[100]

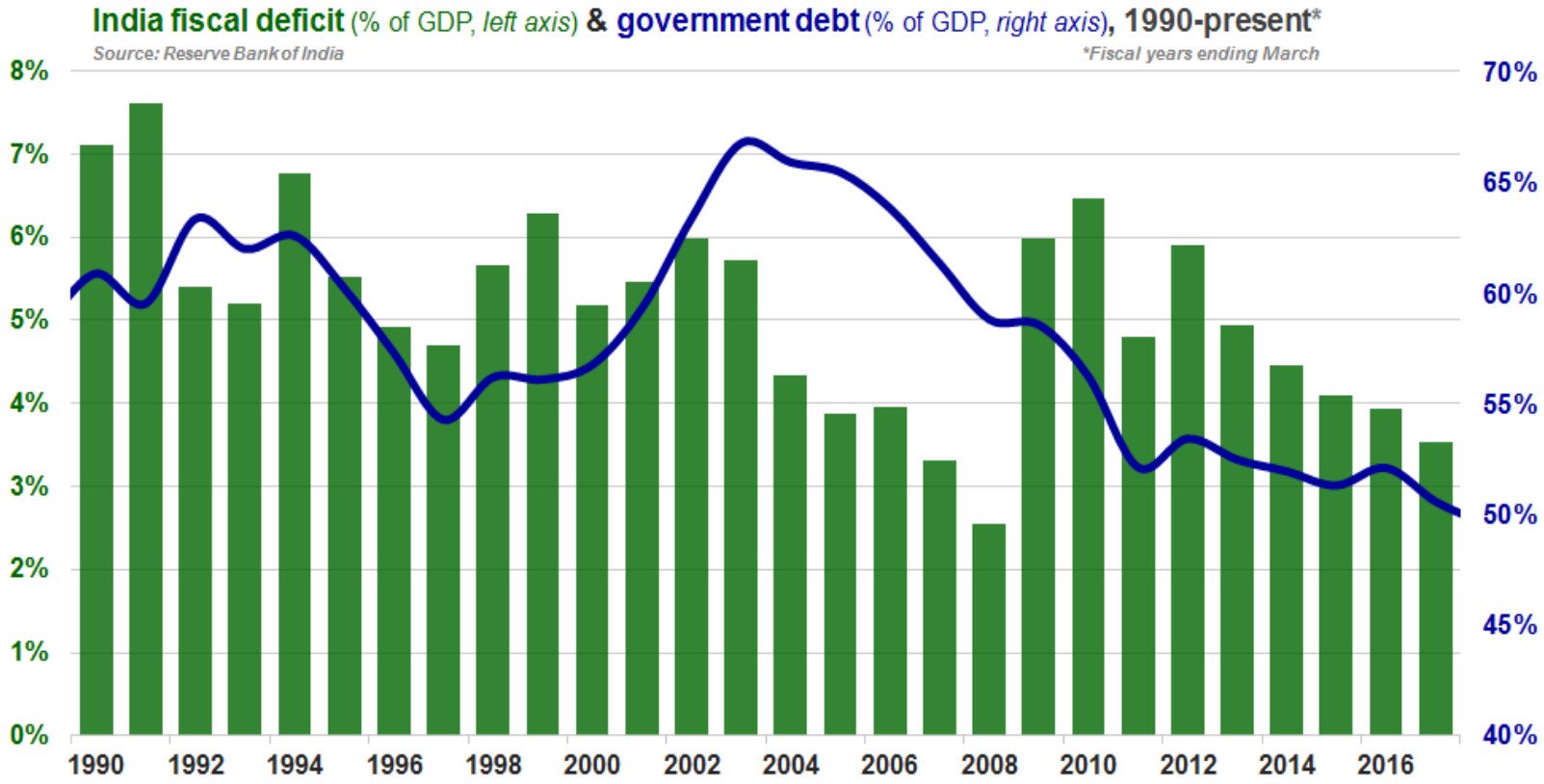


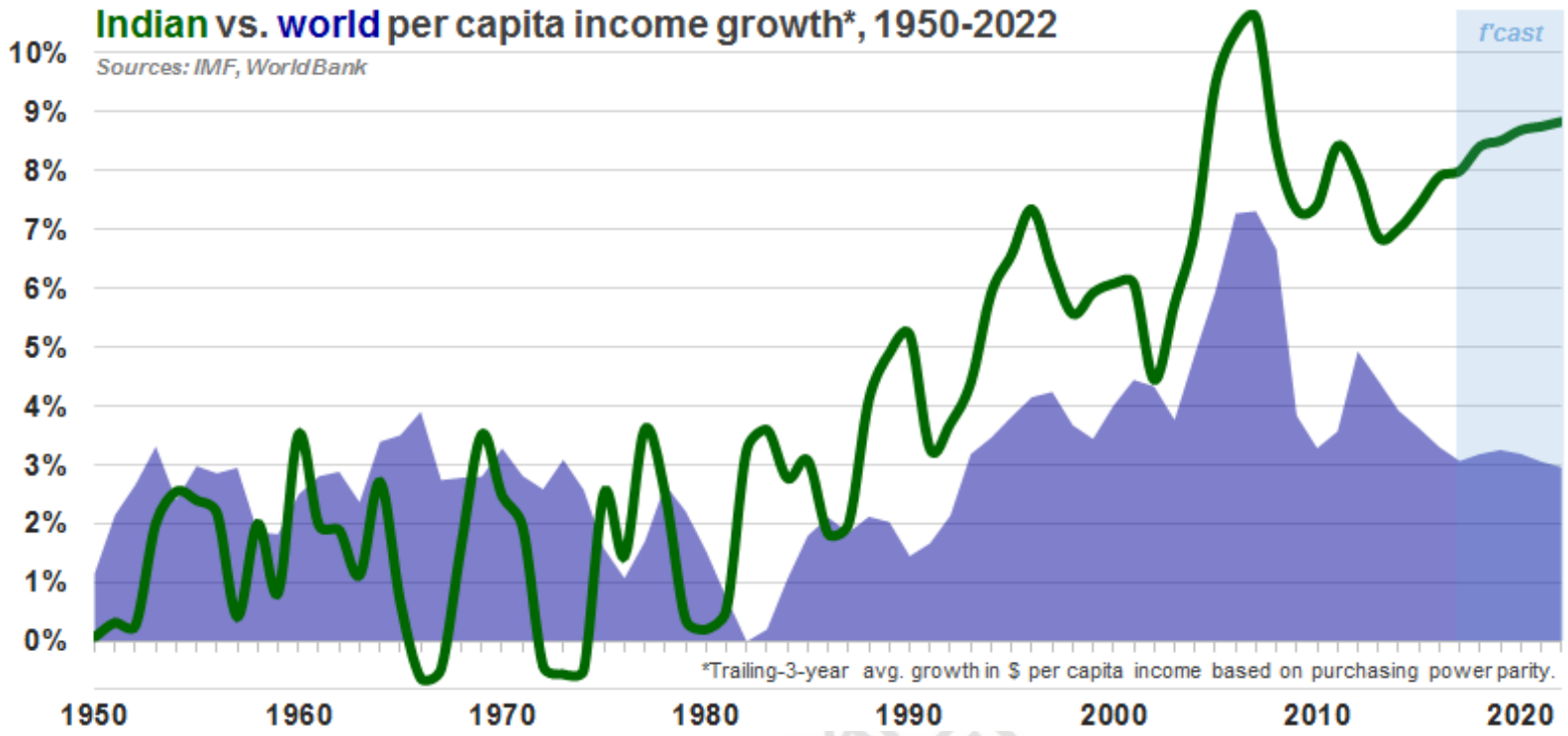
Shop in Medellín, Colombia selling Indian-made Bajaj motorbikes.[101]

The connection between trade and investment liberalization and the post-1991 acceleration in India's economic growth is clear.[102] The availability of new inputs and higher-quality, lower-cost substitutes for domestically-produced intermediate goods gave rise to entirely new products and industries. One-quarter of the increase in India's exports during the 1990s was driven by products that had not been produced prior to the reforms.[103] Access to foreign-made capital goods, along with "spillover effects" from foreign technology firms rushing to take advantage of India's skilled workforce, spurred the country's emergence as a global hub for software development, business process outsourcing, and pharmaceuticals manufacturing. These new industries created tens of millions of well-paying jobs, not only at Indian companies such as Infosys and Wipro, but also with multinationals such as **IBM** – which **now employs more workers in India than in the United States**.[104]

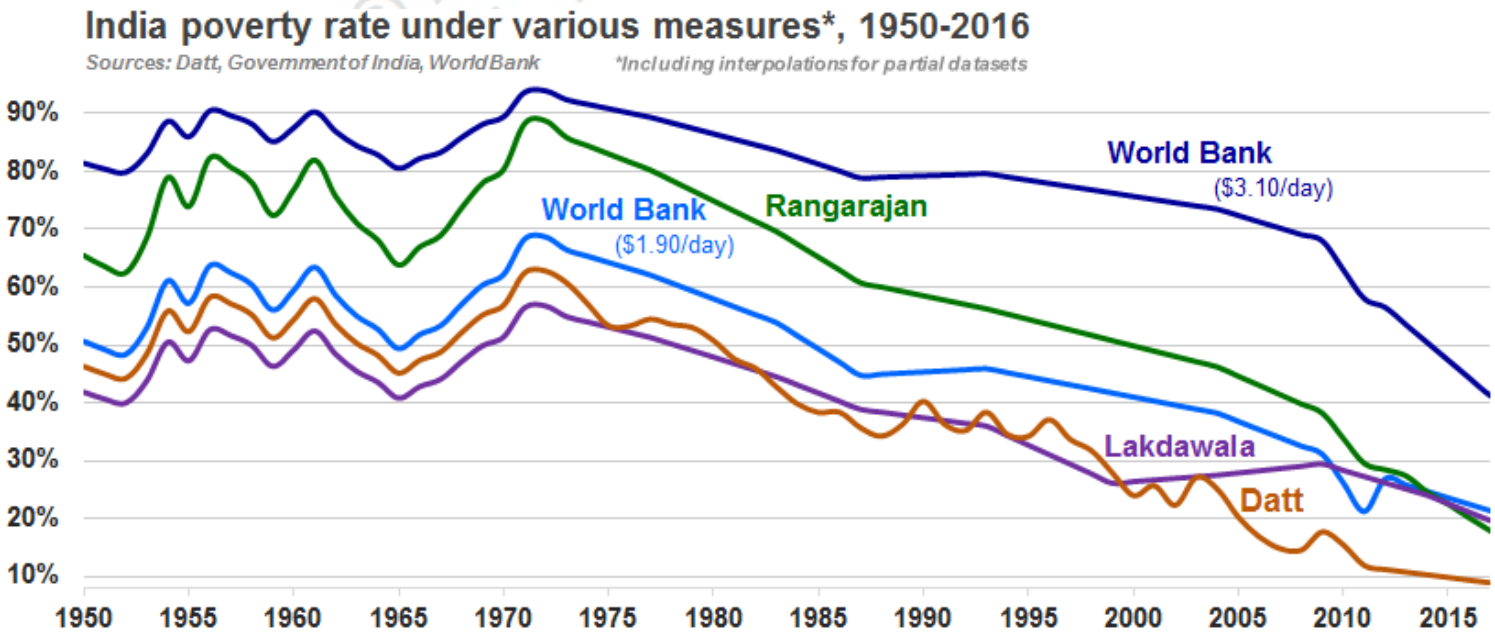
Leveraging their experience dealing with inadequate infrastructure, erratic bureaucrats, and a demanding but thrifty home market, Indian firms have become the world's leading "frugal innovators" – using scrappy design to put "first-world" products within reach of billions of lower-income consumers. Mumbai-based Godrej Group combined high-end insulation and a computer fan to create the "Little Cool": a ₹3,250 ($50) refrigerator that runs on a 12-volt battery.[105] General Electric's Indian subsidiary invented a ₹25,000 ($386) portable electrocardiograph (ECG) device that is now exported to emerging markets around the globe.[106]

Led by a reinvigorated private sector, booming exports, and surging foreign investment, India's economy has expanded nine-fold in the quarter-century since Manmohan Singh quoted Victor Hugo before parliament.[107] The country's share of world stock market capitalization has more than quintupled, to 2.4%,[108] while the government's fiscal deficit (as a percentage of GDP) has been halved.[109] Private-sector investment has doubled as a share of GDP, to 24%.[110] The number of motor vehicle-owning households has increased more than eleven-fold.[111] Since 1992, when the end of state-owned Air India's monopoly gave rise to the country's first private airlines, India's air passenger traffic has ballooned by a factor of twelve.[112] In 1991, Indians faced a three-year waiting list to get a landline connection. Today, the country has over one billion mobile phone subscribers.[113]





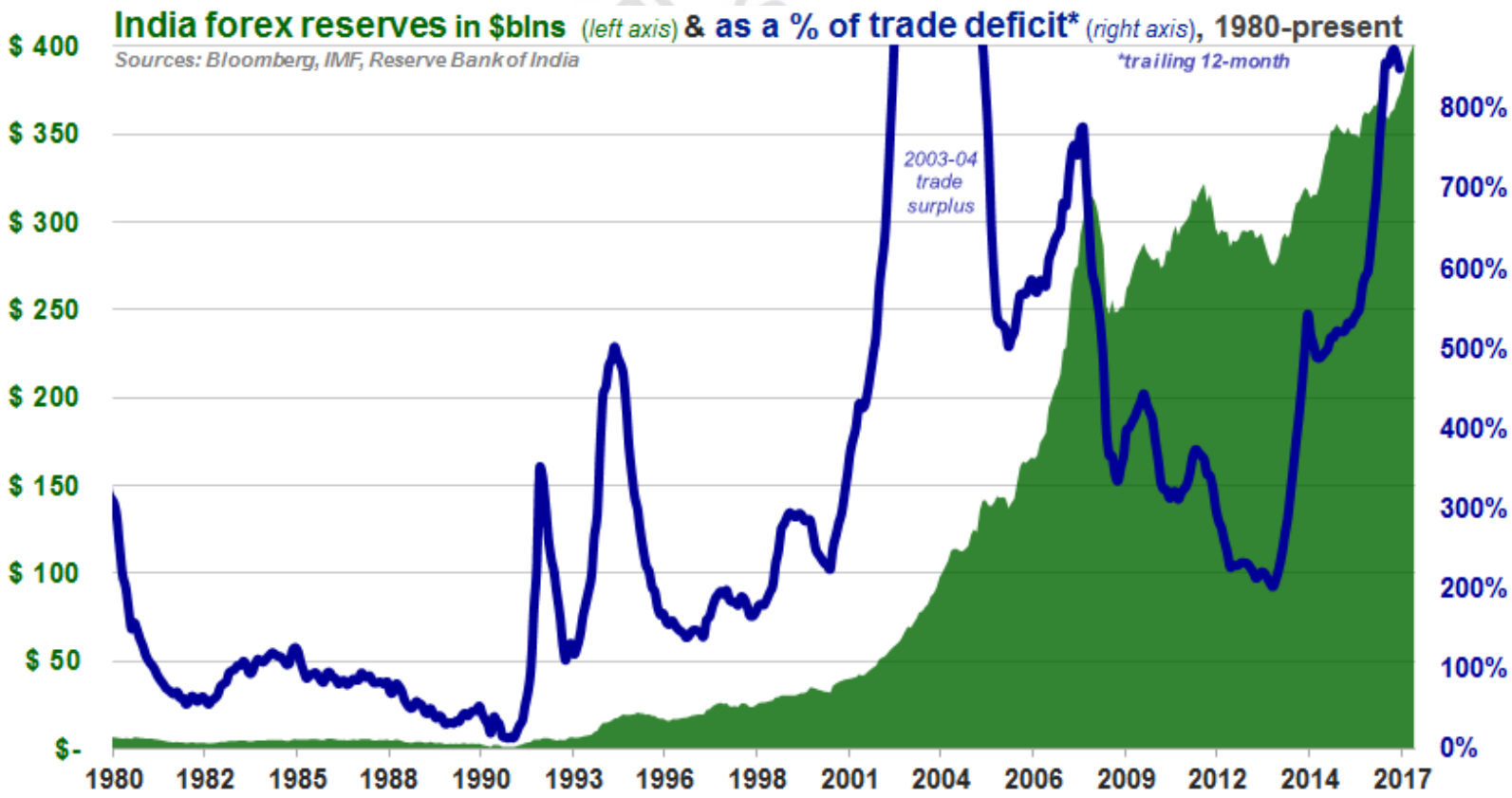
Since 1991, India's per capita income has grown more than three times faster than in the decades that preceded liberalization. Refuting the notion of a so-called "Hindu rate of growth", increases in the country's per capita income have surpassed global per capita GDP growth by a large and expanding margin, outpacing the rest of the world during booms as well as in the midst of global downturns.[114] Belying critics who claimed that reforms would only benefit the rich, the proportion of India's population living in poverty has been cut in half.[115]

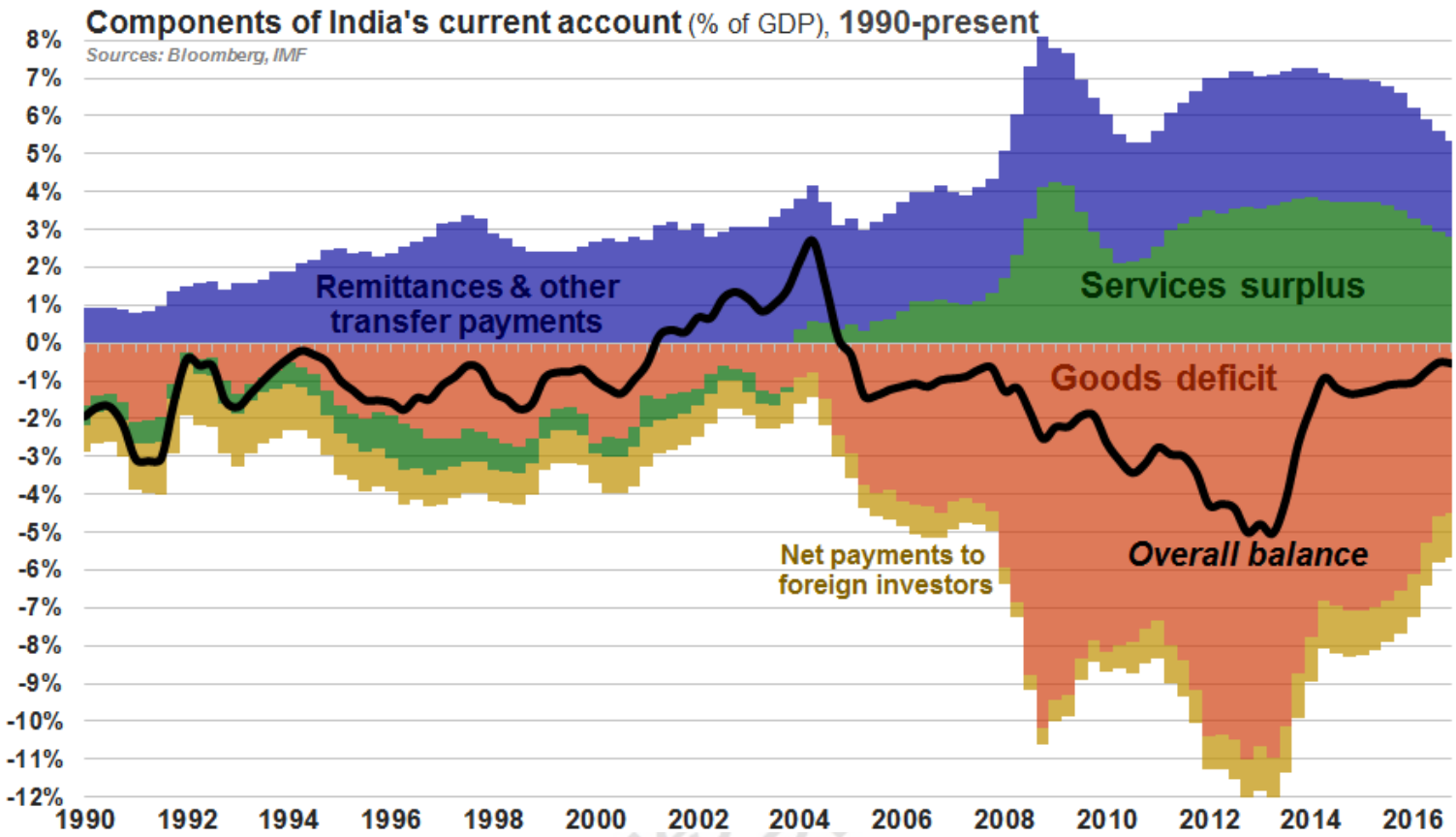


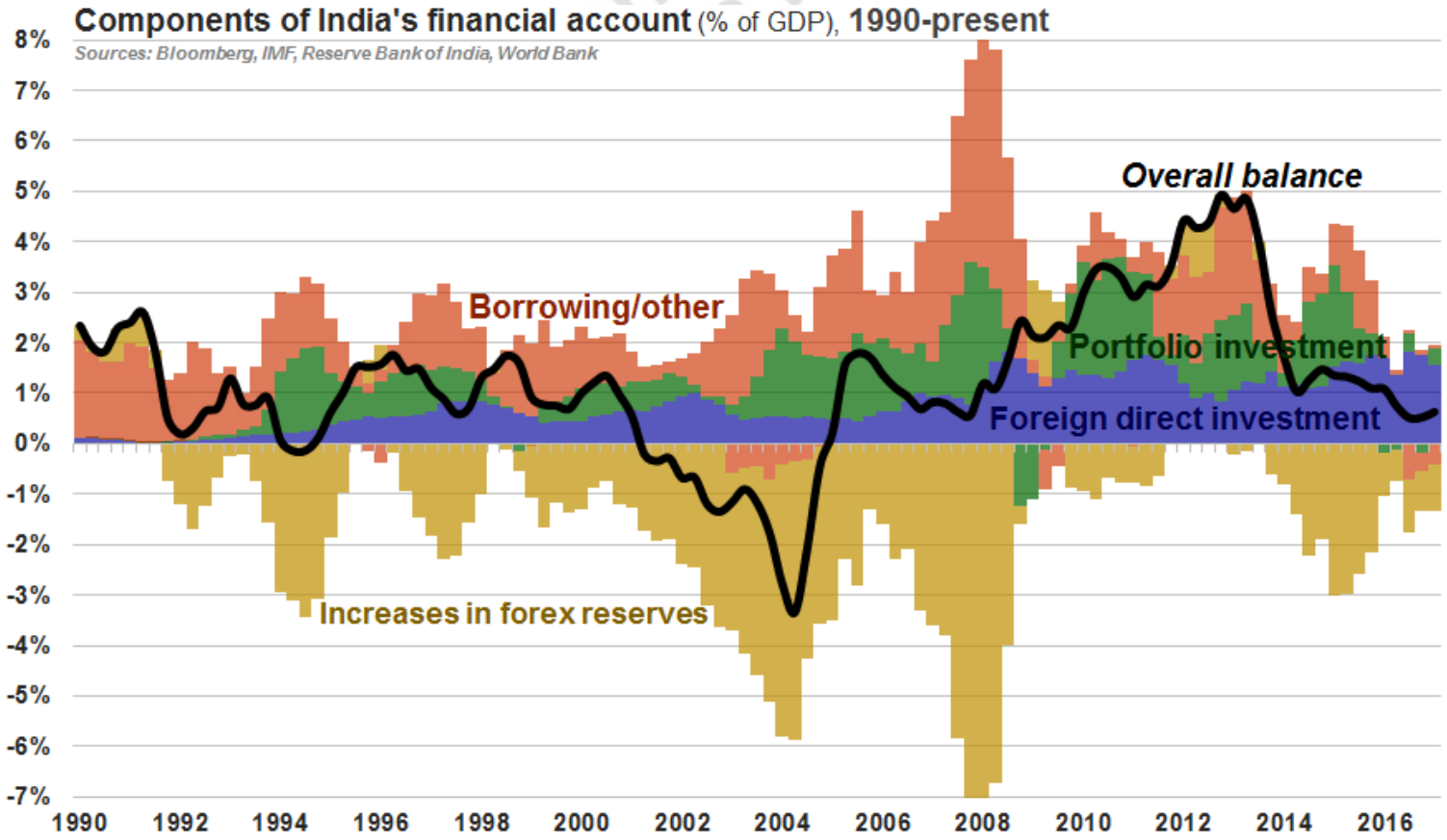
India's decision to open up to foreign trade, capital, and technology has strengthened its financial resilience and stability. The country's exports of information technology and other services have climbed from virtually nothing in 1991 to over $160 billion (as of 2016),[116] helping to offset its merchandise trade deficit. The dramatic decline in oil prices since 2014 – coupled with the government's canny decision to take advantage of the price drop to eliminate costly fuel subsidies – allowed India to narrow its current account deficit to just 0.5% of GDP last year.[16]

More importantly, India now attracts enough "sticky", un-borrowed sources of capital to reliably fund much wider current account deficits, if necessary – allowing the country to calmly surmount oil price surges akin to the one that heralded its 1991 balance of payments crunch.[117] Cumulatively over the past two decades, the amount of foreign direct investment that has flowed into India has covered its trade deficit more than twice over.[118]

Furthermore, by intervening in the currency market during periods in which the net inflow of capital into India (i.e., the country's financial account surplus) has exceeded the amount necessary to fund its current account deficit,[119] the RBI has been able to amass **forex reserves** of **over $400 billion** – enough to cover India's annual trade deficit more than eight times over.[27]







The 1991 crisis triggered reforms that – despite the Rao government's carefully-worded homages to India's erstwhile leaders – effectively repudiated Nehru's vision of India as an autarkic, state-dominated oasis of self-reliance. Yet those same reforms have brought India closer than ever to Nehru's goal of "economic independence". Formerly a supplicant to international development agencies, India is now a net donor of foreign aid.[120] Once dependent on food assistance, India is now the world's largest rice exporter.[121] India repaid its last IMF loans in 2000, and has been a creditor of the Fund since 2003.[122] In 2005, a quarter of a millennium after the first parts of India came under the dominion of the East India Company, its trademarks and other assets were acquired – by an Indian entrepreneur.[123] In 2009, the RBI triumphantly purchased 200 tons of gold from the IMF – triple the quantity it had been forced to pawn during the 1991 crisis.[124]

In a 1995 lecture at Columbia University, Manmohan Singh declared that India's "tryst with globalization had become irreversible".[8] He has been proven right, as every successive government since the crisis has **kept India on the path of reform**, varying only "in terms of speed and emphasis."[125] Nevertheless, India's liberalization is a "half-finished revolution": the country's dynamic economy now churns out world-class companies and engineers, but its average citizen is more likely to be connected to a mobile broadband network than to a sewer.[126] A future series of dispatches will delve deeper into the ways in which the economic reform unleashed in 1991 remains a work in progress, and will examine the tools available to policymakers seeking to realize the half-fulfilled promise of 1991.

* * *

Andrei Stetsenko

October 31, 2017

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