Capitalism and Society

Volume 15, Issue 1 2021 *Article 7*

The 1991 Reforms and the Quest for Economic Freedom in India

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Abstract

This paper studies the 1991 reforms as the beginning of the transition toward a market economy from the socialist policies implemented in the first four decades of the Indian republic. Tracking the major reforms in the three decades since 1991, I argue that economic control and statist policies are the norm and that reforms enhancing economic freedom are the outliers. After an excellent start by the Rao-Singh team in 1991 and a gaining of momentum during the Vajpayee government (1999–2004), India's liberalization and reform process has slowed down considerably in the last decade. The slowdown in the reform process and ad hoc regulation, as well as disastrous policies like demonetization, have become the new trend in Indian economic policy. Simultaneously, India's high rates of growth postliberalization have also slowed down, especially in the last five years, a trend that was visible before the pandemic. One of the reasons is that Indian policy makers pursued socialism for the first four decades after independence and never fully committed to the pursuit of economic freedom after the initial set of reforms in the 1990s and early 2000s. The main lesson from the history of India's reforms is that the problem is systemic and structural and requires a deeper commitment to markets to fix its upside-down state-market relationship.

Keywords: India, liberalization, markets, socialism, 1991 reforms, economic freedom.

I. Introduction

India's status as an emerging economy is a relatively recent phenomenon. India and China were responsible for over half of the global gross domestic product during the two millennia until 1820. India accounted for nearly 30% of the world's GDP from AD 1 to 1000. And though its share declined, India's share was a quarter of the world GDP even as recently as 1700. Western European ascent with the Industrial Revolution further rearranged the global economic order bringing down India's share to 16% in 1820 (Maddison 2001, 2003).

Imperial rule played a large part in India's economic decline in the last two centuries. Under the extractive policies of the East India Company, followed by the British Crown, India's share in global GDP declined to 4.2% in 1947. Especially between 1914 and 1947, when the British government drafted the Indian economy into the war effort, the national income grew at a little over 1% per annum and per capita incomes were stagnant (Roy 2006). Millions of Indians died in successive famines.

Though postindependence India has fared better than it did under imperial rule, the experiment with socialist planning did not help India in its quest for prosperity. As Indian policy makers captured the commanding heights of the economy, India's share in global GDP dropped to 3.1% by 1973, though it was the second-most populous country.

In one sense, the last three decades have seen a reversal of this decline, since India ended its attempt to control and plan the entire economy and partially liberalized its markets in 1991. Prime Minister Narasimha Rao and Finance Minister Manmohan Singh midwifed the 1991 reforms and launched India into the longest run of high economic growth in its modern history. Since the 1991 reforms, GDP per capita has increased sevenfold. As a result of economic growth, a quarter of a billion Indians have been lifted out of poverty; Indians now expect to live 10 years longer on average; and an additional 60 babies per 1000 survive as infant mortality has declined to 28 per 1000. Despite reducing state control over the economy, or rather because of it, the Indian state is also richer. Since 1991, India's federal government revenues have increased by 25 times, and state government revenues have increased by 28 times in nominal terms and about fourfold in real terms. Embracing markets also allowed the Indian government to increase its welfare spending in the mid-2000s. From 1992 to 2017, GDP grew annually at 7% on average, and in 2019 India's share of global GDP rose to about 7%. Decreasing state control, following the prescription of the Washington Consensus, and embracing greater economic freedom have been the path to prosperity for Indians in the last three decades.

In one sense, India is an economic success and belongs to a small group of countries that have grown considerably and sustainably for a long period post-WWII. On the other hand, despite the economic growth delivered by liberalizing India's markets, Indian policy makers could have done better. A lot of the economic-reform program to unleash the Indian economy remains unfulfilled. In comparison, in the post-1978 reform period, China grew at over 9% per annum and even peaked at a staggering 13% (Hu and Khan 1997). China's GDP per capita is almost five times that of India. Prereforms, China's share of global GDP in 1973 was 4.6%, which increased to almost 18% in 2019 (Maddison 2008; Textor 2021). The overall relationship between economic-freedom-enhancing reforms, dubbed the Washington Consensus, and economic growth is well established. Outside of India and China, in 49 cases of generalized reform, Grier and Grier (2021) find a positive, significant, and sizable effect of these reforms on living standards over 5- and 10-year windows.

India's overall performance pales in comparison to the Chinese experience. But India's performance in the last decade is also disappointing compared to the 1991–2011 period. Indian policy makers seem to have lost their way in the previous decade in the quest for economic freedom—the main ingredient for economic growth. There is no clear commitment to continue the market-based reform program or create more state capacity for a smooth functioning of markets. This also aligns with the global trend where the Washington Consensus as a prescription to accelerate development has become unfashionable. The reform process started in the 1990s and continued into the 2000s. It has since stopped or lost its way and devolved into some absurd policies like demonetization in 2016. These policies have further exacerbated the confidence in the Indian economy. Even before the severe economic contraction triggered by the pandemic, India's growth rate dropped to barely 5% in 2019.

A lot is at stake. Pradeep Agrawal estimates that a single percentage point increase in GDP per capita reduces poverty by 0.78% (Agrawal 2015). At prepandemic poverty levels, an additional 1% increase in the GDP per capita could potentially lift about 3 million Indians out of poverty. An additional 3% in GDP per capita over prepandemic levels could have eliminated extreme poverty in a decade.

Furthermore, India is one of the youngest countries in the world. At 1.36 billion, Indians are 17.7% of the world's population. They will outnumber the Chinese in a few years. And more than 40% of Indians are under 25 years of age. The Indian economy needs to productively employ this massive workforce otherwise it will soon lose its demographic advantage and invite economic and social chaos among its youth. Economic growth in India must include a structural transformation that launches hundreds of millions of jobs.

For the sake of over a billion Indians, almost a fifth of the world, India needs to revisit some policies in its past to secure its economic future. It is important to understand India's experience with socialism, the context of market-friendly reforms, and the policies required to launch India into a higher growth trajectory. This paper documents the major reforms in the last three decades in India and the enormous task that remains unfinished.

Section II briefly describes India's socialist economy and its shift toward markets in 1991. Section III details the reforms that followed through the initiatives of different governments following the Rao-Singh prescription. Section IV describes the economics reforms that succeeded and failed from the late nineties to 2014 during the Vajpayee and Singh governments. Section V details how the Modi government has lost its way in the quest for greater economic freedom. Section V discusses some fundamental structural problems in the Indian economy and the reform agenda that still remains. Section VI concludes.

II. License-Permit Raj

Central planning in India began in the midst of WWII. To direct resources to the war effort, "all mill production of wool textiles, all factory production of leather and footwear, all organized production of timber, nearly three-fourths of steel and cement production, over two-fifths of paper production, about one-sixth of cotton textile production and the whole of the normal quota of 600 million yards of cotton yarn had been directed away (by the colonial government) from the civilian economy to serve military requirements" (Tomlinson 1992, 277).

In addition to extraction of resources to fuel the war, the colonial government introduced a system of import controls and capital-issue controls, a precursor to independent India's industrial-licensing machinery, intended to also control increasing inflation and manage foreign exchange. Postcolonial India inherited most of these controls after the war. Some of this was due to the inevitability of some form of continuity of government policy postindependence. But a lot of it was a conscious choice, to establish a planned economy.

As intellectuals moved away from laissez-faire in Europe and the United States, prominent Indian leaders of the 1940s and 1950s who were educated in England in the early 1900s were more inspired by socialist ideas (Rajagopalan 2020b). In the large-scale exercise of the freedom movement and nation building in the lead up to independence, socialism was a foregone conclusion. The type of socialism and the precise development plan were yet to be worked out.

The ideology of planning gradually found its way into the heart of the burgeoning independence movement, the Indian National Congress. The Congress Socialist Party, spearheaded by Jawaharlal Nehru and full of planning enthusiasts, was formed within the broader fold of the Congress in 1934. The Congress also organized the National Planning Commission in 1938 to detail the role that state planning could play in the growth of the nation. The commission met through the late 1930s and early 1940s, developing proposals that greatly influenced the goals and the institutional structure of planning in independent India. In addition to the National Planning Commission's report, intellectuals, activists, and technocrats also worked on economic plans for India. The first plan emerged in 1934, by the engineer M. Visvesvaraya. The essence of his Income Plan was to industrialize India and double national income every 10 years. In the 1940s came the Bombay Plan—chaired by Ardeshir Dalal and drawn up by a group of industrialists restricting potential competition—which outlined various sectors of the mixed economy. The People's Plan, crafted by the Marxist M. N. Roy, encapsulated the position of the more radical communist left. The Gandhian Plan of S. N. Agarwal, which emphasized a self-sufficient closed economy, preserved the village as the unit of economic activity. By the end of WWII, socialism was the new orthodoxy in Indian politics (Rajagopalan 2020b).

Most of the war controls outlived the war. Toward the end of the war, in 1944, the colonial government set up the Department of Planning and Development, which, through its 1945 *Statement of Industrial Policy*, wrote the precursor to Nehru's industrial policy in the late 1940s and early 1950s.

In 1950, along with a newly minted constitution, Parliament set up the Planning Commission led by Nehru. The idea was to create Five Year Plans (FYP) detailing the overall development agenda and spelling out the exact plan in terms of investment, production, and allocation of goods by the public and private sectors across all industries. Tarlok Singh, a student of Harold Laski at the London School of Economics, became Nehru's right-hand man for this exercise. The statistician P. C. Mahalanobis was drafted for the planning exercise and became the architect of India's Second FYP.

To implement the planning exercise, Industrial Policy Resolutions (IPR), first in 1948 and then in 1956, outlined the industrial development strategy of the government. It categorized industries (1) as capital, intermediate, and consumer goods industries; (2) as owned wholly by the public sector, wholly by the private sector, or jointly; and (3) based on scale as cottage, village, small-scale, organized, and so on.

In particular, an important distinction was made among industries to be developed exclusively by the public sector, those reserved for the private sector, and those open to development by either or both sectors. In the IPR of 1956, 17 sectors, including electric power plants and iron and steel, would remain exclusive for state control. Twelve other industries were outlined where the state would progressively establish new plans, and the remaining industries were left to the private sector, though the state could establish enterprises wholly or jointly in these sectors.

The goal of planning in India was threefold: to increase domestic output, to diversify domestic output, especially away from agriculture to industry, and to reduce foreign dependence. This meant a planning system of command and control within India and autarkic trade policy abroad. To implement this, over a few decades, an overwhelming system of licenses and controls had to be created to allocate resources as per the plan targets and priorities. At its peak, the system, later dubbed the License-Permit Raj, involved the following.

First, an industrial-licensing system that decided the size, location, technology, output, employment, and investment of any firm in India, other than very small enterprises. The reason was that India would not rely on foreign trade for its resources, and domestic resources, which were scarce with multiple uses, had to be utilized properly to meet plan targets. This was done by passing dozens of oppressive laws like the Industries (Development and Regulation) Act of 1951, which mandated that no new industrial undertaking could be set up and no existing undertaking could be expanded without obtaining a license from the government of India, and the Companies Act of 1956, detailing minutiae like the remuneration of directors and manner and frequency of board meetings to control private firms. These laws were coupled with delegated legislation and rules empowering scores of government departments to allocate and issue specific permissions.

Second was a price control system. Only those with a license could produce and therefore access the controlled inputs required for production. But with licenses limiting production, supply never matched the demand and prices increased in the market. A socialist system could scarcely allow producers to profit from the licensing system that was required to execute plan targets. So came the price and quantity controls. This was a more direct continuation of war controls, strengthened by legislation like the Essential Commodities Act of 1955. This act, "in the interest of the general public, for the control of the production, supply and distribution of, and trade and commerce, in certain commodities," gave the government the power to "regulate or prohibit the production and control the supply, distribution, and price of certain enumerated commodities and of any other commodities which, by order may be declared 'essential'" (Hanson 1966, 494).

Third was the exchange control system to ensure direct control over foreign exchange utilization. Exporters were required to surrender their foreign exchange earnings to the Reserve Bank of India (RBI) at the official exchange rate. The system allocated the exchange earnings to users through import licensing to domestic producers, who required foreign exchange for importing essential inputs. Through instruments like the Foreign Exchange Regulation Act, any foreign exchange holding above the permitted limit incurred a criminal penalty and jail time. Laws like the Capital Issue Control Act of 1956 gave the government the power to control the issue of both equity and debt finance by joint stock companies. This system led to an artificially overvalued exchange rate. Bhagwati and Desai describe these controls as they existed 1956–1966: "The import and exchange policy regime, throughout this period, aimed at comprehensive, direct control over foreign exchange utilization. Thus administrative decisions had to be made over the allocation of foreign exchange for practically all uses in the economy. . .. Reliance on the direct allocative mechanism was thus almost complete during this period" (1970, 283).

Fourth, the prevailing view post-WWII argued that developing countries and emerging economies should have import-substitution policies to protect domestic industry. India, like most other developing countries at the time, also created a system to protect domestic producers from global competition in priority industries. This, however, meant that domestic consumers as well as domestic producers relying on these priority industries for inputs could not get high quality inputs tailored to their needs on time.

Fifth, agriculture was the first focus of India's central planning, starting with insulating agricultural markets from global trade. India's First FYP expressly stated that its objective was to "reduce disparities in wealth and income, eliminate exploitation, provide security for tenants and workers, and, finally, promise equality of status and opportunity to different sections of the rural population" (Planning Commission 1951, 88). Land-reform legislation in India, intending to give effect to the above objectives, fell into roughly four categories: a ceiling on landholdings with a view to redistributing surplus land to the landless; regulating tenancy to improve the security and protections afforded to tenants; abolition of intermediaries who were rent collectors under the colonial system; and consolidating fragmented disparate landholdings. Food prices were controlled, and simultaneously minimum floors and maximum ceilings were introduced for grain. But with declining productivity, farmers started demanding subsidies, and the government subsidized virtually every single agricultural input: fertilizer, electricity, water, agricultural credit, and so on.

Sixth, none of this could work without controlling the banking system—not only to control the allocation and distribution of credit as per plan priorities and targets, but also to ensure a cheap source of funds for the government. The First FYP said: "The proper discharge of its functions by the banking system will necessitate its operation more and more in the light of the priorities for development indicated in the Plan and less and less in terms of returns on capital. The banking system—and in fact the whole mechanism of finance including insurance, the stock exchanges and other institutions concerned with investment—will thus have to be fitted increasingly into the scheme of development visualized for the economy as a whole" (Planning Commission 1951, 38–39).

In 1969, the 14 largest banks, holding 85% of the deposits, were nationalized by ordinance, and another 6 banks were nationalized in 1980. Bringing credit under the planning exercise for specific plan goals and targets also meant differential rates of interest for different types of loans. The RBI had to manage hundreds of interest rates, and interest-rate structure became very complex, with little relevance to the scarcity value of loanable funds.

T. N. Srinivasan argues that

> the controls taken together were far more restrictive than each of them individually. For example, grant of an industrial license did not imply grant of a capital goods import license so that the capacity licensed could not be operational if the intended imports were essential. Besides the crucial aspect of all the regulations is the uncertainty about their fair implementation because they were essentially discretionary rather than *rule-based* and *automatic*. Although

> some principles and priorities were to govern the exercise of these regulatory powers, these were largely non-operational for two reasons. First it was impossible, even in theory, to devise a set of principles or rules for all the myriad categories of regulations that were mutually consistent and in consonance with the multiple goals of the industrial policy framework, which in themselves were not entirely consistent. Second, the problem of translating whatever rules there were into operational decisions was one of Orwellian dimensions. The allocative mechanism was largely in the form of quantitative restrictions unrelated to market realities. A chaotic incentive structure and the unleashing of rapacious rent-seeking and political corruption were the inevitable outcomes. Indeed, the discretionary regulatory system instituted in the name of planning for national development instead became a cancer in the body politic. (2000, 4; italics in original)

III. The 1991 Reforms

By 1980, these policies impoverished India and made the macroeconomic situation unstable, requiring constant management. Arvind Panagariya estimates India's growth pre- and postliberalization. During the Nehruvian phase immediately after independence, the Indian economy grew at an annual growth rate of 4.1%. During the fifties and sixties, this was considered quite respectable, given the Indian economy had grown at 1% under the extractive policies of the British. The second phase, when Prime Minister Indira Gandhi launched Soviet-style socialism, led to secular decline in growth rates and lasted from 1965 to 1981 with a growth rate of 3.2% (Panagariya 2008).

In the late seventies, especially in post-Emergency with Morarji Desai as prime minister, D. T. Lakdawala at the Planning Commission, and H. M. Patel as the finance minister, there started a phase of new economic thinking and a move away from the command-and-control economy that had served Indians so poorly.[1] Some efforts were made to rethink controls over some essential inputs, and cement, for example, was decontrolled in a phased manner.

The 1980s growth spurt has been hotly debated by economists, since this came about before the big bang 1991 reforms. Rodrik and Subramanian (2005), for instance, use this high rate of growth as proof of the success of large-scale import substitution and a shift in attitude in favor of business in the 1980s. They attribute the growth to perception on the part of the private sector that the government's attitude toward it had changed because of some piecemeal reforms of the industrial-licensing system, in particular the removal of controls that allowed firms to use excess capacity. Therefore, probusiness thinking, as opposed to the promarket

[1] The Sixth and Seventh FYPs reflect the shift in economic policy, moving away from a state-led Nehruvian idea of development to a more market-oriented approach embracing privatization and globalization. There were multiple committees set up that submitted their reports at this time, such as the High Powered Expert Committee on Companies and The Monopolies and Restrictive Trade Practices Act of 1969 under Justice Rajinder Sachar (1978), the Committee on Controls and Subsidies under Vadilal Dagli (1979), the Committee on Trade Policies under Abid Hussain (1984), the Committee to Review Policy for Public Enterprises under Arjun Sengupta (1984), the Committee to Examine Principles of a Possible Shift from Physical to Financial Controls under M. Narasimham (1985), and the Committee to Review the Working of the Monetary System under Sukhamoy Chakravarty (1985).

thinking starting in the 1990s, led to increased growth. Panagariya (2008, 78–94) argues that the growth of the 1980s was itself caused by "liberalization by stealth" that took place through this decade—scattered and unsystematic moves toward the market in a few sectors that nevertheless explain the high growth rates recorded. While Srinivasan (2005, ~~230–31~~) agrees that growth was induced by liberalizing excess capacity in firms, he argues that the 1980s growth was unsustainable and built on the shaky foundations of large-scale external debt and domestic demand that was fueled by fiscal expansion.

Profligate spending funded by short-term external debt in the 1980s led India into a currency crisis.[2] By the end of 1989, Indian foreign reserves could cover only two months of imports. Gulf War sanctions, which almost doubled the oil-import bill, exacerbated an already dire situation.[3] Domestically, India was battling double-digit inflation and double-digit fiscal deficits as well as a brewing political crisis (Misra and Narla 2021).

Moody's put India on credit watch for a possible downgrade in August 1990, making it even harder to raise credit. In December 1990, Yashwant Sinha, the market-oriented finance minister for the fragile Chandra Sekhar government, announced a plan to cut the fiscal deficit by 2%. Ongoing economic diplomacy also resulted in a $1.8 billion loan from the International Monetary Fund (IMF) in January 1991.[4] Yet this was just enough to buy 40 days' worth of imports, as the RBI tried to maintain the fixed exchange rate of the rupee.

Sinha was to announce economic reforms in his February budget to secure funding from the IMF. But Chandra Shekhar resigned as prime minister, after only seven months in office. The very next day S&P downgraded India's credit ratings—a signal of a lack of faith in India's ability to repay its long-term loans.

Sinha was out of options. As a last resort, he sold India's gold to negotiate more foreign exchange and to pay at least for essential imports.[5] But India's creditworthiness was at rock bottom, and purchasers insisted on physically shipping the gold abroad, rather than allowing it to remain in India's vaults.[6] Politically, India was a mess with two successive minority governments barely lasting a year each in office; during the 1991 general election campaign, the front runner for prime minister, Rajiv Gandhi, was assassinated.

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[2] The current account deficit increased from -1.7% of GDP over the period 1980–85 to -2.9% over 1985–90. India's total external debt increased from $20.6 billion in 1980–81 to $64.4 billion in 1989–90. And India's fiscal deficit shot up from 6.3% in the Sixth FYP of 1980–85 to 8.2% in the Seventh FYP of 1985–90.

[3] The Petroleum, Oil, and Lubricants import bill increased due to an increase in both crude oil prices and the prices of petroleum products. From $15 per barrel during April–July 1990, the price of crude doubled to $30 during August–November 1990. It did decline to $19 in December 1990, but the price of petroleum products, which had increased from $182 per tonne to $354 per tonne reduced only to $313 per tonne over the same time periods. India's total import bill increased from $3.8 billion for 1989–90 to $6 billion for 1990–91.

[4] Sanjaya Baru notes an incident in his book where C. Rangarajan, deputy governor of the RBI, and Deepak Nayyar, chief economic adviser to the Ministry of Finance, were secretly meeting Gopi Arora, India's director at the IMF, in January 1991 to secure a loan from the IMF. Based on Yashwant Sinha's earlier announcements on policy reforms, the IMF granted India this loan under their Compensatory and Contingency Financing Facility, which India qualified due to the Gulf War. Later, in May 1991, the IMF and World Bank released a joint note after Rajiv Gandhi's death echoing their support for strengthening India's economy based on the corrective policies that India would implement (Baru 2016).

[5] In April 1991, India sold 20 tonnes of confiscated gold from smugglers to UBS (with a repurchase option), raising $234 million.

[6] Forty-seven tonnes of gold were shipped to Bank of England in July 1991 to raise $407 million.

The story of India shedding parts of its command economy and partially embracing markets begins with these economic and political crises at home.

In June 1991, when an unlikely prime minister, Narasimha Rao, and his Oxford-educated technocratic finance minister, Manmohan Singh, took office, India had just enough foreign exchange reserves to buy essentials like oil for a fortnight. Overall macroeconomic health was dire with a fiscal deficit of 11.01% and inflation at 13.87%. India was on the verge of defaulting on its loans.

What is now known as the big bang 1991 reforms, started with the long-due devaluation of the Indian rupee. The first devaluation against major currencies between 7% and 9% was announced on July 1, and a second round of devaluation of 11% on July 3. This was shrouded in secrecy within the government, and fearing the old Congress Socialist guard, Singh and Rao bypassed members of their own cabinet (Ramesh 2015).

In addition to devaluing the rupee, India had to reform trade policy to capitalize on devaluation making Indian exports more competitive. Prior to 1991 all imports, except a small list of freely tradable items, were tightly controlled, with tariff rates at an average of 113% but ranging to 355% at highest. On July 4, Rao's Minister of State for Commerce P. Chidambaram rewrote India's trade policy, embracing the open market and freeing import restrictions on all except 71 specified goods.[7]

The highly restrictive import licensing regime was dismantled. In tandem, the government provided the stimulus to promote exports through trading houses, while reducing the degree of regulation and licensing control on foreign trade. In its place, an advance licensing system was put in place requiring licenses to be issued within 15 days and with the number of documents reduced from nine to about four documents. Before 1991, importers and exporters needed to go through government channels for certain goods. This policy was known as canalization: government enterprises would retain control and prevent wasteful exports or imports by channeling any foreign trade in certain sectors through government enterprises. About 16 items for exports and 14 imports were decanalized, allowing Indian enterprises to directly buy and sell in the global market. Exporters were incentivized through the introduction of EXIM scrips,[8] then the adoption of a dual exchange rate under the LERMS system, and eventually the adoption of a market-determined exchange rate system—all in a span of 18 months. Foreign technology agreements got automatic approvals to approximately 80 industries across 34 categories, allowing Indian firms to negotiate terms of technology and to hire foreign technicians without prior government permission. And 51% of foreign equity was allowed in some high-priority sectors. The government continued to lower tariffs through its term, and by 1995–96, the highest industrial tariff rate had been brought down to 50% from 355% before 1991.

An institutional redesign, replacing controllers with regulators, was key in moving India from command and control to a market economy.[9] A high-level committee was appointed to eventually eliminate import licensing. The proposals came from P.

[7] This was officially tabled in Lok Sabha as the Statement on Trade Policy on August 13, 1991.
[8] Scrips allow exporters to get reductions in import tariffs up to a certain percentage of their export value.
[9] P. Chidambaram announced the chief commissioner of imports and exports was going to be redesigned as the director general of international trade; Manmohan Singh announced transferring powers of the controller of capital issues to the Securities and Exchange Board of India.

Chidambaram; based on Montek Singh Ahluwalia's M Document (1990),[10] pushed through by Rao and Singh within hours.

The single most important and lasting policy from the July 1991 reforms is industrial delicensing. The government announced the new industrial policy, which in a single stroke brought 80% of the Indian industry out of this license labyrinth. The license requirement for entry of firms was abolished in all but 18 industries. The new industrial policy also removed licensing restrictions on large firms, encouraged foreign direct investment and foreign technological partnership, and targeted the sale of public sector enterprises. It abolished industrial licensing for most categories; the list of sectors reserved for the state was cut; the repressive Monopolies and Restrictive Trade Practices (MRTP) Act of 1969 was modernized; firms no longer required the preentry scrutiny of investment decisions; and the permissions for expansion and restrictions removing mergers and acquisitions in the Companies Act of 1956 were also eliminated. The government also announced disinvestment of government equity and opened up the economy to foreign investment, granting greater autonomy to private players.

Ending July 1991 with his historic budget speech, Manmohan Singh officially announced the end of command-and-control economic policy in India. He dismantled the oppressive industrial licensing and control system, removed price and quantity controls, welcomed foreign investment, and announced a new framework for India's financial regulation system; he further committed to unilaterally lowering tariffs, to the potential disinvestment of state-owned enterprises, and to a redesign of institutions from "controllers" to regulators. Simultaneously India's large deficit and debt problem was tackled by reducing subsidies given to the sugar industry, the fertilizer industry,[11] exporters, and others.[12] Most importantly he declared that the failures of socialist planning must be left in the past and India had to embrace markets for a prosperous future.

The 1991 reforms by the Rao-Singh team were very much in line with the Washington Consensus, a list of policy prescriptions for growth-enhancing reforms. The term was coined by Williamson (1989) and the prescriptions included (but were not limited to): (1) greater fiscal discipline, (2) eliminating public spending on subsidies and redirecting it to health, education, and infrastructure, (3) tax reform, (4) financial liberalization leading to market-determined interest rates, (5) market-determined exchange rates, (6) trade liberalization and a systematic reduction of tariffs to about 10–20%, (7) allowing foreign direct investment, (8) privatizing large public sector enterprises, (9) deregulation, and (10) securing property rights (Williamson 1993).

[10] Officially titled "Towards a Restructuring of Industrial, Trade, and Fiscal Policies," the M Document was written as an internal paper for Prime Minister V. P. Singh in May 1990. The document outlined a medium-term strategy with five key areas of policy reform: (1) achieving macroeconomic imbalance with high investment levels; (2) reform and redefinition of the role of the public sector; (3) reducing and restructuring domestic controls over production and investment licensing; (4) reducing the degree of protection to Indian industry; and (5) opening up foreign investment. Many of these reforms were implemented in 1991.

[11] Low-analysis fertilizers such as calcium ammonium nitrate, ammonium chloride, ammonium sulphate, and sulphate of potash were free from price controls. For single super phosphate, a ceiling on subsidy per tonne was imposed. The expected increase in price of all other fertilizers was nearly 40%. Under immense political pressure, Singh had to later reduce this to 30%.

[12] Export subsidies such as the Cash Compensatory Scheme was abolished after the devaluation on July 3, 1991.

In the Indian edition of reforms, removing socialist relics like industrial policy and price and quantity controls were also crucial. The prescriptions of the Washington Consensus, as well as the transition from socialist planning, were in the direction of greater economic freedom. Overall, the Washington Consensus took root in Indian policy making because there was a lot of buy in among economists and technocrats. Some of the top Indian bureaucrats like Amar Nath Verma, Montek Singh Ahluwalia, and Rakesh Mohan had previously worked at international institutions like the World Bank and the United Nations where they were part of this emerging consensus that free trade and economic freedom would help developing countries break out of poverty and economic instability. -. The 1991 reforms were a result of the Washington Consensus becoming the New Delhi Consensus.

IV. A Reforms Seesaw

The reform agenda continued past 1991 as the Narasimha Rao–led government made progress through policies, like adopting current account convertibility under IMF obligations. This process continued at a fast pace under the Atal Bihari Vajpayee–led government (1999–2004) and at a slower pace under the Manmohan Singh–led government (2004–14).

The most significant area of reforms by the Vajpayee government were in the telecommunications sector, as India today has the highest mobile phone penetration for a country at its income level. In 1997, the government dismantled a controlled telecom sector and created a new regulatory structure under the Telecom Regulatory Authority of India (TRAI) Act to oversee this sector and protect the interests of service providers and consumers. The New Telecom Policy (NTP) of 1999 later unleashed the mobile phone revolution.[13] An amendment to TRAI in 2000 established the Telecom Disputes Settlement and Appellate Tribunal (TDSAT) to adjudicate disputes between service providers and consumers.[14] Under the NTP, the government created a new revenue-sharing system, created Bharat Sanchar Nigam Limited (BSNL), liberalized entry into domestic and international long-distance service, and introduced a unified license system for fixed-line and mobile telecom services.

[13] Before this, there was the National Telecom Policy of 1994, which gave the Department of Telecommunications the larger burden of developing telecom services in India. The DoT retained the lucrative services of long-distance and international services for itself. The private sector was involved only in local services where fixed investments of fiber-optic cables were required. The DoT was both the policy maker and the competitor. Under the NTP of 1999, multiple changes were made to facilitate private enterprise such as a license-fee system with one-time revenue sharing, opening long-distance and international services to the private sector, transparency in the wireless spectrum allocations, and converging of telecom and broadcasting service industries.

[14] TRAI was set up as an independent regulator, and when it blocked the government-run Mahanagar Telephone Nigam Limited (MTNL) from entering cellular services, DoT filed a lawsuit against TRAI, which was ruled in DoT's favor. Thus, TRAI was reconstituted as a recommending body to the government, and its dispute resolution responsibilities were accorded to TDSAT.

The RBI dismantled the highly complex and administered interest rate system with some minor exceptions.[15] The government also significantly reduced the statutory liquidity ratio and credit reserve ratio used for decades as a source of cheap funds for the government.[16]

The MRTP Act had become completely obsolete, and in his budget speech, Vajpayee's Finance Minister Yashwant Sinha announced: "We need to shift our focus from curbing monopolies to promoting competition" (1999, 8). The government passed the Competition Act of 2002 to protect the interest of consumers and ensure freedom of trade. The act was badly designed and challenged in court, and a marginally improved version was enacted in 2007. The government also brought corporate profit tax down to 30% and reduced the tariffs to 20% by 2004.

In addition to liberalizing large firms, the government tackled India's defunct small-scale industry policy. Until 1997, ostensibly to encourage new entrepreneurs and small firms and to protect them from competition from larger firms, the government created a small-scale industry reservation policy where only firms with up to Rs. 10 million in plant and machinery were allowed to make reserved products. Initially this list reserved 47 items for small-scale firms. But by 1996, the list had expanded to reserve 1,000 items. It prevented firms from achieving scale and actually kills industries where India could have labor intensive manufacturing and a comparative advantage globally. The Vajpayee government also made significant progress in dismantling the small-scale industries reservation list, abolishing it entirely for firms exporting 50% or more of their output in 2000.

An important continuation of Manmohan Singh's agenda from his 1991 budget speech was curtailing India's large fiscal deficits. The Vajpayee government passed the Fiscal Responsibility and Budget Management Act (FRMB) of 2003 to curb the high revenue deficit and restrain the government from borrowing to finance its working expenses. But even after two decades, it serves more as a statement of intent than a method of limiting deficits. Absent required penalties for breaching the imposed targets and given the various exceptions (like calamities or national security) for increased spending, the law has been inadequate. The 2017 report of the FRBM Review Committee recommended repealing the act and the rules and implementing a new debt and fiscal responsibility law.

Annual Indian general government fiscal deficits are rarely below 6.5% of GDP and are amongst the highest in the G20 (Patel 2020, 14). As a banking crisis is once again brewing in India, large fiscal deficits and fiscal dominance over the financial sector have become a renewed concern.

When Manmohan Singh took office as prime minister in 2004 to lead the Congress-dominated United Progressive Alliance (UPA) government, expectations for accelerated

[15] After the recommendations in reports by the Committee to Review the Working of the Monetary System under Sukhamoy Chakravarty in 1985, the Working Group on Money Market under N. Vaghul in 1987, and the Committee on Trading in Public Sector Bonds and Units of Mutual Funds under S. S. Nadkarni in 1992, the suggestions of developing money markets and increasing transparency in the interbank market rates was taken more seriously. In 1992, the government started the fixed repo rate cycles of 1/2/3 days and later 14 days. This was then discontinued due to liquidity issues, and a reverse repo facility was started to give liquidity to primary dealers. It is only after the second Narasimham Committee of 1998 that the RBI implemented the policy corridor setting both repo and reverse repo.

[16] The statutory liquidity ratio reduced from 38.5% in 1991 to 25% in 1997. It is at 18% as of 2021. Cash reserve ratio reduced from 15% in 1991, to 5% in 2002. It is at 3.5% as of 2021 (RBI, n.d.).

reforms skyrocketed. This was further fueled by his choice of finance minister in P. Chidambaram, and many felt the old 1991 team was back to continue unshackling the Indian economy.

The UPA government made some progress and brought down the tariff rate to 10% by 2007. It also allowed 100% foreign investment in a large number of sectors. The dismantling of the small-scale industry list continued under UPA and by 2015 the entire reservation policy was dismantled.[17] Some of the other wins for the UPA government were more gradual financial sector reforms, especially in the face of the global 2008 financial crisis. The UPA also made progress in infrastructure by allowing the private sector in airport construction and management and deregulating petroleum prices.

Their main focus, however, was to enlarge the welfare state system through the rural employment-guarantee scheme, compulsory primary-school education with midday meals, housing for the rural and urban poor, among other welfare policies. And these schemes were accompanied by measures to increase transparency and accountability to citizens demanding welfare entitlements, most notably through the Right to Information (RTI) Act of 2005 and the launch of Aadhaar biometric identification scheme.[18] Yet little was done to reform the highly restrictive labor regime, the distorted land market, the agricultural market, or the complex tax system. And given the legacy of the Singh-Chidambaram team, the reforms were largely underwhelming. Some blunders like the retrospective taxation policy imposed on foreign firms[19] and the enormous corruption in the allocation of natural resource and spectrum licenses[20] were major economic setbacks (Mehra 2019). The Singh government started the

[17] In 1991, 836 industries were reserved for small firms. By 2006, this was reduced to 326 industries (Mohan 2006). By 2008, restrictions on 98% of the products were removed with only 20 products still reserved for small-scale industry (Martin, Nataraj, and Harrison 2014).

[18] The Right to Information Act mandates a response by the government to the information that citizens request within 30 days. In the first 15 years till March 2019, estimates suggest that between 4 and 6 million RTIs are filed each year. However, only 45% of them receive the sought-after information. Estimates also suggest that only 3% of Indians have filed these RTIs.

Aadhaar is a 12-digit number linked to the biometric and demographic data of an individual. It notably is a number, not a card, and was envisaged to be used unanimously as an identifier of any person who would be a resident in India. The need for this arose due to an increase in welfare schemes: the food, fuel, and fertilizer subsidies increased from Rs. 1.22 billion in 1991 to Rs. 1.73 trillion in 2010. However, leakages increased in the system with official government estimates acknowledging leakages of 54% in wheat, 48% of sugar subsidy, 41% Kerosene subsidy, and 15% rice were lost. See Aiyar (2017) for more information.

[19] Via an amendment to the Finance Act in 2012, the government introduced a provision of retrospective taxation to tax products, deals, and transactions from before the act was passed. Notably, on Vodafone's acquisition of a 67% stake in Hutchison in 2007, the government raised a tax demand of Rs. 799 million. On appeal, the Supreme Court ruled in favor of Vodafone, forcing the government to pass this law. Similarly, Cairn Energy was taxed with a bill of Rs. 102.47 billion under this law. Both, Cairn Energy and Vodafone approached the Permanent Court of Arbitration at The Hague and cases were ruled in their favor. In 2021, the government offered to drop all retrospective taxation claims benefitting 17 companies including Cairn Energy and Vodafone.

[20] The spectrum allocation scam, popularly known with the moniker 2G Scam, came to notice in 2010 when the comptroller and auditor general of India, the supreme auditing body, revealed that 2G licenses were given at extremely cheap rates causing the exchequer a loss of Rs. 1.76 trillion. The Central Bureau of Investigation filed a 80,000-page charge sheet with accusations such as a distorted first-come, first-served policy, advancing the cutoff date, issuing 2001 prices instead of 2008, and several changes of rules and eligibility criteria prior to

process for reforms in the financial sector, building the architecture for the goods and services tax, and stricter monetary policy, but it had very little political capital during corruption scandals to see the reforms through.

In 2011, the Singh government set up the Financial Sector Legislative Reforms Commission (FSLRC) to review and recast the laws and institutions governing the Indian financial system. The global financial crisis has exposed the fault lines in the underdeveloped and misaligned Indian financial regulatory system, and this was the first step toward the reform. Submitting its report in 2013, the FSLRC flagged that the financial system was governed by a framework of 60-odd laws and multiple rules and regulations. This framework, it criticized, was fragmented and riddled with inconsistencies, gaps, and regulatory arbitrage (Srikrishna 2013). The FSLRC recommended a nonsectoral principles-based Financial Law Code that would replace the bulk of the extant laws. The draft code also restructured the institutions in such a way that the RBI will regulate the banking and payments system and recommended that the proposed Unified Financial Agency subsume existing regulators like the Securities and Exchange Board of India (SEBI), the Insurance Regulatory and Development Authority (IRDA), the Pension Fund Regulatory and Development Authority (PFRDA), and the Forward Markets Commission (FMC).[21] The report was very well received by experts, regulators, businesses, and government. The plan was to repeal specific areas of regulation and pass the relevant portion of the Financial Law Code. Though the Modi government showed interest in these reforms, the FSLRC recommendations are yet to be converted into policy. What perhaps has delayed its implementation is the onerousness of the overhaul it recommends and if it is the necessary course of action. The overarching dilemma is whether existing structures need to be rationalized both in powers and personnel or should an entirely new regulatory structure "complemented by entirely new oversight over regulation" be required (Rajan 2014). To push this through, the Modi government must spend some political capital. The approach of the Modi government has instead been to coerce the informal sector into formalizing and to ensure higher tax collections, without any reform to the underlying misalignment of incentives for business in India.

V. A U-Turn

If reforms under the Singh-led UPA government were underwhelming, they were outright disappointing under Prime Minister Narendra Modi, who won elections in 2014 based on a rhetoric of reforms and development, promising to make a clean cut from decades of socialist policies under the Congress. But his economic vision often invokes the memory of Indira Gandhi's command-and-control economics.

The Modi government started on a good reform-minded note. Based on the 2014 RBI *Report of the Expert Committee to Revise and Strengthen the Monetary Policy Framework*, chaired by Urjit Patel, India made a shift toward flexible inflation targeting and joined the group of countries that have adopted flexible inflation targeting , led by New Zealand in the 1990s. A six-member Monetary Policy Committee was constituted for setting the policy repo rate, and the Monetary Policy Framework Agreement was signed between the Government of India and the RBI in

the auction. It is widely believed that the scam caused Congress to loss power. In 2017, a special CBI court acquitted all the 18 people accused.

[21] FMC was later merged with SEBI in 2015.

February 2015 to formally adopt this new flexible inflation targeting framework. This was followed up with the amendment to the RBI Act of 1934 in May 2016 to provide a statutory basis for the implementation of the flexible inflation targeting framework.

After some opposition and protests for changing India's land acquisition process, Modi's reforms stalled. The reform-minded economic vision and momentum changed with the disastrous demonetization in 2016, where overnight, through a television announcement, Modi invalidated the Rs. 500 and 1000 bills (approximately \$7.50 and \$15, respectively), removing 86.9% of the value of currency in circulation. The goal was to smoke out black money—income and wealth on which taxes have not been paid. The government anticipated that a large share of the old notes was held by tax evaders and criminals, who would not deposit their stock of the revoked currency notes (and eat their losses) to avoid legal scrutiny. The Indian government would receive a revenue windfall based on the black money held in cash and not exchanged for new notes.[22]

The RBI was caught as much by surprise as the general public, which was enormously inconvenienced; a few hundred Indians died due to the currency shortage in the immediate aftermath of the announcement. The RBI issued 57 official circulars between November 9 and December 31, 2016, which kept revising the conditions under which the public could make deposits, withdrawals, and exchanges of the demonetized currency, creating massive confusion and further costs. The small period to return notes (60 days) would obviously place limits on what money launderers could achieve, but the entire exercise had little to no benefit since 99.3% of the revoked currency has been returned through a great money-laundering exercise (Rajagopalan 2020a). There were no discernible benefits (Lahiri 2020), and the costs imposed on the economy, especially on the informal sector, were enormous. Real effects were most discernible immediately after the surprise announcement and dissipated with an increase in circulation of the new currency (Chodorow-Reich et al. 2020).

In 2017, the Modi government announced a major overhaul of India's indirect tax system by introducing the goods and services tax (GST). The GST was initially formulated by P. Chidambaram under the UPA government, which could not get it passed, and was eventually taken forward by the Modi government. It was a major economic reform that would incentivize the private sector, convert federally structured India into a single market, and eventually increase tax revenues. The tax reform to switch to a single-rate GST received widespread support from economists within and outside government. Within the government, various committees addressed the question of the equity trade-off with a single-rate GST. The report by the GST Task Force (2009) argued in favor of a single rate on the grounds of improving efficiency and reducing corruption.

Pre-GST, India's tax system was ineffective, expensive, complex, and full of exceptions. The GST effectively subsumed almost all existing indirect taxes: central excise duty, service tax, VAT, central sales tax, entertainment tax, octroi, luxury tax, many cesses and surcharges, and various other state and central levies on goods and services. The exceptions alone, as estimated by Subramanian (2015), cost the government about 2.7% of GDP. A GST

[22] For example, if 90% of the demonetized rupees had made it back to the RBI, the remaining 10% would have been written off, which would have provided a one-time massive dividend of approximately Rs. 1.5 trillion (\$24 billion) to the Indian government. Some estimated the windfall to be between 10% and 33% of the currency in circulation (Datta 2017; IANS 2017).

would subsume all these different taxes into one single tax. The first advantage was ease. The central government alone had several indirect taxes.[23] Simplifying this into a single tax would reduce compliance costs for individuals and firms, reduce administrative costs for the government, reduce tax and regulatory arbitrage, and increase tax buoyancy.

Second, unifying the state tax system and converting India into a single free trade zone with no differential levies while crossing state borders was a big advantage of switching to GST. Every state within the Indian federation set its own rates for various taxes.[24] One advantage was that unifying the taxes within each state would accrue the same benefits as unifying central taxes of reduced compliance costs, reduced arbitrage, and tax buoyancy. Also, the problem of different entry tax rates in interstate trade is done away with.[25] Furthermore, switching to GST can potentially reduce corruption and tax evasion as the in-built governance processes that are part of the erstwhile VAT system ensure tax credits are only given when the tax liability is disclosed.

The GST, however, was introduced with multiple rates, ostensibly to increase equity and mitigate the regressive nature inherent in consumption taxes. It started out with four nonzero rates. However, for ostensibly pursuing equity, the GST furthered interest groups seeking rents, tax concessions, and privileges. As a result, India now has eight different GST rates—0%, 0.25%, 1.5%, 3%, 5%, 12%, 18%, and 28%—and 21 different cesses in addition to GST. Since 2017, there are hundreds of government notifications clarifying various aspects of the GST. Of these, 28 notifications specifically prescribe tax changes (10 in 2017, 7 in 2017, 6 in 2019, 3 in 2020, and 2 in 2021 so far). Across these 28 notifications, the government has announced a rate change for 500 goods and services categories (Rajagopalan 2022).

The botched up GST reform has imposed an enormous cost on the private sector due to its complexity, and severely hobbled the informal economy, which is two-thirds of India's economy employing more than four-fifths of the workforce.

The GST bungle was dwarfed by Modi's attempt to reform the agricultural sector. The government passed three laws[26] in September 2020 to modernize the farm produce markets by: removing traditional intermediaries, directly connecting supply-chain players with the farmers, creating a framework to facilitate contract farming. The intention was to make

[23] The central government's indirect taxes include central sales tax, central excise duty, additional duties of excise levied under the Medicinal and Toiletries Preparation Act, additional duties of excise levied on textiles and textile products, additional duties of customs (countervailing duties [CVD] and special additional duties [SAD]), service tax, and cesses and surcharges.
[24] State taxes include sales tax or in some states the state VAT; purchase tax; state entertainment tax; luxury tax; entry tax (all forms); taxes on lottery, betting, and gambling; cesses and surcharges; and taxes on advertisements.
[25] Such tax rates essentially fragmented the Indian economy and created tariffs for interstate trade that did not exist for intrastate trade. Van Leemput (2021) shows that interstate trade costs exceed intrastate trade costs by a factor of 7 to 16. Bringing India's interstate trade costs down to the US level (i.e., reducing by a factor of 6) increases welfare by 15%, and eliminating intrastate trade frictions raises welfare by 5%. In other words, India was a single country with freedom of movement, but it was not a single free trade zone.
[26] The Farmers' Produce Trade and Commerce (Promotion and Facilitation) Act; the Farmers (Empowerment and Protection) Agreement of Price Assurance and Farm Services Act; and the Essential Commodities (Amendment) Act.

agricultural markets competitive and remove government controls on various aspects of the sector, ranging from produce prices to land usage.

However, these laws were passed without any parliamentary debate or stakeholder consultation, and lacked a clear roadmap for how to transition farmers from one purchase system to another. It also barred civil court jurisdiction for dispute settlement was also seen as complete abdication of state responsibility in safeguarding farmer interests. In some states, farmers also feared future reforms, especially losing high minimum support prices handed out by the government. Consequently, farmer groups protested for over a year, often in violent clashes with the government, and tried to stall the execution of the laws. Instead of negotiating, the Modi government first used brute force, followed by dilatory tactics, and eventually offered too little too late, and all talks with farmer groups broke down. (Beriya, 2021; Chatterjee, 2021)

Instead of devising methods to reinforce trust, reviewing the laws for potential improvements via amendments, and taking the reforms forward, the government is repealing the laws (Ghosh, 2021). With this single botched reform attempt, all agricultural reforms are effectively off the table for the foreseeable future, in a sector that needs the most deregulation and streamlining. the agricultural sector, still employs the largest proportion of the Indian workforce and is relatively unproductive, propped up by subsidies costing over 2% of India's GDP.

Halfway through Modi's second term is defined by pandemic lockdowns and disastrously handled agricultural sector reforms, with airline privatization as its only reform win. India's flag carrier airline, Air India, was once privately owned by Tata Sons. Starting its operations as a mail service in 1932, began its commercial operations in colonial India. Postindependence, the aviation sector was nationalized under the Air Corporations Act of 1953— a decision that sealed the airline's fate as an unproductive public sector enterprise burdening taxpayers for several decades.

By 1990s as economic liberalization was afoot, the 1953 law was repealed and the private commercial airline carriers were allowed to operate in the sector. Air India's operations could not withstand emergent private competition and became untenable for the government with mounting debts and losses. A saga of doublespeak on the re-privatization of the airline ensued. Since then, it was merged with the domestic carrier Indian Airlines, with multiple efforts to ramp up operations. But talks with its unionized workforce, extensive borrowings, fleet restructuring, all failed to help this enterprise take off (Jain, 2015). In August 2021, the airline was crushed by the pandemic and its 615.62 billion rupee debt. (Manghat, 2021)

Early 2020, the Modi Government expressed interest to sell the government's entire stake. It followed this up with fresh tenders in September 2021, culminating in Tata Sons reacquiring the airline for 180 billion rupees but assuming only 153 billion rupees of the debt. A long due privatization, it is one of the very few wins for Modi's reform agenda, but seems too little to propel other long due deregulation and privatization.

While some criticism for Modi's economic mismanagement is well deserved, just like Rao and Vajpayee are rightly praised, the problem with the Indian economy is more fundamental. India never paid heed to economic freedom for the first four decades postindependence and never continued its pursuit of economic freedom after the initial set of reforms in the 1990s and early 2000s. In the arc of the last 70 years, economic control and statist policies are the trend and reforms are the outliers.

Take the example of human capital, India's greatest resource, which is quickly turning into a demographic nightmare. In the last few years, with demonetization and the GST, India has experienced what has been dubbed "jobless growth" (Vyas 2020).[27] Unemployment rates have been high and fluctuating between 6.5% and 9% since demonetization. And with labor force participation declining, and most of the population working in the informal sector and very vulnerable to economic stress, India's jobs recovery looks distant. India needs a more fundamental structural transformation employing hundreds of millions of job-seeking youth. But its labor regime has prevented that for decades.

Over the decades, India's 40-odd federal labor laws and hundreds of state labor laws have made it very costly, on the margin, to formally hire workers. In response, employers use more capital, a trend we see through a relatively low share of labor in GDP. Or employers circumvent regulation in perverse ways, like having contractors hire workers instead of directly employing them. This has created a two-tiered labor system: a small group of formal, often unionized, workers, who get protection through regulation and cannot be fired easily and a large (90% by some estimates) unorganized pool of labor, who do not get most of these protections. Any limited protection they could have got through a direct contract with their employer is also lost to them as these arrangements are lopsided in practice.

The Industrial Disputes Act of 1950 has been rightly criticized for distorting the labor price while punishing enterprises employing large number of employees. But lesser known is the Factories Act of 1948, which aims to safeguard workers' health, safety, and comfort in any plant with 10 or more employees. Amirapu and Gechter (2020) find that a firm becoming big enough to fall under the purview of the Factories Act adds almost 35% to a firm's costs per worker. But this national average hides wide variation across states. For instance, in Bihar, the cost increase is as much as 69%. In other states it is negligible. This is because states differ greatly not only in their laws, but also in their state capacity to enforce the laws or live with lawlessness.

Despite widespread agreement over the malady, little has been done. The Modi administration streamlined 29 central labor laws into 4 labor codes: the Wage Code,[28] Social Security Code,[29] Occupational Safety, Health and Working Conditions Code,[30] and Industrial

[27] Vyas (2020) elaborates: "The labour participation rate has been declining systematically since 2016–17 when it was 46.1%. In 2017–18, the year that showed the full impact of the November 2016 demonetisation and the July 2018 introduction of GST, the LFPR fell to 43.54%. Then it slid by 77 basis points in 2018–19 and then again by 14 basis points in 2019–20. The two shocks of demonetization and GST delivered within 8 months of each other had a lasting impact on the LPR. During this period, the employment rate has been falling in line with the fall in LFPR. It fell from 42.7% in 2016–17 to 41.6% in 2017–18 and then even more sharply to 40.1% in 2018–19 and then to 39.4% in 2019–20. Between 2016–17 and 2019–20, the employment rate fell by 329 basis points. In September 2020, the employment rate stood at 38%. It was 144 basis points lower than it was in 2019–20."

[28] The Wage Code has introduced a national floor wage. Currently, central and state governments set wages based on skill and experience of the workers. The minimum wage amount hasn't been notified yet.

[29] The Social Security Code provides for universal social security covering organized workers, informal workers, and gig and platform workers. Rules specific to various aspects of social security such as employment injury benefit, provident fund, education assistance, etc. still have to be formulated and notified. A National Social Security Board would be set up to recommend schemes to the central government for informal workers.

[30] Under the Occupational Safety, Health and Working Conditions Code, the government has fixed the maximum daily work limit at eight hours. It mandates implementation of certain additional safeguards in case

Relations Code.[31] It is, however, old wine in a new bottle, and there is little difference in the old laws and the new code. The rules and therefore the incentives are the same. The Modi administration missed the purpose of labor-law reform: removing distortions that make labor artificially costly compared to capital in a labor-rich economy and allowing individuals and firms to contract more freely.

This is also true for other factors of production. The worst experiences involve attempts to buy, sell, use, lease, partition, and gift land – rules governed at the state level in India. While it seems innocuous to get permission from a regulator, Indians face unintentional delays in processing permissions because of limited state capacity and intentional delays by extracting rents and bribes. This has made land markets thin and inefficient, depressing prices, and reducing the wealth of most Indians, especially farmers. Acquiring land has been one of the biggest hurdles for businesses setting up large manufacturing units. Indians do well with start-ups in a room, but the moment a large parcel of land is required, the project is dead on arrival.

Raising capital with a banking sector in deep crisis is not easy either. It serves the politically well-connected and the rich elite, while the poorer and credit-strapped sections of the private sector are unable to raise capital through the formal state-dominated banking system. India's credit-to-GDP ratio remains less than 60%. But oddly, it is not because Indian banks are highly prudent and only lending to high-quality borrowers, since India simultaneously has a nonperforming-asset crisis. India's gross nonperforming-asset ratio was 8.5% even before the economy faced contraction due to the pandemic and is likely to get worse. The public sector banks are the worst affected. Urjit Patel, former governor of the RBI, argues that financial institutions and nonbanking financial companies have been used to support vague (and extraneous) objectives, including disinvestment, public employment, lending to firms of the politically connected, and so on (Patel 2020). With government deficits and debt levels reaching enormous levels and the stress imposed by the pandemic, the government may not have the resources to recapitalize banks. To overcome the incentive problem plaguing the state-controlled public sector banks, Acharya and Rajan (2020) argue that India needs to rethink its bank ownership and management models and offers various suggestions from privatizing banks to reorganizing control and leadership of public sector banks.

India's problem is more fundamental than just reforms in the financial sector, bank privatization, labor-law reform, or import tariffs. It's more systemic. India may claim to have shed its worst socialist tendencies, but it is still a model of state-led development, where policy makers treat Indians as pawns to be easily moved on a chessboard and not as individuals with agency responding to incentives. Indian policy makers are neither committed to genuine economic freedom nor understand the kind of prosperity and entrepreneurship such freedom

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of hazardous conditions. However, it provides a provision for the states to exempt new factories from this code to enable them to create more economic activity and jobs.

[31] Under the Industrial Relations Code, firms with up to 300 workers can now fire workers without prior permission, up from 100 workers. Fourteen states had already amended their laws to increase the threshold to 300 before this reform. The added contribution of the code is to make this threshold applicable across India. The workers will also have to give a notice of 60 days before organizing a strike, up from 2–6 weeks earlier. Flash strikes are not allowed.

can unleash. India's License Raj may have been dismantled in 1991 but the Permit Raj, especially in factor markets, is alive and kicking.

The Heritage Foundation's 2021 Index of Economic Freedom places India at 121st of 180 countries. Of the foundation's five categories—free, mostly free, moderately free, mostly unfree, and repressed—India falls into the mostly unfree category (Heritage Foundation, 2021). The Fraser Institute's 2021 Economic Freedom Ranking places India at 108th of 165 countries (Gwartney et al. 2021). This is not a result of overnight economic policies but decades of bad regulation and policy and a lack of commitment to individual liberty, economic freedom, and market-driven prosperity.

VI. The Upside-Down Indian state

In addition to economic reforms liberalizing and deregulating various sectors of the economy, increasing economic freedom also requires the state to develop capacity to ensure a well-functioning market and society. Since Adam Smith, classical liberals across the world have made a passionate case for a night watchman state. This is a government that prevents private predation by maintaining law and order, enforcing contracts, administering criminal justice, and limiting itself to provisioning basic public goods. While this model served the development of the Western world in the nineteenth and early twentieth centuries, one is hard-pressed to find a night watchman state today, as most countries have drifted from this liberal vision. Yet it is the prescription that works well for developing countries (Grier and Grier 2021), which may need simple and enforceable rules and systems even more (Rajagopalan and Tabarrok forthcoming).

The goal may not be the world of Adam Smith from centuries ago. But if Indians commit seriously to market-driven prosperity, they also need to rethink the role and the limits of the state. The classical liberal project is an attempt to minimize both public and private predation. To ensure that individuals in society do not infringe on the liberty of others—through crime, religious and caste violence and discrimination, theft, expropriation, bribery, fraud, monopolistic behavior, or externalities like pollution and (a particularly Indian issue) open defecation—there is a strong role for the state to provision public goods, maintain law and order, enforce contracts, and minimize externalities like air and water pollution. However, a strong state can lead state actors to abuse state power or to public predation—through expropriation of property, unjust taxation, discrimination, fraud, or false imprisonment or by preventing freedom of speech, movement, exchange, or religious freedom—and therefore, there is a reason to limit or constrain the power of the state.

The Indian state is the antithesis of what any state serving its citizens should do. It barely provides public goods and is instead overwhelmingly present in provisioning and subsidizing private goods and regulating private interactions. Instead of law and order, the government focuses on providing cooking-gas subsidies. Instead of enforcing contracts and having fair rules for all private enterprise, the state picks cronies as economic winners, granting them subsidies and monopoly privileges.

This shift from public goods to unequal private entitlements is the modus operandi of the bloated and costly Indian state postliberalization. It has only strengthened under the Modi government. Toilets instead of sewage systems, government jobs instead of a functional public education system, loan waivers instead of labor law reform, free credit instead of well-regulated banking, and agricultural subsidies instead of agricultural infrastructure—these are the markers of modern India. Spending on private entitlements has two effects. First, fiscal requirements of the Indian state lead to high deficits and borrowing that crowds out private investment. Second, money spent on public-goods provisioning is likely to attract more private investment and private exchange, an opportunity missed by spending on private entitlements.

The Indian state is upside down and simultaneously both strong and weak. It encourages the worst excess of private and state actors. It prevents neither private nor public predation. The Indian state does not have high state capacity to ensure law and order, contract enforcement, and so on. But because of decades of command and control and weak constitutional constraints, it is simultaneously also unable to limit the state from infringing on the rights of its citizens. In this sense, India does not simply need the next stage of reforms in land, banking, labor, and so on but also some introspection and consensus among policy makers and society on first principles and the role of the state and markets in a modern market-based democratic republic (Kelkar and Shah 2019).

The Indian state must turn its approach upside down, exit its provisioning of private goods, and significantly roll back the socialist and regulatory state that is overwhelming and stifling every aspect of private life—whether establishing a news channel, a power plant, a small restaurant, or a large university. Instead, it should focus only on the provisioning of public goods and developing strong state capacity to deliver public goods.

The big bang reforms of 1991 changed India's growth trajectory, unleashed private enterprise, lifted a quarter of a billion out of poverty, and helped India slowly take steps to return to a very long-run trend of dominating the global economy. And India needs a clear reform agenda in various sectors, starting with factor markets. However, the way out is not marginal reforms but a complete redesign of the state-citizen relationship.

VII. Conclusion

This paper studies the 1991 reforms as the beginning of the transition to markets from the socialist policies of the colonial government continuing into the first four decades postindependence. The transition, however, is not complete. After an excellent start by Rao-Singh team in 1991 and gaining momentum during the Vajpayee government (1999–2004), India's liberalization and reform process has slowed down considerably. Accompanied by ever-growing and complex regulation, as well as disasters like demonetization, India's high rates of growth have also slowed down, especially in the last five years, a trend that was visible before the pandemic.

Though Indian technocrats and citizens have embraced markets, the institutional framework to support free exchange is broken in India. The entanglement of socialist policies of the past and the ever-increasing and complex regulatory state created in the last two decades has left Indian enterprise shackled.

Though some criticism for Modi's economic mismanagement is well deserved, just as Rao and Vajpayee are rightly praised, the problem with the Indian economy is more fundamental. Despite the evidence of high economic growth and increase in living standards post the 1991 reforms, India never fully committed to the pursuit of economic freedom after the initial set of reforms in the 1990s and early 2000s. Nor have Indian policy makers made serious investments in public goods, infrastructure, state capacity, and education required to support a strong market economy. This article shows how economic control and statist policies are the trend and economic-freedom-enhancing reforms are the outliers. And for India's future prosperity it must choose the opposite –market friendly reforms that will fuel economic growth.

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