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India and the World Economy
A perspective on India's economic reforms
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I

1 I deem it a great privilege to be invited to deliver this year's Nehru Memorial Lecture. I am very grateful to Lord Romsey and other members of the Board of Governors of the Jawaharlal Nehru Memorial Trust for this honour.

2 By any reckoning, Jawaharlal Nehru must be considered as the main architect of independent India. India's emergence as a secular democracy after the trauma of partition in 1947, guaranteeing equal rights to all citizens regardless of their religion, caste and creed, owes a great deal to Nehru's vision and his steadfast commitment to the ideals which inspired India's freedom struggle under the leadership of Mahatma Gandhi. His was the pioneering role in the establishment of a system of parliamentary democracy based on universal adult franchise, a system of Government which has helped to establish durable and productive links between India and the United Kingdom. Nehru will long be remembered for the strenuous efforts he made to nurse and strengthen the institutions of a pluralistic, constitutional, multi-party democracy capable of dealing with the enormous social strains and stresses associated with the processes of modernisation and nation building in a poor country. India's strategy of development, with its emphasis on industrialisation and the use of science and technology as an important instrument of development, was profoundly influenced by Nehru's thinking. He laid the foundations of a broad-based industrial structure that is now a major national asset. Nehru's strong belief in the powerful role that human knowledge could play in the transformation of India's economy and society led to the establishment of a large number of national institutions of higher learning, with strong emphasis on scientific and technological education and research.

3 Of all the leaders of independent India, Jawaharlal Nehru was probably the most cosmopolitan in outlook. Even when fighting for India's freedom, he viewed India's freedom struggle as part of a world movement for decolonisation and for the establishment of a just world order. After independence, he had the wisdom to recognise the importance of India retaining its membership of the Commonwealth, in the process transforming its character as an Association of Sovereign and Equal States. He was conscious of the increasing interdependence of nations as few other leaders of his time. This is clearly brought out in the memorable speech he delivered to the Constituent Assembly on the eve of India's independence on 14th August 1947, Nehru said:[1]

"And so we have to labour and to work, and work hard, to give reality to our dreams. Those dreams are for India, but they are also for the world, for all the nations and peoples are too closely knit together today for anyone of them to imagine that it can live apart. Peace has been said to be indivisible; so is freedom, so is prosperity now, and so also is disaster in this One World that can no longer be split into isolated fragments."

[1] *Tryst with Destiny,* Speech delivered in the Constituent Assembly on 14th August 1947 published in Jawaharlal Nehru's Speeches, Vol. I, p.26, Publication Division, Government of India, March 1992

II

4 It may therefore seem ironic that the economic development strategy associated with Nehru's name (described hereafter as the Nehru-Mahalanobis model) led to a progressive decline in India's share of world exports from about 2 per cent in 1950 to 0.4 per cent in the late 1980s. India pursued a trade policy which restricted imports to bare essentials needed for the fulfilment of plan targets. Import control authorities evolved the doctrine of 'indigenous' availability under which an item which was produced domestically was not eligible for import. Both trade policy and exchange rate policy severely discriminated against exports as compared to production for the home market. The pattern of development laying emphasis on import substitution at whatever costs did lead to the establishment of a considerably diversified industrial structure. But nearly total neglect of considerations of cost and quality stood in the way of the emergence of a dynamic export sector. As a result, despite substantial inflows of external assistance, a chronic shortage of foreign exchange became an enduring feature of the Indian economic scene.

5 At the time of independence, there was sizeable private foreign direct investment in industries such as tea and jute. These industries were allowed to operate freely until 1973 when a new Foreign Exchange Regulation Act was enacted. An important objective of this Act was to reduce the foreign equity in foreign owned enterprises so as to conserve foreign exchange. Overall, India remained distrustful of both trade and foreign investment. This factor further contributed to her isolation from the technological and economic trends sweeping the world economy.

6 That the Nehru-Mahalanobis model of development which remained the main guiding factor of India's economic policies until 1991 did not produce the desired results in terms of growth of output and employment and reduction of poverty has been well known for quite some time. For example, the Indian economy grew at an average annual rate of no more than 3.5 per cent during the first three decades of independent India. There was no perceptible decline in the proportion of people living below the austerely defined poverty line of the Indian Planning Commission. In the 1980s, the economy's growth rate went up to 5.5 per cent and there was also a perceptible decline in the proportion of people living below the poverty line between 1977-78 and 1987-88. Nevertheless, taking the period of fifty years of independent India as a whole, one has to admit that the overall pace of social and economic development has fallen far short of the aspirations of the Indian people as well as of the objective potential of the Indian economy. It also compares unfavourably with the development experience of many countries of East and South East Asia, some of them far less well endowed than India in human and natural resources. Industrialisation in India, unlike in East and South East Asia, has not been associated with any significant diversification of India's occupational pattern. The proportion of people dependent on land has declined only marginally.

7 The recognition that India was lagging behind in the race for social and economic development led in the 1980s to some significant attempts to liberalise the economy. The overall growth performance of the economy improved very substantially in the 1980s even though it was facilitated by an unsustainable increase in the fiscal deficit and external borrowings. In human affairs, inertia has often a strong hold on the minds of policy makers. An old American saying – if it ain't broke, don't fix it – has wide applicability. Thus the reform process did not make much headway in the 1980s. We had to wait for the economic crisis of 1991 to make a first major break with past thinking for the management of the Indian economy.

8 Before I deal with the economic reforms of the 1990s, I would like to deal with two important issues which arise in any discussion of the Nehru-Mahalanobis model of development. First, how much blame for the failings of the economy could be laid on the shoulders of Nehru himself? Second, if the development strategy was not producing results, why was there no serious challenge to it until the economic crisis of 1991?

9 Nehru's basic thinking, that in an overpopulated agrarian economy, rapid industrialisation alone could provide a lasting solution to the problems of underdevelopment is valid even today. His emphasis on the pioneering, promotional and entrepreneurial role of the State in economic development in the initial stages of development was also not misplaced. This activist role of the State was also endorsed by most of the development economists of the time who justified it on the basis of perceived "market failure" and the externalities often associated with processes of development. Similarly, the import substitution strategy of development also enjoyed powerful intellectual support from a powerful group of economists who believed in the doctrines of balanced growth, big push and take off into self-sustained growth. The experience of the inter-war years had given rise to a widespread pessimism about prospects of exports of primary products and light manufactures from the developing countries. The industrialisation process in most developing countries started by laying emphasis on import substitution, though the more successful ones among them graduated later on to a more export oriented pattern of growth.

10 As for the role of the foreign investment, most development economists in the fifties and the early sixties were highly sceptical about the ability of developing countries to attract large inflows, characterised as they were by poor infrastructure and low domestic demand. Considering the actual trend of foreign investment flows until the early 1980s, this did not turn out to be an unrealistic assumption.

11 Events subsequent to the Nehru period provided ample evidence about the limitations of a development strategy which assigned the commanding heights of the economy to the public sector. The progressive deterioration in the standards of political conduct and the growing influence of competitive populist politics in determining both tariff policies and resource allocation eroded the efficiency, profitability and resource generating capacity of a large number of public enterprises at the Centre and the States. As a result, they could not perform the pace setting role in processes of capital accumulation assigned to them in the Nehruvian development strategy. A large number of these enterprises had to be subsidised by the budget thereby reducing the flow of public funds for vital social services such as elementary education and primary health care. However, it would not be fair to blame Nehru for the failure of his successors to live up to the high ideals and standards of conduct in public life which he upheld.

12 The export pessimism which provided an important justification for the import substitution strategy was shown to be unwarranted by the rapid growth of world trade in the post-war years particularly in products such as textiles, leather goods and light engineering goods in which India had a considerable intrinsic comparative advantage. However, the adverse effects of the import substitution at whatever cost strategy on the efficiency or production structures were not easily discernible during the period 1957-63. Overall, the Indian State during the Nehru period performed reasonably well in articulating the Indian people's aspirations for development and in responding constructively to them. Until the Chinese invasion of 1962, the entire Nehru period was characterised by a high noon of optimism and self confidence in the nation that the development enterprise was making good

progress. We should not lose sight of this perspective in any evaluation of Nehru and his great contribution to the development of the Indian economy.

13 The diminishing returns yielded by the Nehru-Mahalanobis development strategy became visible by the mid-60s. Over-centralisation and bureaucratisation of economic processes, emphasis on import substitution at whatever cost and associated built-in discrimination against exports and neglect of the role of market mechanism in resource allocation gave rise to many structural distortions which affected the growth of the economy. An attempt was made to correct these distortions with the help of a World Bank aided programme in 1966. Had this attempt succeeded, India by now would have become a major power-house of the world economy. However, two severe droughts, the non-availability of the promised amount of external assistance and domestic political instability combined to erode the effectiveness of the programme in a short period of time. The old control and command system remained intact.

14 As stated earlier, a concerted multi-faceted effort to reform the system had to wait until 1991 even though the shortcomings of the old development model were visible much earlier. The long delay in introducing reforms, even when the case for them was so strong, was largely due to the fact that several important and influential groups had come to acquire a strong vested interest in the perpetuation of the command and control development model. The control instruments such as industrial licensing, import and exchange controls, control over capital issues and price and distribution controls conferred enormous discretionary powers on politicians and civil servants charged with the responsibility of administering those controls. Similarly, the industrial development strategy – with its emphasis on central allocation of resources and infinite protection for industry conferred important privileges on those industrialists who were lucky enough to secure government approval for the establishment of new capacity and for the import of the needed machinery and raw materials. Enactment of paternalistic labour legislation restricting employers' rights to the redeployment and retrenchment of labour ensured that the organised labour unions and their work force would also form a part of those privileged groups. So also were important groups of intellectuals engaged in teaching and research in institutions of higher learning. Although India was not able to find enough resources to universalise access to elementary education for all her children up to the age of 14, considerable amounts of resources were devoted to establish and support an impressive system of higher education, scientific and technological research and development. All these groups, constituting important leaders of public opinion had a powerful stake in the perpetuation of the old system even when it was obvious that the overall interest of the economy demanded a major overhaul.

III

15 The economic crisis of 1991 was deep and acute. Recourse to large internal and external borrowing in the 1980s had given rise to an unsustainable fiscal and balance of payments deficit. The economy was highly vulnerable to sudden external shocks and to political instability at home. In the event, the rise in oil prices in the wake of the Gulf war led to an increase in the balance of payments deficit on current account to 3.2 per cent of GDP in 1990-91. The unstable political situation in India made it difficult to finance a deficit of this order. International commercial banks and non-resident Indians who had in the 1980s financed a substantial part of the deficit became extremely reluctant to do so. By June 1991, India's foreign exchange reserves had been nearly exhausted. The country had to undergo the humiliation of shipping abroad a part of official gold to raise a small loan in foreign exchange. The tightening of import controls led to the stagnation of output and accentuation of

inflationary pressures. India was on the verge of default in meeting her international debt servicing obligations. After a long time, the influential political class and the thinking segments of population realised that India's economic policies needed a major overhaul. The collapse of the Soviet Union and other Socialist economies of Eastern Europe provided confirmatory support of this view.

16 It was in this background that a minority Congress Government led by Mr P V Narasimha Rao came to office after the general elections held in June 1991. I was asked to head the Finance Ministry. I had to improvise a coherent programme of action to deal with the crisis. In doing so, I had to bear in mind the fragility of the minority Government that Mr Rao was heading. I was left in no doubt that I would be the scapegoat if the programme failed. I was prepared to accept this challenge.

17 It was obvious that we needed a credible programme of stabilisation to restore a measure of macro economic stability in the shortest time period with a view to controlling both inflation and the deficit in the balance of payments. I worked for a reduction of full two percentage points of GDP in the fiscal deficit of the Central Government for the fiscal year 1991-92. In the situation we were then placed, a sharp cut in public expenditure was unavoidable. The cut had to be large enough to be credible. At the same time I had to bear in mind that, in a rather indisciplined democracy that India was, it would be difficult to sustain a programme of austerity for a prolonged period of time. Austerity had to be large enough to have a credible immediate impact and its duration had to be short enough to avoid unfavourable political fall out. Furthermore, even in the short run, every effort had to be made to minimize the creation of unemployment and idle capacity. To this end, expenditure reduction policies had to be supplemented by appropriate expenditure switching policies. It was for this reason that a credible adjustment of the exchange rate preceded the presentation of my first budget on 24th July 1991.

18 The experience with stabilisation programmes world-wide is a mixed one. There are many instances in which the built-in inflexibilities and structural distortions ensured that a stabilisation programme ended up by producing stag-flation. I was concerned that this should not happen in India. Accordingly, side by side with stabilisation measures, we worked out a multi-pronged structural reform programme designed to deal with the distortions which had led to a persistent low productivity of resource use in the Indian economy. The main elements of structural reforms included:

a) Industrial policy reforms removing restrictions on the establishment and expansion of Indian firms;

b) Enlarging the areas of operation for the private sector;

c) Trade policy reforms leading to a progressive reduction in import duties and liberalisation of quantitative import controls;

d) Financial sector reforms seeking to enhance the role of commercial banks and capital markets as financial intermediaries for an efficient allocation of community's savings;

e) Partial privatisation of profit making public sector units through sale of equity to the public at large, thereby exposing these units to the discipline of the market;

f) Liberalisation of price and distribution controls so as to strengthen the role of market forces in the allocation of resources;

g) A medium term programme for the reform of the tax system, laying emphasis on moderate rates, broader base and stricter compliance with tax laws;

h) Opening up of the Indian economy to private foreign investment by a liberalisation of the policy applicable to foreign direct investment and allowing portfolio investments in India's stock markets by foreign institutional investors.

IV

19 The depth and speed of reforms did not proceed as originally planned. There was a visible weakening of the political commitment to the reform agenda as the sense of economic crisis disappeared by 1993. Even then, the overall results of the reforms, incomplete though they are, have been highly favourable.

i) In the first year of reform, i.e. the crisis year of 1991-92, India's GDP increased by a modest 0.8 per cent. However, during the subsequent five year period ending March 1997, the growth rate of the economy averaged 6.5 per cent. The Reserve Bank of India expects the economy to grow at the rate of 6 per cent in the current fiscal year.

ii) The fiscal deficit of the Central Government declined from 8.2 per cent of GDP in 1990-91 to 5.1 per cent in 1996-97. Although the overall public sector deficit (including Centre and the States) is still very high, the reduction in the fiscal deficit at the Centre has helped considerably to moderate inflationary expectations. The annual rate of inflation measured by the movement of the wholesale price index on a point to point basis is currently less than 4 per cent.

iii) Tax reforms at the Centre – covering both direct and indirect taxes – have made impressive progress. However, the tax systems in the States are in a messy state, and the goal of having a national indirect tax system which is a close approximation to the value added tax is still far away.

iv) There has been a strong improvement in the balance of payments. The deficit in the current account was as high as 3.2 per cent of GDP in 1990-91. In the last five years, it has averaged 1.5 per cent. Import liberalisation and an early exchange rate adjustment facilitated a strong growth of exports averaging 20 per cent per annum from 1993-94 to 1995-96. The growth of exports considerably slowed down in 1996-97. However, so did import growth. Invisible earnings increased substantially and the year ended with a current account deficit no higher than one per cent of GDP. Foreign exchange reserves (excluding gold and SDRs) have been handsomely replenished at the end of March 1997 equalled nearly seven months' imports. The rupee has been convertible on current account since 1994.

v) Import tariffs have been reduced sharply. Imports of raw materials and capital goods are now free of quantitative import restrictions. The liberalisation process is now being extended to consumer goods. The fear that the liberalisation of imports would lead to deindustrialisation of India has turned out to be unfounded. Industrial production increased rapidly after 1993-94 and the growth rate in 1995-96 was as high as 12 per cent. Since then the rate of industrial growth has declined to 6 - 7 per cent. However, the deceleration is basically due to weakening of export growth and investment. There is no evidence that the country has been flooded with unwanted imports.

vi) The external debt of the country has been managed prudently. The debt-GDP ratio fell from 30.4 per cent in 1990-91 to 25.9 per cent in 1996-97. Over the same period, debt service ratio (expressed as a percentage of current receipts) declined from 35.3 per cent to 25.4 per cent. Of the total debt stock of $91 billion at the end of March 1997, 93 per cent was long term. The short term debt was no more than 6.7 billion dollars. The ratio of debt stock to current receipts declined from 329 per cent in 1990-91 to 163.5 per cent in 1996-97.

vii) Until 1990-91, India attracted insignificant amounts of private foreign investment. In the last three years, the annual flow of direct investment has been about two billion US dollars. Including portfolio flows, the annual inflow of private foreign investment now exceeds five billion US dollars. The Government of India has entered into bilateral investment agreements with a large number of countries guaranteeing an investment regime based on most favoured nation treatment and non-discrimination between domestic and foreign investors.

viii) Financial sector reforms have added to the transparency of operations, improved the accounting standards and promoted competition in the financial markets. The entry of foreign service providers in the financial services industry has imparted an added incentive to improve the efficiency of this sector. The supervisory and regulatory systems have been revamped and strengthened.

V

20 Although the initial results of the reforms have been highly encouraging, the reform agenda is far from being complete. The overall fiscal deficit of the public sector (close to 9 per cent of GDP) is still too high and real long term interest rates cannot decline substantially if this deficit is not reduced significantly. The challenge ahead is to reduce the fiscal deficit in such a manner that it does not affect essential public sector investments in infrastructure and social sectors such as education and health. Greater buoyancy of the tax system through a tighter system of administration and broadening of the tax base constitutes one leg of the programme. But more important is a tighter control of expenditure involving a cut in unmerited subsidies, including subsidies for loss making public enterprises, and a significant reduction in the interest burden of the public debt through a bold and more ambitious programme of privatisation. The reduction of unmerited subsidies is bound to hurt some well entrenched vested interests and this is a task which requires strong political nerves. Weak governments at the centre and some states cannot muster the required political courage.

21 Under trade union pressures, public sector reforms, involving, among other things, a bold programme of privatisation, have not made much headway. It has not been possible to build a national consensus going beyond partial privatisation of public sector units not exceeding 49 per cent of equity. These very pressures have also prevented action being taken to reform the system of industrial relations so as to reduce the rigidities of the labour market, reduce state intervention in the management of industrial relations and to put in place a much needed exit policy for unviable enterprises. Present labour laws and rigidities associated with them create a positive disincentive for entrepreneurs to employ more workers even in highly labour intensive activities. However, the labour aristocracy represented by the trade unions is more interested in protecting the interests of their existing members than in increasing the total volume of employment in the industrial sector.

22 Reforms of tariffs and management practices in the infrastructure sectors, which mostly happen to be in the public sector, are not proceeding fast enough. The pace of these reforms needs acceleration both to enable the public sector entities to generate more internal resources for a further expansion and modernisation of their capacities as well as for creating viable incentives for greater private sector participation in infrastructure sectors.

23 The reform of the fiscal system seeks to restructure public finances and to provide more public funds for investment in vital social sectors such as education and health. But this objective cannot be realised if there is no willingness to cut unmerited subsidies or to undertake viable reform for the restructuring of public sector enterprises. As of now, there is no adequate appreciation of the fact that fiscal reforms are absolutely essential to enhance the government's ability to devote more resources for social development and for the creation of effective social safety nets for the poor and the needy.

24 There has been a considerable advance in reforms relating to trade policy. But even now, Indian tariffs are higher than the competing Asian Countries and there is resistance to phasing out of remaining quantitative import restrictions, particularly those relating to consumer goods. Fortunately, it is now hoped that a mutually acceptable solution to this problem – acceptable to both India and her major trading partners – will be found through negotiations currently underway in Geneva. However, if the economy and in particular the industrial sector do not grow fast enough, the pressure to delay action on the lifting of the remaining import controls may well increase. It is also distressing to note that India's leading trade partners have accused her of not honouring her obligations under the TRIPS Agreement of the Uruguay Round. Both the extreme left and the extreme right have joined hands in the Indian Parliament to block the enactment of the needed legislation.

25 Annual inflows of foreign private investment, both direct and portfolio, still account for a very small proportion of total investment in the economy. There are many policy and procedural bottlenecks (multiple approvals, lack of credible regulatory and tariff fixation mechanisms in infrastructure sectors) which hamper a larger inflow. The removal of these procedural barriers and domestic policy distortions is essential to improve the climate for foreign investment and to secure larger economic benefit from it. However, now that the balance of payments crisis is over, certain segments of Indian industry have revived the plea for a more restrictive attitude towards foreign private investment, particularly in the consumer goods industries. There is a growing talk of a lack of level playing field (high domestic interest rates, poor infrastructure, lack of adequate financial resources at the disposal of Indian firms as compared to their foreign competitors) which places Indian industry at a disadvantage in competing with foreign investors. There is an element of truth in this statement but this only strengthens the case for faster reform of the infrastructure sectors and the financial sectors. Moreover, if the intention is to ensure that foreign private investment does not remain concentrated in consumer goods industries, it is necessary to further reduce tariffs and quantitative import restrictions applicable to consumer goods. Furthermore, in so far as the plea for a level playing field is a response to the fears of an approaching economic recession, the proper response ought to be to create an enabling environment conducive to a faster growth of both investment and exports which currently happen to be weak points of the economy.

26 As regards the financial sector, thanks to reforms of the last six years, it now operates in a more competitive environment. However, there are still many structural weaknesses (bureaucratic management structures and inflexible labour practices) which prevent Indian banks from responding to fast changing environmental conditions with speed and efficiency.

Through the operations of foreign institutional investors, the India stock markets are being progressively integrated into the global financial markets. However, the volatility associated with portfolio flows often creates doubt about their sustainability. Strong macro-economic fundamentals are a necessary though not always a sufficient condition for longer term sustainability of these flows. Insurance sector reforms, which are vital for increasing the supply of long term funds for the development of the infrastructure sectors, stand blocked for the time being due to combined opposition of the left and the right in Parliament.

VI

27 An important objective of economic reforms is to bring about a progressive integration of the Indian economy with the global economy, There are both opportunities and risks in operating in a globalised world economy. The challenge is to make full use of opportunities while minimising the risks in the process of integration. I for one believe that, on balance, India can gain immensely from an intelligent use of the opportunities provided by the liberalisation and expansion of world trade and international capital movements.

28 It is often not recognised that on a per capita basis India is not particularly well endowed with natural resources. India, like Japan and South Korea, has to be a major trading nation if her future development is not to be constrained by a chronic shortage of commercial energy and important industrial raw materials. A recent World Bank study suggests that given sound economic policies, it is feasible for India to raise her share of world trade from 0.7 per cent at present to about 4 per cent by 2020.[2]

29 In the 1990s, there has been a very rapid expansion of flows of international private capital to the developing countries. According to World Bank estimates, the net flow of private direct investment was 93 billion dollars in 1996. The estimate for the portfolio flows is 91.5 billion dollars.[3] India currently attracts about 2 per cent of private flows to all developing countries. There is a vast scope to improve upon this performance. Larger inflows would ensure that the rate of investment in the economy was not rigidly constrained by the availability of domestic savings.

30 Thus in the areas of both trade and capital flows, there are significant opportunities which remain unexploited. India needs to create a policy environment which encourages multinational corporations to make India an important export base for their regional and global strategies. However, an integrated holistic approach to policy reforms is essential to take full advantage of the emerging opportunities. Further measures are needed to enhance to competitiveness and contestability of markets, encourage entrepreneurship and skill formation through greater emphasis on human resource development, speedy modernisation and expansion of the physical and financial infrastructure and putting in place credible social safety nets to protect the weak and more vulnerable sections of population during the phase of transition to a more dynamic economy.

31 Recent developments in East Asia and South East Asia have once again revived issues of sustainability and volatility of private flows and their impact on the real economy. These developments as well as the experience of Mexico in 1995 suggest that cyclical fluctuations in private flows cannot be assumed away. At the same time, the Mexican experience further suggests that once sound policies are in place, recovery of private flows need not be unduly

[2] Global Economic Prospects and the Developing Countries, 1997, p.24
[3] Global Development Finance, 1997, p.5

delayed. Without being dogmatic, one can assume that the sustainability of private flows is closely linked to the design and effectiveness of basic macro-economic policies and the behaviour of macro variables such as the fiscal deficit, inflation rate, the state of the balance of payments, export trends, size and structure of external debt and the magnitude of debt service payments. Countries following sound policies will be in a better position to sustain private flows. Markets can also react quickly to policy shortfalls. Thus an increasing reliance on private flows would require a greater sense of social and political discipline and a significant improvement in the quality of governance to ensure that prudent macro economic polices were in place.

32 Even if the sustainability of private flows is not in doubt, one has to recognise that a world of integrated trade, money and capital markets will probably witness greater volatility of interest rates and exchange rates. Markets can over-react to events. Thus there will be need for effective mechanisms for risk management. Portfolio flows are particularly volatile. As such, a good case can be made for not removing currency and capital controls in haste. While the longer term orientation must be towards a progressive integration of financial markets, the actual pace ought to be related to the speed of reforms in the real sectors of the economy and the effectiveness of measures to strengthen the management systems, supervisory and regulatory arrangements for the financial markets.

33 The success of India's efforts for integrating her economy with the global economy will also depend on the overall global economic outlook and environment. The international community has the responsibility to preserve the integrity of the multilateral trading system. The expanding role of regionalism in Europe and North America ought not to be allowed to subvert the non-discriminatory character of the global trading system. The protectionist pressures in the developed countries ought to be kept firmly in check. It is a worrying thought that the high rates of unemployment in Europe and the decline in real wages of unskilled workers in the USA since 1973 are increasingly being attributed (though wrongly) to the import of cheap labour intensive products from developing countries. There is also a danger that the current concerns for internationally agreed standards for labour and environment related issues and the demand for the harmonisation of an ever increasing number of domestic policies may give rise to a vicious new wave of protectionism in the developed countries. These fears, if not allayed, will discourage investment in export oriented sectors in developing countries.

34 If for some reason the programme for the establishment of a monetary union in Europe is delayed, it can have a major upsetting influence on the level of economic activity in Europe, thereby further strengthening the protectionist sentiments. The developed countries, particular the G-7 countries, need to pursue co-ordinated economic policies which are sufficiently expansionary and keep unemployment at tolerable levels. The poor economic performance of Japan in recent years is an important factor contributing to sluggishness of exports and overall growth in East and South East Asia.

35 As a general proposition, the G7 countries, in this age of increasing global interdependence, have to be adequately sensitive to the interests and concerns of the emerging nations and these concerns have to be taken into account in the formulation of their economic policies. The time has come to create a formal consultative mechanism for this purpose.

VII

36 As I survey the current Indian economic scene, I discern a fair amount of reform fatigue. The absence of a sense of crisis which prevailed in 1991-92 has diluted the enthusiasm for reforms. Political developments of recent years have created doubts about the ability of the Indian Government to push ahead with the unfinished reform agenda.

37 In a democracy, it cannot be ensured that the reform process will always proceed along a smooth linear path. Fortunately, there are several encouraging developments taking place. For one thing, the solid gains secured through reforms in the past six years have ensured that no major political party is talking in terms of rolling back the reforms. The economy is now well set to grow at an annual rate of 6 percent. India's domestic savings rate in 1995-96 exceeded 25 per cent of GDP. There are indications that the underlying demographic trends, particularly the rise in the proportion of population of working age, will bring about a further increase in the savings rate in years to come. Liberalisation policies have also led to improve productivity of investment. Assuming a capital inflow of no more than 2 – 2.5 per cent of GDP, a basis now exists for the economy to achieve a growth rate of 7 per cent. Secondly, in an increasingly information driven world we live in, the people of India are becoming increasingly impatient for an acceleration of the pace of economic development. The fact that a growth rate of 6 per cent is now considered a recession, is an indication of the changed mind set of the people. The aspiration that the economy needs to grow at an annual rate of 7 – 8 per cent has widespread support. Thirdly, thanks to the reforms of the last six years, India is now a much more open economy than until 1990. The increased contacts with the outside world by way of trade and investment links are creating a new awareness about the yawning economic and social distance between India and the rest of the world. These contacts are also suggesting that there are real opportunities for making up for the lost time. Fourthly, the marked economic success of the people of Indian origin in countries of their adoption is creating a new sense of self-confidence among the people back home. They are asking: Why should Indian scientists and engineers have to go to the Silicon Valley to prove to the world that they are second to none in terms of creativity? Why can we not create within India itself an environment conducive to exercise of a similar creativity? Fifth, the dismantling of the old centralised command and control system has increased the role and responsibility of the State Governments for the management of the economy of their respective States. There is a growing realisation on their part that hereafter they will not be able to blame the Central Government for the slow pace of development of their States. Thus many of the State Governments are now seeking to create a suitable enabling environment for investment. The fiscal squeeze which many State Governments now face is forcing them to squarely face the task of reforming their public enterprises and cutting unmerited subsidies.

38 The economy does not function in a political vacuum. India needs s strong and purposeful political leadership which can recapture some of the idealism of Jawaharlal Nehru and can effectively articulate the India people's aspirations for India to emerge as a benign economic giant, a powerhouse of intellect and science and technology consciously applied to economic and social processes. The political landscape is currently not very cheerful. For the time being, there is no big idea animating the major political actors. In this Fiftieth year of our Independence, this is not a very comforting thought. Nevertheless, the emergence of a strong civil society in India, in particular the vast reservoir of entrepreneurial, managerial and technical skills and an increasingly influential middle class provide a basis for the hope that the political leadership cannot for long remain indifferent to the great national enterprise of building a strong and prosperous India in the framework of a democratic polity and an open society. Sustained economic and social development is vital for the success of democracy in

India. In so far as the reform agenda is rooted in this vision, its future is secure. There are grounds for optimism on this score.