STRUCTURAL ADJUSTMENT IN INDIA:
ECONOMIC CRISIS AND POLICY CHOICE

BY

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ABSTRACT

The decision to undertake a structural adjustment program usually comes at a time when a country is facing a severe economic crisis. In India, the conditions surrounding the economic crisis of 1991 left Indian policy-makers with little alternative but to pursue liberal economic policies. This thesis examines three aspects of India's economic crisis, political, economic and international, in an attempt to explain the Narasimha Rao government's policy choice. Three dimensions of the decision -- timing, scope, and content -- are used to simplify the analysis, and to measure the contributions of various factors. Whereas the ideology and international systems explanations only play an indirect role in India's policy choice, I argue that convergence of factors highlighted by the interest group, political institutional and international financial institutional explanations resulted in India's decision to liberalize its economy.
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INTRODUCTION

The year 1990-91 was the most devastating of India's post-independent economic history. An intense economic crisis brought the country to its knees as India's balance of payments position became extremely precarious. The threat of defaulting on external loans seemed imminent as India's foreign exchange reserves plunged to less than one day's requirements. In addition to the ominous balance of payments crisis, India's inflation rate and fiscal deficit were reaching unprecedented levels. It became apparent that a decision to grapple with India's economy was critical, and it is the nature of that decision which is the focus of this thesis.

Three dimensions of India's economic crisis are examined. First, the political dimensions highlight the domestic political constraints encountered by India's policy-makers. Institutional features of India's polity, such as democracy and state capacity, as well as the relative power of key interest groups directed the outcome of the crisis. Second, the economic dimensions of the crisis feature the economic pressures on policy-makers to act. A history of expansionary economic policies, high levels of foreign debt, and poor fiscal and monetary policies resulted in a critical economic crisis. Finally, the international dimensions reveal the factors beyond India's domestic control. External factors such as the global financial climate, the Gulf War, and the power of international financial institutions influenced the decisions of India's policy-makers.

There are two major approaches to be taken in explaining the decision to pursue a structural adjustment program. The first is from an international relations perspective, which posits that external factors influenced the decision. Some analysts, such as Susan George, argue that the crises which precipitate changes in economic policy in developing countries are caused by external circumstances beyond the control of any domestic jurisdiction. For example, the
OPEC crises, declining terms of trade, and lower rates of growth and demand in industrialized countries have resulted in acute economic crises in the developing world. Other scholars such as Thomas Biersteker focus on the role of international financial institutions and their influence on the decision to pursue liberal economic policy. This approach centers on the practice of conditionality by the IMF and the World Bank. By attaching conditionalities to loans, these organizations are able to direct policy changes in countries that are dependent on these loans.

The other approach to explaining economic policy decisions in developing countries is from a domestic political perspective. This perspective argues that policy decisions are influenced by domestic political factors. Policy-making is a compromise among different interest groups who hold power over decision-making. In addition, institutional factors such as state capacity, type of regime and electoral cycles can play a role in influencing policy decisions. Further, the role of ideology informs the views of those who participate in the policy-making process.

I argue that both the international relations and domestic politics perspectives help to answer the question of why India decided to change from a mixed economy to a more free-market liberal economy. The theories that best explain the decision are the interest group, political institutional and international financial institution explanations. The question of how to measure the influence of the various factors highlighted by these explanations needs to be addressed. I will provide a detailed case study of India, with specific reference to the political, economic, and international dimensions of the crisis, in an attempt to measure the value of the five explanations. In order to simplify this study, I have approached the decision from the standpoint of timing, scope and content, and will examine which factors determined each aspect of the decision.
CHAPTER ONE
THEORIES EXPLAINING POLICY CHOICE

This chapter seeks to examine explanations for the decision to undertake liberal economic policies in developing countries. While no one explanation can alone account for policy change in developing countries, the domestic interest, political institutional, ideology, international systems and international financial institutional based theories are effective for analysing this phenomenon. When the factors emphasized by these theories converge, liberal economic policies are likely to be pursued. When a developing country is facing a severe economic crisis, the constraints imposed by both its domestic political circumstances and external conditions guide the policy direction of decision-makers. There is a great deal of interplay among the various explanations and the relationships among them need to be explored. In seeking to explain the choice of the Government of India to pursue liberal economic policies, I will examine the factors that influenced this decision and attempt to assess to what degree these factors played a role.

Global Liberalization and Adjustment Programs

What Biersteker terms "the 'triumph' of neoclassical economics," and Ruggie called "the resurgent ethos of liberal capitalism" refers to a global phenomenon of economic liberalization among developing countries as well as the former socialist nations of Eastern Europe (Biersteker, 1992:102, Ruggie, 1982:413). Attempts to explain this occurrence only emerged recently when it became clear that the debt crisis of the 1980's was continuing unresolved into the 1990's. Total developing country debt doubled from 1980 to 1990, while the real prices
of many primary commodities fell during this same period.¹

Liberalization, the so-called panacea for developing countries, has had varying degrees of success in different countries. It is important, therefore, to understand the ways in which these policies are spread and the rationale behind their implementation. The process of economic liberalization can be defined as the institutionalization of economic policies which remove state intervention from specific sectors of the economy, leaving market forces free in the economy. What follows is not intended as an evaluation or assessment of particular economic policies, but rather an analysis of the origins of the political and economic will to implement such policies in developing countries.

There are two dominant types of adjustment programs involved in IMF and World Bank loans. The first is stabilization, a short-term policy which aims to reduce the balance of payments deficit and inflation to sustainable levels. In many countries a severe economic crisis usually precipitates the involvement of the IMF and World Bank, and drastic intervention is needed to stabilize the economy. A significant devaluation of the local currency and a reduction in government spending are typically involved.

The second phase of adjustment is structural change, which is designed to reallocate resources and change factor accumulation in order to achieve sustained growth in the face of a more adverse external environment (Selowsky, 1987: 2). The policy instruments are chosen in light of the distinctive circumstances of the recipient country, such as the particular institutional environment and the organisation of the economy (Guitian, 1981: 4). Common components of adjustment policies are: decrease of government expenditure on public services, cessation of price controls, imposition of wage controls, restrictions on domestic credit, and

¹Prices of primary commodities fell an average of 18 per cent from 1980-1988 (UN Department of Public Information, September 1989).
reduction of controls in trade, foreign exchange and investment. Structural changes normally require a longer time frame than stabilization and necessitate more drastic changes to the domestic economy.

Explaining Policy Choice

There are various theories explaining the current convergence of economic thinking and policy on a global scale. There are two major approaches I utilize in explaining economic policy decisions in developing countries. The first approach is from a domestic political perspective, and argues that policy decisions are influenced by domestic political factors, including interest groups, political institutional and ideology. The second approach is from an international relations perspective which claims that the negotiating power of international financial institutions and international systemic factors beyond the control of individual countries influence decision-making.

Interest Groups

The interest-based explanation argues that since structural adjustment programs create winners and losers, politically powerful groups are going to use their power to support or oppose certain policies. Interest groups derive their power from lobbying, threats, donation of funds, and the promise of votes (Haggard and Kaufman, 1989:220-21). Joan Nelson argues that the content of policy is influenced by the distribution of power amongst interest groups. Specifically, governments depending on labour and popular support will pursue heterodox
policies\textsuperscript{2}, whereas governments depending on business and financial support will pursue neo-orthodox policies (Nelson, 1990:25). In practice, however, the correlation between the balance of interests and content of policies is more complex. Distributional consequences of policies are not always clear and can vary between short and long run (Haggard and Kaufman, 1989:221). In addition, divisions within interest groups exist and can impede the ability of the group to mobilize politically. It is therefore necessary to undertake a more detailed discussion of the relevant interest groups, that is, business, labour, and the agricultural rural sector, in an attempt to identify sources of power and divisions within groups.\textsuperscript{3}

The power of business comes from its ability to provide or withhold investment. The government must establish confidence and stability in the economy in order for businesses to be willing to take investment risks. In addition, businesses are a source of financial support and patronage to politicians and can therefore be a strong lobby group. Often leftist governments with previously antagonistic relations with business will have difficulty establishing credibility. Import-competing industries and companies dependent on government contracts will oppose reform and are at a great disadvantage when markets are opened to foreign competition. Politicians often suffer from the dismantling of enterprises that provide them with patronage and financial support. Businesses which favour reform include export-oriented industries, financial interests, and larger industrial and commercial firms (Haggard and Kaufman, 1989:222).

\textsuperscript{2}Heterodox policies are an alternative to traditional orthodox policies. They include measures to achieve self-reliance and a more equitable distribution of income. Analysts such as Lance Taylor, who endorse heterodox policies argue that developing economies are structurally different from developed economies. Heterodox policies were pursued in Argentina, Brazil and Peru in the mid-1980's.

\textsuperscript{3}The bureaucracy will be discussed in a later section concerned with state capacity (pp. 10-11).
The ability of labour to influence government policy is dependent upon the degree to which they organize politically. The urban informal sector is perceived as powerful due to the threat of rioting. Unionized workers derive their strength from their ability to organize quickly and their threat of striking. In contrast, rural workers are difficult to mobilize politically. Both the urban informal sector and unionized labour are likely to oppose structural adjustment programs due to the anticipated consequences for real wages and employment (Haggard and Kaufman, 1989:225). The relationship between government and labour is also an important factor in determining the content of policy. Leftist governments which cooperate with labour organizations are more likely to elicit support from workers and provide compensatory programs to reduce the burdens of adjustment.

As with the cases of business and labour, it is necessary to make a distinction within the agricultural sector between large landholders on the one hand, and small-holders, tenants, and landless agricultural labour, on the other. Again, the distributional impacts of structural adjustment policies are complex, but the effects of devaluation and reduced subsidies are seen as damaging to the agricultural sector as a whole. Whereas small-holders, tenants, and landless agricultural labour have difficulties mobilizing politically, large landholders are often able to secure particular compensations through their ability to solicit votes from their labourers and through patronage and financial support. Large landholders are therefore better positioned than other groups in the rural sector to influence policy.

Another approach to the domestic interest explanation, discussed by Manuel Pastor, contends that the impetus for change comes primarily from a new economic elite who have much to gain from liberal economic policies. This economic elite has the power to shift the burdens of adjustment onto the poorer sectors of the domestic economy, while benefitting from the changes in policy. Such an analysis emphasizes the rise of this new economic elite
and explores the reasons for its dismantling of the old system of Import Substitution Industrialisation (ISI) in favour of the new free-market oriented economy.

The closed economy associated with ISI impedes the outflow of capital, which restricts opportunities for trade in foreign markets and attempts at capital flight. In addition, sheltered by a protected economy, labour is able to organise into unions and gain political and economic power. While the protectionist system of ISI initially promotes both economic growth and the emergence of elite and working classes, the elite soon encounters a variety of political and economic difficulties (Pastor, 1987:93).

The willingness of the local elite to implement structural adjustment programs is a result of both the failure of the ISI system and the attraction of the new free market economy. Various policies associated with structural adjustment are propitious for the local elite. First, a devaluation of local currency favours elites because they often hold funds abroad, which increase in value when their domestic currencies depreciate. The implications of this policy are obvious when one considers that capital flight equals the external debt in some Latin American countries (Pastor, 1987:55). Second, the new policies ease outflow of capital and expand opportunities for trade in foreign markets. Third, in an attempt to improve competitiveness, there is a downward pressure on wages and social services. The burden of adjustment thus falls on the poorer segments of society who rely primarily on wages. When there is wage deflation in a labour surplus economy, the working class is adversely affected and its ability to organize for change is reduced. Finally, the elimination of food subsidies harms poorer segments of society who spend a large proportion of their income on food.

Political Institutions

Stephen Haggard and Robert Kaufman identify three institutional variables important
for explaining variations in policy choice during structural adjustment programs: the type of regime, political or electoral cycles, and the strength of the administrative apparatus.

...Policies are affected by short-term shifts in the political context that condition the expectations of key actors and shape opportunities for mobilizing support for new policy initiatives (Haggard and Kaufman, 1989:239).

The government is able to impose losses on certain groups that are excluded from the government process, whereas groups that have good access will see their interests reflected in government policy. The institutional explanation is implicitly linked with the interest-based explanation because the institutional setting can determine which interests matter politically.

It is generally assumed that democratic regimes have more difficulty introducing liberalization programs. Since democratically elected governments must accommodate many different interest groups, they face a very delicate balancing act when initiating austerity programs. In contrast, authoritarian regimes are often able to bypass or suppress any interest groups opposing government policies. Nevertheless, two studies examining the correlation between regime types and ability to stabilize found no systematic association. A more recent study by Barbara Stallings and Robert Kaufman, however, found a correlation by categorizing regime type more specifically. They confirmed the belief that authoritarian regimes are most likely to adopt strong orthodox programs, whereas regimes in transition to democracy are most likely to adopt heterodox programs. Established democracies are likely to adopt orthodox programs, but have difficulty sustaining them in the long-term, due to their reluctance to reorganize economic structures (Stallings and Kaufman, 1989:208-9).

When examining political or electoral cycles, we find that the critical variable is the

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4Karen Remmer studied 114 stabilization programs in nine Latin American countries from 1954 to 1984; Stephen Haggard surveyed thirty extended fund facility programs in twenty-four countries (Nelson, 1990:22).
time horizons of governments. When political cycles are determined by relatively routine and stable changes of governments, the timing of elections can have great consequences for government policy. John Waterbury presents two electoral scenarios for a government seeking to adopt a structural adjustment program. In the first case, leaders call an election for a general endorsement of the program and then, backed by a fresh mandate, push through the adjustment program (Waterbury, 1989:53). In the second scenario, the government begins implementation emphasizing benefits to the rural sector and then appeals to this block of voters for support. Other scholars such as Joan Nelson, Stephen Haggard and Robert Kaufman argue that governments facing elections are less likely to adopt orthodox measures and are likely to employ expansionary fiscal and monetary policies to garner support.5 The approach of an election can be very divisive as pro-and anti-adjustment factions arise both within and between political parties. The period following elections, on the other hand, will allow governments more freedom to introduce reforms, because the government is likely to have high legitimacy and opposition groups are in disarray. If a new government is elected, the greater the perception of failure of the previous government’s policies, the greater the space for innovation and reform (Haggard and Kaufman, 1989:243).

Haggard and Kaufman examine both the administrative capacity of the bureaucracy and the state as an interest group. The bureaucracy is important because public employees constitute an extremely powerful political force, and state capacity affects the ability to carry out coherent economic policy (Haggard and Kaufman, 1989:245). Policies such as fiscal and wage restraint and the privatization of state-owned enterprises pose direct challenges to the

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5In industrialized countries, however, this does not usually hold true, due to mediating factors such as welfare, the media and more permanent forms of consultation (Haggard and Kaufman, 1989:241).
interests of public employees. Joan Nelson provides several measures of state capacity: the number of well-trained and experienced staff; their cohesion and reasonable autonomy; their ability to formulate coherent policies; instruments and institutions that permit implementation; and the degree to which they exercise effective financial and substantive control over major public sector agencies. Countries with a high degree of state capacity will be in a better position to formulate effective policy in a reasonable amount of time.

Ideology

The role of ideas is an important factor in spreading liberal economic policies among developing countries. By themselves, ideas cannot influence political decision-making, but when these ideas are adopted by powerful political interest groups, they can have widespread implications. Although it is difficult to measure the influence of ideas on policy-making, without ideas, reaching consensus on a policy decision would be impossible. One of the most accurate measures of the influence of ideas is the adoption of policies which reflect those ideas.

Peter A. Hall's *The Political Power of Economic Ideas* examines the influence of Keynesian thought on policy-making in developed countries. Hall's analysis has much relevance for the spread of liberal economic ideas in developing countries. He proposes three approaches to explain the influence of economic ideas on policy-making: the economist-centred approach, the state-centred approach, and the coalition-centred approach.

The economist-centred approach emphasizes the role of professional economists in policy-making. When professional economists reach consensus on economic theory, they convince policy-makers of the need to implement policies based on their knowledge. Peter Haas, in his book *Saving the Mediterranean*, discusses the role of epistemic communities in influencing government decision-making.
An epistemic community is a professional group that believes in the same cause-and-effect relationships, truth tests to assess them, and shares common values. Its members share a common interpretive framework, or consensual knowledge, from which they convert such facts, or observations, to policy-relevant conclusions (Haas, 1990:55). Thus, when professional economists reach a consensus and become an epistemic community, and if these economists have a substantial degree of influence, they can then gain access to the decision-making apparatus of the state and convert their ideas into policy-relevant prescriptions. The effectiveness of this approach hinges on a number of factors including the existence of a large and advanced group of academic economists, and the openness of public authorities to advice from professional economists (Hall, 1989:9).

The state-centred approach argues that "...the reception accorded new economic ideas will be influenced by the institutional configuration of the state and its prior experience with related policies" (Hall, 1989:11). Ideas are important for determining the content of policy, but need the support of institutions which promote those ideas to result in an effective method of spreading programs and policies. The relative openness of policy-making institutions to advice from economists outside of the government is dependent on the state capacity to implement policies, and the relationship between economists and policy-makers. In addition, a state's policy-makers will be predisposed toward policies with which they have already had a positive experience. Thus, this approach emphasizes the ability of the state to communicate with professional economists and integrate knowledge with policy prescriptions.

The coalition-centred approach argues that policies must have the backing of broad coalitions of economic interest groups on whose votes and support elected policy-makers ultimately depend (Hall, 1989:12). In order to explain how ideas influence policy it is necessary to identify decision-makers who take up the policy issues and then explore the broader political context that allows specific ideas to evolve into policy (Gourevitch, 1989:88).
The ability of politicians to mobilize consent on policy issues and win elections influences their readiness to adopt the policy. Therefore, economic ideas which are supported by a broad coalition of powerful economic and social interest groups are more likely to be adopted by policy-makers.

The convergence of economic thinking in developing countries is traced historically by Miles Kahler who concludes that the...

...1980's, a decade of economic crisis for many developing countries and slow growth for industrialized countries, is often portrayed as a decade in which the "supply" of economic ideas and policy prescriptions has been heavily tilted toward a resurgent orthodoxy (Kahler, 1990: 33).

During the 1960's and 1970's many developing countries experimented with policies such as nationalisation, indigenisation, self-reliance, and import substitution. These policies were directly influenced by the dependency theorists of the time who advocated isolationist approaches to development. The 1980's were then characterized by changes in policies, with the resurgence of neo-classical economic ideas and the refutation of the ideas of dependency theorists. The intellectual, economic and political elites in many developing countries embraced neo-classical economic ideas, and advocated a reduced role of the state in the economy. In addition, the emergence of the Newly Industrialized Countries (NIC's) provided evidence of the benefits of export-led development, of reducing the role for the state in the economy, and of greater integration into the global economy (Biersteker, 1992:119). These ideas have continued to a large extent into the 1990's, but with some attempts to cushion the hardships associated with liberalization through 'adjustment with a human face' initiatives.

The debate questioning the presence or absence of consensual knowledge based on neo-classical economic ideas consists of two opposing arguments: the power relations and social learning explanations. The first, advanced by many in the South, argues that developing
countries have not been convinced by neo-classical economic ideas, but have been coerced into accepting a false consensus (Kahler, 1990:33). Those who support neo-classical economic ideas have gained bargaining leverage with the different external conditions in the 1980's. This argument assumes that any apparent ideological consensus is false, and rests entirely on the power of the developed countries to impose their will. The opposing social learning argument points to the disastrous experiences with socialist alternatives combined with the economic success of orthodox ideas in practice (eg. in the NIC’s) as cause for an intellectual consensus on economic ideology (Kahler, 1990:33). Kahler argues that both the former, power relations argument and the latter, social learning argument are inadequate explanations. Heterodoxy has always found important intellectual support in the North, and some of the most severe orthodox experiments were indigenous to the South. Although an evolution in intellectual consensus is involved, the distinction between North and South is not as clear as the social learning explanation suggests.

**International Systems**

The international systems explanation argues that change within states is a result of changes in the global economy, such as the slowing of growth in industrialised countries, declining terms of trade and high interest rates. These changes have had devastating impacts on developing countries in the form of a net flow of resources from South to North in the 1980’s (Figure 1). A reduction in the demand for developing country goods resulted in an effective devaluation of their exports in relation to their imports, particularly in the area of primary commodities (Figure 2). In addition, high interest rates increased the costs of servicing their existing debts while making new credit difficult to obtain.

Other events in the international arena also contributed to change in the local
economies of developing countries. Probably the most significant event contributing to the debt crisis was the effective control of oil prices in 1973 by OPEC. By forming a cartel these countries were able to corner the oil markets and force prices to soar throughout the world. The vast surpluses accumulated by OPEC were recycled back into the global economy primarily through Eurodollars, and thus provided a source of funds for non-oil exporting developing countries. This, inadvertently, led to a massive increase in external indebtedness in many developing countries, which was repeated in 1979, during the second oil crisis. Other events which had important implications for developing countries were the rise of the NIC's in Asia and the collapse of the Soviet Union. These events effectively impaired a Marxist model of development while providing a successful capitalist model to emulate. Thus, the
system level explanation asserts that exogenous factors beyond the control of developing countries, rather than domestic mismanagement, were the main contributing sources of economic crises in developing countries. Subsequent policy changes were required to remedy the crisis and stabilization programs based on the liberal economic model were adopted.

International Financial Institutions

The final explanation is the international institutional approach which emphasizes the power of organisations such as the World Bank and the IMF to exert pressure on developing countries to change policies. Biersteker states that "the international financial institutions are involved in significant aspects of the economic policy-making process of most countries in the
developing world today" (Biersteker, 1992: 116). The question of how these institutions use their power to exert pressure towards policy change will be examined. The answer centres on the conditional lending policies of the IMF and World Bank, which impose austerity measures on recipient countries.

Both the IMF and World Bank were created at the close of World War II, at the Bretton Woods Conference in New Hampshire, and are known collectively as the Bretton Woods Institutions. These organizations were founded on principles of free market economy, and continue to operate based on these values. Unlike the World Bank, the IMF did not fund development projects but was initially concerned with restructuring the international economic system. The IMF was to administer a code of conduct regarding exchange rate policies to facilitate balanced growth of international trade, and to promote exchange stability among its members, who were primarily industrialized countries (IMF, 1985: 2-3). Although Irving S. Friedman, a founder of the IMF, claims that "developing countries have always been active members of the Fund" (Friedman, 1987: 19), the fact that many were not yet independent states and that the relative sizes of their economies were small suggests that their role in both the IMF and World Bank must have been limited.

The IMF and World Bank have taken on new roles in the international economy during the last two decades. The World Bank provides long-term financing for development projects and programs, whereas the IMF assists countries that find themselves with temporary balance of payments problems, by providing short to medium term credit. Many developing countries have come to view the International Monetary Fund as the lender of last resort. In the last decade, the IMF has provided loans to over 70 developing countries to assist with their balance of payments problems. Access to IMF funds is made conditional on the implementation of various stabilization policies which require the recipient to undertake a
program to adjust its balance of payments. The Fund’s approach to growth and its methods of achieving sustained growth are subject to great debate.

The World Bank, on the other hand, provides most of its financial and technical assistance to developing countries by supporting specific projects. In the last decade, the Bank shifted in favour of a greater role for private enterprise in developing countries through its affiliate, the International Finance Corporation (Driscoll, 1984:9). The emergence of the debt crisis in the 1980’s resulted in the transformation of the World Bank from a development organization into a debt-management institution. The World Bank provides loans through two institutions: the International Bank for Reconstruction and Development (IBRD), and the International Development Association (IDA). Loans given through IBRD are considered hard loans, whereas IDA financing provides soft loans with concessional terms which are reserved for only the poorest countries.

The voting structure in both the IMF and World Bank is weighted in favour of wealthier contributing members, with developing countries holding less than thirty per cent of the vote in each organisation (Figures 3 & 4). This, in effect, precludes the poorer nations of the South from wielding effective decision-making power.

The IMF and World Bank use various methods to change the economic policies of developing countries, most fundamental of which is the policy of conditional lending. In order to qualify for IMF loans and most World Bank programs, a country must comply with certain conditions which restrict the role of the state in the economy. The purpose and rationale behind conditionality is to guarantee repayment; to encourage alignment with accepted global economic policies; and to attempt to manage and regulate world macroeconomic conditions (Pastor, 1987: 18). These so called "austerity measures" have severe impacts on local economies, with restrictions on government spending in welfare areas,
elimination of subsidies, and wage freezes. Although policy prescriptions vary somewhat according to specific country conditions, liberal economic policies which restrict the role of the state in the economy are predominantly introduced.

Stand-by arrangements, the major form of interaction between the Fund and developing countries, set out an agreement for the implementation of Fund programs. The agreement is unpublished, but a Letter of Intent by the developing country government is issued in return for drawing privileges on IMF funds. The release of credit is made conditional upon the implementation and attainment of various program targets.

In addition to conditional lending, the IMF plays the role of a "certifying agent," without whose approval commercial banks, the World Bank, and, to some degree,
governments would not loan money to a country. At the point when a country is experiencing a severe balance of payments deficit and requires foreign exchange, the coercive measures that can be imposed by denying credit may induce a state to adopt austerity measures.

Frequently, Fund loans are secured during a period of economic crisis, which leaves the developing country in a weak negotiating position:

The policy conditions laid down may be resented, both because of the loss of sovereignty implied and because of a belief that the Fund’s objectives do not necessarily coincide with those of the national government (Sutton in Killick, 1984a:4).

The relationship between the IMF and a developing country in the midst of an economic crisis
is grossly unequal, leaving the IMF in a position to dictate its programs without much opposition.

Thomas Biersteker discusses four bases of debtor bargaining power vis-a-vis international financial institutions. First, if the size of a country’s debt is large enough to threaten the international financial system, the power of the debtor country increases. Secondly, the strategic significance of a country can influence its power position. Geographical features, history, as well as ideological affinity and alliance behaviour can place the debtor country in an attractive negotiating position. Thirdly, a country with access to non-conditional resources is less vulnerable because it will likely have fewer political incentives to make difficult economic decisions. Finally, the domestic political sphere of the debtor country can restrict or expand the government’s bargaining space.

In order to measure the effects of conditionality on a debtor country, several indicators must be considered. External loans can alter the economic policy trajectory of a country, increase the overall level of confidence, and alter the expectations of economic agents in the debtor country (Kahler, 1990:145). The intensity of the impact of external advice and guidance is difficult to measure, but it is useful to examine stand-by and extended fund facility agreements with the IMF as well as structural adjustment loans from the World Bank. In addition, due to the complex nature of negotiations, it is necessary to conduct a detailed study of specific cases to fully understand the nature of negotiations and, ultimately, answer the question of what would have happened without external intervention.

There is a great deal of interplay among the various explanations of the convergence of economic policies among developing countries. The systemic factors have greatly contributed to the advent of economic crises throughout the developing world. Policies
designed to respond to an economic crisis are affected by political institutions such as the bureaucracy that shape economic policy. In addition, political institutions help determine which interests groups matter politically. Key interest groups mobilize to support or oppose policy depending on the ideology held by the particular group. International financial institutions are then able to impose their programs on debtor governments, depending on relative bargaining strength.

By examining the ways in which liberal economic policies are adopted by developing countries, insights can be gained which help an explanation of the adoption of liberal economic policies in India. Different factors such as the timing, scope, and content of the new economic policy in India will be considered in order to evaluate the utility of each of the explanations. For example, did a change in ideological attitudes amongst India’s intellectual elite help determine the content of the new economic policy, and what was the role of India’s elections in determining the timing of the decision? Did the power of the IMF and World Bank extend the scope of the Indian government’s economic reforms? The five explanations discussed in this section can now be applied to the case of India in an attempt to test the validity of various theories.
CHAPTER TWO
DIMENSIONS OF INDIA’S ECONOMIC CRISIS

This chapter will focus on India as an example of a country undergoing economic liberalization. India’s economic crisis and the subsequent policy changes provide good evidence of the reasons why a developing country may undertake liberal economic policies. The economic reforms pursued by the Government of India restricted the role of the state in the economy and opened the country to foreign investment and trade. I begin by examining the economic crisis that prompted India to apply for an emergency IMF loan in January, 1991. Political, economic and international dimensions of the crisis will then be discussed. The conditions surrounding India’s adoption of liberal economic policies will be explored in order to explain the spread of liberalization among developing countries.

India’s Economic Crisis

By the end of 1989 when Chandra Shekhar assumed the leadership of India, the domestic economy was in critical condition. Double-digit inflation rates, an unsustainable fiscal deficit, exorbitant trade deficit and insufficient foreign exchange reserves left the new government in a desperate predicament. A budget, introduced in March 1990, temporarily eased pressures on the economy by projecting a decreased fiscal deficit and an improvement in the balance of payment position. However, there was a dramatic reversal of these conditions in the following months. The Gulf War which followed the annexation of Kuwait in August 1990 put significant pressure on India’s foreign exchange reserves. A combination of higher oil prices and the cessation of remittances from non-resident Indians (NRI’s) in the Gulf, contributed to the precarious balance of payments deficit. A shortage of the hard currency necessary to pay back its loans meant that India was under threat of defaulting on its foreign
debt for the first time in its history.

The immediate nature of India's economic crisis was monetary. The Government of India had quite literally run out of foreign currency. While there was no shortage of domestic currency, the Rupee was not, at that time, convertible on the international market. The Indian government, which controls the flow of hard currency through the Foreign Exchange Reserve Act (FERA), had begun to run dangerously short of convertible funds. By December 1991 reserves had fallen to Rs 2,152 crore, barely equal to two weeks of import requirements. India then successfully applied for an emergency IMF loan totalling US$1.8 million as a short term remedy. The loan was obtained on concessional terms with the first payment not due for three years at an interest rate of nine per cent, but with a commitment by Chandra Shekhar's government to reduce the deficit from 8.3 to 6.5 per cent of GDP.

The respite offered by the IMF emergency loan was extremely short-lived. Several months later, India was again facing a severe balance of payments deficit. By the spring of 1991, estimates of India's foreign exchange reserves ranged from several days to only twenty minutes (Figure 5). Commercial bankers had cut off India's supply of short term credit out of fear that India might default on its expanding foreign debt. India's foreign debt had risen to US$70 billion by January 1991, from approximately US$19 billion in 1980.

This foreign exchange crisis was compounded by India's inability to procure significant hard currency loans on the international market in order to meet the shortfall. To ensure continued credit from commercial sources, the World Bank and the IMF, it was essential that India proceed with liberalization policies. At stake was US$3-4 million per year from commercial banks, US$3 billion in new loans from the World Bank and IMF, and billions more in credits already in the aid pipeline (Far Eastern Economic Review, 21 Mar. 1991:63; Economist, 23 Feb. 1991:33). By June of 1991, India's credit rating had dropped to B/B+,
which is below an investment grade. This was interpreted as "a warning to banks not to lend until the country agrees on a reform package with the IMF" (Economist, 8 June 1991:78).

Chandra Shekhar’s government responded to the monetary crisis by initiating a number of stabilization measures that were designed to restore internal and external confidence. The first task was to avoid a default in loan payments by finding other means of raising the much needed foreign currency. This was accomplished by leasing 19.6 tons of confiscated gold to the Union Bank of Switzerland in May of 1991 (Far Eastern Economic Review, 4 July 1991:49). In addition, the government began to sell equity in selected public-sector firms, and was able to raise US$1.32 billion (Far Eastern Economic Review, 21 March 1991:63).
The second task was to implement policies designed to reduce the rising levels of imports which were exacerbating India’s trade deficit (Figure 6). Along with restrictions on capital goods imports, the Rupee was devalued, making Indian exports cheaper while increasing the cost of imports (India Today, 30 September 1991:53). Although these policies decreased the pressure on foreign currency reserves, they also resulted in reduced tariff revenues. The funds thus raised helped India’s internal and external credibility, and facilitated further borrowing. These injections of hard currency were used as emergency funds until further loans could be arranged with the IMF and World Bank.

Due to the upcoming election set for June of 1991, it was difficult for Chandra Shekhar’s government to make policy choices that could inflict hardships on the Indian
populace. Although subjected to considerable pressure from the IMF, World Bank and other creditors to reform, the government was unable to meet its commitments as demonstrated by the absence of a budget and the temporary ‘band-aid’ solutions to the economic crisis.

Political Dimensions of the Crisis

Key Interest Groups

Interest groups are a strong political force in Indian government decision-making. With regard to the key interest groups, business, labour, and agricultural, I will consider both the history of their influence on government policy, as well as their current stand on India’s new economic policies.

The political role played by business is inextricably tied to the influence of organized business associations. Links between the Federation of Indian Chambers of Commerce and Industry (FICCI) members, which now includes more than 150 Chambers of Commerce and over 350 business houses, and the Congress Party date back to before Independence, when Indian business aligned with the nationalist movement against the colonial power (Indrayan, 1985:124-5; Misquitta, 1991:108). Indian business organizations have actively sought to influence government policy since before independence. They demanded higher tariffs to protect infant industries and to encourage the creation of new industries, and also called for more credit facilities, lower taxes and a more favourable sterling-rupee exchange rate. Since their demands were largely ignored by the British colonial power, business associations shifted their support to the Indian nationalist movement. Initially business associations were not interested in pressing for free-market policies, but instead supported an increased role for government in the Indian economy.

Since independence, business communities in India have had to adapt themselves to a
government that was often critical of the private sector and mostly concerned with the
development of the public sector. The private sector has not been opposed to planning, and
has adapted itself to socialistic policies and to the system of government that has given rise to
these policies. The private sector has been subject to much government control, but
"...knowledge of how to use the channels of influence is highly developed in business circles
and opportunities for big gains have not been lacking" (Morris-Jones, 1987:220). Indian
business associations have had direct legal access to government through business
representation on government consultative bodies; the opportunity to voice their opinions
before government commissions; and, most frequently, direct personal contact with
government officials (Weiner, 1962:123). At the administrative and local levels where business
is exceedingly influential, the socialist element of policy has often been nullified.

The Indian business community had the most to lose from a continuing decline in the
Indian economy. At the same time, they have the most to gain by being in a position to take
advantage of new opportunities during structural adjustment. By the early 1990's, business
organizations were calling for less government intervention and more liberal economic policies
(Economist, 4 May 1991:IS5). Many leading Indian business people, including the Chairman
of Bajaj Auto, the President of the Confederation of Indian Industry, and the Director of Tata
Sons, spoke in favour of the reforms (India Today, 31 January 1992:70-73). Privatisation would
bring them opportunities for new and profitable investments as Indian investors were
encouraged to buy shares in previously public sector industries. Trade liberalisation would
expand their markets and provide incentives to participate in export industries. These
industries could profit from India's comparative advantage in cheap labour and access to
natural resources. Increased foreign investment in the Indian economy would bring new
opportunities for Indian entrepreneurs. Cooperation with foreign multi-national corporations
would bring foreign technology, expertise and profits. India’s business community was well-positioned to take advantage of these changes.

Organized labour associations have a long history in India. In 1920 a federation of unions under Communist Party of India (CPI) influence, the All-India Trade Union Congress (AITUC), was established. In 1926, as a result of a lockout in the textile industry in Madras, the Indian Trade Unions Act was adopted to facilitate the registration and protection of trade unions. Subsequently, in 1948, the Indian National Trade Union Congress (INTUC) was established under the influence of the Congress Party.

The threat of strikes is a common method of union pressure on business and government. They are seen not just as threats to industry, but to the nation. Since ministers have specific jurisdictions and considerable influence over labour legislation, trade unions target both ministers and legislators for support (Weiner, 1962:75). The implementation of law is another arena in which unions seek to influence government. For example, when non-enforcement occurs in particular plants, union leaders will seek support from inspectors. In addition, union leaders may run for public office to enhance their ability to influence policy-making and implementation.

Protected markets have allowed workers in larger companies to demand, and receive, higher wages. Trade unions are therefore hostile to the privatization of public sector banks and hostile to exit policies which can result in unemployment (Far Eastern Economic Review, 21 March 1991:63). An International Labour Organization-United Nations Development Program workshop estimated that India’s economic reforms would result in the unemployment of four to eight million people in 1992-93 and a further four to ten million more in 1993-94 (Times of India, 12 December 1992). The government created the National Renewal Fund (NRF) with the intention of providing a safety net for workers who could be
displaced through the process of structural adjustment (Times of India, 10 January 1992). This funding was ironically subject to the government's implementation of the exit policy, which allowed for the closure of unprofitable industries, including those in the public sector, which would result in large numbers of unemployed.

Adjustment policies largely disregard 80 per cent of India's working population. These people work in the so-called informal or unorganized sector and fail to qualify for benefits under the Indian welfare system. The NRF will only compensate workers in the formal sector, even though adjustment programs will have a greater impact on the informal sector. In response to pressure from the informal sector, the government adopted a Work Security Fund (WSF) to help safeguard the informal sector against the costs of adjustment. The WSF will ensure the provision of "minimum needs" with better access to food, education and health care (Economic Times, 29 April 1992).

Rural workers and agricultural labour have experienced difficulty organizing as a pressure group. The All-India Kisan Sabha, a peasant association established in 1936, is dominated by the CPI. The Congress Party, on the other hand, relies on medium and large landholders for support in the rural sector. Large landholders have little to gain, and much to lose from the organization of the peasantry, and thus promote the division of peasantry along locality, family, and caste lines in order to dissipate their strength (Frankel, 1978:201).

The agricultural sector shows a strong capacity to resist the implementation of government policy. Large and small landlords have been very successful in frustrating land reform legislation. Many of the credit facilities provided by the government benefit landlords, while poorer tenants must rely on high interest rate money lenders for credit. There is no nation-wide association of farmers which can influence government decision-making. Influence comes largely at the state and local levels and at the stage of implementation where landowners
are able to exercise considerable political leverage (Weiner, 1962:131). Some states have powerful farmers' organizations and lobbies, such as the Shetkari Sanghatana led by Sharad Joshi in Maharashtra, the Bharatiya Kisan Union in Punjab, and the Agriculturists Association in Tamil Nadu (Misquitta, 1991:177). The distribution of political power in rural areas results in a situation where landowners have access to government officials and can suppress the ability of the tenants to organize. Political parties derive much of their political support from rural areas in the form of both voting blocks and financial contributions. They are therefore hesitant to press for policies which will harm this sector.

The major areas of government policy which affect the rural sector are fertilizer subsidies, spending on water resources and rural development. It is widely acknowledged that fertilizer and irrigation subsidies benefit richer farmers, while enabling the government to be perceived as acting on reducing rural poverty. In August 1991 the government raised fertiliser prices by 30 percent which enabled a cut in fertiliser subsidies by 10 per cent in the 1991-92 budget, however, the revised figures show a sharp increase in fertiliser subsidy spending. The reduction in fertiliser subsidies was offset by an increase in crop procurement prices (India Today, 15 August 1991:10). Spending on irrigation and flood control increased significantly during this same period (Table 1).

Table 1  Government Expenditure on the Rural Sector

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<tr>
<td>Fertiliser Subsidies</td>
<td>4000</td>
<td>5205</td>
<td>4000</td>
<td>4400</td>
<td>4542</td>
</tr>
<tr>
<td>Irrigation and Flood Control</td>
<td>231</td>
<td>217</td>
<td>267</td>
<td>41</td>
<td>46</td>
</tr>
<tr>
<td>Rural Development</td>
<td>2610</td>
<td>2356</td>
<td>2702</td>
<td>2535</td>
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While expenditures on rural development were budgeted to increase in 1991-92, the revised figures show a sharp decline in spending. It is difficult to gauge the actual extent of support for India’s new economic policies amongst the agricultural sector, due to the absence of an all-India farmers association. However, in response to the Dunkel draft on the GATT agreement on agriculture, a seminar on "GATT and Agriculture" was organized on February 8, 1992. While discussing the Dunkel draft, which basically creates "free trade" in agricultural commodities, including a measure allowing intellectual property rights in agriculture, Indian farmers also addressed the new economic policies and agricultural subsidies. Representatives from farmers’ organizations resolved that

> the new economic policy of Mr. Narasimha Rao’s government announced under pressure of the IMF and the World Bank and negotiations taking place in GATT are a threat to the very survival of the farming community of India (The Business and Political Observer, 13 Feb. 1992).

The seminar concluded that the cuts in subsidies harm the poorer segments of the farming community and that liberalization of trade leads to a displacement of Indian farmers.

In the case of India, it is also important to mention group divisions along caste, linguistic and kinship lines, as well as economic divisions. These additional divisions can make mobilization of a particular socio-economic group more difficult. It is argued that "...propertied classes, far from being outflanked by popular majorities, showed themselves adept at manipulating the fragmented peasantry along divisions of kinship, caste, factional and economic lines" (Frankel, 1978:201). Caste associations can promote the interests of a particular caste, but it is difficult to overcome these divisions to organize on a broader level to effect change in government policy.
Ideology and Public Opinion in India

India has a rich history of economic thought dating back to a 4th Century B.C. text, Kautilya's *Arthasastra*. Although the major theme in the *Arthasastra* is the science and art of politics, it also gives a thorough account of economic administration in the Mauryan state (Parmar, 1987:23). Kautilya showed that the success of planning lay not only in the formation of policies and their implementation, but in new and effective administrative techniques (Parmar, 1987:110). The tradition of economic thought in India continued into the twentieth century during the nationalist movement under the leadership of Mohandas Karamchand Gandhi and Jawaharlal Nehru. Although both leaders borrowed from Western scholars⁶, a distinctively Indian ideology emerged with contributions from associates such as Asoka Mehta and Vinoba Bhave. Most Indian scholars adhered to the idea of self-reliant, socialist development with a large role for the government through planning.

A study by N.K. Indrayan (1985) explored Indian public opinion regarding the ideas of socialism, as pioneered by Nehru; and free enterprise and decentralisation.⁷ Indrayan found that pragmatic socialism, as pioneered by Nehru, was popular among the mainstream of Indian public opinion. There was a notable change in thinking, however, in the late 1960's and early 1970's, which was reflected in increased support for parties such as Swatantra, the Jan Sangh and Congress (O) which had some rightist elements in their policies (Indrayan, 1985:97).

The 1980's were characterized by a major shift in economic thinking when it became clear that Indian industries were inefficient and uncompetitive. Public sector firms were

⁶Gandhi was influenced by Leo Tolstoy, John Ruskin, and Henry David Thoreau; and Nehru by Karl Marx and V.I. Lenin (Jha, 1988:12,93).

⁷Findings were based on various surveys, manifestos and resolutions of political parties, and opinions of individuals representing public opinion.
incurring lasting losses and Indian businesses were unable to import or acquire necessary technological and computer support. Many influential Indian politicians and scholars, including Indira and Rajiv Gandhi, advocated the liberalization of the Indian economy. Many influential economists and scholars in India were educated abroad or worked with international organizations where neo-orthodox economic ideas were pervasive. Liberalization policies are based on neo-orthodox economic ideas which were growing prominent in Indian economic thought. This change was based, not so much on ideological predilection, but on pragmatic necessity.

The Indian Political Scene

India stands as a rare case amongst developing countries in that it has sustained a democratic regime throughout its post-independence history. With the exception of the Emergency period, under Indira Gandhi’s leadership, India has held regular general elections after which a peaceful change in government ensued. The Indian parliamentary system is modelled after the British parliament, with both an upper and lower house. The government in power has the prerogative to call an election, but it must do so within the five year term. The Prime Minister has to maintain the confidence of a majority in the parliament and in the case of a minority government dependent on outside support or a coalition government, the government’s tenure is insecure. The spread and deepening of political participation in India have resulted in increased demands made on governments (Sridharan, 1991:1206).

The administration of the government is not easily separated from politics. The bureaucracy acts as the custodian of rules and regulations framed by the politicians, but ultimate decision-making power is vested in the minister concerned (Upadhyaya, 1987:1). India’s bureaucracy, the Indian Administrative Service (IAS), is a progression of the colonial
Indian Civil Service (ICS). Recruitment to the IAS is extremely competitive and the training for both generalist and specialist administrators is intense (Potter, 1986:204).

1989-1991 General Elections

The struggle for power in India was intense between 1989 and 1991. For only the second time in India’s history, a non-Congress government was elected. For years, those in opposition to Congress had been attempting to create a viable alternative to the dominant Congress Party. The ruling Congress government, under Rajiv Gandhi’s leadership, announced the November 1989 election on October 17. Opposition parties campaigned around the issue of corruption, due to Rajiv Gandhi’s involvement in the Bofors scandal, and were able to mobilize quickly and gain support. The National Front, a predominant contesting party, was a coalition of several parties with the Janata Dal at its core. Although the Congress Party won the most seats in parliament (197 out of 545), V.P. Singh, the President of the Janata Dal and the National Front convener, formed the government (Table 2). Since the National Front did not command an absolute majority in the Lok Sabha, the Bharatiya Janata Party (BJP) and the Left Front lent support from outside the government. The minority government’s hold on power was rather tenuous due to the ideological differences of its coalition partners, the BJP and the Left Front, as well as difficulties with internal factions in the National Front.

Sitting on such an unstable foundation, the government did not survive long, and was

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8The Janata Party ruled from 1977-1979, under the leadership of Morarji Desai.

9The National Front succeeded to gain the support of powerful state leaders such as Devi Lal, the Chief Minister of Haryana; N.T. Rama Rao, the Chief Minister of Andra Pradesh, leader of the Telegu Desam Party, and Chairman of the National Front; and Surjit Singh Barnala, leader of the Akali Dal.
brought down in November 1990. This was a result of large scale demonstrations against the government’s decision to implement Mandal commission recommendations, and the subsequent withdrawal of BJP support. Chandra Shekhar, the leader of the newly formed Janata Dal (Socialist), formed the new government as requested by the President. Although Chandra Shekhar’s government had the support of Congress (I) as a coalition partner, it did not have the legitimacy of a general election. Chandra Shekhar acceded to various Congress (I) demands, such as the dismissal of the DMK Government in Tamil Nadu and the termination of the refuelling facilities to the American planes, in order to retain their support. However, there was a surveillance scandal in which the Home Minister of Haryana, Sampat Singh, stationed intelligence plainclothesmen outside on the Congress (I) President’s residence (Ahuja, 1992:75). The scandal resulted in serious challenges to Chandra Shekhar by Congress (I), so, in a pre-emptive move, Shekhar resigned on 10 March of 1991 and recommended a new election. Chandra Shekhar was aware of Congress (I)’s efforts to attract defectors and form a government, and his resignation took Rajiv Gandhi by surprise (Ahuja, 1992:76).

On May 21, 1991, Rajiv Gandhi, the leader of the Congress Party was assassinated in a bomb blast 40 kilometres from Madras. This event shook the Congress Party as well as the entire country. The day after the assassination, however, the *Times of India* headline read "Narasimha Rao slated to lead". The issue of succession to Rajiv Gandhi was not so clear as the *Times* implied. Initially, Congress leaders wanted Rajiv Gandhi’s wife, Sonia, to lead the party into the election, and thus take full advantage of the sympathy factor.\(^{10}\) When Sonia Gandhi declined, however, a power struggle ensued between Narasimha Rao, N.D. Tiwari, Arjun Singh and Sharad Pawar. Rao, who was seventy years old, was chosen due to his strong

\(^{10}\)The sympathy factor was critical for Congress (I)’s victory, with a 7.75% change in party performance between the pre and post-assassination phase (Kumar, 1991:45).
support base in the South and his longstanding involvement with the Congress Party.

Narasimha Rao had held every major portfolio in the Union Cabinet, except for Finance. Under Rao’s leadership, the Congress (I) won the 1991 election with 226 seats, 12 short of an absolute majority, and formed the government (Table 2). The Prime Minister and the defence and finance ministers were not members of either house, and had to get elected to one within six months to keep their offices. Sharad Pawar was given the Defence portfolio and Arjun Singh became the Human Resources Development Minister and leader of Congress (I) in the Lok Sabha. For his Finance Minister, Rao chose Dr. Manmohan Singh, one of the two non-elected Council Ministers, but an economist of international repute. Dr. Singh had served as deputy chairman of the Planning Commission, finance secretary, governor of the Reserve Bank of India and chief economic adviser to the Government of India (Kumar, 1991:9). He was also the general secretary of the South Commission that aims at promoting South-South cooperation.

What got Singh the job was Prime Minister Narasimha Rao’s need for a finance minister who knew his job, had an unsullied image, wasn’t a camper within or outside the party, had a believable public face, and could adapt to economic policy changes (India Today, 15 April 1992:32).

Dr. Singh led the economic team responsible for India’s new economic policies, which

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11 The Congress Alliance was comprised of Congress-I, AIADMK, JD(G), IUML, KC(M), and UCPI. The National Front consisted of the Janata Dal, Telegu Desam, JMM, Cong(S), and HVP.
Economic Dimensions of the Crisis

A Brief History of India’s Economic Policies

As a result of its colonial experiences, at the time of India’s independence there was a suspicion of foreigners, foreign trade and free-market capitalism. Nehru thus adopted a model which combined Soviet-style central planning with the needs of India’s economy. Five year plans were implemented and mixed economic policies were adopted. While the private sector and private property continued, the public sector was chosen to play an important role in the Indian economy. In an attempt to develop it, vast investments in capital goods, the industrial sector and necessary infrastructure were undertaken. In order to become self-sufficient, imports were strictly regulated. In addition, Indian policy-makers ignored export production. The rationale was that India’s large internal market was sufficient to drive the economy.

Mixed economic policies continued through the 1970’s until 1981 when Indira Gandhi’s government undertook India’s first economic stabilisation program, with a commitment of US$5 billion from the IMF. Although foreign trade and capital inflows were liberalised at this time, exports were still not promoted and the trade deficit continued to rise.

Rajiv Gandhi continued his mother’s economic reforms. The most notable were a decrease in income tax and some liberalization of the industrial licensing system. The sudden
awareness of the need for technological advancement in India was a critical driving force behind the reforms. Indian business could not compete with the outside world without entering the computer age. Although both Gandhis pursued liberal economic reforms, their efforts did not effectively extricate the government from the economy. Industrial growth was encouraged, but without curbing the expansion of the public sector, resulting in growing fiscal deficits. Reliance on borrowed foreign currency, instead of revenue from exports or foreign investment, led to an expansion of India’s balance of payments deficit.

**Foreign Debt**

While India has almost always been indebted to foreign donors of aid, the composition of debt changed dramatically during the 1980’s. The combination of deposits from NRI’s and the increase in the share of funds borrowed from private creditors (over one-third of total debt in 1991) had been of grave concern to potential creditors (Figure 7). Deposits from NRI’s were considered unstable because they could be withdrawn on demand. NRI’s had, in fact, slowed their investment in India during 1991 and, according to some observers, began to withdraw their hard currency deposits in search of safer investments elsewhere. In addition, debt from private creditors carried higher interest rates and shorter maturities than loans from official sources. This debt was quite unstable as it must be frequently renegotiated. If the economy were to begin to slow down, banks would be less likely to re-lend money on favourable terms, thus compounding the existing foreign exchange problems.

The severity of India’s debt crisis in 1991 was such that India needed US$6-7 billion in new credit just to meet its financial requirements (Far Eastern Economic Review, 4 July 1991:49). The burden posed by these foreign loans is indicated by India’s rising debt-service
Monetary Mismanagement and Fiscal Fumbling

Some of the roots of India’s economic crisis lie in long term monetary mismanagement by successive governments. Like many developing countries pursuing an import substitution industrialization strategy, India has continued to import more than it exports. By 1991, the annual trade gap had widened to US$5.93 billion. With the slowdown in foreign aid of the...
late 1980's, India was forced to use some of its hard currency reserves to pay for the trade imbalance.

A further domestic source of the economic crisis was the Union government's growing budget deficits (Figure 9).

Between 1986 and 1991 the fiscal deficit increased over 200% from Rs. 55,650 million to Rs. 177,660 million. Large fiscal deficits drove inflation which, in combination with a controlled currency, led to an overvalued exchange rate. This resulted in cheaper imports for India, while Indian goods became more expensive abroad. This in turn, exacerbated the already growing trade gap and increased pressure on foreign exchange.

The development strategy which India had pursued for the previous fifteen years also
contributed significantly to the economic crisis in 1991. Seeking rapid economic growth, imports had been partially liberalized in the 1980's. The increase in imports was financed by increased foreign borrowing, while foreign investors were, for the most part, excluded from India's huge market. Foreign borrowing had thus increased from US$19 billion in 1980 to US$70 billion by 1991. A greater proportion of borrowing in the 1980's was in the form of short-term loans from commercial sources. India's debt servicing ratio subsequently rose from 10% in 1981 to over 28% by 1992. The increased amount of hard currency devoted to loan servicing, of course, added to the pressure on India's foreign reserves.
India’s New Economic Policies

When Narasimha Rao’s government took office on June 21, 1991, it inherited an economy replete with problems. Inflation rates had reached double-digits, foreign exchange reserves were at a dangerously low level, and India had entered a debt trap. The costs of servicing India’s debt had reached unsustainable levels; 62 per cent of new aid was needed to service past loans. Nevertheless, increased external borrowing was perceived as the only immediate solution. Other solutions, such as increasing exports and attracting foreign investment, could only improve India’s balance of payments position in the medium- to long-term.

With injections of US$220 million in IMF grants and US$200 million against gold in July 1991, the immediate crisis was overcome, and the government initiated a series of economic reforms (India Today, 30 September 1991:53). Referring to the first week of July 1991, a leading Indian businessman attested that there were "...more moves towards reform in a week than in the past four decades" (India Today, 31 July 1991:13). The week began with two devaluations of the Rupee totalling as much as 20 per cent against major foreign currencies. Although the devaluations were critical for the improvement of India’s terms of trade, they were principally a measure to prevent capital flight by NRI’s (India Today, 31 July 1991:11). In an attempt to offset the advantage of the devaluations for exporters, the government also eliminated export subsidies.

Dr. Manmohan Singh announced the budget on 24 July 1991. Although The Economist called it an "economic revolution", it was generally seen as a "soak the rich" budget (Economist, 27 July 1991:36). Corporate taxes were increased and many consumer goods were taxed. The Left was appeased by not lowering tariff barriers substantially, or taking steps to dismantle the public sector or banking (India Today, 15 August 1991:10). In an effort to
reduce the role of the government in the economy, the industrial policy proposals heralded the end of the licence raj system. Also, foreign investment was welcomed with an increase to 51 per cent foreign ownership allowance, compared with 40 per cent before. Promoting foreign investment and exports created opportunities for India to earn much needed foreign exchange. The acquisition of foreign technology was made easier, to help Indian companies compete on level terms with multinationals.

In a memorandum to the Director of the IMF dated August 27, 1991, the Indian Finance Minister, Manmohan Singh, requested an 18 month stand-by arrangement in an amount equivalent to US$2.5 billion and outlined the Indian government’s new policies. These policies were designed to increase the efficiency and international competitiveness of industrial production, to increase utilization of foreign investment and technology, to improve the performance and rationalize the scope of the public sector, and to reform and modernize the financial sector so that it could more efficiently serve the needs of the economy (Singh, 1991:2).

The 1992-93 budget, was announced by Manmohan Singh on 29 February 1992.

Singh’s speech was preceded by a week of sustained attack from leftwing opposition parties, who made unproven charges that policies were being "dictated" by the IMF and World Bank and that international banks had been informed of policy decisions ahead of parliament (Far Eastern Economic Review, 12 March 1992:36).

The budget had a major impact on India’s trading system. The list of restricted imports was reduced, and the devaluation of the rupee and its partial convertibility made foreign trade easier and more profitable. Other new measures in the budget included further progress towards far-reaching reforms in tariffs, banking, privatization and taxation.
International Dimensions of the Crisis

The International Financial Climate

The state of the international political economy in 1991 rendered it hostile to Indian economic development in several ways. The global recession had decreased investment and aid from industrialized countries as Western governments became increasingly concerned with domestic issues and were hesitant to allocate large budgets to their overseas development or aid agencies. A contraction of foreign markets also lowered the demand for Indian products abroad. In addition, foreign investors were hesitant to invest in risky countries such as India, and were becoming more inclined to invest in their own regions, especially as regional trade blocs such as the EEC and NAFTA became more integrated. This period contrasts sharply with the global conditions under which countries like South Korea developed when there was a great deal of foreign capital to invest in developing countries.

India’s Relationship With The Soviet Union

India’s changing economic relationship with the former Soviet Union was another immediate cause of the 1991 economic crisis. India had had very strong trade and aid relationships with the USSR since the 1950’s. These deteriorated significantly after Gorbachev’s perestroika reforms and the subsequent collapse of the Soviet Union. Through the mid-1980’s, the USSR was India’s largest trading partner. Trade with the Soviet Union was conducted in Rupees so there was no pressure on the hard currency reserves of India. This mutually beneficial relationship between India and the Soviet Union began to disintegrate, however, as major economic and political changes occurred in the USSR. The Soviet Union was not delivering much needed oil imports to India, and trade declined by 50% in 1990-91.
India’s Strategic Importance

During the Cold War, India was able to position itself in between the United States and the Soviet Union. It could choose to align itself with one, the other, or neither depending on which course was in its best interest. The Soviet Union had established extensive economic and political ties with India. With the demise of the Soviet Union and the end of the Cold War, however, India emerged as a significant middle power (Cohen in Oldenburg, 1991:45). The Non-Aligned Movement, which India cofounded, was an important source of power for India among other developing countries. For the United States, however, India has geopolitical significance in South Asia. Both the vastness of India’s area and its population can have serious reverberations for the region and the world during periods of instability. Thus, the interest of the Americans lies in both the economic and political stability of India.

The Gulf War

The impact of the Gulf War on India’s economic crisis was immense and constituted an immediate cause for the ensuing economic decline. India depends on foreign suppliers for approximately 37 per cent of its crude oil needs and, as the price of oil increased because of the war (up from $14 to $34 a barrel in early 1990), India’s foreign exchange reserves were depleted. Domestic conditions exacerbated the situation as unrest in the oil-producing state of Assam reduced domestic oil supply. The Gulf War also forced the repatriation of over 130,000 Indian nationals who were working in Iraq and Kuwait. This eliminated the flow of remittances from the Indian migrants, which amounted to an estimated US$270 million and was an important source of foreign exchange (Saith, 1992:108). The Gulf War was not only detrimental for the displaced Indian workers and their families, but for the Indian economy as a whole, which was too fragile to absorb the changes in both oil prices and foreign currency.
remittances.

Debt Negotiations

India made its first drawing from the IMF in 1956 but its debt to the Fund remained relatively small for the next twenty-five years. This changed in 1982 when India was awarded the largest Structural Adjustment loan that the IMF has awarded to date. As India had a very high credit rating and a low debt service ratio, the loan was awarded under fairly generous conditions. Since that time, however, India’s level of external debt has continued to increase.

Historically, India has been the largest borrower from the World Bank, but has only recently received its first structural adjustment loan from the Bank. India had long avoided structural borrowing because it entailed outside intervention in policy formulation and for many indicated a loss of sovereignty. These loans, like those from the IMF, have conditionalities attached to them. In addition, the terms of loans from the World Bank have become stricter, with an increased proportion of loans coming from IBRD.

India received its first loan from the IMF in January 1991 with low conditionality, but subsequent loans entailed stringent conditionalities. In a letter to Michel Camdessus, Managing Director of the IMF, Manmohan Singh agreed to improve several macroeconomic indicators including inflation and the deficit (Table 3). An elaboration of the monetary, pricing, external, social, and structural policies of the Government of India was also presented to the IMF. A stand-by loan agreement was then signed with the IMF in October 1991 in which the Fund pledged $2.27 billion to be dispensed in eight disbursements over the period ending May 1993. India did not enter the structural adjustment facility in which $1 billion could be received virtually interest free, but with further conditionalities (Business Standard, 30 June 1992).
Table 3  India’s Key Macroeconomic Objectives for 1991-92 and 1992-93

<table>
<thead>
<tr>
<th></th>
<th>1990-91 (Est.)</th>
<th>1991-92 (Program)</th>
<th>1992-93 (Program)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Real GDP growth</td>
<td>5</td>
<td>3-3.5</td>
<td>4</td>
</tr>
<tr>
<td>Inflation</td>
<td>12.1</td>
<td>9</td>
<td>6</td>
</tr>
<tr>
<td>Overall public sector deficit/GDP</td>
<td>12.5</td>
<td>10.0</td>
<td>8.5</td>
</tr>
<tr>
<td>Union Government deficit/GDP</td>
<td>9.0</td>
<td>6.5</td>
<td>5.0</td>
</tr>
</tbody>
</table>

Source: Singh, 1991:10

India’s Structural Adjustment Loan (SAL) agreement with the World Bank specified many of the conditionalities of IMF and World Bank loans.\(^{12}\) When the second tranche of the loan was to be released, the World Bank laid down 25 similar conditions to be met by India by April-May 1992, including plans to de-control and de-regulate the steel industry. The World Bank then delayed on its proposed $500 million SAL for the financial sector and its promise to support the National Renewal Fund, and the IMF delayed the release of the second and third disbursements of their loan (Business Standard, 6 June 1992). Despite expectations of credit, commercial lending did not resume as expected, and by Spring 1992 India was still given a B/B+ credit rating.

The government of India continues to actively seek loans from the IMF and World

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\(^{12}\)They included measures to improve criteria for determining sick industries, to specify all details of the National Renewal Fund (NRF), to remove price and distribution controls, to provide automatic approval for the import of capital goods, to abolish cash margins requirement for imports, to remove export licensing, to substantially reduce the average and maximum level of tariffs, to eliminate budgetary transfers and loans to sick industries, and to divest at least 20 per cent of the equity of selected public enterprises to yield at least Rs 25 billion (Economic Times, 28 Feb. 1992).
Bank, which require adherence to a large number of structural adjustment policies. These loans currently exceed US$10 billion, and are going to continue until at least 1995.

Although India has made some attempts at economic liberalization in the past, the changes which followed the economic crisis in 1990-91 represent the most comprehensive effort. The Indian government has complied with the conditionalities attached to the IMF loans and pursued policies which extricate the government from the economy. The three dimensions of the crisis, political, economic and international, highlight the conditions causing and surrounding India's economic crisis and the specific impediments facing the economy. It is necessary, however, to explore the reasons why India chose the liberal economic path to development with its far-reaching economic reforms. The next chapter will assess the five explanations for the adoption of liberal economic policies as applied to the case of India, and consider three aspects of the decision in detail.
CHAPTER THREE
EXPLAINING POLICY CHOICE IN INDIA

In order to simplify the analysis of India's decision to restructure its economy, three aspects of the decision will be examined: timing, scope and content. The five theories, as outlined in the first chapter, will be utilized to explain why India decided to choose the liberal economic path to development, why India made the decision when it did, and why India chose a program with the scope that it had. Each theory is useful in explaining some part of the decision, but no one theory alone can fully explain India's policy choice.

Aspects of the Indian Government’s Decision

Timing of the Decision

The timing of the decision to restructure an economy is crucial to success. A preemptive decision can facilitate a smooth and relatively easy resolution of a crisis, while postponement of such a decision can exacerbate an already difficult position. In the case of India, the decision to undertake liberal economic policies to remedy the economic crisis came at a late stage. India had to resort to an emergency IMF loan and place its credit rating at risk. In addition, the government of India failed to pass a budget, and thus postponed any economic decision-making whatsoever.

Two aspects of the political institutional explanation are useful for explaining the timing of India's decision. Since India has a parliamentary system of government, the government in power is able to call elections when it believes it can win. This institutional feature gave the government of India the ability to postpone any difficult decisions until an election was called. Analysing the actual electoral cycle in India will, however, give more insight into the timing of the decision.
The timing of elections was paramount in determining the timing of the decision to undertake a structural adjustment program. The defeat of the Congress party in the 1989 election and the emergence of the minority coalition governments of V.P. Singh and Chandra Shekhar created a period of great instability in Indian politics. Not only did V.P. Singh fail to respond to economic indicators that pointed to severe economic decline, Chandra Shekhar only provided quick 'band-aid' solutions once the economic crisis hit with full force. Having formed a government without any election, and heading a minority coalition, Chandra Shekhar had neither the legitimacy nor the mandate required to undertake economic reforms. In addition, the tenuous and unstable nature of his hold on power resulted in the initiation of short-term policies designed primarily to give Chandra Shekhar credibility and generate popular support for the Janata Dal (Socialist) party in the upcoming elections.

In contrast, after the elections Narasimha Rao emerged with a definite mandate and considerable power to push through economic reforms. Although the Congress party did not possess a majority of seats in parliament, its revival was significant. Nevertheless, a trend had been established where the Congress party had lost its traditional hold over Indian government and could be threatened by other political parties. The Congress Party was therefore under considerable pressure to perform successfully.

Economic decisions associated with a structural adjustment program have many immediate negative impacts on powerful interest groups in society. It is therefore essential for a government to project an image of stability and legitimacy, in order to impose such widespread austerity programs on its political constituents. The time horizons of the government must be extended in order to allow for a change in policy which risks short-term losses for potential long-term gains. The new government was able to blame failures on past governments and appear to be the saviour of the Indian economy. Invigorated with a new
mandate, the Congress party decided to undertake major economic reforms.

The international systems theory contributes to an explanation of the causes of India’s economic crisis, but adds little to the understanding of the timing of the decision. Both the decline in trade with the Soviet Union and reduced global demand in general placed considerable strain on the Indian economy. The Gulf War however, had an even more immediate and significant impact on the Indian economy. At a time when India was running short of foreign exchange, an increase in the price of oil and a drop in NRI remittances exacerbated the crisis. Backed into a corner by an international crisis in oil prices, the Indian government was forced to act quickly to remedy the situation. Thus, the link between international systemic factors and the timing of India’s decision to undertake economic reforms was indirect, with events such as the Gulf War causing the crisis, not the decision. Nevertheless, an understanding of these factors by the Indian electorate and the elected representatives in parliament, pressured decision-makers to plan for action.

The role of international financial institutions also contributed to the timing of India’s decision. Pressure from organizations such as the IMF, the World Bank and commercial banks could not be ignored. The role of the IMF and the World Bank as certifying agents quickly put pressure on India to act. By setting India’s credit rating at B/B+, international financial institutions effectively cut off India’s access to external credit. Once India accepted its IMF emergency loan in January 1991, access to IMF or World Bank funds came with stringent conditionalities. India tried different remedies, including selling gold and equity in the public sector, but by the spring of 1991, India had to choose between defaulting on its loans or submitting to pressures from the IMF and World Bank to undertake economic reforms.
Scope of the Decision

The scope of the decision to liberalize an economy varies between narrow adjustment choices which are largely confined to stabilization programs, and broader adjustment packages which initiate longer-term structural reforms after initial adjustment. India’s adjustment program can be categorized as a broad package which included far-reaching reforms of the financial, trade and industrial sectors. After initiating a series of stabilization measures, India undertook widespread reforms in the economy. Thus, the question of why India did not stop at stabilization, and continued with reforms must be addressed.

The interest group explanation suggests that the Indian business community had the most to gain from widening the scope of economic reforms. To stop at stabilization would have restricted opportunities for competitive Indian businesses. Liberalization of trade, industry and the financial sector gave the Indian business community new opportunities at home and abroad. The power of business to withhold investment in an economy provided a strong incentive for the Indian government to ensure that the interests of business were protected and advanced. At a time of economic crisis, the government needed to retain the confidence of the business sector. A failure by the government to dedicate itself to economic reforms in the long-term would be interpreted by business as a lack of commitment to improving the economy, and a signal for the retraction of investment.

The political institution explanation also contributes to an understanding of the scope of India’s economic reforms. Only a government with a long-term horizon could undertake a broad economic reform package. If a government felt insecure about its ability to remain in power, it would be unlikely to have the political strength to initiate a policy with short-term losses and potential long-term gains. The stability of the new Congress government, although not completely solid, was considerably stronger than its predecessors under V.P.
Singh and Chandra Shekhar. As the traditional ruling party in India, the Congress party was seen as the best party to lead India through tough economic reforms and short-term sacrifices, while maintaining some level of political stability. The new mandate of the 1991 election created an environment where policies with potential long-term benefits could be pushed through. This contrasted sharply with the short-term policies pursued by both V.P. Singh and Chandra Shekhar, who procrastinated over tough decisions due to the fragile nature of their power.

The ability of the Indian bureaucracy to formulate a cohesive set of policies facilitated the decision to undertake a wide scope of economic reforms. In comparison to many other developing countries, India has an effective and well-developed bureaucracy. India's administration was under immense pressure to formulate policies that complied with the conditionalities established by the IMF and World Bank. Manmohan Singh's economic team, supported by a well-trained and highly skilled bureaucracy, was able to propose comprehensive economic reforms, acceptable to the international financial community, in a limited period of time.

The conditionalities, in effect, forced India to widen the scope of its economic reforms. By conceding to the conditionalities, India became committed to undertaking long-term widespread economic reforms. The power of international organizations such as the IMF and the World Bank was instrumental in India's acceptance of widespread economic reforms. The cost of non-compliance with the conditionalities was millions of dollars in aid and new loans.

India's power, on the other hand, lay in its strategic significance and the size of its debt. With the proximity of Communist China to the North, the influence of the Soviet Union,
and the strength of several Communist parties within India\textsuperscript{13}, India has historically been seen by Western countries as somewhat vulnerable to Communist influence.\textsuperscript{14} India's strategic significance was prominent in the early 1990's as the Communist regimes of the Soviet Union and Eastern Europe were collapsing. There was still a question of who or what would fill the political and economic vacuum left after the collapse of the superpower. The United States, who was concerned with India's economic and political stability, was quick to enter the vacuum in a time of economic crisis, and support India and its economic reforms.

The international financial community was eager to avoid a default on India's foreign debt. Although India's debt of $70 billion was large enough to threaten the international financial system, a complete default on all of India's loans was unlikely. In contrast to the Mexican debt crisis in the early 1980's, there was no widespread panic in the international financial system. The Indian crisis was actually seen as an opportunity by many, inside and outside of India, to make meaningful changes in the economy.

**Content of the Decision**

The content of the decision varies between neo-orthodox and heterodox initiatives. Although neo-orthodox decisions are most likely to be taken in the initial stabilization period, some steps may be pursued in order to cushion the impacts of structural adjustment or

\textsuperscript{13}Communist parties in India won 45 and 49 seats in the 1989 and 1991 elections respectively. In addition, they are the governing party in two states: Kerala and West Bengal.

\textsuperscript{14}Historically, American interests in the sub-continent were fuelled by their principal foreign policy concern, the containment of communism. "For several years the American government interpreted India's criticisms and its refusal to collaborate in Western collective security efforts as a form of open hostility undermining American foreign policy objectives" (Vinod, 1991:226).
heterodox alternatives. India's economic reform package is generally categorized as neo-
orthodox. Although it contained some attempts to protect certain groups and sectors from
hardship, the reforms aimed to remove government involvement in the economy, to open up
the country to trade, and to liberalize the financial and industrial sectors.

The first relevant theory which addresses this question is the interest group explanation
which posits that the distribution of power among interest groups in a society will be reflected
in government policy. Interest groups in a democratic system derive their power from
lobbying, threats, donation of funds and the promise of votes. While business groups (such
as FICCI) and trade unions are powerful lobbies in India and have relatively easy access to
policy makers, peasant groups are less amenable to mobilization and thus have less access to
government. The power of the rural sector is significant, however, as it controls a majority
of votes. Few interest groups were active in lobbying for economic reforms. Labour groups
and the rural sector were, for the most part, openly opposed, while business groups saw gains
in the long-term at the expense of short-term sacrifices. While acknowledging that changes
in the economy were necessary, the key interest groups differed widely in the solutions they
supported.

Although business in India was supportive of leftist policies in the 1950's and 1960's,
many were aware of the problems that such policies involved. Despite this, however, many
businesses flourished under the planned economy and benefitted from government spending
and patronage in the public sector. A growing interest in free-market policies became apparent
in the 1970's as businesses complained about the endless red tape and regulations which limited
their actions. For many, India's planned socialist economy was becoming increasingly
ineffective. A frustrated entrepreneurial class, when faced with a choice, opted for a more
open, liberal economy where they could take advantage of India's natural resources, skilled
labour, and cheap workforce.

In India, organized labour is easily mobilized and can pose a direct threat to the government. The increased unemployment and wage freezes in India associated with the economic reforms were perceived as a strong warning to labour groups. They therefore lobbied for and received compensatory programs such as the National Renewal Fund (NRF) and Work Security Fund (WSF). The WSF was seen as a program intended to pacify the urban informal sector, whereas the NRF appeased organized labour. These programs were an important concession provided by the Indian government to a powerful interest group. The Indian government was under direct pressure from the World Bank, which was concerned about the specific sources of finance and the methods of financial distribution contained within the reform programs.

Neo-orthodox economic policies were a direct threat to the agricultural sector, which relied heavily on the protection and subsidies of the Indian government. Indian agriculture sought to avoid an open market, where its prices would be determined by international trade. In addition, subsidies provided for irrigation and fertilizer purchases made up a substantial level of savings for the Indian landholder. The fertilizer price increase was seen as damaging to the agricultural sector, but as noted before, it was difficult for this sector to mobilize at the national level. On the other hand, the power of landholders at the local level is immense, and may help explain the moderate cutbacks in both the 1991-92 and 1992-93 budgets, on agricultural expenditures. The government appreciates the importance of this sector in terms of vote blocks and local patronage, and hesitates to impose heavy costs on it. There is an absence of policies which cushion the hardships on small landholders and landless peasants who have little political power or access to policy-makers.

Ideology-based explanations are useful in explaining the content of economic reforms.
Structural adjustment policies are based on neo-orthodox economic ideas, which have gained significant favour in India. There is no definite consensus among economists in India in favour of liberal economic ideology and many cling to socialist ideas. Despite this opposition, however, the supporters of liberal economic ideology in India are vocal and influential. Whether or not they form an epistemic community, as envisioned by Haas, is difficult to ascertain, but they did support the government’s economic reform in the media and in their writings. Many economists were educated abroad and returned to India with hopes to emulate the development successes in East Asia. In addition, the appointment of Manmohan Singh, a pro-liberalization economist, as Finance Minister, illustrates the influence of such economists and their access to government in India.

The role of international financial institutions in shaping the content of India’s economic decision is best illustrated by looking at the conditions attached to India’s loans. The IMF and World Bank prescriptions are exclusively neo-orthodox in nature. Reduction in government spending is demanded in order to relieve the fiscal deficit. Partial privatization of most public sector enterprises and widespread liberalization of trade and finance are promised in Manmohan Singh’s ‘letter of intent’ to the IMF and required in the World Bank’s Structural Adjustment Loan agreement.

Before turning to a more in-depth discussion of the specific theories and their relevance to the case of India, it may be useful to summarize the factors which appear to be the strongest determinants of adjustment decisions.

* The interest group explanation is useful for understanding the scope and content of India’s decision. An understanding of India’s business sector is helpful in analysing the scope of decision, while all key interest groups helped determine the content of India’s adjustment decision.
* The political institutions explanation contributes to understanding of both the timing and scope of the policy choice. In particular, the type of regime and electoral systems determined the timing of the decision, while electoral systems and state capacity were instrumental in the scope of adjustment.

* Ideology provided a basis for the content of India’s liberalization initiatives.

* The international systems explanation helps explain the timing of India’s decision to restructure its economy. Both the Gulf War and the international financial climate in general, placed pressure on India to focus on its economy.

* International financial institutions played a role in determining the timing, scope and content of India’s adjustment decision.

Theories Explaining Policy Choice

Instead of one factor determining India’s policy choice, a convergence of all five suggested by the foregoing explanations determined most aspects of India’s policy choice. The prominence of the international financial institution explanation, with a role in all three aspects of the decision, does not lend it any more credibility than the role of ideology in explaining content. Measuring the importance of any one theory against the importance of the others is complex, and should be reserved for a wider comparative study.\(^{15}\)

For the case of India, however, several theories do merit specific attention. The international systems explanation, for example, does not directly account for the timing of the decision, instead it explains the timing of the actual economic crisis. The role of ideology, although difficult to measure, also acts as a somewhat indirect factor in the content of policy choice. Ideas do play a role in informing the opinions of economists, politicians and key interest groups, but their access to decision-making is more a reflection of political institutions. Given the weaknesses of the ideology and international systems explanations, the remaining

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theories play a more direct role in influencing India’s policy choice. Although it is impossible to prove or disprove any of the theories based only on one case, given the data in chapter two, some conclusions can be drawn.

Interest Groups

The interest-based explanation can be tested by assessing the degree to which the interest of the dominant interest groups were in fact included in the content of the policy. According to Pranab Bardhan’s *The Political Economy of Development in India* and most of the data in this study, the propertied classes are predominant in India. In contrast to developed countries, however, this group is heterogeneous and includes both the urban industrial class and large landholders in the rural sector (Bardhan, 1984: 54). In addition, the urban industrial class is divided between competitive industries and those industries dependent upon government contracts and hand-outs. The new economic reforms have given great opportunities to the former group, but threatened the very existence of the latter. While the intention of government policy was to cut government spending, expenditures on the rural sector did not decline significantly. Vulnerability to international trade, however, and the increase in fertilizer prices, were detrimental to the large landholders in the rural sector. Thus, divisions within the dominant propertied classes prevented this group, as a whole, from securing gains, but certain factions did benefit substantially.

The concessions given to labour groups, through the NRF and WSF, are also notable, and reveal this sector’s influence on the government of India. Although not the most dominant of interest groups, they are easily mobilized and have historically been adept at exercising influence within government.

The record for interest groups is therefore mixed, with dominant groups such as large
rural landholders and uncompetitive businesses failing to have their interests reflected in the reform policies. On the other hand, labour groups received some concessions, and competitive industries prevailed as the big winners.

**Political Institutions**

The three political institutional variables important for determining policy choice during structural adjustment programs, namely the type of regime, political or electoral cycles and the strength of the administrative apparatus, help determine the accessibility to government by different interests.

The existence of a relatively stable democracy in India would suggest that a variety of interests should be represented in policy-making. It is expected that established democracies are likely to adopt orthodox programs, but have difficulty sustaining them in the long-term (Nelson, 1990:23). India did, in fact, adopt an orthodox program, but has so far encountered few serious threats to the policy.

In the case of electoral cycles, India seems to fit the theory neatly. As expected, the Chandra Shekhar government, facing an election, did not have the power to adopt orthodox measures and could only postpone tough economic decisions. According to John Waterbury’s first election scenario, the Congress government gained sufficient legitimacy in the 1991 elections to push through their program. Narasimha Rao’s government was able to blame the policies of past governments for the crisis and thus initiate policy change.

The administrative apparatus of India is important for both its role as an interest group as well as its capacity to shape and implement policy. Many of the economic reforms, such as wage restraint and privatization, are clearly against the interests of the bureaucracy. India’s bureaucracy would be well positioned to sabotage policy if it went against their interests, but
it is difficult to measure the extent of opposition or sabotage. On the other hand, India’s administrative capacity is proficient relative to other developing countries. It is thus expected that India would have been in a good position to formulate policy in a reasonable period of time. Given the time that elapsed between the election and the 1991-92 budget, and the consistency of the program, the response of the Indian bureaucracy was swift and coherent.

**Ideology**

India’s economic reforms clearly emulate neo-classical economic ideas. From Peter Hall’s three approaches to explaining the influence of economic ideas on policy-making, the economist-centered approach, the state-centered approach, and the coalition-centered approach, one would expect widespread support for neo-classical economic ideas in India. Although there has been some move in this direction, opposition to these ideas has a clear and strong voice. Nevertheless, the government has been able to assemble a cohesive economic team with a unified ideology in favour of liberal economic policies. Within India, the economic policies were reflected in the ideology espoused by a growing community of economists. Both the state-centered and coalition-centered approaches add little to an understanding of the influence of ideas in Indian policy-making, given the detailed attention devoted to political institutions and interest groups.

**International systems**

While the international systems explanation contributes to an understanding of why the Indian economic crisis occurred in the first place, it does little to explain the nature of the decision. With a widespread belief that external forces caused the crisis, a different policy response might obstruct external involvement in the domestic economy by restricting
international trade and investment. However, the perception that the crisis was a result of external factors beyond India's control did not prevail, as other factors such as government spending were widely believed to be at fault.

**International Financial Institutions**

The international financial institution explanation emphasizes the role of the IMF and World Bank as certifying agents and their ability to attach conditionalities to loans. When India's credit rating was reduced to a B/B+ level and its access to external financing was effectively cut off, India had little option but to default on its loans or accede to conditionalities. India was thus in a very weak position with regard to the international financial community and had little choice but to give the IMF and World Bank latitude to dictate their programs without much opposition.

Nevertheless, India did have some degree of power in negotiations with the World Bank and IMF. According to Thomas Biersteker, there are four bases of debtor bargaining power vis-a-vis international financial systems: the size of debt, strategic significance, access to non-conditional resources and the domestic political sphere (Biersteker, 1993:6-8).

The international financial system wanted to avoid a default on India's $70 billion external debt. Although a complete default was unlikely, it would set a bad precedent for the international financial system if a large and influential power such as India were to default on its loans. Given India's close proximity to China and its leftist leanings, India's strategic significance gave it a degree of power vis-a-vis international organizations. By the time Narasimha Rao took power, there were few avenues left to non-conditional resources. The selling of gold and equity in the public sector were desperate measures taken to avoid the almost inevitable IMF and World Bank conditionalities. Finally, given the 1991 election
results and the support of certain sectors of Indian business, India’s political sphere gave the
government considerable room to manoeuvre in its negotiations with the IMF.

Although India’s power bases were considerable, the weakness of a country facing an
intense economic crisis such as the one India faced in 1991, cannot be overlooked. The effects
of conditionality on India were considerable. India may have undertaken reforms regardless
of conditionalities, but it must be acknowledged that the conditionalities not only established
general criteria for policy, but also assigned exact prescriptions to be followed.

The most important theories for explaining India’s policy choice are those focused on
interest groups, international financial institutions and political institutions, specifically
electoral cycles. While key interest groups in India were not united in their opposition to the
economic reforms, a large degree of dissatisfaction was apparent. Several concessions were
given to certain groups, including labour and the rural sector, but hardships and discontent
among many groups was unavoidable. Due to their ability to withhold investment and
provide financial contributions, the support of many business groups was an important source
of strength for the Indian government during the difficult period of adjustment. India’s
elections played a key role in determining the timing of the adjustment decision. The victory
of the Congress party gave it sufficient leverage and legitimacy to undertake difficult economic
choices. Finally, international financial institutions factored in every aspect of the decision.
Given the role of the IMF and World Bank as certifying agents, the pressure on India to accept
their conditionalities was substantial. Thus, a convergence of factors led to the Indian
government’s decision to undertake far-reaching, liberal economic reforms in 1991.
CONCLUSION

Some theories examined here, exhibit certain weaknesses when applied to the case of India. For example, it is difficult to measure the impact of ideology on decision-makers or the public. Both Peter Hall's state-centered and coalition-centered approaches appear to mirror the political institutional and interest group theories. For the case of India, separating ideas from the interest groups who adhere to them, or from the state institutions that reflect them is indeed a complicated task. Thus, theories which address more tangible factors are more useful for the purpose of analyzing such a complex and intricate policy choice with all its far-reaching implications.

Another weakness of the theoretical framework is its inability to account for exceptional events or individuals. It appears that various factors such as Rajiv Gandhi's assassination and the Gulf War had a great impact on both the economic crisis and the policy decision, but can be considered "accidental" or outside of the Indian government's control. Another factor which played an important role in determining the policy decision was the involvement of influential individuals at the forefront of the economic reforms. In particular, it was Dr. Manmohan Singh who initiated, framed and designed the economic reforms. He had a high degree of integrity and assembled a team of outstanding public servants to carry out the difficult and controversial task of restructuring the Indian economy. Such factors, along with more systemic factors such as the influence of propertied classes, the power of international financial institutions, and the control of the bureaucracy, determined the timing, scope and content of the decision.

Although the policy choice may indeed have occurred without one or more of the factors, the convergence of all the events, individuals, and systemic forces discussed in this thesis compelled the Indian government to undertake liberalization. The policy choice ensued
from a severe economic crisis as well as from a period of political instability. Perhaps it is only in circumstances of desperation and vulnerability that the government of such a demanding, heterogeneous populace can pursue policies which may put considerable burdens on powerful groups in the society. The Indian government, backed into a corner by the severity of the crisis, was forced to undertake measures to stabilize the economy. However, efforts to confront the structural and systemic problems of the economy, by pursuing widespread liberal economic reforms, were the result of persistent pressure from powerful groups in Indian society and from international financial institutions. Thus, the Indian government showed that it could meet both the demands of the Indian populace and the pressures of international financial institutions, and chart a new course into an uncertain future.
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