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India's Evolving Economic Model:

A Perspective on Economic and Financial Reforms

By SURENDRA K. KAUSHIK*

ABSTRACT. Over the course of the past 50 years, India has developed as a stable economy. Economic policies of the *Indian government* have guided and shaped India into a *mixed economy*. Political stability has been a significant factor in this process. The United States and European economic and political systems had a significant impact on evolution of India's economic model. Financial and *economic reforms* since 1991 have accelerated the pace of change toward an open *market economy* both in its internal operations and in its linkages with the *global markets*. India's economic future is now promising as it moves forward on its unique path of economic policy.

I

Introduction

INDIA'S ECONOMY has been attracting attention from the Western press, diplomats and businesses since 1991. This is when Prime Minister Mr. P. V. Narasimha Rao inherited the mantle of the Congress Party following the tragic assassination of Prime Minister Rajiv Gandhi. Mr. Rao was a loyal long standing member of this, the political party of Mohandas Gandhi and Jawaharlal Nehru, which gained independence from Great Britain on August 15, 1947 and which has governed India for most of the 50 years since.

Mr. Rao is consolidating all the strengths of the Indian economic system to integrate India's economy with that of the rest of the world through policies boldly enunciated since 1991. The new economic policy is bold in the sense that it effects an apparently significant departure from a certain philosophy and pragmatism that had served India during the Cold War between the West and the Soviet Union from 1945 to 1991. During these decades, India was labeled a "socialist" economy and society, a perception that makes the current focus on liberalization and competition, both internally and externally, bold and almost revolutionary.

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But, in fact, independent India has always attempted to gain the most from a combination of market forces and an appropriate role for the government in what is called a mixed economy. India was never wedded to socialism. This paper sketches a broad perspective on the policy choices made by India for the past 50 years and helps explain where India's economy has come from, the forces that have shaped it and where it is going. As a sub-theme, the paper shows how India is adopting U.S. market processes and institutions to strengthen its solid foundation based on British laws, practices and procedures. The U.S. is India's biggest trading partner, and India is expected to become more important to the American economy as its appetite for American products and services grows along with its economy.

II

India at Birth: Background for Policy Choices

JUST BEFORE INDEPENDENCE, the political map of India and its governance structure resembled a matrix where the feudal system co-existed with some areas under direct rule of the British Raj from Delhi. Some of the 650 or so self-governing principalities and areas reported to each other, others reported directly to Delhi and paid their annual tribute to the central government. At independence, they were given options to remain separate entities, join India or join a newly created entity named Pakistan. Pakistan was created to satisfy a political need felt by some Muslims. As it happens, today there are more Muslims in India than in Pakistan.

The first challenge thus was to create a new political entity named India through mergers of as many parts of pre-independence India as possible. Prime Minister Jawaharlal Nehru, and his Deputy Prime Minister, Vallabh Bhai Patel met that challenge. To keep the new political India together was no small task either. Colonialism had not totally left India and there was fear that it could easily reassert itself. The roles of Britain and the British in India, not to mention all the Rajas and Maharajahs, were not clear either.

Before any allocation decisions could be made, the first economic policy task was assessing the economic resources and productive capacity in existence. It took five years to take an inventory of India's resources. The main economic activity was agriculture. Large areas of land were owned by the feudal lords and small areas held by members of the upper caste population. About 60 percent of India's Gross Domestic Product in 1947 was from agricultural activity, mainly dependent on monsoon rains with no significant irrigation system in place (Planning Commission, 1969).

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Total productivity and output were low. Most of the 350 million people lived in abject poverty, many as landless laborers. With regard to educational resources there was a handful of colleges in the country. There were many more secondary and primary schools which produced mainly clerks. But illiteracy was higher than 80 percent in much of the country.

India was, and still is, fairly well endowed with minerals and natural resources but most had not been developed. Power, water and transportation systems were almost non-existent except for the railway system connecting major cities.

Perhaps, necessity is the mother of invention, and Indians became an enterprising people and very adept as merchants. These qualities helped the country in general business activity. Indians ascended to high civil service positions after a rigorous course of study, which had been developed for a select few Britons. They were indispensable in the setting up of government and political institutions and financial markets in India. Two and a half years after independence, India became a democratic republic and a parliamentary form of government patterned after Great Britain in adopting a written constitution on January 26, 1950. It also borrowed heavily from the French and the United States constitutions, especially with respect to personal freedoms and freedom of the press. This established a solid foundation for a stable and free political system which has so proven itself for 47 years.

The economic situation in the first few years of the new country was grim, however, with few manufacturing industries, very little income, hardly any national savings and consequently very little capital investment. The big question of course was: What should be the economic model for India? What should Jawaharlal Nehru do, with regard to economic policy in the circumstances prevailing in 1953?

III

Economic Policy from 1950 to 1970: The Two Sector Model

IN THE EARLY YEARS there were two competing philosophies. One approach came from Mahatma Mohandas Gandhi and the other from Prime Minister Jawaharlal Nehru. Gandhi was assassinated on January 30, 1948, within six months after India gained independence. Gandhi believed that India should grow by using the indigenous resources where people, materials and technology are. This would avoid mass migration to urban centers and all the associated problems of unemployment, homelessness and crime. Gandhi's ideal industrial policy was that the creation of small scale industries, guided by the principle of self-reliance, should be used to achieve self-sufficiency in food, clothing and shelter—the basics of life.

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This did become government policy and a number of programs were developed towards this end. However, they did not accomplish much, relative to the general entrepreneurship in the marketplace which spawned millions of small family businesses (Goheen, 1958, 1–12; Dasgupta, 1964, 100–02). Nehru agreed with Gandhi as regards' rural development and the need to increase food production. Agriculture thus was to be the basis on which India would come out of its economic backwardness. But Nehru thought it would take too long for India to achieve economic self-sufficiency only from small scale industries (Nanda, 1995). He wanted rapid economic progress. He wanted to create a large base of education and science and technology to build India (Planning Commission, 1952). But basic industries of steel, heavy machinery, machine tools, etc. did not exist. What to do?

Nehru found the solution in the idea of economic planning. Indian mathematicians, statisticians and economists borrowed the concept of economic planning, which in the Soviet Union was expressed as directives, and in France as indicative planning, to develop what came to be called the two-sector model of economic planning, one sector, agriculture, the other, industry (Kahn, 1963, 42–54).

The first Five Year Plan (1951–1956) proposed roughly equal amount of investment in the two sectors. In agriculture, government would provide information, loans, seed, and irrigation to private farmers, all variously subsidized. The idea of collective farms, fortunately, never reached India. By the end of the third Plan (1961–1966, with an extension to 1968) the investment ratio was 2 to 1 in favor of industry—the bulk of the government's industrial investment in public sector large scale industries (Planning Commission, 1969; Sarma, 1958, 180–238). For the private sector, the government Plan indicated which industries it should invest in to achieve the overall goals of the economy. Regulatory and licensing structures guided private investment into desired areas and discourage or ban investments in others (Cohen, 1953, 196–208).

One practical policy outcome of the concept of self-sufficiency was the diversion of scarce resources into investments that would benefit the whole population. Conspicuous consumption by the rich and the comfortable was discouraged or simply "banned" through the licensing requirements. Automobiles, for example, were considered luxuries and therefore their production was severely limited. This was a good move for political stability but it left the Indian auto industry forty years behind technologies elsewhere. Since road travel was discouraged, roads also were not built. Thus the entire multiplier process connected to the modern automobile and other consumer industries was delayed for forty years (Kangayappan, 1973, 76–81). Self-reliance also meant that imports of consumer goods were banned or were subject to stiff tariffs. Imports of in-

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dustrial machinery and materials suffered a similar fate. This economic policy was designed to encourage domestic economic activity and to conserve extremely scarce foreign exchange for importation of food and what was deemed essential industrial goods for both the public and the private sectors.

There was also strict control on foreign exchange, as there was in many other countries for years after World War II, even though India was among the original signatories to the Bretton Woods agreement, which created the IMF and through it promoted convertibility and free movement of currencies (Malenbaum, 1964, 390–99; Millikan, 1956, 399–407). Thus was born the industrial policy of import substitution as part of the two-sector model of economic growth. Import substitution may do some good, under the "infant industry" argument for it, but it also does much harm to an economy. India suffered considerable economic damage and missed many opportunities as a consequence of this policy.

Preservation of the political entity remained at the base of all economic choices during this period (Jackson, 1974, 614–15). To build heavy industries such as steel, chemicals, petroleum, power generation, telephone, radio and TV and to construct dams, irrigation systems, atomic power plants, etc., which were all to be built and run by the government or government companies, Nehru sought financial and technical help from nearly all industrial countries in addition to borrowing from the World Bank for long-term infrastructure development. He also sought foreign aid, which India received mostly from the United States, but Great Britain, France, Germany, and the Soviet Union all contributed. Thus was born a huge Indian public sector. The number of industries reserved for the public sector (and not allowed in the private sector), the magnitude of investment, both in absolute amount and relative to private investment, plus closer ties with the Soviet Union earned India the label of a socialist economy even though gross public sector investment in the economy was less than 50 percent of total investment (Ministry of Finance 1994; Planning Commission, 1992, Vol. 1).

To understand this focus on government enterprises, it is important to know that there was no alternative to government taking the lead. As the economic development literature later came to call it, the "lumpiness" problem, the private sector in India did not have the industrial base nor did it have financial capital in the scale which was needed. Government investment in the economy was necessitated by marketplace reality and not driven simply by the personal Fabian socialism and its idealism followed by Prime Minister Nehru. Nehru's motivations were to bring India into the modern world as quickly as possible while maintaining a free society and a stable political system (Reddaway, 1962).

Foreign aid played an important role in India's economy during its first twenty years. Much of it was used to import food and other necessary items, probably

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crucial to India's survival as a new country. While it is fashionable these days, however, among economists and policy makers to debunk the role of foreign aid in economic development, the "green revolution" in India probably could not have happened without the aid. The aid financed agroeconomic research in hybrid seed, irrigation and use of fertilizers from Iowa and Illinois, among other places. Nor could hydro-electric dams, basic industries and institutes of engineering and management have been created without foreign aid-financed collaborations with Harvard, MIT and other universities in the U.S. and Europe. The criticism that foreign aid reduced domestic saving may be partially true but the net effect was that foreign aid boosted the total savings available for investment. The idea that foreign aid was given to make the givers feel good by absolving themselves of colonial guilt does not fit the use of foreign aid as a tool for enhancing U.S. foreign trade and making friends, as Senator Hubert H. Humphrey said in the Senate and as Vice President (*The New York Times,* 1957, 3). It is worthwhile to remember that foreign aid, the World Bank , the IMF and other similar mechanisms and institutions were created to fill the voids left by the market mechanisms and private financial institutions. So in many of its roles, foreign aid was of direct benefit to India (Bhagwati, 1970).

It should be noted that India repaid its creditors and foreign aid donors either in foreign currency, local currency or in exports of goods and services. For example, the PL-480 food imports that were paid mostly in Indian rupees. A large unused rupee balance itself was ultimately donated back to India by the United States under the Indo-U.S. Rupee Agreement (USAID/India Program Summary, 1995, 44). Rupee balances were also used by the United States in its programs and activities in India including local currency expenses of the U.S. Agency for International Development programs, and libraries and activities of the Unites States Information Service, just to name a few.

Similar arrangements were made with the former Soviet Union and other donors. The Soviet Union was repaid mostly in exports of industrial and consumer goods making it the biggest trading partner of India during the Cold War period. Nehru and India did become closer and closer friends with the Soviet Union because of continuing disputes and wars with Pakistan, which has been consistently supported by the United States and Great Britain. While the Soviet Union did not give or invest anywhere near the amounts invested in and donated to India by the United States, it supported India at the United Nations and supplied military hardware. Nehru was extremely effective in getting economic, political and military help where he could to further India's interests. As poor as India's infrastructure base was by 1994, it is easy to imagine what it would be had India not invested heavily in the public sector in its first thirty years.

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These investments included many fine engineering colleges, polytechnical institutes, management institutes, medical institutes, etc. as well as industries. Even today, with so much invested in education in India, there are not enough spaces for all the students who want to get higher education (Planning Commission, 1992, Vol. 1).

The two sector model of economic planning and development created a pragmatic mix of private and public sectors within industry and a strong private sector in agriculture. The choices made in the 1950's and 1960's yield desirable results today. While more of the current economic situation will be discussed below it is appropriate to point out here that, today, India is self-sufficient in food. While feeding almost one billion people, it manages with a small export surplus of food grains. It has become the second biggest exporter of rice in the world behind the United States (Yap, 1996, 23). Also it is ranked the 12th most industrialized country in the world with a broad base of industries, mostly in the private sector (Heeks, 1992, 15–34).

IV

Economic Policy During the "Nehru Dynasty" Years: 1970 to 1990

CHINA'S ATTACK IN 1962 shocked India. Because Prime Minister Nehru had so trusted Chinese Prime Minister, Chou En Lai, during the latter's visit to India, the betrayal of that trust and friendship depressed him. He never recovered from it and eventually died of a stroke in 1964.

His successor, Prime Minister Lal Bahadur Shastri, had to deal with an attack from Pakistan in 1965. He died in Tashkent, Uzbekistan, USSR, in January 1966 at the conclusion of a peace summit and an agreement of "no-war" over the question of Kashmir with President Ayub Khan of Pakistan. The meeting was hosted by Premier A. Kosygin of the Soviet Union. Mr. Shastri was succeeded by Mrs. Indira Gandhi, daughter of Jawaharlal Nehru, who served as Prime Minister from 1966 to 1977 and again from 1980 until her assassination in 1984.

The fourth plan (1969 to 1974) and the subsequent Plans evolved from the successes and failures of the 1960's. The impact of all these events on economic policy was to place emphasis on industrial development and a build up of defense and nuclear industries in the public and private sectors. In other words, the Ricardian model of the industrial sector being built over time on surplus from the agriculture sector was further upset (Appleyard, 1968, 189–99). The focus shifted from increasing food grain output through bringing more acreage under cultivation to increasing productivity through more use of new hybrid seeds, expanding irrigation and more use of fertilizers. India did not have a fertilizer factory until 1967.

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The 1970's saw further evolution of setting priorities and economic resource allocation. Key features of the Indira Gandhi regime were to diversify the economic base and to increase investment. During her long lasting government, Indira Gandhi furthered the growth of private industry and of consumer goods industries. She continued the privatization of the priority sectors of agriculture and heavy and large scale industry which were previously in the public sector. It was recognized that the purpose of large scale public sector industries was to create the necessary infrastructure base for the private sector (Planning Commission, 1992, Vol. 1). Increase in and mobilization of national savings became a major goal of the economy in order to finance increased investment. High priority was given to the financial sector to open banks and other saving mechanisms to promote savings.

In her zeal to accomplish financing of every sector rapidly and fairly, and not entirely trusting the private banks to do this, the Indira Gandhi government nationalized all major banks early in her regime. She had some basis for not depending on the large private banks because they were controlled by large industrial houses whose affiliated businesses had better access to funds than did outside borrowers. The nationalization of banks in 1970 led to a rapid expansion of branch networks of all banks in their areas. Some were allowed to open branches outside their areas to create competition among nationalized banks.

Indira Gandhi accomplished a lot but also made many mistakes in her policies. Nationalization of banks, assumption of emergency powers by her government, forced sterilization of poor people to control population, misuse of political campaigns, and sending troops into the Golden Temple, the holiest of Sikh shrines in Amritsar, (to root out Sikh criminals taking shelter there with a substantial cache of firearms), were among the notable mistakes she made as Prime Minister. She met her fate at the hands of Sikh assassins, her own bodyguards at the Prime Minister's house, in 1984.

Mr. Rajiv Gandhi, the older of two sons of Mrs. Gandhi, had been grooming for her job since his election to India's Parliament in 1981. He succeeded his mother as head of the Congress Party and as Prime Minister as he and his party were returned to power in a landslide election victory in 1984. He served as Prime Minister till 1989 during which period he welcomed back foreign business and investment to India, began a process of liberalization of the economy, gave highest priority to modernization of the economy through computers and telecommunications, and attempted to establish friendly and close relations with Western governments. He appreciated the workings of market forces and competition in national policies and began liberalization of foreign trade and payments. The economy did reasonably

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well under his one term but he lost power in 1989. He was assassinated by a human bomb during an election campaign in the state of Tamilnadu in 1991 for his military campaign against Tamil extremists in Sri Lanka where they control a province and have been demanding autonomy from the central government in Colombo.

From 1966 to 1989 the economy achieved a real annual growth rate of 4 percent in GDP, and a per capita growth of about 2.2 percent a year. For a shorter period, 1975 to 1984, the real GDP grew at 5 percent a year. The same is true for 1984 to 1993. Foreign exchange reserves have grown from SDR 365 million in 1966 to almost 4 billion in 1993. Imports have grown from $3 billion to $26 billion over the same period. The current account balance changed from $1.5 billion in 1976 to −$0.7 billion in 1989. In 1990–91 India invested 26 percent of GDP which was financed by 24 percent domestic savings and the balance by borrowing; industrial production had more than doubled in ten years; the budget deficit was 8 percent of GDP; exports were $18 billion and imports were $24 billion; the current account deficit was −2.6 percent of GDP and external debt was 21.4 percent of GDP; foreign investment was coming in at a rate of $300 million a year; agriculture's share in GDP was 32 percent; the private sector contributed 75 percent to net domestic product; petroleum and capital goods were 50 percent of imports; agricultural products, engineering goods and gems and jewelry constituted 50 percent of exports; 10 percent of its imports came from the United States and 5 percent from all of Eastern Europe including the USSR; 16 percent of exports went to the United States compared with 11 percent to Eastern Europe; and the rest of trade was fairly evenly spread among other countries of the world (Ministry of Finance, 1994, 1993–1994 Report).

To finance its chronic balance-of-payments deficit India borrowed heavily from the public financing sector of the world, *i.e.* the IMF, the World Bank, and the Asian Development Bank. (Anagol, 1992, 88–102). India had not yet become sufficiently credit-worthy to borrow in world banking and normal commercial credit markets. It thus avoided the debt problems faced by many countries during the 1980s. As other Third World markets dried up for bank lending, Western banks began to qualify India, both public and private sectors, for borrowing. India began to borrow just as quickly as Poland, Mexico, Brazil, Argentina, Venezuela, Peru, Bolivia, Turkey, Nigeria and others had done in the 1970s. By the end of the 1980s, India had accumulated a total foreign debt of $75 billion. The foreign debt increased to over $90 billion by the end of 1994 and neared $99 billion by the start of 1996(Reuters, Limited, 1996). The oncoming debt-service problem was visible and India needed to and did avert a default towards the end of the 1980s (Anand, 1988, 135–146).

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V

India Reforms Its Economy: 1991–1994

PRIME MINISTER P. V. NARASIMHA RAO was chosen as the Party leader in 1991 following the death of Rajiv Gandhi. Mr. Rao had been a successful member of the legislature, and Chief Minister and Governor of the state of Andhra Pradesh in south India before moving on to represent his state in the national Parliament in 1972. As a true believer in Indira Gandhi's leadership, Mr. Rao served as General Secretary of the All India Congress Committee in 1975–76. He also served in her cabinet as a minister in various departments including foreign affairs, and home affairs from 1980 to 1984. Mr. Rao served in the government of Rajiv Gandhi, from 1985 to 1989 as Defense Minister, Minister of Human Resource Development including education, Minister of Health and Family Welfare, and Minister of Foreign Affairs. Mr. Rao was intimately involved in the policies and programs of the two Gandhis over twenty five years.

The new Prime Minister knew in 1991 that India had matured as a country, as a political system and as an economy which could be let on its own. Economic liberalization and opening of the economy to the rest of the world was deemed essential to realize higher internal economic growth. It had to begin to grow faster and to have access to the foreign exchange needed to avert a major debt-service problem ahead (Nicholson, 1995, 12). The disintegration of the Soviet system with which India had important but protective ties might also result in the loss of foreign markets for 10 percent of its exports.

Soon after coming to power Mr. Rao and his finance minister, Dr. Manmohan Singh, announced a program of economic liberalization. A good ally, Dr. Singh had faithfully served Mrs. Gandhi's governments as economic adviser and Mr. Rajiv Gandhi's government as head of the Planning Commission which is responsible for Five Year Plans. An economist trained in neoclassical economics with specialization in international trade, Dr. Singh has proven himself to be flexible in adapting to ideas and practices of market economies as well as regimes which include economic planning. He changed and shifted his policies to suit his new Prime Minister and new economic situation at home and abroad.

The new policy and programs announced in 1991 included a significant reduction in import tariffs and elimination of import quotas except for consumer goods, elimination or reduction of restrictions on foreign ownership, currency convertibility on the trade account, reduction in licensing requirements, regulations and red tape, opening all industries except six to private ownership and reduction in domestic excise taxes, among others.

As a result of these reforms foreign direct investment is pouring in from companies such as Pepsi, General Motors, General Electric, International Busi-

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ness Machines, Coca-Cola, McDonald's, Enron, etc. and similar companies from Great Britain, Japan and Germany. Mutual funds, investment banks, securities firms and commercial banks are investing in Indian securities. Indian companies are raising funds in the world capital markets and merging with one another and with foreign companies. Inflation and the budget deficit have come down. GDP is growing at about 5 percent. All this in just two and a half years and in an environment in which it is still difficult to do business.

Emboldened by the success of 1991 reforms, Mr. Rao and Dr. Singh have continued the reform process. There is universal appreciation of the proposed changes in and out of India. The reforms so welcomed in the 1994–95 budget, among others, included reduction in customs duties, reduction in corporate tax, reduction in income tax, and a ceiling on the central bank financing of government debt beyond which the government has to go to the market (Finance Minister, 1994).

VI

Future Prospects for India and Its Economic Policy

THE INDIAN ECONOMY is ready for a take-off because investment is growing, foreign capital and technologies are coming in, competition is at work, state intervention is less and there is an estimated middle class of 100 to 300 million consumers with a total number of consumers approaching one billion persons (Rostow, 1962, 7). The future looks promising indeed. The safest way to achieve strong economic growth will involve an economic policy which seeks macroeconomic stability. The policy will include control of inflation, budget deficit and a careful management of debt, and more use of equity markets to finance growth. Policies beneficial to India would be those that promote expanded trade with other countries, competition within the economy, confidence in its currency, and increased savings and investment in private initiatives and activities.

The policies India should not follow, and is unlikely to follow as a primary focus, are those that were proven failures in India and elsewhere, especially given the stunning example of the former Soviet system. These policies relate to public sector enterprises whether they are in agriculture, manufacturing or services and to the practice of maintaining a closed market within a country or a region with government controlled prices. First, the issue of public enterprises.

One of the main reasons for inefficiencies, low productivity, lack of innovation, and lack of progress in public enterprises is that the manager is the only, or practically the only, source of ideas; therefore, productivity suffers. This is generally the result across countries and across different types of activities such as agriculture, manufacturing or services. Private organizations too have these fail-

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ures unless they allow for multiple sources of ideas for improvement and change, provide incentives that foster new ideas, and encourage risk-taking and being different. India clearly should avoid the trap of economic stagnation and death the Soviet system has experienced. India's own success in agriculture is through millions of small private farms, not the collectives, but the ideas came from U.S. government spawned research. Indeed that example is being replicated in manufacturing as India moves away from public enterprises. Even now, only about 8 percent of the labor force is employed in the organized sector (including the school system, government employment and private industries where there are labor unions) and of that, roughly one-half is in public enterprises. So in terms of output of GDP (75 percent) and employment (more than 92 percent because the 8 percent includes unionized private corporations) India's economy is essentially a private enterprise system (Ministry of Finance, 1994). Markets in resources, goods , and services, which are geographically closed to outside and inside competition, result in a non-innovative economic environment and uneconomical use of domestic resources and technologies. Closed markets cannot take advantage of specialization. India is learning this lesson and is rapidly opening its markets to inside and outside competition in all three areas of resources, products and services. It should continue to expand open trade in all areas normally open in other countries following the spirit and the letter of the new General Agreement on Tariffs and Treaties approved in 1993.

Another aspect of foreign trade is the prices used in imports and exports. Fortunately for India, the lessening of its trade at government fixed prices with the former communist bloc countries is going to be helpful in increasing the share of foreign trade with open price competition. The new policy of a convertible rupee for current transportation should be a permanent policy that leads to full convertibility in capital accounts as well. This can happen by the end of this century. The signaling function of prices and of the exchange rate in the working of the economy should achieve allocation and consumption efficiencies and, thereby, higher economic levels. Promotion of competition in the economy should be promoted through economic policies, be those fiscal, monetary, exchange rate or policies related to subsidies and indirect taxes (Chopra, 1995, 233, 241–44).

India's maturity reflects its ability to withstand external competition, but also that India has substantially reduced inflation. Domestic price stability (around 5 to 7 percent inflation in recent years compared with 15 percent in the 1980s) and the absence of the problem of flight capital (unlike that experienced by Brazil, Mexico, Peru, Argentina, Venezuela in the 1980s and the former Soviet Union more recently) has allowed India to adopt an outward looking policy. Therefore it requires India's commitment to maintaining macroeconomic dis-

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cipline. It was reflected in the 1994–95 budget which, for the first time, puts a limit on monetization of public debt as an automatic financing technique. This policy indicates a goal of not letting deficit financing and inflation become problems for India.

Reduction in income tax, capital gains tax, corporate tax, and excise taxes on a large variety of items establishes an economic environment of incentives for savings and investment. There is no more suppression of consumer industries in favor of investment in heavy and large industry in public enterprises. Licensing and other bureaucratic nightmares are also being reduced and financial markets are being liberalized to increase investment in the economy.

As a federal republic, India's political structure depends on what happens in its constituent states. There is a sense that there is some resistance to change at the state level. This may be true, but is not sufficient to stop the reforms. There may be somewhat slower change in certain activities politically important in a given state. Generally though, state level policies are forward looking (Reuters, Sept. 1995). It is a good sign that the central government is not forcing states or persons or companies into whatever it might think is important. Instead, it follows a policy of incentives, tax reductions and liberalization. Likewise, communal conflicts are wisely left out of the economic calculation.

One of the great strengths of India through the centuries has been its ability to absorb new ideas and for its people to learn to live together by and large in peace over a long period of time. All this makes for a healthy political and social milieu for the economic renewal India has begun to demonstrate. It seems that India will stay on the path of economic reform with virtually no chance of backsliding (Finance Minister, 1995).

Mohandas Gandhi knew the scale of the effort required to cope with India's poverty, and that is why he wanted economic growth to happen in the towns and villages where people are. Policies promoting economic growth and slowing down population growth seem to be the only solutions to India's poverty. That is why economic reforms are important to widen the gap between the growth rates of the economy and the population. The subsidies available to a large segment of the population for the purchase of food and other essentials are the only ways government has been trying to help on the consumption side. There are, of course, subsidies on the production side. But the idea now is to remove subsidies and let market forces do a better job of signaling price and profit incentives to producers. One thing this long process needs is patience and, fortunately, India is rich in that.

It is a good thing that God is part of every activity in India. Otherwise there would be social revolutions every week. This, however, is not the same thing as the misconception about the fatalistic nature of Indian society that has been

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propagated over time. As of 1996 India appears to be on a path of significant growth. India's economic future looks promising as it has never before as it moves forward on its unique path of open economic policy.

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