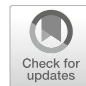
# Chapter 1
# Contextualizing the 1990s' Economic Reforms in India: A Politico-Economic Narrative




**Tanmoy Sarkar and Mukunda Mishra**

## 1.1 Introduction

In the economic history of independent India, July 1991 is considered as a benchmark. It is marked by a drastic shift in economic policy following bold economic and policy reform decisions by the Rao-led Government of India (GOI). The ripples of the conventional wisdom of economic reform of 1991 have been arguably prevailing in the country till date, and the policy decisions followed by every succeeding cabinet of the GOI, irrespective of political ideology, have curved its way since decades back.

The democratically elected first-ever Government in Independent India had many more challenges. In 1950, India was a newly independent nation with only 14% literacy, one-seventh of the world population with a meager per capita income, and three-fourths population engaged in the primary agricultural sector with primitive tools and techniques (Adhia 2015). The colonial past of the country has had a significant impact on its territorial disputes and also contributed to poverty, illiteracy, and structural distortions. The Nehru-led government had the challenge to counter and shape the crystallization of the colonial economic structure that led to poverty, underdevelopment, and a dependence on and subordination to Britain (Chandra et al. 2000). The colonial history and pro-Britain policies stagnated the Indian agricultural sector in large part of the country. The early years after independence (1947–1964) were devoted to reconstructing the nation, to shape its polity, economy, and society. Nehru focused on modern industrial transformation, agricultural revolution, and

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implementation of five-year centralized planning for India to be self-reliant. In the colonization-driven underdeveloped scenario, firstly, India approached import substitution industrialization to develop, protect, strengthen, and encourage the local economy and to reduce the dependency on developed nations. The economic policy of India was set to counter foreign capital domination. The introduction of land reforms by abolishing the Zamindari system for the potential use of land and social justice appeared as one of the most remarkable reforms (Basu 2008; Dey Biswas 2014). Introducing cooperatives, especially service cooperatives, was another important step by the government to focus on growth, welfare, and equity.

Moreover, the Nehru Government's expenses for the pro-poor and welfare approach led to the debt crisis. The operationalization of the so-called Nehruvian socialism with the mixed economy model of centrally planned development initially evolved into a serious domestic economic crisis and finally consequent in the balance of payment (BOP) crisis in 1957 (Chandra et al. 2000). On the eve of independence, this crisis was further intensifying due to divestment by foreign business houses from their holdings in the nation and halting of domestic investment in India.

DeLong (2003) criticized Nehru's Fabian socialism turn, centralized form of planning, and bureaucratic red tape (License Raj) for India's stagnated development and rampant corruption along with massive inefficiency. On the other part, the uniqueness of Indian development consensus with rapid industrial transformation within a democratic electoral government system led to an uncharted path that must be considered (Chandra et al. 2000). The mixed economic model in the early years after independence aimed to encourage the private and public sectors in a fashion where the coexistence was complementary to each other, and the development of private sectors allowed freedom as much as possible within the periphery of the National Plan. After the abolition of the British Raj, Indian industrial policy and economic development started to be governed by the "License Raj." The industrial policy resolution of 1956 and the Second Five-Year Plan came up with a new resolution and restrictions for foreign capital and private sector dominance.

Though the Nehru-Mahalanobis strategy put thrust on heavy and capital goods industries in the Second Five-Year Plan that led to more importance on the public sector, import substitution policy was taken to reduce foreign capital dependence, boosting Indian domestic capital investment and getting self-reliance. It was the decision in response to that time. Labor-intensive and capital-promoting community projects in the agricultural sector, along with community development programs (CDP) and development of cooperatives, were taken to respond to the then massive unemployment situation. Nehru-Mahalanobis emphasized growth with equity and assumed that higher growth could encourage higher levels of equity. The complicated industrial "License Raj" and control system were set up with the objectives of leading development along centrally planned lines, reducing foreign dependency and monopoly, protecting domestic entrepreneurship and small industry, and channelizing the resource following the government-directed priorities to reduce regional imbalance (Chandra et al. 2000). The situation led to the balance of payment (BOP) crisis in 1956–1957. The government decided to impose stringent import and foreign exchange controls to overcome the acute shortage of foreign exchange.

**Table 1.1** Indices of industrial production in India: 1951–1979[a]

| Industrial group | 1951 | 1961 | 1971 | 1978–1979 |
|---|---|---|---|---|
| General | 55 | 109 | 153 | 186 |
| Textiles | 80 | 103 | 106 | 110 |
| Basic metals | 47 | 119 | 209 | 144 |
| Machinery | 22 | 121 | 373 | 208 |
| Electrical machinery | 26 | 110 | 405 | 162 |

*Source:* Government of India (1980); Johnson (1983); Adopted from Chandra et al. 2000, p. 481

[a]1960 = 100 (for 1951–1971) and 1970 = 100 (for 1978–1979)

However, the overall Indian economy performed impressively well compared to the colonial period. India's gross national product (GNP) showed an average growth rate of about 4% per annum between 1951 and 1964–1965 (Chandra et al. 2000). The domestic savings and investment rate showed remarkable growth from 1951 to 1965. Apart from the industrial sector, the agricultural front had been going through a reform process that started after independence. Large infrastructural investments in irrigation, power, and community development initiatives at the village level were implemented, and the development strategy centered around the land reform strategy in the 1960s. The indicative form of planning in the agricultural sector allowed farmers to make output and investment decisions with a serious thrust to achieve self-sufficiency in food grains. However, the impressive agricultural growth was not enough to match the escalating population demand for food, and India had to rely heavily on imports. The situation was altered after adopting modern industrial output and modern technology, using high-yielding variety (HYV) seeds, adopting mechanized farm tools, developing irrigation facilities, etc., in the form of the green revolution since the mid- and late 1960s. The industrial front showed comparatively faster growth due to the import substitution of consumers, capital, and intermediate goods (Table 1.1).

The share of investment in GDP and population growth rate is considered an important parameter to determine the growth scenario of a country, and India was significantly lacking in both of these parameters (DeLong 2003). There are several illustrations considering the limited economic growth and overall inefficiency in India during the Nehruvian dynasty. The impact of post-World War II also could not be ignored. Nehru's attraction to Fabian socialism and central planning contributed to the stagnant situation though there are some counterarguments also. The alternate argument is that the welfare policy consideration of Nehru for the deprived and poorest section of the country was the demand of time and space where extreme poverty, utmost unemployment, and serious social and economic inequality prevailed (Dandekar 1988). Therefore, India's policy decision was framed with the objectives of achieving decent growth, boosting social justice, and attaining self-reliance (Kaushal 1979). The "License Raj" undoubtedly affected the private sector economy, and the inefficiency in resource mobilization limited the promotion of policy efficiency in India.

## 1.2 Departure from the Nehruvian Legacy (1965–1991)

After the demise of Jawaharlal Nehru in 1964, Lal Bahadur Shastri took over as Prime Minister of India. The failure of the Third Five-Year Plan (1961–1966) was explicit. India had already experienced the India-China war in 1962. This period started with two massive monsoon failures in 1965 and 1966, and the agriculture-dependent Indian economy massively underperformed. Apart from these successive two climate hazards, the Sino-Indian War of 1962 and the Indo-Pak War of 1965 caused havoc on the Indian economy. The inflation was sharply elevated to around 12% from 2% in 1963, and the fiscal deficit was markedly increased. In his brief 19-month period of prime ministership, Shastri had to face violent anti-Hindi agitation in South India (1965), the country's worst-ever food crisis, and the crushing economy after the military escalation of the Sino-Indian border disputes, and most importantly, he had to face a continuous fragmented consensus within his party since his charge. His strong leadership in the most crisis-ridden period in India is worth appreciation. He tried to shift the focus to agricultural growth rather than heavy industries. Amidst those crises, his focus on food security and the role of agricultural scientist M.S. Swaminathan made India free from the dependency on the USA for food aid that, in turn, was supposed to influence the country's foreign policy autonomy. The introduction of "green revolution," under the leadership of Lal Bahadur Shastri and Indira Gandhi, revolutionized the food and agricultural sector of India with complete self-reliance. After the success of the green revolution, the country experienced the success of the white revolution in the dairy sector through the cooperative movement.

The importance of the development of the private sector, increase in foreign investment, and market-oriented approach to production were being considered by the government, but a lack of bold reform decisions could not make such change in the scenario. After the death of Shastri, Indira Gandhi took over the charge as Prime Minister of India in 1966. Indira Gandhi-led Indian Government had the challenge of responding to devaluation, economic turbulence, and inflationary recession. The BOP crisis triggered the need for import liberalization to get external assistance. The problems of exploding population and escalating unemployment were not resolved; however, the successive two wars against China and Pakistan greatly burdened the Indian economy. The Indian rupee was devalued by 36.5% in 1966 to reduce the gap between domestic and external prices, promote development, and get economic discipline. This devaluation encouraged the competitive market approach to address the country's trade economy and balance of payments.

Along with devaluation, several existing special export promotion schemes providing import entitlements against exports and the scheme for tax credit certificates were abolished. GOI had the plan to slow down the monetary expansion, simplification, and rationalization of import tariffs and policy designed to shape the improvement in the BOP position (Srinivas 2017). The Fourth Five-Year Plan was rescheduled in 1969 as the GOI declared a "plan holiday," and three consecutive annual plans were taken in response to the severe drought for 2 years and two wars

with China and Pakistan on the borderland. The primary objective was to accelerate exports and to find a way for efficient utilization of industrial assets. The devaluation decision in 1966 was accompanied by several import liberalization decisions. However, the outcome was not satisfactory as expected.

Post-1967 India experienced several national political events, which in turn influenced the economy at large. While Indira Gandhi got a landslide setback in March 1971 election with the "Garibi Hatao Desh Bachao" (i.e., "remove poverty, save the country") campaign and took over the charge as Prime Minister of India, the radical socialist policies came into force to complement the populist democratic prepoll slogan. However, in the long run, these made some distortions in the way of reform. Government control was increased with the nationalization of banks, insurance (1972), and coal industry (1973). The objective of bank nationalization was to regulate bank lending towards the agricultural sector and to align the banks' move to the government's welfare policy direction. Bank credit in the rural economy was markedly picked in the post-nationalization period. However, the politically influenced economic pathways started causing economic pressure on the banking system.

The introduction of the Foreign Exchange Regulation Act (FERA) in 1973 put severe restrictions on foreign capital investment and made it difficult for the functioning of foreign companies in India. In addition, the policies of acquiring loss-making industries built more pressure on the economy. Although these decisions worked as the remedy for unemployment and stressful economic conditions, they paved the way for the BOP crisis in the coming days.

The 1971 Census of India estimated the population at 548.2 million, and the workforce was measured at 184 million, with which agriculture contributed 68.3% of the workforce (Kumar 2021). The green revolution was already in force, and it was mainly concentrated in a few pockets. The sharply elevated share of agricultural laborers (24% in 1961 to 37.8% in 1971) clearly indicated that small farmers were losing land. However, agricultural growth has been recorded as the highest in India after independence under the leadership of Mrs. Gandhi (Kundu 2016), and the green revolution had a pivotal role to play.

Inequality in every sector continued to grow. Underdevelopment, unemployment, and poverty were everywhere, but few pockets had the greater possibility of responding rapidly compared to others. With limited opportunity and limited funds, the government had to consider the places that looked promising for development. The vision of the trickle-down effect actually continued to accelerate the rural-urban divide as infrastructural investments were concentrated mainly in the urban areas. The per capita income in India declined by 0.9% in 1971–1972 though the state's income grew slightly by 1.4% (Kumar 2021).

The Fourth Five-Year Plan (1969–1974) was introduced in response to a devaluation, drought condition, and inflationary recession and had the vision of self-reliance with an ambitious goal of 5.6% growth. But the War with West Pakistan, the independence of Bangladesh, a massive flood of refugees from East Pakistan (Independent Bangladesh) and the subsequent economic pressure on India, the Asian oil crisis of 1973, and successive monsoon failure were the major obstacles

against the achievement of this five-year plan. The political rhetoric of welfare politics continued to govern the economic policies during the tenure of Indira Gandhi. The industrial sector did not experience a major setback during Mrs. Gandhi's tenure. However, several industrial policies had been taken to boost investment, including new industrial licensing regulations to reduce control over small investment (CIA 1973), but the control over large firm investment remained tight. The CIA report mentioned that the Monopolies and Restrictive Trade Practices Act (1970) became law, which reads:

> "... any investment by firms with greater than 200 million of assets, or by firms with assets with assets of more than Rs. 10 million that control more than one-third of the market for a particular project, must be approved by the government"—CIA (1973)

Apart from this licensing raj and direct controls, several policies were reformed to include several financial measures to provide more government control over private investment. Mrs. Gandhi's political vision of employment maximization with restrictive policy by the protection of labor-intensive, inefficient, traditional techniques in village industries was thought to be responsible for the slowdown in the industrial growth—from 6% in 1968–1979 to 4% growth of industrial output in 1972 (CIA 1973). The process of long-term bureaucratic screening and rigid government process to consider applications for new direct investment was continued rather more intensified in the tenure of Mrs. Gandhi. The objective of progressive and steady Indianization of foreign firms continued to slow down industrial growth to a large extent.

We must remember that the economic policy was not always economically decided; rather, it had been on the political situation, the demand for democracy, and the ineluctability of the electoral voting process. Prior to the 1980s, interventionist policies, import controls (Bhagwati and Desai 1970), and discouraging entrepreneurship were the features of the government's economic policies.

After the assassination of Prime Minister Indira Gandhi, her son Rajiv Gandhi took charge as PM and continued from 1984 to 1989. Rajiv Gandhi-led government had taken primary initiatives to encourage the import of capital goods by relaxing the bureaucratic red tape of industrial regulations. Moreover, the tax system was also regularized, and the attitudinal shift in government vision to encourage all entrepreneurial initiatives boosted a belief in national and international industry stakeholders. India experienced an economic boom in the 1980s with the policy shift towards trade liberalization and relaxation of "License Raj" in investment, though the growth rate was highly variable throughout the decade. Joshi and Little (1994) emphasized the role of fiscal expansion financed by internal and external borrowing to boost economic growth. The unsustainable economic growth in the 1980s was "fuelled by a build-up of external debt that culminated in the crisis of 1991" (Ahluwalia (2002). The liberalization policy initiatives of the 1980s provided the necessary groundwork for the forthcoming 1991 reform in India. A major pace in policy decisions to consider industrial relaxation was considered during 1985–1988. GDP growth achieved a remarkable peak at 7.6% during 1988–1989 to 1990–1991 (Panagariya 2004). The export had marked a remarkable growth at 14.4% during

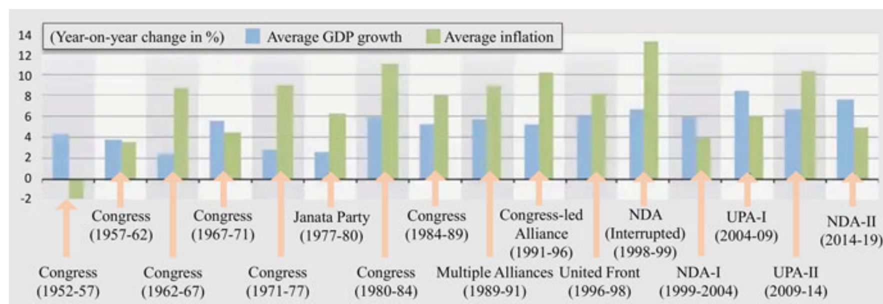



**Fig. 1.1** A brief history of the Indian economy and the ruling government in center, 1947–2019. (Source: Prepared from the World Bank data, https://data.worldbank.org/)

1985–1990 from 1.2% during 1980–1985 (Fig. 1.1). Reducing the share of government in canalized imports, expansion in the number of the capital goods items in the OGL list, several export intensives, reduction of interest rate on export goods, duty-free imports of capital goods for selected thrust areas, relaxation in the industrial controls, and realization of exchange rate contributed towards the way of reform.

## 1.3 The Economic Reform in 1991: Expectations and Realities

The economic reforms in 1991 were not abrupt; the preparation had started in the 1980s. The growth rate took off a pace in the 1980s as the immediate effect of a few liberalizing attitudes of the Rajiv Gandhi-led government. The change in official attitude regarding the policy of encouragement despite discouraging the "investment" and the entrepreneurial economy was the key to sustaining the economic growth in India, irrespective of the major policy shift in 1991 (DeLong 2001; Rodrik and Subramanian 2004). Dr. Manmohan Singh's 1991 historic budget speech acknowledged the contribution of the policy and development initiatives taken by former Prime Ministers since 1947, and the policy shift in 1991 was not sudden. The Nehruvian policy of mixed economy (Kumar 2017) has had a great contribution to paving the way forward to adopt a reform in 1991 as it must not be considered a piecemeal decision.

After Rajiv Gandhi-led Congress government, India had two coalition governments led by Vishwanath Pratap Singh (December 2, 1989, to November 10, 1990) and Chandra Shekhar (November 10, 1990, to June 21, 1991). After these coalition-led unstable phases, P.V. Narasimha Rao was sworn in as India's premier on June 21, 1991. The massive fiscal and BOP crisis that was continuously building up since independence climaxed in 1991. And Manmohan Singh took charge of the finance minister on June 22, but his primary statements on economy and inflation were not supposed to be from a canny politician. PM Rao had to face a sharp attack and

continuous criticism from his own party itself. Singh, a man with sobriety, quiet dignity, and unparalleled academic brilliance, had offered to quit several times, but PM Rao was determined to stand by him all through. As the finance minister, PM Rao and Manmohan Singh were unswervable to break through the traditional vote bank-based economic mindset and were ready to take an unprecedented, revolutionary economic reform decision that rescued India in perhaps its unlighted juncture but controlled the Indian economy for the last three decades. PM Rao appointed reformers and known liberalizers in important government portfolios: Mr. Singh as finance minister, P. Chidambaram as commerce minister, Jairam Ramesh as an officer on special duty, Amar Nath Verma as principal secretary, and Montek Singh Ahluwalia appointed as a commerce secretary. India was going through a profound macroeconomic crisis and an acute shortage of foreign exchange reserves that was a potential threat to the sustainability of growth. Due to several external and internal factors like the Gulf War and oil price hike in the international market, the political instability in India was extremely high; capital inflow sharply declined as the lack of international confidence in Indian economy. The entire country was in search of a leader who could make bold decisions and will respond to the macroeconomic imbalances. In June 1991, the nation had the exchange only to pay for just 2 weeks of imports (Ramesh 2015, also cited in Kumar 2017). And finally, on July 24, 1991, Manmohan Singh[1] presented the "historic" budget speech:

> "... There is no time to lose. Neither the Government nor the economy can live beyond its means year after year ... Any further postponement of macro-economic adjustment, long overdue, would mean that the balance of payments situation, now exceedingly difficult, would become unmanageable, and inflation, already high, would exceed limits of tolerance. For improving the management of the economy, the starting point, and indeed the centrepiece of our strategy, should be a credible fiscal adjustment and macro-economic stabilisation during the current financial year to be followed by continued fiscal consolidation thereafter ... Macro-economic stabilisation and fiscal adjustment alone cannot suffice. They must be supported by essential reforms in economic policy and economic management as an integral part of the adjustment process, reforms which would help to eliminate waste and inefficiency and impart a new element of dynamism to growth processes in our economy."

In his budget speech, Dr. Manmohan Singh outlined the thrust of the reform process. The great economist speculated that a reform is essential:

- To increase the efficiency and international competitiveness of industrial production
- To utilize for this purpose foreign investment and foreign technology to a much greater degree than the country has done in the past
- To increase the productivity of investment
- To ensure that India's financial sector is rapidly modernized

[1] See the Union Budget, Ministry of Finance, Government of India. Available at https://www.indiabudget.gov.in/bspeech.php.

- To improve the performance of the public sector so that the key sectors of Indian economy are enabled to attain an adequate technological and competitive edge in a fast-changing global economy

There is ample literature during the late 1990s and the first decade of the new millennium that have analyzed the "reforms" critically on the ground of what we "expected" and what actually "happened." While those "sky-kissing expectations" have been verified with the "ground-rooted realities," most of them concluded with the lists of "unfulfillment" from the reform. 1990s' economic reform is, like many other such earlier reforms in India and abroad, certainly not a "panacea" to work equally to resolve all possible issues.

While a popular expectation is often set that trade liberalization encourages economic activity and hence raises production and employment, it sounds somewhat unrealistic to expect immediate benefits through such a channel. The ground reality is that the trade liberalization that implies increased foreign competition leads to the closure of less competitive firms, and therefore job losses and income reduction in the initial phase are a hard reality (Siggel and Agrawal 2009). Trade liberalization in the initial post-reform years has shrunk India's manufacturing base in terms of value addition and employment (Nambiar et al. 1999). However, the scenario changes in the long run. Indian economy started experiencing increased productivity, competitiveness, and accelerated growth since the mid-1990s. Moreover, amidst the break of the "dream" of revamp of production, import liberalization came forward to challenge the historically prevailed syndrome of "high protection-high cost-poor quality" in the production system.

There are objections about the non-materializing of rapid and sustained growth of output and employment; getting the industrial base narrowed; finding the employment growth in the 1990s negative in 5 out of 9 years; and stagnancy of labor productivity after 1995/1996, despite getting increased in the early 1990s and many more (Chaudhuri 2002). Alongside, there was a decline in debt/equity ratios in the majority of industries, especially in new firms consequent to financial reform. The matter of TFP decline was mainly attributed to trade and licensing reforms. However, the reform facilitated the industrial sector in expanding its capacity (Balasubramanyam and Mahambre 2001). While Ahluwalia (2002) considers the 1990s' reform as gradualist, it raises the query of whether it is attributed so by design or the consequence of political constraints. Still, the cumulative impact of 1990s' reform was substantial, and it was successful in creating the basis for accelerated growth.

## 1.4 Bringing Efficiency for Politico-Economic Leadership in South Asia

The collapse of the multipolar and bipolar geopolitical world has made inevitable changes in both the economic and the security model globally. While the earlier security models were mostly based on the balanced confrontation between the

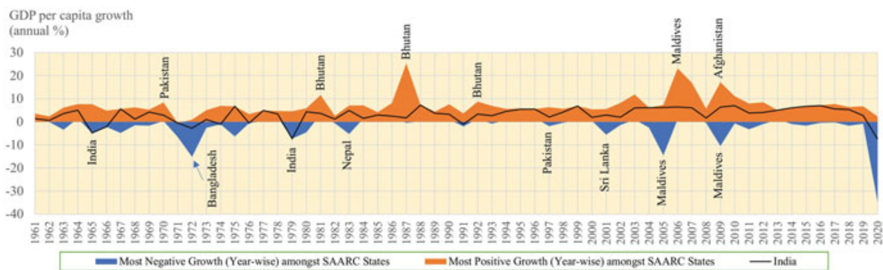
powers or superpowers and their allies, the current security is envisaged as the interdependence and cooperation between states. Moreover, globalization, liberalization, and established institutional structures work as essential stimuli. Similarly, economics in the pre-Cold War world was discussed mostly on a national scale and, to a large extent, a self-sufficient model, which has now significantly included the possibilities of significant external cooperation and foreign affairs agendas. It embraces both the hard (i.e., military) and soft (i.e., nonmilitary) dimensions, and, in some complex cases, the "soft" are now taking the lead over the "hard"—both at the national and international levels (Zukrowska 1996). As Kukuka (1994) mentioned, the size of the country, stability of the economy, stability of the political system, relations with neighbors, ability to adjust to changing internal and external conditions, institutionalization of external relations, and opening up of the economy are the critical factors for "soft" dimensions, and all these are the deciding factors for a state to emerge as a politico-economic leader of a region. A politically and economically stable India could make it executed successfully in South Asia:

> "The enabling and constraining capabilities of India with regard to promoting regional cooperation in South Asia had been discussed even before the conceptual journey of the South Asian Association for Regional Cooperation (SAARC) began in 1983. India occupies a unique position in the South Asian region. By the virtue of its size, location and economic potential, India assumes a natural leadership role in the region."—Bhasin (2008)

The data of the annual change of GDP and inflation over the last 60 years (1961–2021) of the eight SAARC states (i.e., Afghanistan, Pakistan, India, Sri Lanka, Bangladesh, Bhutan, Nepal, and Maldives), retrieved from the World Bank data portal (https://data.worldbank.org/), makes the scope of a comparative discussion amongst the SAARC states' economic portfolio in the last six decades. Plotting of the annual change in GDP and inflation in India with the backdrop of the maximum (keeping "positive" at the ceiling and "negative" at the floor) change of annual GDP (Fig. 1.2a) and inflation change (Fig. 1.2b) makes meaningful interpretation.

From 1992 onward, India's annual GDP change has always been positive until the severe effect of the Covid-19 pandemic on the economy to find a negative change (−7.484%) in 2020. Indian economy witnessed a consistently stable trend since the reform, except abrupt declines from +5.471% (in 1996) to +2.071% in 1997; from +6.851% (in 1999) to +1.965% in 2000; from +6.093% (in 2007) to +1.630% in 2008; and from +7.013% (in 2010) to +3.818% in 2011 to fall into a consecutive declining trend between 2017 and 2020 (i.e., from +6.980% in 2016 to +5.56% in 2017, +5.302% in 2018, +2.6797% in 2019, and −7.48% in 2020) (Fig. 1.2a). While situating the Indian GDP trend within the GDP scenario of the ambient SAARC nations, the post-reform Indian GDP trend looks more robust and consistent than its neighbors.

The trend of post-reform inflation in India is somewhat straightforward up to 2003. There was a gradual and consistent decline of inflation (GDP deflator as annual %) from 1991 (13.751%) to 1999 (3.068%), and it stayed almost stable up to 2003 (3.867%). It was followed by a rising curve to reach the highest in that spell



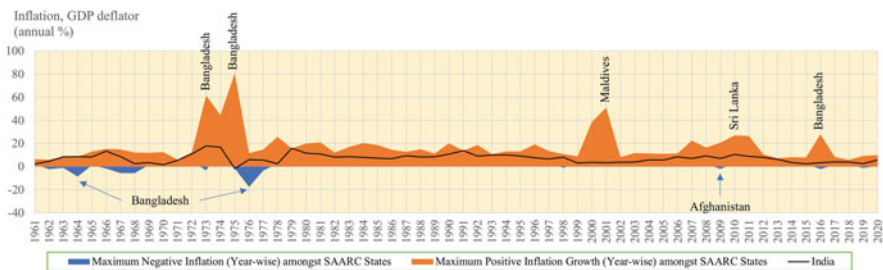




**Fig. 1.2** The most positive and negative annual change in (**a**) GDP and (**b**) its deflator across the last 60 years (1961–2020) in the states of South Asia and India, 1961–2020. (Source: Prepared from the World Bank Data, https://data.worldbank.org/)

in 2010 (10.527%) and then gradually declined to 2.390% in 2019. This trend is robust without any abrupt rise like the Maldives in 2001 (50.892%), Afghanistan in 2007 (22.527%), Pakistan in 2009 (20.666%), Sri Lanka in 2010 (26.934%), Nepal in 2011 (26.397%), and Bangladesh in 2016 (27.850%) (Fig. 1.2b).

The 1990s' economic reform in India took place amidst a rapidly changing global political and economic scenario during the post-Cold War era. While a number of states erupted into internal conflict, another significant number of postcolonial states allowed partial or total liberalization of their commercial regime at the bilateral or less-than-multilateral level (Fawcett 1995; Ravenhill 2008). Alongside, the diminishing trend of "superpower relations" was opening up prospects for regionally preeminent powers to adopt more overt managerial roles in their respective regions (Ayoob 1991). At the recession of the superpowers, the successful practice of the open-market economy and multilateral economic cooperation system was prevailing in many parts of the globe—the Organization for Economic Cooperation and Development (OECD) in the West with Anglo-Saxon members, the noticeable success of the transforming economies of China, the little dragons of East Asia along with their neighbors in the Association of South East Asian Nations (ASEAN), and open economic and trade policies in Latin America, notably in Mexico, were the major propounders. However, better late than never, the South Asian nations took up until 1985 to form the South Asian Association of Regional Cooperation (SAARC),

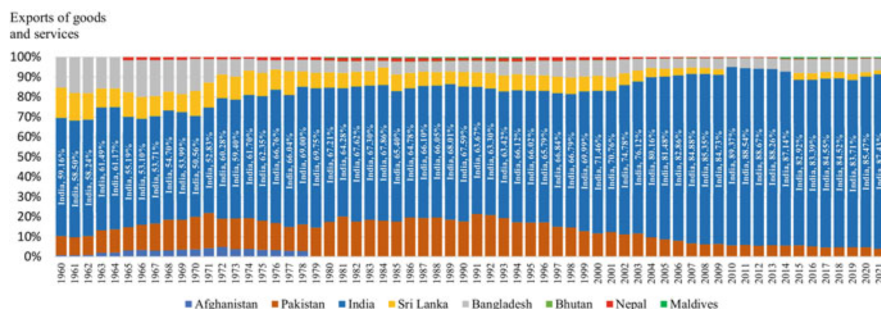



**Fig. 1.3** Share of exports of goods and services in the last 60 years (1961–2020) amongst the SAARC states, 1961–2020. (Source: Prepared from the World Bank Data, https://data.worldbank.org/)

where India was expected to create confidence amongst the members by deeds and words so necessary to make the beginning, and India was referred to as the "key to the development and progress of SAARC."[2]

Amidst several cohesive and tensional forces, 1990s' economic reform of India played a critical role. The structural approach to power considers an advantaged position to India in South Asia historically. India, sharing its international borders with all South Asian countries, enjoys a vital physical link in the region, sharing 72% of the land surface, with 77% of the population of the South Asia (Bhasin 2008).

Amongst the SAARC states, India's export figure had been conspicuous historically (Fig. 1.3). However, the introduction and/or expansion of several export incentives, especially after 1985, helped imports directly when imports were tied to exports and indirectly when relaxing the foreign exchange constraint:

> "Exporters were given REP licenses in amounts that were approximately twice their import needs and thus provided a source of input imports for goods sold in the domestic market. The key distinguishing feature of the REP licenses was that they allowed the holder to import items on the restricted (and therefore those outside of the OGL or canalized) list and had domestic import-competing counterparts. Even though there were limits to the import competition provided through these licenses, as exports expanded the volume of these imports expanded as well. This factor became particularly important during 1985–90 when exports expanded rapidly."—(Panagariya 2004)

Joshi and Little *(*1994*)* ascribed those export incentives as the "quasi-Southeast Asian-style" reforms which included the following:

- 50% of business profits attributable to exports were made income tax deductible in the 1985 budget and were extended to 100% in 1988.
- Interest rate on export credit was reduced to 9%, which was 12% earlier

[2]Address by His Majesty Junius Richard Jayewardene, President of Sri Lanka, at the Fourth SAARC Summit, Concluding Session, 29–31 Dec. 1988, Islamabad, Pakistan, *From SARC to SAARC: Milestones in the Evolution of Regional Cooperation in South Asia* (1980–88) Vol. I, SAARC Secretariat, Kathmandu

- In April 1988, access for exporters to imported capital goods was increased by widening the list of those available on OGL and by making some capital goods available selectively to exporters without going through "indigenous clearance." Assurance was given that the incentives announced in the export-import policy would not be reduced for a period of 3 years.

Now, we should focus on the political stability or fragility in South Asia. The Fragile State Index (FSI) is developed by the Fund for Peace (FFP), an independent, nonpartisan, 501(c)(3) nonprofit research and educational organization that works to prevent violent conflict and promote sustainable security. The FSI has its original methodological concept rooted in FFP's Conflict Assessment System Tool (CAST), developed in the 1990s to help policymakers and field practitioners better understand and measure conflict drivers and dynamics in complex geopolitical environments.[3] The FSI is based on a total of 12 indicators—three cohesion indicators (i.e., C1: Security Apparatus; C2: Factionalized Elites; and C3: Group Grievance); three economic indicators (i.e., E1: Economic Decline; E2: Uneven Economic Development; and E3: Human Flight and Brain Drain); three political indicators (i.e., P1: State Legitimacy; P2: Public Services; and P3: Human Rights and Rule of Law); and three social and cross-cutting indicators (i.e., S1: Demographic Pressures; S2: Refugees and IDPs; and X1: External Intervention). Based on CAST's comprehensive social science approach, data from three main streams (i.e., preexisting quantitative datasets, content analysis, and qualitative expert analysis) is triangulated and critically reviewed to obtain final scores for the FSI. While the index inherently ranks different countries to visualize how some are more fragile or more stable than others, the FSI score (where a higher FSI score denotes higher fragility) of the SAARC states has been picked up for the years of 2006, 2011, 2016, and 2021 (Table 1.2).

While the efforts of liberalization, preferential trade agreements, politico-economic union formations, etc. were empowering the multilateral economic integration, the issues of political fragility of the states were excerpting disintegrative force that had serious repercussions not only for those particular states and their people but also for their neighbors. Postcolonial states in South Asia and the states in sub-Saharan Africa had been witnessing alarming political fragility historically (Fig. 1.4). These have emerged from ethnic tensions, civil wars, or several forms of revolution; whatever the cause might be, they resulted in complex humanitarian emergencies.

South Asia has remained the epicenter of border disputes, military movements, armed standoffs and skirmishes, and even war during the postcolonial era. Since the early 1960s, there has existed an alliance between China and Pakistan. After formally resolving all of its boundary disputes with China through the Sino-Pakistani Agreement of 1963, Pakistan started receiving Chinese military assistance in 1966. It was followed by the formation of a strategic alliance in 1972 and the launch of economic cooperation in 1979 that has been making China the

[3] See the FSI Methodology Handbook available on the URL: https://fragilestatesindex.org/wp-content/uploads/2017/05/FSI-Methodology.pdf.

**Table 1.2** Fragile State Index score and rank of the SAARC states in the years 2006, 2011, 2016, and 2021

| Country | FSI 2006 | | FSI 2011 | | FSI 2016 | | FSI 2021 | |
|---|---|---|---|---|---|---|---|---|
| | Rank | Score | Rank | Score | Rank | Score | Rank | Score |
| Afghanistan | 10th | 99.8 | 7th | 107.5 | 9th | 107.9 | 9th | 102.1 |
| Bhutan | 39th | 87.9 | 50th | 85 | 78th | 77.6 | 96th | 68.3 |
| India | 93rd | 70.4 | 76th | 79.3 | 70th | 79.6 | 66th | 77 |
| Maldives | n.a. | n.a. | 91st | 75.6 | 91st | 74 | 99th | 67.6 |
| Sri Lanka | 25th | 92.4 | 29th | 93.1 | 43rd | 87.7 | 55th | 80.5 |
| Pakistan | 9th | 103.1 | 12th | 102.3 | 14th | 101.7 | 29th | 90.5 |
| Bangladesh | 19th | 96.3 | 25th | 94.4 | 36th | 90.7 | 39th | 85 |
| Nepal | 20th | 95.4 | 27th | 93.7 | 33rd | 91.2 | 51st | 82.2 |

Source: Official website of the Fragile State Index, https://fragilestatesindex.org

largest supplier of armaments and the third largest trading partner overall to Pakistan. Gradually, Beijing took a central part of Islamabad's foreign policy. On the military front, the People's Liberation Army and the Pakistan Armed Forces started sharing a notably close relationship. While Beijing started supporting Pakistan's position on the Kashmir conflict, Islamabad started seconding the Chinese stance on the Xinjiang controversy, the sovereignty of Tibet, and the Taiwan issue. The conflicting and competing interests between India and the China-Pakistan alliance resulted in a complex situation in South Asia. Amidst the power tussle between the USA, the "defending champion," and China, a strong contender for sharing the domination, the emergence of an economically and politically strong India as the regional politico-economic leader of South Asia could be the solution for peace and stability in the entire region, the cornerstone of which was laid in the 1990s' economic reform.

## 1.5 Conclusion

1990s' India, which was then emerging as the regional politico-economic leader, has transformed itself into the fifth largest economy of the world within the latter three decades by virtue of effective democratic governance, rational public policies, and internal political stability. An overly regulated economy, inadequate state capacity, complex state-society relations, and limited rationalization across state and society writ large, most of which persisting since India's emergence as an independent nation, pose challenges to its accelerated growth. However, the post-reform period has demonstrated the country's ability to achieve multidimensional success in terms of improving its economic performance and comprehensive regional integration, coupled with sustaining its democracy successfully. From the abysmal 3.5% annual growth until the 1980s, the reforms accelerated the improving 5.5% growth rate to

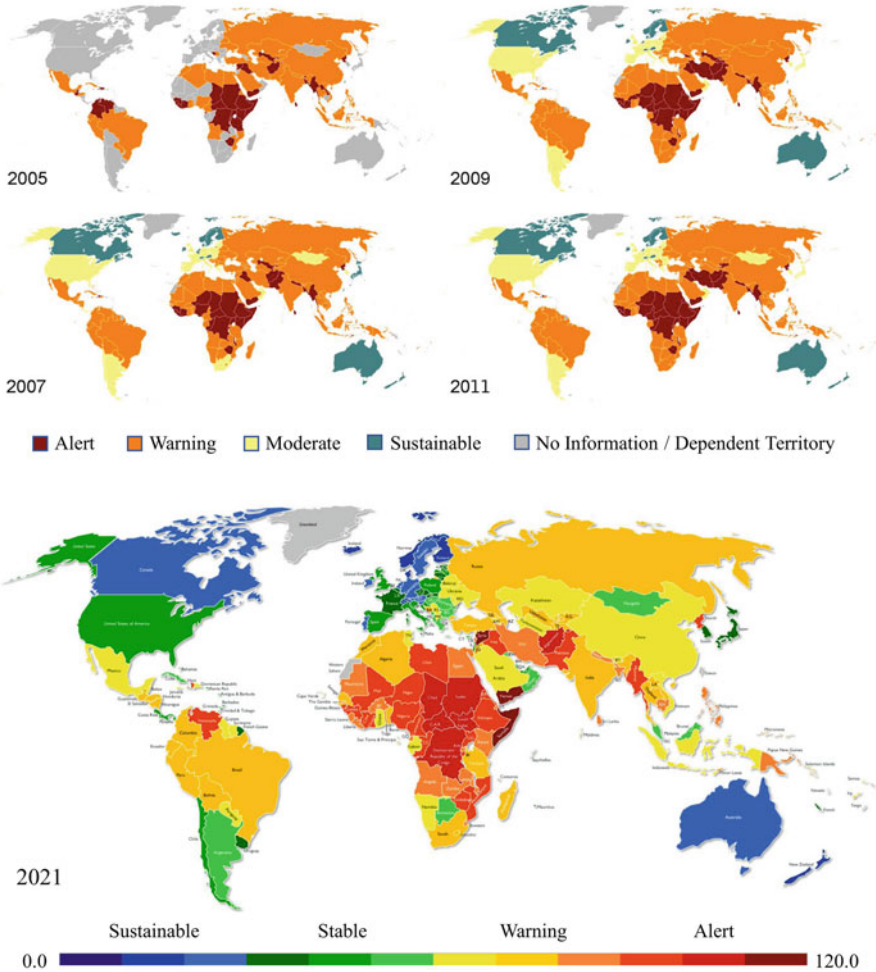



**Fig. 1.4** The status of political fragility across the world, and, especially to the South Asia, as envisaged by the Fragile State Index (FSI), developed by the Fund for Peace (FFP), an American nonprofit, nongovernmental research and educational institution, founded in 1957

the 7% demonstrated since the new millennium. The country is determined to expand specific forms of collaboration, evidenced by its efforts to build strategic partnerships with more than 30 different countries globally. Presently, India has been advocating in a focused way to enact policies and build institutions towards ensuring self-reliance (*atmanirbhar*) in all facets of the economy. Its goals are multi-dimensional and broad, as mentioned by the Prime Minister of India that,

> when India speaks of becoming self-reliant, it doesn't advocate a self-centred system. India's self-reliance is concerned with ensuring the whole world's happiness, cooperation and peace. A quarter of a century ahead of the economic reform, India's role in successfully

blending the democratic governance, the self-reliant economy, and the robust effort of peace-making with an advantageous geostrategic positionality sounds promising in advocating stability and achieving sustainability in South and Southeast Asia.

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