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A Decade of Economic Reforms: Political Discord and the Second Stage

Losing Momentum

Gains from the economic reforms introduced after the 1991 debt crisis by the Congress (I) government led by Prime Minister Narasimha Rao and his Finance Minister Dr. Manmohan Singh created a massive bubble of hope. Starting in June 1991 with devaluation of the rupee by 20 percent and abolition of export subsidies, the government pursued a new vision of a self-reliant economy under conditions of integrated global markets. Drastic reduction in the number of industries reserved for the public sector and removal of compulsory licensing and registration for the vast majority of industries paved the way for policies to provide producers with technology and access to imports at reasonable rates, along with foreign investment to "progressively integrate the Indian economy with the world economy."[1]

Over five years the package of policies, gradually implemented, lowered peak tariffs from more than 300 per cent to 50 percent, progressively reduced Quantitative Restrictions (QRs) on imports, pushed down average tariffs on raw materials, capital goods, electronic components and application software to about 20-25 percent, achieved convertibility of the rupee on current account, welcomed foreign investment, especially in critical infrastructure sectors like power, allowed foreign pension funds and institutional investors to invest in India's capital markets, established the Securities and Exchange Board of India (SEBI) to regulate the stock markets, set up a modern National Stock Exchange, created the National Renewal Fund to retrain workers, and simplified and lowered corporate and personal taxes to encourage compliance and increase collection.

The cumulative impact of all these measures pushed up the annual growth rate to 7.8 percent by 1994-95. By 1996-97, the third year of above 7 percent growth, it began to seem as if sustainable growth rates of 7-8 percent per annum were within reach. The Finance Minister, P. Chidambaram, despite the problems of dealing with the successor United Front coalition government, presented his 1997-8 budget with the hope that a concerted effort could produce sustained 8percent annual growth and eliminate the poverty of five thousand years "in my lifetime."

India's potential for high growth caught the attention of multinationals led by U.S. Fortune 500 companies. Foreign Direct Investment (FDI) steadily edged up to a little more than $3 billion in 1997-98. And before the beginning of the Asian financial crisis, Foreign Institutional Investors (FII's) signaled growing confidence in India as the destination of choice for portfolio investment in developing countries. In 1996-97, for the first time since the reforms were introduced, India edged out Brazil, China and the Southeast Asian countries in the competition for portfolio equity flows.

In 1996-97, for the first time since the reforms were introduced, India edged out Brazil, China and the South-east Asian countries in the competition for portfolio equity flows.

In retrospect, as shown by the Economic Indicators below, 1996-97, the third consecutive year in which GDP growth topped 7 percent also was the year in which serious doubts began to surface that India had reached a higher plateau of development.

Most prominent of the warning signs that surfaced in 1996-97 was the sharp decline in growth of industrial production to 5.6 percent (from the peak performance of 12.7 percent in 1995-96), and the steep slide in the annual increase of exports to 5.2 percent (from 21 percent in the previous year). The break in industrial momentum and the slowdown in exports was accompanied by a similarly large deceleration in import growth, marked decline in key infrastructure sectors, reduction in corporate demand for bank credit, and a depressed stock market. Unlike 1994-95 and 1995-96, when all sectors of the economy, except agriculture, showed robust gains, 1996-97, showed an unusually large spurt in agricultural production at 9.3 percent that powered the third year of record growth.

Portfolio Equity Flows

US$ Millions

	1992	1993	1994	1995	1996
Brazil	1,734	5,500	5.082	4,411	3,981
China	1,194	3,818	3,915	2,807	3,466
India	241	1,840	4,729	1,517	4,398
Indonesia	119	2,452	3,672	4,873	3,099
Malaysia	385	3,700	1,320	2,299	4,353
Thailand	4	3,117	-538	2,154	1,551
Philippines	333	1,445	1,407	1,961	1,333
All Developing Countries	11,000	45,000	33,000	32,000	46,000
India's Share (%)	2.9	4.09	14.33	4.74	9.56

Source: *Economic Survey 1997-98*, p. 88.

Economic performance in

Economic Indicators

US$ Millions

	1990-91	1991-92	1992-93	1993-94
GDP Growth (annual rate %)	5.4	0.8	5.1	5
Fiscal Deficit (actual as % of GDP)	8.3	5.9	5.7	7.5
Current Account Deficit (% of GDP)	3.2	0.4	1.8	0.1
Export as percentage of Imports	66.2	86.7	81.2	90.5
Foreign Exchange Reserves	2,236	5,631	6,434	15,068
Export Growth (annual rate %)	9.23	-1.54	3.76	19.97
Industrial Product Growth (annual rate %)	8.25	0.61	2.34	5.98
Savings (as % of GDP at Current Market Price)	24.3	22.8	22.1	23.1
Investment (as % of GDP at Current Market Price)	27.7	23.4	24	23.6
Foreign Investment Inflows				
Portfolio Investment	NA	8	246	3,649
Direct Investment	68	154	344	586

Source: *DBI*

the next two years indicated that the setback was not just a temporary downward correction. In 1997-98, when agricultural growth plummeted, the deceleration in the growth of industry and exports stood out in sharper relief. Annual GDP growth fell to 5 percent. Even this figure understated the real decline. The effective GDP growth rate amounted to approximately 4 percent, after subtracting one percentage point contributed by the pay increases awarded by the Fifth Pay Commission for government servants and included in the sub-sector of "public administration and defense."[2] In 1998-99, strong agricultural growth again compensated for decline in industrial production by 3.8 percent and negative growth in exports, although the official estimate of 5.8 percent annual GDP growth has been questioned.

Skeptics cite the release of a new GDP series by the Central Statistical Organization shortly before the 1999-2000 budget proposals, changing the base year from 1980-81 to 1993-94. The 1993-94 series which included many new items produced in the unorganized sector was constructed on the basis of sample data, in contrast to the census of establishments carried out for the earlier series. In itself, this does not present a serious problem. But an appearance of statistical manipulation was created by the Finance Ministry's official estimate of 5.8 percent GDP growth rate (close to the 6 per cent target) only weeks after the respected Centre for Monitoring Indian Economy (CMIE) projected the 1998-99 growth rate at 4-4.5 percent.

Whatever distortions may have crept into the macroeconomic data, there is ample evidence to show that a major cause of declining momentum in GDP growth has been the failure of successive governments to curb borrowings required to finance the operations of the central government, and to provide capital investment on infrastructure as well as higher outlays on agricultural and social development. Compared to the goal first set by Dr. Manmohan Singh in the early 1990's, of reducing the fiscal deficit to 3.5 percent from the crisis level of 8.3 percent in 1990-91, the fiscal deficit as a proportion of GDP had crept back up to over 6 percent by 1998-99. The consolidated government deficit, including shortfalls at the states, reached approximately 8 percent of GDP.

Economic Indicators

US$ Millions

	1994-95	1995-96	1996-7	1997-8	1998-9
GDP Growth (annual rate%)	7.8	7.6	7.8	5.0 (4.0)	5.8
Fiscal deficit (actual as % of GDP)	5.6	4.9	4.7	5.7	6.5
Revenue Deficit (% of GDP)	3	2.4	2.3	2.8	2.7
Exports (% change)	18.4	21.1	5.2	4.6	-4
Imports (% change)	22.9	28.4	6.6	6.1	0.8
Exports (% of GDP)	8	8.7	8.4	8.3	8
Foreign Exchange Reserves, March-end	20,809	17,044	22,367	25,975	29,567
Industrial Production Growth (annual Rate%)	8.4	12.7	5.6	6.6	3.8
Agricultural Production (% change)	4.5	-2.1	9.3	-5.4	6.8
Services (annual rate%)	7.8	7.6	7.8	5	5.8
Savings (% of GDP at current Market price)	24.2	24.1	24.4	23.1	
Investment (% of GDP at current Market price)	25.4	25.8	25.7	24.8	
Foreign Investment Inflows					
Portfolio Investment	3,579	2,661	3,312	1,826	1,000
Direct Investment	1,228	1,943	2,526	3,165	2,000

Source: *Economic Survey 1998-1999, pp. 3, 24; "Monthly Review of the Indian Economy," CMIE, June 1999, pp. 4-8.*

** Estimate of India's Finance Minister, Yashwant Sinha, July 28, 1999.*

There are, of course, major differences in India's macroeconomic fundamentals between 1990-91 and 1998-99. In 1990-91, the fiscal deficit ballooned because of combined internal and external debt. Deficits in the balance of payments pulled up by short-term commercial borrowings from foreign private institutions depleted India's foreign exchange reserves, and brought the economy to the brink of default. The fiscal deficit in 1998-99 is primarily based on domestic borrowings. Foreign exchange reserves are about twice the level of short-term debt, including portfolio investment, and total debt service is around 45 percent of exports.

Nevertheless, the chronic inability of successive governments to meet their own targets for reducing the deficit, and the return to high levels of borrowings, has significantly contributed to the factors that are stunting growth. Revenue deficits which decreased sharply from 3.2 percent of GDP in 1990-91 to 2.3 percent in 1996-97 have reversed course and reached approximately 2.7-2.8 percent in the past two years. By 1998-99, the revenue deficit was estimated at 53 percent of the gross fiscal deficit compared to about 32 percent before the economic reforms. Government borrowings to cover this gap are increasingly being used to finance current expenditure. Capital expenditure which accounted for about 33 percent of total government expenditure before economic reforms, declined to 22 percent in 1998-99. The Finance Ministry has warned that Government borrowings are competing with the private sector for public and private funds, driving up financing costs, and making private investment less attractive, particularly in infrastructure projects which require very large outlays and produce returns only after long gestation periods. If the interest rate on debt as a percent of GDP becomes higher than the growth rate, the fiscal deficit will also become unsustainable. This situation loomed as an imminent danger in 1998-99 when the fiscal deficit reached 6.5 per cent of GDP (compared to the target of 5.6 per cent), and the Finance Minister, Yashwant Sinha, responsible for piloting the reforms under a B.J.P.-led coalition turned caretaker government, warned that "an internal debt trap" was around the corner.

The International Economic Environment

The Asian financial crisis beginning in June 1997, and its dramatic effect in depressing world growth to less than 2 percent in 1998 can appear to offer an obvious reason for the sharp decline in India's exports and decrease in overall growth. Yet, while India's negative growth in exports in 1998-99 did owe a great deal to shrinking demand in Southeast Asia and Japan, the fact is that the marked slowdown in GDP growth affecting virtually all sectors, including exports, predated the Asian crisis. The sharpest fall in export growth occurred in 1996-97, when world trade growth was still high (at 6.6 percent), and continued to decline in 1997-98 when India's major trading partners, the United States and the European Union, accounting for about 55 percent of all India's exports, continued to absorb about the same share. By contrast, all of Asia (exclusive of Japan) accounted for about 21 percent to 23 percent of India's exports.

The rather laconic observation of the Finance Ministry's *Economic Survey 1998-99* that "India was not wholly immune to unfavorable developments" in the international economic environment seems a fair assessment that implies the turbulent conditions in much of the world economy affected India only in a modest way. There are good reasons for this, the most important being India's relatively weak links with markets in Asia, and incomplete integration with the global economy. Unlike the Southeast Asian countries, whose exports constituted about 30 to 40 percent of GDP, India's exports made up about 8 percent of GDP. India's share of world exports, reflecting the weak competitive position of the majority of export goods, was about 0.62 percent in 1997 (compared to 3 percent for China).

The economy was also inoculated against the contagion of capital flight which resulted in the sharp devaluation of the Russian ruble and the Brazilian real. The government's policies, going back to the early years of economic reforms, prohibiting convertibility on capital account and restricting short-term borrowings by private companies from foreign banks, removed India's

Direction of Trade: Exports

	1994-95	1995-96	1996-97	1997-98
EU	26.7	26.5	25	25.2
USA	19.1	17.4	19.6	19.5
Canada	1	1	1.1	1.2
Japan	7.7	7	6	5.5
Russia	3.1	3.3	2.4	2.6
Saudi Arabia	1.7	1.5	1.7	2
Africa	2.5	3.4	2.9	3.2
Asia	20.1	21.3	22.9	21.3
Latin America	1.3	1.1	1.3	3.8

Source: *Economic Survey 1998-99.*

currency from the hit list of foreign speculators. On the contrary, the Reserve Bank of India (RBI) followed guidelines approved by the Finance Ministry which ruled out a significant devaluation of the rupee. The RBI sustained a "managed float" resulting in a depreciation of about 17 percent which even brought some positive results. At a more realistic exchange rate, remittances from overseas Indians increased to about $1.1 billion a year. The prolonged recession also resulted in declining costs of oil imports as prices dropped. And a boom in software exports at $2.6 billion in 1998-99 contributed to a decrease in the current account deficit while foreign currency reserves continued to grow.

The announcement by the BJP government of a series of nuclear tests in May 1998, (followed by those of Pakistan) converted the pre-existing caution of multinationals about new investment in India into virtual paralysis, particularly among US investors.

The most difficult costs to absorb came from competitors, whose currencies sharply depreciated in value, allowing them to sell similar commodities and manufactured products at cheaper prices in India. This raised the alarm among domestic producers that they would have to take losses from cutting their own prices to preserve market share against countries like China and South Korea that were accused of "dumping" their products in India.

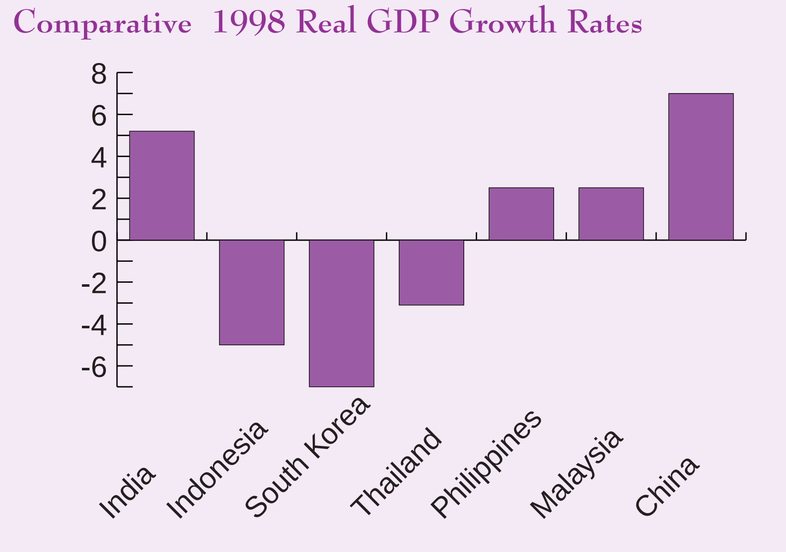
The damage from declining investment inflows, while real, was contained. Negative inflows in portfolio investment in 1997-98 and 1998-99, measured against the peak inflow of $3.6 billion reached in 1994-95 were moderate at about $2.3 billion. Some amount of the decline in foreign portfolio investment and especially in Foreign Direct Investment (FDI), moreover, cannot be attributed to the fallout of the Asian financial crisis. The ratio of FDI inflows to FDI approvals had been slowly increasing from 17.5 percent in 1995-96 to 22 percent in 1996-97 and peaked at 29 percent in 1997-98. This rise was reversed in 1998-99 when the ratio fell back down to 22 percent, pushing absolute amounts of FDI down to l995-96 levels at $2 billion.

The slowdown reflected 2 different factors. The first was a reappraisal by multinationals, led by U.S. investors, about the risky investment climate created by growing political uncertainty. Two United Front minority coalition governments collapsed within eighteen months and the February-March 1998 elections produced an even more fragmented governing coalition led by the Bharatiya Janata Party (BJP). The BJP, moreover, had campaigned on a platform of economic nationalism that attacked the Congress government for foisting "phony liberalization" upon the country, thereby ushering in "a period of record loot under which foreign companies flourished and the Indian ones floundered." They advocated the idea of "Swadeshi" or "India First" which stressed protection for domestic industrial, financial and service sectors for several years until India's economy could become globally competitive.[3]

The second factor, the announcement by the BJP government of a series of nuclear tests in May 1998, (followed by those of Pakistan) converted the pre-existing caution of multinationals about new investment in India into virtual paralysis, particularly among U.S. investors. The tests triggered U.S. laws imposing economic sanctions on India. These included suspension of loans and loan guarantees for U.S. multinationals planning investments in India, by the Export-Import Bank and the Overseas Private Investment Corporation (OPIC). The U.S. also took the lead in persuading the G-8 not to facilitate private borrowings by Indian firms, or to support new loans to India from international lending institutions. A number of Indian firms had to cancel GDR and External Commercial Borrowings pushing up interest costs on new loans. Most U.S. companies put new projects on hold. The loss to India's economy in FDI cannot be exactly measured, since some foreign investors probably would have postponed plans to enter the Indian market on the strength of their doubts about the investment climate alone. But, according to estimates by the Confederation of Indian Industry (CII) the opportunity costs to India were approximately $2-$3 billion. Another $2 billion in new loans were suspended by the World Bank, although enough funds were in the pipeline to avoid an immediate blow.

The sanctions did relatively little damage before the first moves by the Clinton Administration to lift them after the U.S. Congress in October 1998 empowered the President to do so in response to progress made in several rounds of a non-proliferation dialogue between Deputy Secretary of State Strobe Talbot and India's Minister of External Affairs Jaswant Singh. Partial lifting of sanctions in November 1998 restored support of the EXIM Bank, OPIC and Trade and Development Agency (TDA) to lending programs for U.S. business entering India, as well as U.S. bank lending to the Government of India. The Clinton Administration still withheld U.S. approval for loans by international financial institutions for India, and continued restrictions on U.S. export of "dual use" technologies that could have military applications. Export controls were actually tightened by the Commerce Department, which published an "Entities List" in November 1998. The Entities List specified that U.S. corporations were required to apply for a government license to engage in trade with 40 public sector and private companies and their 200 subsidiaries, including sub-contractors involved in nuclear, missile or military research and production. The export controls, which prevented imports by a broader range of Indian companies than previously existed, hardly had a serious effect on the Indian economy as a whole, but created anger in the Indian Government, scientific community and corporate sector against coercive action criticized for interfering with the free flow of trade, technology and finance. This scenario still has to play itself out. The U.S. Senate, in June 1999 set in motion a legislative process that aimed at suspending all sanctions for at least five years. But the timetable for implementation became uncertain after India announced a proposed nuclear weapons doctrine in August 1999 based on a triad of land, air and sea delivery systems.

Ironically, the long way that India has to travel before becoming a major player in the world economy



Source: IMF, *World Economic Outlook*, May 1998.

can be measured by the minimal effect of all this external turbulence on GDP growth. At the height of the 1998-99 crisis, simply by staying steady at roughly the same rate of 5- 5.5 percent growth as in 1997-98, India emerged with virtually the highest real GDP growth among developing countries in Asia.

Among the technocrats who had played a leading role in crafting the 1991 economic reforms, the response was one of satisfaction at their own good economic management, especially the refusal by then Finance Minister Manmohan Singh to accept the International Monetary Funds' advice to introduce full convertibility of the rupee, and the Reserve Bank's policies restricting foreign lending, which had moderated any serious spillover from the crisis; yet, this was tempered by recognition that the crisis revealed larger structural problems in India's exports, and by extension the long-term competitiveness of Indian industry.

The strong surge in India's exports during 1994-95 and 1995-96 owed a great deal to the competitive boost derived from the 20 percent devaluation of the rupee against the dollar in July 1991, followed by phased elimination of Quantitative Restrictions on hundreds of imports and removal of excises on exports. Once the benefits from these reforms peaked, a closer look at factors responsible for the declining rate of export growth brought into sharp focus a host of limiting conditions. The most important of these is the continuing preponderance of low value primary products and manufactured goods in India's exports. Policies providing reservation of hundreds of manufactured products for Small Scale Industries (SSI's) to maximize employment, also resulted in proliferation of plants below the minimum economic scale and unreliable quality of products, notwithstanding that SSI's accounted for about 35 percent of India's exports. Related to this, high tariffs on import of synthetic fibers and restrictions on technology imports to modernize textile mills placed India at a competitive disadvantage once China's textile exports entered an upward spiral. In addition, low levels of investment by major Indian corporations in R&D, upgraded technology, advertising and packaging, and the lack of recognized Indian brand names, reflected the continuing preference of domestic producers for the relatively protected internal market. Finally, infrastructure bottlenecks including breakdowns in power supply, poor road, rail and air transportation, and turnaround times of over one week for ships in major ports also discouraged multinationals from considering India as an export platform. Only exports of pharmaceuticals and software showed impressive growth, reflecting a combination of favorable import policies, long-term corporate commitment to competitive export strategies and insulation from infrastructure weaknesses.[4]

The Asian crisis highlighted more than the structural weaknesses undermining India's efforts to achieve global competitiveness. It also illuminated the long-standing failures of policy-makers to address the root causes of these limitations.

India's problems are embedded in the domestic, political and cultural environment which has cross-pressured policy-makers since the early years of economic reforms. In practice, no party, including the Congress-I, ever succeeded in forging a political consensus on the second stage of reforms. The result, manifest since the mid-1990's, is that cohesive groups which oppose key elements of the unfinished agenda, are able to hold minority governments and unstable coalitions to ransom on moving forward.

The Unfinished Agenda

Few politically influential groups outside the technocrats concentrated in the Ministries of Finance, Commerce and Industries believe that economic liberalization can achieve all that is claimed for it: an overall increase in productivity; conditions for a rapid expansion of exports; job creation to absorb new entrants in the labor force; annual growth rates of 7 to 8 per cent; and elimination of hard core poverty in ten or fifteen years. Rather, as Dr. Manmohan Singh obliquely recognized in virtually every budget, some Members of Parliament and important sections of their constituencies including Indian business, harbored the "fear of the East India Company," in a new guise as multinational investors, and worried that lower duties would create a flood of imports leading to the "deindustrialization" of India. In his last full budget presented on March 15, 1995, the Finance Minister took a final opportunity to restate the inspiration for the Government's economic policies of a "resurgent India, taking her rightful place as an economic power house in Asia." But he also acknowledged the "vast unfinished agenda", and the "partisan strife" that could prevent India from seizing the unprecedented opportunities for achieving excellence and social justice.

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At the top of the unfinished agenda is the objective of reducing the fiscal deficit. In part, the difficulties of accomplishing this reflect the persistent revenue constraints within which Government operates, representing fixed payments on accumulated debt, as well as increases for defense and public administration. The gradual reduction of import duties, excises and income taxes, which produced losses in government revenue, could be only partially offset by efforts to tax services, introduce estimated income tax schemes for businesses in the unorganized sector, broaden compliance by simplifying and reducing personal and corporate taxes, and undertake sale of partial equity in selected public sector enterprises.

More basic, the continuing pressure on the deficit comes from the slower pace of industrial growth and exports than targeted and the associated shortfall in tax collections. But even more fundamental, is lack of political consensus on the pace and sequence of the next stage of economic reforms required to rapidly increase GDP growth.

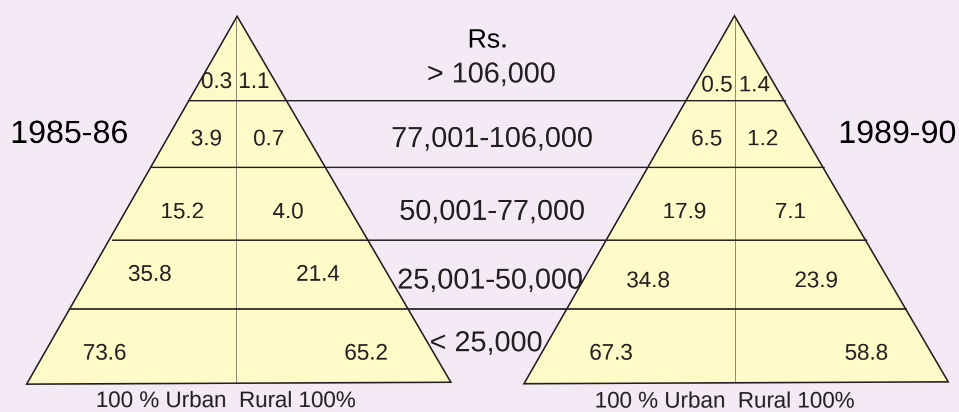
The economics of sustaining annual growth rates of 7-8 percent are not in dispute. One prerequisite is to increase the rate of investment from 25 percent of GDP to about 30 percent. But while the rate of private savings at about 22.7 percent in 1994-95 was respectable compared to other fast growing countries in Asia, the public sector savings rates at 1.7 percent of GDP compared "very unfavorably". At a minimum, this level has to be pushed up to at least 5 percent. Yet the national political consensus required to close down loss-making public sector units and carry out a substantial program of privatization of non-strategic public sector industries, including an exit policy for redundant workers, has yet to materialize. Another clear requirement is to bring down the substantial drain on central and state government finances by cutting back hidden or "non-merit" subsidies on social and economic services. In 1994-95, the aggregate cost of these subsidies constituted 14.4 percent of GDP, with those on "merit" goods involving significant externalities, accounting for less than 1 percent of GDP, and subsidies justified on grounds of income distribution, for example, food, making up less than 2 percent. Altogether, "non-merit" subsidies amounted to 10.7 percent of GDP, of which almost 90 percent was from unrecovered users' costs, particularly from consumers of power and irrigation. Such consumers constitute a vast constituency spilling over the divide between rural and urban areas that no party wishes to antagonize. Finally, the public sector banking system is in need of substantial restructuring. At present, 9 percent of its assets are tied up in non-performing loans, and these have to be liquidated to make larger funds available at lower costs for productive investments.

One result of these domestic constraints on raising internal resources is to place a premium on attracting larger inflows of foreign private investment which peaked at about $3 billion in 1997-98. By contrast, in January 1997, the Chief Ministers of the states, meeting at the National Development Council estimated the need for FDI at $10 billion per annum for 5 years with 3 to 4 billion of this amount earmarked to finance efficient and cost-effective infrastructure. In August 1998, Indian trade bodies estimated that the country needed a total of $200 billion in investment, domestic and foreign, by 2002 to increase power output and improve infrastructure in telecommunications, ports and roads. The prospect of raising such enormous sums from the domestic private sector and multinationals depends not only on ending central and state government monopolies in power (1991), telecommunications (1994), as well as insurance, but on setting up transparent regulatory frameworks and assuring remunerative prices for the services provided.

The unfinished agenda comes up against a coalescence of strong constituencies which anticipate losses from rapid implementation of the basic design of economic reforms. They include the middle classes, rural and urban, who are the primary beneficiaries of subsidies on fertilizer, power, and telecom costs; trade unions whose members will lose jobs from restructuring of the public sector, estimated to have 1,000,000 redundant workers; political parties ideologically committed to government control of utilities and communications and/or to protecting India's basic services from foreign control; bureaucrats reluctant to give up patronage and power over government monopolies in infrastructure sectors, and the aspiring sections of the lower caste cultivating peasantry who demand larger allocations for rural development.

A political consensus among all of these groups, difficult as it would be to achieve in India's democracy, still does not offer a solution to the most serious social consequences of the economic reforms. Unless the budgetary resources released by reducing the deficit are also reallocated to provide a substantial increase in investment for the social sectors, the bottom 36 percent of India's population (320 million in 1993-94) will continue to live below the poverty line, with no prospect of even primary school education, adequate nutrition and protection from infectious diseases. Indeed, relying on higher growth rates alone to ameliorate poverty would require 10 years of 7.1 percent GDP growth to cut in half the percentage of population living below the poverty line.[5]

Distribution of Household Annual Income



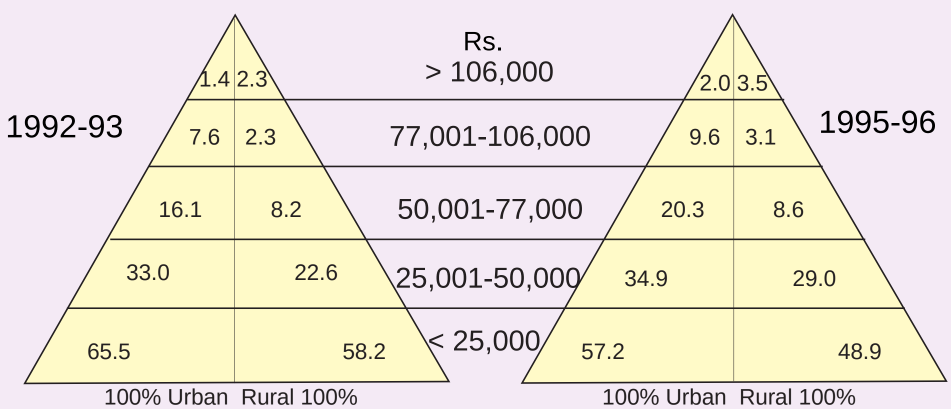
Source: I. Natarajan, *India Market Demographics Report 1998.*

Meanwhile, disparities will widen between income groups in urban as well as rural areas. While households in the upper income groups (with annual income of Rs.50,000 or more in 1995-96), accounting for 32 percent of urban households and 15 percent of rural households had increased by almost 67 percent compared to the pre-reform period, the rate of decline in the much larger low income groups of over 57 percent in urban areas and 48.9 percent in rural areas (with annual income of Rs. 25,000 or less in 1995-96) had fallen by about 10 percent relative to the pre-reform period.

Moreover, estimates of the size of the Indian middle class, based mainly on the distribution of household income, have proved too optimistic. The figures, widely cited in the mid-1990's, of consumer classes on the order of 200 to 300 million were substantially inflated. Using household income along with several other variables, such as whether a household is urban or rural, the level of education of household members, the type of housing and what range of durable goods these households are likely to own presents a very different picture.

According to these criteria, about 62 million of India's 180 million households would not own even the most basic consumer items; another 41 million are likely to possess a bicycle, radio or a fan, while only 21 million households own all three of these. This means that 124 million households or nearly 70 percent of the population is not integrated into the market for western-style consumer goods. At the other end of the spectrum, one to two million households with an annual income equivalent to US$10,000 come closest to the living standards of the American middle class. They can afford such possessions as a car, an air conditioner and a computer. Another nine million households own a color TV, scooter, household appliances, and may reasonably aspire to acquire a car or a computer. Altogether, these households make up about 40-50 million people that are the real market for most consumer durables.

Distribution of Household Annual Income



Source: I. Natarajan, *India Market DemographicsReport 1998.*

The new estimates suggest a demographic drag on rising growth rates for lack of robust domestic demand. They also serve notice of a greater political danger. This is increasing alienation among the absolutely deprived, and unemployed youth experiencing relative deprivation in the 35 million households which can afford only lower cost items best symbolized in the ownership of a television set. The danger that crime, or communal conflict, already on the increase, can deteriorate into a situation of violence and chaos amid so much poverty is well understood by the very policy-makers who fail to implement their own reforms. Finance Ministers, whether in the Congress (I) government or the BJP-led government have similar worries. *The impoverished rural poor do not any longer need to walk twenty miles to see how rich people live in cities. They are able to see this on television, which magnifies disparities further by the use of glamorous advertisements. Frustrated people without jobs or prospects are likely to turn to violence.*

Problems of Political Consensus

Pre-1991

Almost all of the fiscal pressures which ultimately resulted in the 1991 economic reforms by the Congress (I) government of Prime Minister Narasimha Rao were evident a decade earlier. The central government's fiscal deficit reached 6 percent of GDP in 1980-81 and rose to 9.3 percent in 1985-86, climbing to 10.9 percent in 1986-87 with minimal reductions in the years leading up to 1990-91. Overall, India had lost considerable ground in the relative size of its industrial economy, falling in rank from 13 to 27. In absolute terms, India's manufacturing sector was about half the size of that of Brazil's or China's and about equal in size to South Korea. Total manufactured exports fell from an already infinitesimal 0.6 percent to 0.4 percent of world exports between 1976 and 1983, at the same time that the share of developing countries in the export of manufactures increased from 15.9 percent to 17.5 percent. Even though imports were low (about 7percent of GDP), current account deficits began to widen. By 1986-87, the debt service ratio on loans to cover the external gap in resources had risen to more than 24 percent.

The changes were resisted as a departure from Nehru's policy of self-reliance and Indira Gandhi's pro-poor programs.

Yet no consensus existed within the Congress party for a departure from the socialist pattern of planned development led by the public sector, and identified with self-reliance, limited investment by multinationals, dispersion of industries, employment generation and commitment to over-all "pro-poor" policies. In the early 1980's, under Prime Minister Indira Gandhi, a very cautious policy of piecemeal economic liberalization was pursued. Successor governments, headed by Prime Minister Rajiv Gandhi (1984-89), and Prime Minister V.P. Singh (1989-90) quickened the pace of deregulation: the list of industries exempted from licensing was enlarged; quotas on imports of raw materials, components and capital goods were selectively replaced by tariffs; and the restrictions imposed on the larger business houses against expansion were eased. Yet Rajiv Gandhi, whose Congress (I) party had won 48 percent of votes and 80 percent of seats in the Lok Sabha in December 1984, came up against a political brick wall when his own party refused to endorse a New Industrial Policy, advocated by his closest advisors and senior officials in the Ministries of Finance and Commerce, and in the Planning Commission, for an integrated strategy of economic liberalization. The changes were resisted as a departure from Nehru's policy of self-reliance and Indira Gandhi's pro-poor programs.

Rajiv Gandhi's Congress (I) lost the watershed election of November 1989, on issues of corruption and communal conflict that had little direct connection with the economic reforms agenda. The Congress (I)'s popular vote declined to 40 percent, but its share of seats in the Lok Sabha fell disproportionately to 197 (of 529 seats). The defeat foreshadowed the eclipse of the Congress as the party of national consensus in the face of two diverse opposition groupings, the National Front, a coalition of political fragments and regional parties dominated by the Janata Dal with a support base among the lower caste cultivating peasantry, and the Bharatiya Janata Party (BJP), disproportionately upper caste and urban, and committed to "Hindu secularism", a concept equating Indian culture with Hindu identity.

The successor National Front minority government led by Prime Minister V.P. Singh was initially supported in the Lok Sabha by the BJP as well as the left parties. Nevertheless, the Government's announcement that it would implement the 1980 Mandal Commission's recommendations to reserve 26 percent of all posts in the elite Indian Administrative Service and Indian Police Service for disadvantaged candidates among lower castes or Other Backward Classes (OBC's) and Muslims transformed Indian politics. It clashed with the BJP's strategy to consolidate the Hindu vote across caste lines, evident in the party's active support for the campaign by the Vishwa Hindu Parishad (VHP, World Hindu Council), to "liberate" the Babri Masjid (mosque) at Ayodhya in Uttar Pradesh and to build a Ram Mandir (temple) on the site believed to be the birthplace of Lord Ram, (Ram Janmabhoomi). In North India conflicts between Forward Castes and Other Backward Classes over reservations, and polarization between Hindus and Muslims over possession of the disputed site, dominated the political arena and pitted the advocates of Mandal vs. Mandir against each other as attention shifted from the deteriorating economic situation.

The effort in July 1990, by Prime Minister V.P. Singh to adopt an economic reforms package similar to that favored by Rajiv Gandhi found no support before the collapse of his government in January 1991. Instead, the short-lived successor coalition led by the socialist Prime Minister Chandra Shekhar sent Finance Minister Yaswant Sinha on a fruitless quest for loans to Japan and the United States, and then reluctantly turned to the International Monetary Fund for a $1.8

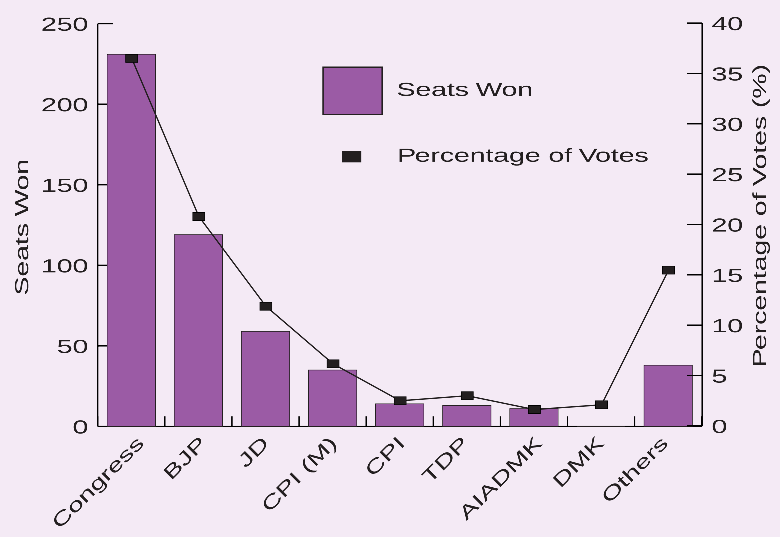
billion balance of payments credit to pay for oil imports. Sinha, in presenting an Interim Budget for 1991-92 stated that the accumulated internal and external debt had totally exhausted the Central Government's room for manoeuvre, that soft options had disappeared, and that by the time of the next regular budget, then planned for May 1991, a comprehensive package of macro-economic adjustment would be the only sustainable solution to the fiscal crisis.

The Congress (I), 1991-96

In June 1991, it was the Congress (I) that returned to power after the collapse of two coalitions in less than two years, and the assassination of Rajiv Gandhi during the election campaign. The party was a shadow of what it had been in the 1980's. It could no longer muster a majority of seats, and it had to govern as a minority in need of allies. While the popular vote of Congress (I) had declined further to 36.5 percent, this time a divided opposition, reflected in the fragmentation of the Janata Dal into regional groupings, allowed it to win 232 seats (of 520). It gained another 18 seats from an alliance with the Tamil Nadu based All India Dravida Munnetra Kazagham (IADMK) and support of tiny parties, splinter groups, and nominated members. Even so, for the first 7 months it could rely only on 244 M.P.'s. An unexpected victory in Punjab in February 1992 brought another 12 M.P.'s ; but it was only in late 1993 that it achieved a majority and even then by winning over defectors through suspect methods.

Narasimha Rao's minority government enjoyed a larger margin of movement toward an integrated economic reforms strategy than its predecessors. In 1990-91, total internal debt accumulated to 55 percent of GDP. Interest payments reached 4 percent of GDP and 20 percent of the total expenditure of the Central Government. In the same year, the current account deficit in the balance of payments, financed by borrowings from abroad, was more than 2.5 percent of GDP, and debt service on borrowings from abroad amounted to 21 percent of current account receipts. India's credit rating was so low that the Government could no longer raise loans from foreign banks to finance essential imports except by putting up gold as

10th Lok Sabha (1991-95)



Source: CASI

collateral; foreign exchange reserves fell to the equivalent of 2 weeks imports. Under such crisis circumstances, it was much easier to argue that the only recourse was to the International Monetary Fund, and that the IMF would require the very policies for macro-economic adjustment that had been foreshadowed by Yaswant Sinha in his Interim Budget.

Those who remained unconvinced were temporarily silenced by the collapse of the Soviet Union. This discredited the model of centralized planning which was not working in India. Practical problems perhaps proved more persuasive. It became impossible to proceed with agreements between Rajiv Gandhi and Mikhail Gorbachov, to raise India's manufacturing exports to the USSR to over 47 percent by the end of the decade in a continuation of the ruble-rupee trade that bartered mediocre products for military equipment and oil.

The 1991-92 Budget (June 1991) set out the basic elements of the integrated strategy for trade, tax and foreign exchange reforms aimed at reducing the fiscal deficit, providing inputs for a growing volume of exports and encouraging inflows of foreign exchange for investment. An IMF loan of $1.4 billion under the Compensatory Finance Facility followed soon after.

The opposition groupings, that of the National Front-Left parties and the BJP were in no position to attack the shift to economic liberalization. They were too weak to provide an alternative government. The Janata Dal and the 2 communist parties among them had 108 seats and 20 percent of the vote. The BJP, which received a major boost from Hindu voters sympathetic to the campaign for the construction of the Ram temple, almost doubled its popular vote from over 11 percent in 1989 to approximately 21 percent in 1991, but had only 119 seats. Both the left and the BJP, moreover, feared the repercussions of precipitating a third election in three years.

Nevertheless, the minority Rao government lacked the leverage to move quickly toward the second stage of reforms. Within months, critics in the Janata Dal and left parties denounced the Congress (I) government for taking an IMF loan imposing conditionalities as robbing India of economic independence and condemning its people to increasing unemployment and escalating prices. The senior CPM leader E.M.S. Namboodiripad, characterized the government's argument that there is no alternative to an IMF loan as "like a thirsty man taking a cup of poison on the plea there is no alternative with which he can quench his thirst." Foreshadowing the BJP's commitment to Swadeshi or "India First", E.M.S. asked Indians to remember the Swadeshi movement that was part of the freedom struggle when a small elite had also become habituated to luxury goods produced with foreign capital and technology "while the large mass of people could not satisfy their essential needs."[6]

The minority ruling party, moreover, became more dependent on support of the communist parties in the Lok Sabha as enmity escalated between the Congress (I) and the BJP after January 1992, when militant Hindu nationalists made good their threat to tear down the Babri Mosque, leading to the worst Hindu-Muslim violence since Independence. L.K. Advani, the president of the BJP had already built up the party's strength around the Hindutva agenda from its low in 1984 when it won two seats in the Lok Sabha, to 89 seats in 1989 and 119 seats in 1991. After the BJP led state government of Uttar Pradesh failed to honor its assurances to the Center that it would control the militants and preserve law and order, the Rao government was subjected to bitter recrimination from Muslims who felt betrayed by the Prime Minister's decision not to impose President's Rule and prevent the demolition. As early as May 1992, moreover, the Finance Minister, Dr. Manmohan Singh came under blistering attack across the political spectrum, for failing to detect a Rs. 4500 crore financial scam, involving insider trading by brokers in collusion with top officials of the State Bank of India and foreign owned private sector banks. The scheme relied on using bank receipts for government securities only notionally bought by brokers to invest in higher yielding bonds in the stock market, driving up prices and profits for all involved, until the irregularities were discovered, bankrupting several smaller banks. Having weathered this crisis, the Rao government was hit by a series of corruption scandals in 1994, resulting in unprecedented indictments against several Cabinet ministers, including the Minister for Telecommunications charged with bribery in connection with awarding licenses to operate newly privatized telephone services.

In the year preceding the May 1996 elections, the Congress (I) government's economic liberalization policies were subjected to virulent attacks from both the left opposition parties and the BJP. Between them, the left parties, decried by the BJP as anti-national because of their long association with the Soviet Union, and the BJP excoriated by the left as anti-secular and communal, succeeded in turning back or slowing down all government initiatives to implement the second stage of reforms.

Policies to attract foreign private investment in government-owned infrastructure sectors, particularly in power generation, initiated as early as 1991, were effectively stymied. In August 1995, the BJP, from its position as a coalition partner with the militant Hindu Shiv Sena in Maharashtra state, challenged the integrity of the 1991 private sector policy developed by the Central Government and the previous Congress (I) state government. The policy was a carefully crafted package based on direct negotiations between the Central Government and multi-nationals to sign a Memorandum of Understanding (MOU), involving counter-guarantees by the Government of India to foreign investors, ensuring the central government would guarantee payment of the Power Purchase Agreement on the terms negotiated if the state government or bankrupt State Electricity Boards were unable to do so. The policy led to signature of eight MOU's with multinationals, of which 5 were submitted by American multinationals. The BJP and Shiv Sena coalition in their unilateral decision to terminate the agreement signed between the previous Congress (I) led state government and the Dhabol Power

Company, a subsidiary of Enron, claimed secret negotiations and inflated costs would impose an unwarranted burden of high electricity prices on the people. These charges, triggering a national debate, cast doubt on the fairness of all eight "fast-track" power projects in Maharashtra, Gujarat, Andhra Pradesh, Karnataka, Orissa and Rajasthan. Although the Enron project was eventually renegotiated, the public suspicions aroused made it impossible for the Central Government to use this route for instilling confidence in foreign investors. Instead, the Power Ministry set out on the much more time-consuming and politically problematical process of persuading state governments to disband bankrupt State Electricity Boards, and replace them, with World Bank assistance, by separate commercial corporations for transmission and distribution of electricity.[7]

Prime Minister Rao, facing opposition from the left parties as well as the BJP, also felt constrained to wait until after the 1996 elections to bring forward the insurance sector reforms ending the monopoly of government companies, recommended by the Malhotra Committee in 1994 and endorsed by the Cabinet in 1995, to attract domestic and foreign private investors to augment capital resources for the starved infrastructure sectors. Finally, the government failed to muster majority support for legislation to amend the 1970 Patents Act which allowed only "process patents" in foods, medicines and drugs. This kept India out of compliance with the World Trade Organization agreements ratified by the Rao government in 1994, including a commitment to provide Exclusive Marketing Rights (EMR's) for pharmaceuticals and agro-chemicals as interim protection for intellectual property prior to phasing in full-fledged product patents by 2005. An ordinance promulgated in 1994-95 amending the Patents Act and presented as a Bill in 1995 was blocked in the Rajya Sabha, or upper House of the States, where it was referred to a Select Committee and expired after the tenth Lok Sabha was dissolved.

Shortly before the 1996 elections, the Confederation of Indian Industries, (CII), considered to be the strongest proponent of seeking foreign investment in India, fired the most controversial, and unexpected, broadside against the multinationals. An appraisal of the dealings between Indian companies and multinationals since 1991 described a lopsided relationship in which benefits favored foreign investors in joint ventures rather than Indian partners. The list of criticisms included complaints that the multinationals brought in obsolescent technology and products; that they initially accepted 40 to 50 percent equity agreements but quickly moved to acquire majority control; and that a number set up wholly owned subsidiaries for the manufacture and distribution of high quality products to avoid technology transfer and profit sharing. Without mentioning the BJP, the statement endorsed the party's attack on "fast-track power projects" for pitching costs and the price of power to the people at higher than necessary levels.

Prime Minister Rao hardly mentioned the economic reforms as a major achievement of his government in the election campaign of 1996. Instead, the Central government deliberately slowed down the pace to curb inflation during an election year without increasing prices of essential commodities or cutting back on subsidies. After 5 years of economic reforms, the cumulative internal debt in 1995-96 reached more than 52 percent of GDP; almost 39 percent of revenues were preempted by interest payments. Capital expenditure could not be increased and total expenditure during the government's latest 5-year plan declined. As the Central Government increased its share of market borrowings, it also drove up banks' prime lending rates to 20 percent and created a credit crunch for the corporate sector that hit each industry's expansion plans and contributed to the onset of recession.

In any event, Congress (I) lost the elections in a humiliating defeat, only to be followed by 2 minority United Front coalitions in eighteen months. A national election in 1998 produced an even more fragile coalition led by the Bharatiya Janata Party (BJP), which itself lost a vote of confidence after 13 months and remained in power as a caretaker government until the general elections announced for September-October 1999.

Coalition Governments: The United Front, May 1996-October 1998

The 3 years of coalition governments, from 1996-99, with few exceptions, stand out as a period of paralysis in moving to the second stage of reforms. Among those who helped make the early reforms happen, it seemed as if *we have been marking time, losing time* preoccupied with pushing back attacks from extremists on the left, and then extremists on the right.

The eleventh general elections of May 1996, followed in short order by the twelfth general elections of February-March 1998, delivered decisive defeats to the Congress (I). In 1996, its' share of the popular vote plummeted to 28 percent and it gained only 139 (of 534) seats in the Lok Sabha. In 1998, the steep trajectory of the decline was moderated by the emergence of Sonia Gandhi, the widow of Rajiv Gandhi and the only link to the Nehru-Gandhi family. She surfaced as a forceful champion of the secular values which India's first Prime Minister Jawaharlal Nehru had protected from the BJP's predecessor, the Jana Sangh, in its

ELEVENTH PARLIAMENT 1996

Total Strength – 544

Ruling Government 14 Party Coalition	
Janata Dal (JD)	44
Tamil Manila Congress (TMC)	20
Dravida Munnetra Kazhgam (DMK)	17
Samajwadi Party (SP)	17
Telugu Desam Party (TDP)	17
Asom Gana Parishad (AGP)	5
All India Indira Congress (T)	4
Samajwadi Janata Party (Rashtriya)	3
Maharashtra Gomantak Party (MGP)	1
Madhya Pradesh Vikash Congress	1
Communist Party of India (CPM)	32
Communist Party of India (CPI)	12
Revolutionary Socialist Party (RSP)	5
All India Forward Block (AIFB)	3
Total	181
Support from Outside the Government	
Congress (I)	137
Jharkhand Mukti Morcha (JMM)	1
Kerala Congress (M)	1
Sikkim Democratic Front (SDF)	1
United Goa Democratic Party (UGDP)	1
Bhartiya Kisan Kamgar Party	1
Total	142
No Support	
Bharatiya Janata Party (BJP)	162
Shiv Sena (SS)	15
Bahujan Samaj Party (BSP)	11
Shiromani Akali Dal (SAD)	8
Samata Party (SAP)	5
Haryana Vikas Party (HVP)	3
Muslim League	2
All India Majlis-E-Ittehadul Muslimeen	1
Autonomous State Demand Committee	1
Total	208
Independents (IND)	8
Nominated	2
Vacancies	3

* The Left Front parties are in red.

efforts to introduce Hindu nationalist ideology into electoral politics. Even so, the Congress (I) and the BJP proved virtually even in their vote-getting ability at about 25 percent. In both 1996 and 1998, the BJP overtook the Congress (I) as the single largest party in the Lok Sabha.

The Common Minimum Program hammered out by the major constituents of the United Front presented an appearance of continuity with the Rao government in endorsing growth-oriented goals. Yet, no consideration was given to an integrated set of regulatory and pricing reforms that could attract multinationals.

Most dramatic, the degree of political fragmentation revealed by the election results went far beyond conventional generalizations that India was moving from an era of single party government to one of multi-party coalitions. The umbrella United Front (UF) coalition formed in 1996 consisted of 14 parties, only 3 of which were classified as national parties by the Election Commission, using the modest standard of a party recognized as a State Party in four or more States. The Janata Dal won only 44 seats. It had been all but destroyed as a national political force, once local leaders from its core constituency among the lower caste cultivating peasantry formed their own state parties and localized splinter groups. The largest political bloc in the Lok Sabha was constituted by the left parties, dominated by the Communist Party of India, Marxist (CPM), which together controlled 53 seats from their regional strongholds in West Bengal and Kerala. The United Front's continuation in office depended on the support of the Congress (I) from outside the government, an arrangement rationalized only by the common desire to keep the BJP at bay.

Economic reforms of the precarious United Front government under 2 Prime Ministers (H. D. Deve Gowda, and from April 1997, Inder Kumar Gujral) fell prey to chronic political uncertainty as well as opposition from the left parties inside the coalition. These circumstances left little scope for the Finance Minister P. Chidambaram, despite support from Prime Minister Deve Gowda and the Industry Minister, Murasoli Maran to move the economy to the next stage of reform.[8]

The Common Minimum Program hammered out by the major constituents of the United Front presented an appearance of continuity with the Rao government in endorsing growth-oriented goals. Sights were set on GDP growth rates of 7 percent per annum over ten years, and industrial growth rates of 12 percent annually. Yet an emphasis on growth leading to greater self-reliance included no consideration of an integrated set of programs to achieve this aim. Debates on public sector enterprises virtually ruled out privatization. Instead, the United Front proposed to rehabilitate some 100 loss-making public sector enterprises, (of 245); to make public sector companies with a comparative advantage into "global giants"; and to protect trade unions. The only concession was a promise to establish a Disinvestment Commission to "carefully examine" the question of withdrawing the public sector from non-core and non-strategic areas, but subject to assuring the job security of workers or providing retraining and reemployment. Against this unwillingness to raise funds from even partial privatization of the public sector, the minimum program appeared particularly vague on measures needed to raise resources and drive down the fiscal deficit to the target of 4 percent of GDP. The most concrete suggestion was to target subsidies to the really needy and poor. And while estimating the cumulative requirement for infrastructure development at $200 billion over the next 5 years, the only reference to the insurance industry, whose funds were considered essential in providing long-term financing for lumpy and long gestation projects, was to strengthen the public sector Life Insurance Company and the General Insurance Company. Similarly, the need for foreign investment, put at $10 billion a year, was joined to recommendations for fiscal and other measures to ensure that the bulk went to core and infrastructure sectors. No consideration was given to an integrated set of regulatory and pricing reforms that could attract multinationals to these sectors.

Chidambaram, former Minister of Commerce in the Rao government and a Harvard M.B.A. known as the most vocal advocate of speedy reforms, did as much as possible within these constraints. The "leap of faith" 1997-98 Budget met the demands of India's industrial leaders for a level playing field relative to the multinationals with dramatic tax cuts on personal and corporate rates, and encouraged investment by FII and venture capital funds by raising the ceiling to 30 percent and 20 percent respectively of holdings in the equity of a company. Simultaneously, peak tariffs were reduced to 40 percent (from 50 percent), and to much lower levels on specific imports to make domestic production more competitive in major sectors, among them steel, power, chemicals, textiles and information technology. These changes were supplemented by an export-import policy, 1997-2002, removing Quantitative Restrictions on 542 items (of more than 2700), a first installment on India's commitment as a member of the WTO to phase out all such quotas on imports by 2005.

Little else could be accomplished except piecemeal expansion of existing reforms, and moderation of changes that would have moved the process backward. For example, new categories of basic industries and infrastructure were made eligible for automatic approvals by the Reserve Bank of India of FDI at levels of 51 to 74 percent of equity; and at even 100 percent under some circumstances. Guidelines announced by the Ministry of Industry for FDI reflected the preferences of the left parties in prioritizing proposals for foreign investment to infrastructure and high-technology industries, but were sufficiently permissive to leave room for discretionary decisions.

The Disinvestment Commission, established in August, 1996 under the leadership of G.V. Ramakrishna, former member of the Planning Commission and Chairman of SEBI, the only person acceptable to all parties of the UF, including the left, found its work stymied not so much by the communists, but by the bureaucracy. Original terms of reference to the Commission invested it with substantial powers to review applications, make recommendations and to follow up, monitor and supervise the implementation of its decisions. The Industry Ministry referred scores of public sector units to the Commission for advice. But once the Commission recommended that the Union government sell majority equity in 5 public sector enterprises to national or foreign buyers and clarify policies to retrench workers through voluntary retirement schemes, the bureaucrats delayed for months in taking decisions or forwarding recommendations to the government. Even Chidambaram was persuaded to change the terms of reference to the Disinvestment Commission and curtail its powers to making only recommendations, which were then completely ignored.

No forward movement proved possible on opening the insurance sector to foreign investment. The most that could be accomplished, given the vehement opposition of the communist parties, was to recommend that a few Indian controlled companies be allowed to enter the health insurance market. Failure to establish independent regulatory authorities in the major infrastructure sectors reflected both the concern of the communist parties about foreign control over basic national services, and the reluctance of the bureaucracy to let go of its power.

The Bill to amend the 1970 Patents Act, bringing its provisions in conformity with WTO guidelines, narrowly defeated in 1995, could not be reintroduced at all. The left parties strongly opposed it as against the national interest. This set the stage for a long and bitter dispute between India and the United States, as well as India and the European Union, which eventually was brought before a WTO dispute settlement panel by the United States.

Chidambaram's legacy to the BJP-led coalition was an ironical one. His gamble that tax incentives would induce private investors to jump-start another upward spiral of industrial production, corporate profits, higher revenue collections and lower fiscal deficits was lost because of other major obstacles to investment, such as high interest rates on bank loans and inadequate infrastructure. Yet in the absence of a package of reforms to stimulate higher levels of economic growth, Chidambaram unwittingly set the stage for even more pressure on the Central Government's finances. He carried through the promise made by Manmohan Singh in the 1994-95 Budget to phase out ad hoc Treasury Bills over a period of 3 years, from 1997-98, "so that the Government would no longer have direct access to the Reserve Bank for financing the deficit and will have to meet its entire requirements through borrowing from the market." The statutory agreement between the Finance Ministry and the Reserve Bank of India (RBI) ended government issue of ad hoc treasury bills to the RBI at artificially low interest rates as a means of financing the Central Government budget deficit through de facto printing of money. It established that the RBI would lend money to the Central Government only to bridge temporary imbalances between receipts and deficits. The amount of such ways and means advances would be limited by agreement, and require the government to pay close to market rates. The RBI agreed to subscribe to primary issues of government borrowings but only up to a specified limit, and in the form of a monetized deficit.

The BJP-led Coalition, March 1998-April 1999

The twelfth general elections of February-March 1998 revealed an even more extensive pattern of fragmentation. Divisions along state, religious and caste lines spread to all regions of the country. A record number of 41 "parties" won representation in the Lok Sabha: 7 of these groupings had 2 or 3 members and fourteen had one member each. 6 M.P.'s were elected as Independents.

Many more "parties", 176 in 1998, were registered by the Election Commission, of which only 30 were "recognized" as state parties and 7 as national parties. Yet, 11 percent of the electorate voted for registered parties (compared to 3 percent in 1996) and almost 20 percent voted for state parties (as opposed to 21 percent in 1996), accounting altogether for more than 31 percent of the electorate. The steady decline in voter support for parties classified as national parties emerges from the comparison with 1980 when national parties altogether received 85 percent of the vote.

The BJP, the single largest party with 179 seats of 545, put together a coalition led by Prime Minister Atal Bihari Vajpayee through opportunistic alliances dictated by political arithmetic. Pre-poll alliances with the All–India Dravida Munnetra Kazhagam (AIDMK) of Tamil Nadu, and with localized regional parties as well as splinter groups having no more than one M.P. each, along with post election wooing of other small groups, pushed up the coalition's strength to 264. Yet it won the vote of confidence in the Lok Sabha only through a deal on the post of Speaker with the Andhra Pradesh-based Telugu Desam Party (TDP), which, however, declined to join the government.

TWELFTH PARLIAMENT 1998
Total Strength – 545

BJP/Alliance	
Bharatiya Janata Party (BJP)	179
AIADMK	18
Samata Party (SAP)	12
Biju Janata Dal	9
Shiromani Akali Dal (SAD)	8
Shiv Sena (SS)	8
Trinamul Congress	7
PMK	4
MDMK	3
Haryana Vikas Party (HVP)	1
Janata Party	1
Lok Shakti	1
TRC	1
Total	252
Congress/Alliance	
Congress (I)	142
RJD	17
RPI	4
Muslim League	2
UMF	1
K. Cong. Mani	1
R.J. Party	1
Samajwadi Janata Party	1
Total	169
United Front	
Communist Party of India (CPM)	32
Communist Party of India (CPI)	9
Revolutionary Socialist Party (RSP)	5
All India Forward Block (AIFB)	2
Samajwadi Party (SP)	21
Telugu Desam Party (TDP)*	12
Dravida Munnetra Kazhgam (DMK)	6
Janata Dal	6
Tamil Manila Congress (TMC)	3
National Conference*	2
MIM	1
Total	99
Others	
Bahujan Samaj Party (BSP)	5
Haryana Lok Dal	4
Arunachal Congress	2
Peasants & Workers Party	1
Sikkim Democratic Front (SDF)	1
IISC	1
ASDC	1
MSCP	1
Independence	1
Total	17

*TDP and NC broke from the UF Alliance
The Left Front parties are in red.

During the entire period in which the BJP held office, it was vulnerable to threats of defection from members of the alliance. An inordinate amount of time was spent simply in keeping the alliance partners together in the face of constant demands for patronage as a condition of their loyalty. The largest political bloc in the coalition, the Tamil Nadu based AIDMK was also the greatest threat to its stability. Jayalalitha Jayaram, the former Chief Minister of Tamil Nadu, facing a series of corruption cases in her own state, and out on bail, continually demanded important portfolios for her own supporters and dismissal of other Ministers on vague charges. She pressed the Prime Minister to recommend that the Tamil Nadu state government be dismissed on grounds of misrule, leading to new elections (and presumably the end of the cases against her), and failing that, to transfer the cases pending against her from state to Union courts. This constant drama played by Jayalalitha (a former actress), of making demands that implicitly threatened the viability of the coalition, the attention diverted of senior Ministers in placating her, and the denouement in which Jayalalitha actually made good her threat and precipitated the circumstances leading to the coalition's defeat on a no-confidence motion on April 17, 1999 kept the BJP government constantly off balance.

The fractured results of the 1998 national elections had another effect. The outcome convinced the BJP leaders of the new government that neither the majority of coalition members nor the voters shared their party's vision of Hindutva as "One Nation, One People and One Culture." Promises in the Election Manifesto to facilitate construction of a "magnificent Ram Mandir in Ayodhya;" to adopt a uniform civil code overriding Muslim family law, and to abrogate Article 370 of the Constitution creating a special status for the Muslim majority state of Jammu and Kashmir, racked by secessionist struggles supported across the border by Pakistan, all had to be put on the "backburner."

Instead, the BJP gave precedence to The National Agenda for Governance, a consensus document endorsed by its allies and heavily weighted toward economic reforms. Like their predecessors in the United Front, the BJP-led alliance promised to bring GDP growth to 7-8 percent and control the fiscal deficit. Moreover, in an effort to expand and consolidate its popular base in rural areas, it proposed to earmark 60 percent of Plan investment for agriculture, rural development and irrigation, and to achieve a "quantum leap in agricultural production" and income for agriculturists. Indeed, the National Agenda for Governance made sweeping promises to eliminate unemployment, eradicate illiteracy, create a hunger-free India, provide housing for all, and empower women.

Yet, as with the United Front, no coherent strategy was presented for achieving these goals. Only broad brush strokes of policy were proposed. The statement reiterated "a strong Swadeshi thrust" to the reform process, so that "India shall be built by Indians," and promised to analyze the effects of globalization and "calibrate" the process of it to suit India's national requirements. It envisaged a supplementary role for Foreign Direct Investment in core areas, and proposed to rely primarily on raising internal resources by increasing national savings to 30 percent of GDP.

The incoherence within the BJP-led coalition, which lurched from one internal crisis to another, was sufficient to create the general perception that the party was unable to provide effective governance. Yet, divisions which rested on competing demands of ambitious personalities and factions for a greater share of power, were actually of more superficial significance than the lack of political consensus within the BJP. The party was itself divided between the moderates who downplayed the Hindutva agenda, and those who saw the departure from commitments in the Election Manifesto as a betrayal of the BJP's vital difference as a party. Such disagreements not only centered around the commitment to cultural nationalism as the core of national identity, but to the Swadeshi approach for making India into a global economic power.

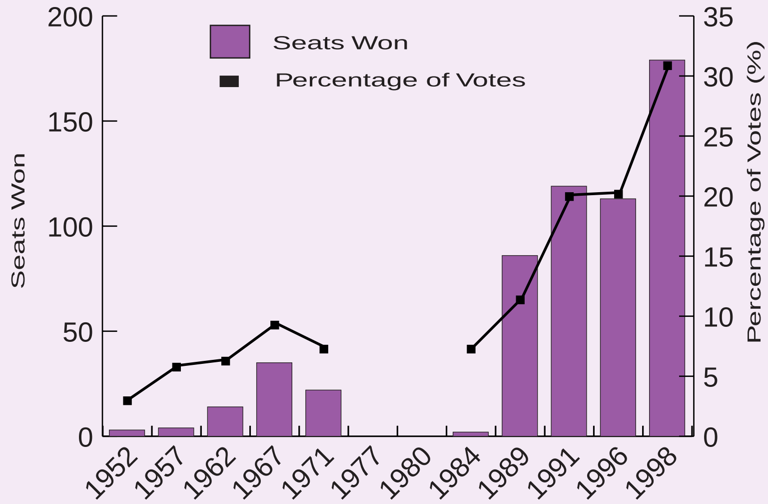
The BJP and the Sangh Parivar

The BJP, by itself, accommodated individuals more attracted by its promise of clean government than to its Hindutva ideology. As a party, however, its origins made it a part of the larger Sangh Parivar, or Sangh family of organizations affiliated with the Rashtriya Swayamsevak Sangh (RSS-Association of National Volunteers) founded in 1925. This hierarchical organization, headed by leaders nominated for life, with numerous local branches (shakhas), combined training in physical strength and self discipline, with instruction about the Hindu Rashtra as the basis of ideological community. After Independence, a number of RSS activists led by Atal Bihari Vajpayee and L.K. Advani took a leading role in forming the Jana Sangh, the precursor of the BJP. Beyond representation in party politics through the Jana Sangh (and subsequently the BJP), the RSS developed other front organizations, at first to resist anti-national communist influence, including the Akhil Bharatiya Vidyarthi Parishad (ABVP) in 1948 to organize students; the Bharatiya Mazdoor Sangh (BMS), a workers trade union in1955 and the Bharatiya Kisan Sangh, (BKS), a peasants organization.

There was another, explicit anti-Western component, represented among the associations affiliated with the RSS. The Vishwa Hindu Parishad (VHP, World Hindu Council) established in 1964, brought together Hindu sectarian leaders aspiring to world wide reach, partly to build a solid front against the activities of western missionaries in India. The missionaries were suspected of seeking to reestablish western supremacy by bringing about conversions to Christianity under cover of educational and other humanitarian activities.

During the evolution of the Jana Sangh and its successor Bharatiya Janata Party, tensions emerged about the emphasis that should be placed on the purity of Hindu nationalism as a guiding ideology versus political compromise with non-Congress opposition parties necessary to integrate Hindu traditionalism into mainstream Indian politics. Atal Bihari Vajpayee, a member of the RSS since

BJP Seats and Votes in the National Elections



Source: CASI

Note: For 1977 as well as 1980, separate figures are not available for the BJP, since it was part of the Janata Party.

the early 1940's, had evolved through a long career as an advocate of integration into mainstream Indian politics. As a Jana Sangh M.P., President of the Jana Sangh, Minister of External Affairs in the short-lived Janata Party government,1977-79, (in which the Jana Sangh briefly merged its independent identity), and then as President of the Bharatiya Janata Party formed in 1980, he sought to widen the party's political base by stressing socio-economic programs. Under Vajpayee's direction, the BJP was opened up to politicians who did not have an RSS background, including Muslims.

In practice, the BJP's openness came to be perceived as a source of weakness. A dismal electoral showing in 1980 and 1984 revealed alienation among its grassroots activists who remained loyal to the RSS ideology. By 1989, long-standing RSS leaders and Jana Sangh stalwarts, who had supported Vajpayee's strategy, were ready to follow the lead of the Vishwa Hindu Parishad, which mobilized religious leaders, to unite the majority "Hindu vote" in rural areas, including the Other Backward Classes and Dalits. The rallying point of this strategy from 1984 became the emotive movement in Uttar Pradesh to liberate the Babri Mosque. It drew the support of veteran RSS and Jana Sangh leaders, demoralized by the political debacle of the "openness" strategy. Foremost among them was L.K. Advani who became General Secretary of the BJP in 1985; and then replaced Vajpayee as party president in 1986, appointing RSS men to the posts of General Secretary. As the RSS and the BJP drew closer together at the organizational level, and Advani threw his support behind the campaign to build a Ram temple, a "division of labor then took shape between Advani and Vajpayee, who presented a more moderate face of Hindu nationalism."[9] It was Advani who put forward Vajpayee as nationally the most acceptable BJP candidate for Prime Minister in the elections of 1996 and 1998 and it was Vajpayee's "universal acceptability" that earned him the formal endorsement of the party as its leader.

Swadeshi and Globalization

Shortly after the introduction of the 1991 economic reforms, the BJP leadership formulated an offensive against the Congress party aimed at convincing the electorate that the party most closely identified with Indian nationalism as the leader of the freedom movement, had abandoned its historic role by selling out to the I.M.F., while becoming totally corrupt. Partly, this was tactical, involving the search for an issue that an opposition party aspiring to national leadership could use against the ruling party. Partly, it was dictated by the BJP's strong base among small businessmen and traders, who were committed to internal liberalization, but opposed to globalization that could bring unmanageable competition from multinationals. Under the leadership of the BJP President, L.K. Advani, the National Executive of the party slowly shifted the public emphasis in its concept of Hindutva from an Indian identity based on Sanskritic language, laws and religious rituals to a culture wider than religion. The new formulation, emphasizing Swadeshi (Swa deshi, or own country) was copius enough to satisfy the advocates of a Hindu Rastra who branded Islam and Christianity as not Swadeshi, but Pardeshi, coming from outside India. Yet, it could also be used to attack globalization as abetting the designs of multinationals and the West, especially the International Monetary Fund, the World Bank, GATT (General Agreement on Tariffs and Trade), and the World Trade Organization (WTO), formally established in January 1995, all of which were represented as impinging on India's sovereignty and economic self-reliance. The slogan of Swadeshi stimulated the collective memory of invasion over the last 1,000 years, the suspicions of foreigners, made it persuasive to *a person who has not left India, that now the Americans are coming, and they think they can partition the country again, they can break up the country again. There is a sense that multi-nationals represent another form of invasion.*

The Swadeshi Jagaran Manch, (SJM, Self-Reliance Awareness Front), formed in 1994 by Datto Pant Thengadi, the indefatigable RSS organizer who had previously founded the student, workers, and peasants fronts, was triggered by the treaty establishing the World Trade Organization and signed by the Narasimha Rao government. The WTO was viewed as a new power center to expedite the spread of economic imperialism by breaking down barriers to the flow of foreign capital and technology controlled by multinationals in league with leaders of western countries, the World Bank and International Monetary Fund. Tracts published by the SJM were written in language almost identical to that of Marxist propagandists, although expressed as the Swadeshi view of globalization.[10] As put by Daya Krishna, globalization was nothing less than the new design of the West, under the leadership of the United States, to re-colonize the poor countries of the world. He discerned this aim from WTO demands to allow cheap imports of agricultural products into India (and other developing countries); to provide legal protection for patents or Trade-Related Intellectual Property Rights (TRIPS), overwhelmingly held by multinationals, and to enforce Trade Related Aspects of Investment (TRIMS), removing quantitative restrictions on imports. These policies were denounced for impoverishing resource poor small farmers and for destroying India's industrial base before domestic industries could become capable of facing competition. Instead of globalization, the SJM invoked self-reliance to bring about the economic reconstruction of India. At the minimum, they insisted that policy makers protect traditional industries, encourage potentially competitive modern sectors, and resort to foreign investment and multinationals for capital and technology only after putting adequate safeguards in place. The SJM, its polemical pamphlets often written in Hindi, remained in obscurity and at the periphery of debate about the pace at which India should open its economy, until the BJP-led coalition came to power.

At the time Prime Minister Vajpayee took office, the RSS claimed to be "the largest voluntary organization in the world today" with over 30,000 branches, 20,000 service centers and 55,000 full-time workers across the country. The BJP was described as one of 140 front organizations of the Sangh, leaving "no area of Indian life where the Sangh has not left its imprint."[11] This extended to the area of economic reforms. The RSS and SJM had prevailed in preventing the appointment of Jaswant Singh as Finance Minister, the first choice of the Prime Minister as his close confidant, a former cavalry officer without RSS commitments who also had a reputation for being pro-economic reforms. The appointment of Yashwant Sinha to that post, who had previously served under the socialist Prime Minister Chandra Shekhar, had the approval of the SJM partly because Sinha was expected to be sympathetic to their criticisms of multinationals and also unlikely to pursue his own independent agenda. Indeed, after L.K. Advani resigned as President of the BJP to become Home Minister in the government, Kushabhau Thakre, an organizer for the RSS from 1938, widely known for his organizational skills and uncompromising Hindu nationalist ideology, took control of the party. Under Thakre's leadership, the National Executive and National Council of the BJP formally passed a resolution on May 2, 1998 endorsing the critique of globalization for placing India's economy under great pressure from one-sided competition with the multinationals. On the same day, Prime Minister Vajpayee reiterated the Government's commitment to speeding up internal liberalization while adopting a "carefully calibrated approach" to globalization.

The notion of "calibrated" globalization, first used in the BJP's Election Manifesto, was crafted by Mohan Guruswamy, a Harvard Ph.D. who subsequently served briefly as Advisor, Ministry of Finance on Advani's recommendation. The phrase implied indirect criticism of the "pseudo-reforms" pursued by Narasimha Rao and Manmohan Singh as giving the multinationals a free run. But the concept was deliberately muddy *and opaque*. It facilitated a balancing act between Hindu nationalists suspicious that the BJP was too influenced by liberalizers, and foreign investors who needed to be reassured the BJP wanted to go "full-throttle" on economic reforms. As an economic slogan, it also was useful to Government efforts aimed at minimizing damage to India's basic industries like steel and cement and to traditional business houses finding it impossible to become globally competitive.

Yet the BJP-led government was also caught in a dilemma. Its stated investment strategy relied primarily on self-reliance in raising greater internal resources, mainly by a much more aggressive approach to disinvestment, especially of loss-making Public Sector Enterprises. Within the foreseeable future, however, there was no alternative to seeking foreign investment for infrastructure -- power, telecommunications, ports and roads -- and in areas where transfers of technology and managerial skills were essential to make Indian industry internationally competitive.

These contradictions led to a logic intended to be persuasive with Ministers inside the Cabinet opposed to the entry of American capital without some quid pro quo. L.K. Advani, Home Minister and Murli Manohar Joshi, Minister of Human Resources, personally identified with the formulation of the Swadeshi doctrine, had to be carried along not only on broad principles of economic policy, but on individual major investment agreements. Advani, in his person, brought the concerns of the RSS and the SJM into the decision-making process of the government.

The degree to which decision-making on economic policy was transformed by the influence of Ministers outside the Finance Ministry, and their links to shadow advisors in the RSS and SJM was reflected in the experiences of CII leaders accustomed only to discussing economic policy with the Finance Ministry. In May 1998, after sanctions were imposed because of the nuclear tests, and as FDI declined, FII funds flowed out, and the rupee diminished in value, leading industrialists found it difficult to identify the key decision-makers to whom they could explain their concerns about the effects of declining foreign investment and trade with India's largest economic partners, the United States and the European Union, and with major donors, including Japan, the World Bank, Germany and the United States. Prime Minister Vajpayee and Finance Minister Yashwant Sinha did not have the last word on economic policy. In practice, proposals had to be vetted by L.K. Advani, and then tailored in terms acceptable to the RSS, basically rationalized to present private investment as essential for building India's power and glory so that India would not need to rely on foreign investment in the future. The CII found that they were suddenly dealing with a very different set of people, *RSS pracharaks living in spartan small rooms, without television, in isolation, with no knowledge* *of what changes are taking place in the world.* CII leaders and industrialists went to these small rooms, made their case in Hindi, and put up with rude responses, all in an effort to carry along the RSS as fellow Indians committed to India's greatness.

The CII nevertheless failed to make their case to the government for devaluation of the rupee at a time when Indian exports were undercut by competitors in Asia whose currencies had depreciated about 30 percent to 40 percent compared to 17 percent for the Indian rupee. As an alternative, the CII combined forces with the Federation of Indian Chambers of Commerce and Industry (FICCI) to press the case of Indian industrialists for a "level playing field" in the form of higher import duties.

The 1998-99 Swadeshi Budget presented in June 1998 by Finance Minister Sinha responded to all these pressures. The Finance Minister tried to balance his policies to meet the visible problems of Indian industry affected by the rapid reduction of tariffs, and dumping by China of low-priced goods on the Indian market. He was also sympathetic to the argument of the traditional big business houses that they needed more time to restructure and become competitive, and felt receptive to the Swadeshi Jagaran Manch, in their opposition to consumerism as antithetical to Indian culture. These strands, woven into the fabric of economic policy, shifted the emphasis apparent since the Rao government from forcing Indian industries to become competitive by progressively exposing them to international competition, to one of providing interim protection by an understanding government so that over a period of several years Indian industries could compete in the global marketplace.

The Budget imposed higher import duties on several items like steel and paper, and a flat import duty surcharge of 8 percent on a wide array of items to protect Indian industries. These duties had a cascading effect on allied taxes like countervailing duties so that the final effect was to boost the cost of imports by 11 to 12 percent. At the same time, excise duties were raised on several brand name food products, manufactured mainly by foreign companies.

Other elements of the budget placed major emphasis on internal liberalization: coal, lignite and petroleum products were no longer reserved for public sector production, and sugar was allowed to be produced without requiring an industrial license. Beyond this, the Budget was the first to suggest genuine privatization of non-strategic Public Sector Enterprises (PSE's) by proposing gradual reduction of government equities in some PSE's to 26 percent. It also opened the insurance sector to competition from private Indian companies and promised to establish a statutory Insurance Regulatory Authority.

There was continuity with previous budgets on schemes to raise revenues. The income tax exemption limit was lowered and efforts made to improve tax collections by extending estimated tax schemes from 12 to 35 cities; and extending the tax in services to chartered accountants and management consultants. The lion's share of development spending, 60 percent, was earmarked for the rural sector.

Finally, projecting the fiscal deficit at 5.6 percent, the Budget proposed to fund road-building by raising the tax on petrol at Rs. 4 a liter; and it took a bold step to sharply reduce the fertilizer subsidy.

Both in India and abroad, the greatest criticism fell on the across the board import duty surcharge of 8 percent. In India, this was criticized as poor "packaging" by justifying the measure to provide a "level playing field" when it might have been presented as a temporary revenue raising device, or combined with reduction in some of the highest tariffs. Moreover, sections of Indian industry were actually hard hit. The failure of the Finance Minister to fully understand the complexity of the industrial structure meant that he took his cue from many traditional business houses which simply wanted protection, but did not make provision for competitive industries in new areas like information technology that needed to import components at low prices.

In the United States, just at the time when members of the US-India Business Council were cooperating with the Confederation of Indian Industry to lobby Congress into passing legislation allowing the President to waive sanctions, the Budget signaled that the Indian Government was not committed to liberalization. Rather, it sent the message that India was abandoning the commitment of previous governments to reduce tariffs to levels prevailing in neighboring Southeast Asia countries and reverting to protectionist policies. As one of the Prime Minister's advisors put it, the reaction of foreign investors to the Budget was so negative because for *seven years the machinery of government was going north, and then in the Budget turned southeast, so that all the expectations created earlier were reversed.*

The Budget also came under attack for its large cuts in subsidies on food grains, cooking gas and fertilizer from the BJP's coalition partners, as well as the opposition; and from the urban middle classes angry at the increase in petrol prices. In the rural areas, farmers protested against higher fertilizer prices.

As the Finance Minister responded to the chorus of criticism from key constituencies by rolling back the increase in the petrol price, the increase in fertilizer price, and even the import duty surcharge to 4 percent from 8 percent, the ridicule in the newspapers of "Roll-Back Sinha" contributed to the sense that the BJP lacked sufficient determination to revive the economy.

The debacle of the first Budget led advocates of economic reforms in the Prime Minister's Office

(PMO) and the Planning Commission to combine forces in prevailing on Prime Minister Vajpayee to take over personal direction of economic policy. Vajpayee, who then had no thought of running again for political office, was receptive to advice that he should not worry about the RSS, the Jagaran Manch or the VHP, because history would remember him only for whether he had provided effective government.

After weeks of intensive debate, L.K. Advani came around to the view that internal resources were insufficient to prevent further deterioration in the economy and that it was necessary to open up insurance to foreign investors and restore confidence.

Restoring Momentum?

By August 1998, when Vajpayee turned his attention to economic reforms, India's sovereign credit rating had been downgraded (by Moody's in June 1998 followed by Standard & Poor in October), FII's were selling their securities heavily, the stock market was down by about 30 percent over the previous year, the gross fiscal deficit was on the way up to 6.5 percent, infrastructure growth had declined, and inflation in the prices of food staples topped 10 percent. The PMO made a concerted effort to drive home the point that the Prime Minister, previously preoccupied with foreign policy and domestic political crises, had decided to engage himself in economic decision making in a hands-on way. The most high-profile of the initiatives taken was to set up two advisory councils, an economic advisory council and a council on trade and industry to consider bold policies that could impart momentum to the growth process. The symbolism of this effort was more important than its substance. The twelve member council on trade and industry, including CEO's of major corporations, and the 10 member council of eminent economists, were staffed by N.K. Singh, Secretary, PMO as Member-Secretary, a known supporter of economic reforms. More pointed, the Prime Minister decided to chair both councils, interpreted as the "first time India's business community has officially been granted a role in the formulation of state policy. With one stroke of the pen, Mr. Vajpayee has bestowed the imprimatur of legitimacy on a sector of Indian society that has hitherto been treated with suspicion and even disdain."[12]

Most provocative, on September 3, 1998, the Finance Minister, Yaswant Sinha announced that Prime Minister Vajpayee had set up a Group of Ministers under the chairmanship of Jaswant Singh, Deputy Chairman, Planning Commission, to make recommendations on the entry of foreign equity in the insurance sector. By the end of October, the ministerial panel recommended to the Cabinet that joint ventures should be established in the insurance sector with foreign equity participation, as a major step toward mobilizing long-term funding for infrastructure projects. After weeks of intensive debate, L.K. Advani came around to the view that internal resources were insufficient to prevent further deterioration in the economy and that it was necessary to open up insurance to foreign investors and restore confidence. The Union Cabinet, on November 29, 1998, took the "momentous decision" to allow foreign insurance companies 26 percent of equity in new insurance ventures, and FII's, NRI's and Overseas Corporate Bodies (OCB's) an additional 14 percent, or a total of 40 percent. In another major decision, the Cabinet, facing an April 19, 1999 deadline of the dispute settlement body of the WTO for India to provide patent cover for pharmaceutical and agro-chemical innovations, following a successful complaint by the United States under Articles 70.8 and 70.9 of TRIPS, approved amendment to the 1970 Patents Act. The new legislation proposed to grant Exclusive Marketing Rights (EMR's) to foreign product patent holders as a first step toward a complete product patent regime mandated for developing countries by 2005.

These decisions veered sharply away from Swadeshi toward globalization. They were described in the press as a clear victory of the "pro-changers over the swadeshi lobby" and as "brave as they come on the eve of assembly elections."

The RSS and the SJM did not wait to act until the government's public announcements of the shift in policies which had been signaled by the Prime Minister's decision in August to appoint and chair the pro-reforms council on trade and industry and council of economists. During a two-day meeting of the steering committee of the Swadeshi Jagaran Manch beginning August 31, 1998, senior leaders of the RSS, the SJM and other front organizations, including the BJP General Secretary K.N. Govindacharya demanded that the BJP-led government reverse its anti-people and anti-swadeshi policies. This was the first public warning by the RSS to the government and it was combined with an implied threat that the BJP-led coalition would pay a high price in forthcoming November 1998 state assembly elections in Madhya Pradesh, Rajasthan and Delhi. The RSS, and not the BJP controlled the Bharatiya Mazdoor Sangh, by then the largest trade union organization in India, as well as the student organization, Akhil Vidyarthi Parishad. The VHP, along with its own student and women's associations, had been establishing its organizational networks in several states. The open disapproval of the Sangh Parivar of the BJP-led government's policies at the same time that RSS leaders also held important positions in the BJP put into question the reliability of organizational support for the party.

The price paid by the BJP and its allies, in fact, was extremely high. Only 8 months into its term of office, the BJP-led coalition suffered defeats at the hands of the Congress (I) in the 3 Hindi-belt states where Prime Minister Vajpayee's vote-getting ability was considered a major factor in previous victories. BJP governments in Delhi and Rajasthan were turned out of office, and in Madhya Pradesh, where the "anti-incumbency" factor was expected to work against the Congress (I) government, the ruling party defied all predictions and won a clear majority. Suddenly, Sonia Gandhi, the Congress (I) party president, seemed to have triumphed over those who attacked her Italian origin, to challenge Prime Minister Vajpayee as a leader in her own right with national vote-getting potential.

Virtually overnight, the presumption took hold that the BJP government would lose its majority any time the Congress (I) felt strong enough to take advantage of the disarray in the fragile coalition and either try to form an alternative government, or force an early mid-term election, probably after the state assembly elections scheduled in October 1999.

The Vajpayee government, facing strong opposition in the winter session of the Lok Sabha on the Bills to open up the insurance sector and to amend the 1970 Patents Act, relied on L.K. Advani to act as mediator with RSS/ BJP M.P.'s.

Opposition parties, as well as the press argued that the Prime Minister had lost the moral authority to govern and called for his resignation. Vajpayee, who dismissed these demands outright, and party leaders who sought to explain the election results as an expression of the voters' anger over rising prices of essential commodities, were aware of a deeper malaise that had contributed to the electoral rout. At the January 5, 1999 meeting of the BJP National Executive, the depth of differences between the party and the government on issues of economic reform surfaced as an important source of the "sense of despair" setting in among BJP workers. Party President Kushabhau Thakre, saying the poll defeats could not have been caused by the price rise alone, pointed to organizational deficiencies and indiscipline, conceding that the party and the RSS cadre had not mobilized their traditional voter base or explained the achievements of the government. This was coupled with renewed emphasis on the dangers to the BJP of losing its image as "the party with a difference". Thakre pointed out that if it became like any other party and won elections it would be of "little importance to the people who have sustained the party's hopes for decades".

The major battle between the Prime Minister and the party leadership was fought over the Insurance Regulatory Authority (IRA) Bill, incorporating the participation of foreign companies in the insurance sector, and the Patents Amendments Bill. Both were attacked as a departure from the National Agenda for Governance and in direct conflict with the position of the party organization on swadeshi and self-reliance.

On the face of it, Vajpayee and his supporters in the Union Cabinet prevailed over the RSS and their swadeshi-minded colleagues in the party. They wrested the initiative from Thakre and other members of the National Executive in passing a resolution expressing appreciation for the government's accomplishments, and endorsing the need to amend the Patents Act, arising out of obligations assumed by the Narasimha Rao government under the WTO, and accepting foreign participation in the insurance sector. At the same time, the party attempted to circumscribe the government's freedom of action on both issues. The resolution recommended that foreign direct investment in insurance should not exceed 26 percent, that foreign companies should not hold the largest share of equity and that all insurance companies must follow guidelines issued by government to the Life Insurance Corporation and the General Insurance Corporation. Sections of the BJP who remained opposed to the WTO also made their voices heard. The resolution called on the government to evaluate the impact on India's economic sovereignty of the entire gamut of WTO obligations. Although the outcome was presented as a victory for Prime Minister Vajpayee and the supremacy of the government over the party, Thakre did not disguise his anguish at the "emerging trend to project a leader" rather than the party. Others, equally disillusioned, privately depicted the Vajpayee government as acting against the policies of the BJP.

Relations between the BJP and the affiliate organizations of the Sangh Parivar had deteriorated into open confrontation even earlier. On December 3, 1998, the Swadeshi Jagaran Manch held a protest sit-in near parliament against opening up the insurance sector to foreign investment, linking the decision to discussions between U.S. Deputy Secretary of State Strobe Talbot and Planning Commission Deputy Chairman, Jaswant Singh, appointed Minister of External Affairs a few days later. On December 16, one day after Finance Minister Yashwant Sinha tabled the Bill allowing up to 40 percent foreign equity in insurance joint ventures, the Bharatiya Mazdoor Sangh took the lead in organizing a national strike of more than 200,000 workers of India's state-run insurance firms to protest the Bill, disrupting work in Bombay, Calcutta, Madras, Bangalore and Hyderabad. The RSS and the Akhil Bharatiya Vidyarthi Parishad meeting in Nagpur on December 28 passed a resolution criticizing the BJP's policies, and decided to observe a "warning day" on January 18. Virtually at the same time, the Vishwa Hindu Parishad and their aggressive youth organization, the Bajrang Dal, noting that the Vajpayee government had moved away from the issue, decided to reactivate the Ram Janmabhoomi movement by staging a march to Ayodhya and reiterating the promise to construct a Ram temple at the site. The VHP also intensified its campaign against Christian missionaries to "stop conversion of the poor." Senior officials nevertheless denied they were involved in violent attacks on Christians in Gujarat especially during the Christmas season, blaming an "American conspiracy" aimed at discrediting the Hindu nationalists because of opposition to India's nuclear tests.

The Vajpayee government, facing strong opposition in the winter session of the Lok Sabha on the Bills to open up the insurance sector and to amend the 1970 Patents Act, relied on L.K. Advani to act as mediator with RSS/ BJP M.P.'s. Even then, they found it difficult to table both Bills and were unable to complete passage of either, as legislators from several small parties joined the attack on the government for bowing to pressure from the International Monetary Fund and the WTO. The Insurance Regulatory Authority Bill was not taken up at all. As drafted, the IRA followed the recommendations of the 1994 Malhotra Committee for a total of 40 per cent foreign equity in joint ventures and provided for the establishment of an Insurance Regulatory Authority as a statutory body. The Bill was referred to a parliamentary standing committee where it remained for the duration of the session.

The government made greater headway toward amending the 1970 Patents Bill, which was supported by the Congress (I) thereby preventing the left parties from getting the Bill referred to a select committee. Yet, the Patents Bill underwent several revisions. An initial version, approved by an expert committee appointed by the Union Industry Minister had proposed to recognize product patents from 2000, and do away with an interim regime of Exclusive Marketing Rights (EMR's) for pharmaceuticals and agro-chemicals, which under the TRIPS agreement of the WTO would be replaced by full patents in 2005. It was argued that very few drugs would qualify for an EMR before the end of 2004, because some 8-10 years normally was required for a drug to move from the patent application stage to the market. However, the amended legislation reverted to provision of EMR's for pharmaceutical and agro-chemical innovations over a period of five years, or until the grant or rejection of a patent. The language used raised questions about the circumstances under which an application could be rejected by providing for compulsory scrutiny and licensing of EMR's even if the product had been already patented in another country, and also required a determination that the product is an invention as defined by the Act.[13] The compulsory licensing provisions, in addition, allowed the government to permit a domestic firm to produce or market an essential drug manufactured by a foreign firm, in the public interest, or in the interest of national security, and to fix ceiling prices for such drugs. Finally, to win the support of the Congress (I) in the Rajya Sabha, the government introduced a new amendment not to provide EMR's to foreign patent holders for an article or substance based on the Indian system of medicine already in the public domain. The U.S., which had objected to the compulsory licensing clause from the time it was first inserted, decided to forego another appeal to the dispute settlement mechanism of the WTO. Indian opponents of the Patent (Amendment) Act, 1999, including the left parties, condemned it for conceding too much. Former Prime Minister Chandra Shekhar predicted the new legislation would bring economic "ruin and slavery" to the country and only help multinationals to further exploit and hurt the poor.

The effort to impart momentum to growth did in the end keep the direction of economic reforms.

Yashwant Sinha's Budget for 1999-2000 presented on February 27, 1999 did not mention the word "Swadeshi". Rather, it presented a big picture approach to reducing revenue and fiscal deficits, accelerating internal liberalization, reviving exports, strengthening knowledge based industries, and concentrating on programs for human development that was consistent with "calibrated" integration of the Indian economy with the world economy. The proposals for surcharges as part of schemes to rationalize customs duties and excises, were presented in the context of the need to raise revenues balanced against the commitment to further phase down India's customs duties to Asian levels. The Budget included a number of enabling measures to foster industrial restructuring of Indian industries, and to boost competitive high-tech sectors, especially Information Technology, as well as the Indian entertainment industry, in which India had the potential to become a "global media superpower". The most important thrust was aimed at reviving the capital markets through a fiscal package to make equity investments more attractive by fully exempting from income tax all income from the Unit Trust of India and other Mutual Funds and capping the long-term capital gains tax at 10 percent. A disinvestment program in non-strategic public sector enterprises was expected to raise $ 2.3 billion (Rs 100 billion) to help fund social and infrastructure requirements. The Finance Minister predicted that his medium-term strategy, including "hassle free" clearances for foreign direct investment, would restore the fiscal health of the economy; and that within 5 years, "Indian industry will have restructured and become fully competitive in world markets".

At the same time, the parliamentary standing committee, which reported out the Insurance Regulatory Authority Bill, forced the government to make substantial concessions. The final version of the IRA passed by the Lok Sabha capped foreign equity at 26 percent, eliminated the provision for an additional 14 percent of equity for FII's, NRI's and OCB's, provided that a foreign investor should not be the biggest single shareholder in an insurance company, and made private insurance companies subject to government regulations for public companies. As the government prepared to introduce the modified IRA Bill into the Rajya Sabha, Jayalalitha suddenly made good her threat to withdraw her party's support to the coalition. On April 17, 1999, when the BJP-led government lost its majority by one vote, the Insurance Regulatory Authority Bill had still not been passed into law.

The effort to impart momentum to growth, led by Prime Minister Vajpayee, Jaswant Singh, Yaswant Sinha, Industry Minister Sikander Bakht, Commerce Minister Ramakrishna Hedge and advisers in the PMO and the Planning Commission, did in the end *keep the direction* of economic reforms. In areas where this group of Ministers were free to act a number of initiatives were taken which anticipated the second stage of reforms. In August 1998, India unilaterally removed quotas on all imports from neighboring SAARC countries, facilitating operations of multinationals established in Sri Lanka, and signed an agreement with Sri Lanka to create a Free Trade Area by 2007. At about the same time that the WTO upheld the U.S. complaint that Quantitative Restrictions (QR's) on Indian imports could not be justified by India's balance of payments situation, the Commerce Minister, Ramakrishna Hedge, on March 31, 1999, announced a new Export-Import policy for 1999-2000. Presented as further incentives to exporters, Quantitative Restrictions on imports were removed on 1,308 products including consumer

Progress, however remained painfully slow on a core item at the unfinished agenda.

goods, leaving a relatively small list of 667 items still to be phased out. Hedge also announced that from July 1, 1999, all Export Processing Zones would start to be converted to Free Trade Zones, and that existing labor laws would not be applicable in these zones.[14]

The government also adopted the recommendations of a National Task Force on Information Technology and Software Development headed by Jaswant Singh. The recommendations provided a blueprint for an integrated approach to the development of a national informatics policy that ended the public sector monopoly of Videsh Sanchar Nigam Ltd as the international gateway for the Internet. This was combined with a New Telecom Policy, announced on March 26,1999 that sought to transform telecommunications' infrastructure and facilitate direct interconnectivity between local, long distance, international and Internet services over a 5 year period.

At the time the government collapsed, these initiatives, hardly off the drawing board, remained on paper. Yet, other less dramatic policies to tackle improvements in infrastructure signaled the government's determination to move ahead. The National Highway Authority of India (NHAI) was established to speed up widening and modernization of national highways, and an experiment started to open the first toll road under private management. Foreign investment was attracted to build and run several new ports. And the major public sector banks substantially expanded their project financing divisions, increasing lending for infrastructure projects.

Progress, however remained painfully slow on a core item of the unfinished agenda. The Prime Minister, supported by the Finance Minister and the Planning Commission could not implement the recommendations of the Disinvestment Commission on 43 cases, primarily because the bureaucracy was still persuasive with Ministers who came to accept their view that privatization would cost too much in lost power over jobs, contracts and appointments. During 1998, only the freight-handling firm, Container Corporation of India (Concor) was sold, but this fell far short of the $1.2 billion projected for sale of shares in the fiscal year to March 1999. In 1999, Videsh Sanchar Nigam Ltd. was opened up to foreign investors although at depressed prices, partly because domestic and regional markets were in a slump. Sinha's projection of raising $2.3 billion by selling shares in state-run companies for 1999-2000, provoked only skepticism.

Outlook

India is experiencing multiple upheavals, of which the changes arising from the 1991 economic reforms is only one. The failure to find an alternative to the Congress (I) as a party of national consensus reflects the fragmentation of politics at the local and state levels as resurgent regional parties and historically disadvantaged social groups claim a direct share of state power. The BJP's attempt to adapt its policies to the new political realities by constructing a patchwork of alliances brought it to national office, but only at the cost of effective governance. Its greatest impact during the 13 month period was not on the unfinished economic agenda, although during the final months the outline of a strategic direction was visible. Rather, it was in transforming India's national security policies by opting for nuclear weapons, and rejecting all pressure by the five recognized Nuclear Weapons States, led by the U.S. to sign the Comprehensive Test Ban Treaty, cap production of fissile materials, and slow down development and deployment of delivery systems. On the contrary, India's proposed nuclear weapons doctrine, announced on August 18, 1999, calls for a strategic defense system based on a triad of delivery systems, including land-based missiles, planes and submarines.

As the country conducts the thirteenth national elections and the third in 3 years, the outcome is likely to be influenced by events that occurred after the collapse of the BJP-led government. The failure of the Congress (I), led by Sonia Gandhi, to put together an alternative coalition, enabled Prime Minister Vajpayee to continue as head of the caretaker government for almost five months. He was in position to make a decisive military response once Pakistan's infiltration at Kargil, across the Indian Line of Control in Kashmir, was discovered, and to win international support, including that of the United States, for attacks, involving bombing, over eleven weeks in May-July 1999. After Kargil, the BJP, buoyed by public opinion polls showing a jump in popular support for the Prime Minister, decided on a campaign strategy to focus on Vajpayee, and through him link the BJP to the victory of the Indian Army.

Kargil was also fastened upon by the opposition. The Congress (I) under Sonia Gandhi painted the dark side of the picture. This was of a government so inept that the Prime Minister traveled by bus to Lahore in February 1999 to signal the beginning of a new era in peaceful resolution of conflicts between India and Pakistan, completely unaware of the Pakistan supported intrusion underway because of a massive intelligence failure. This was of a government so cynical that it

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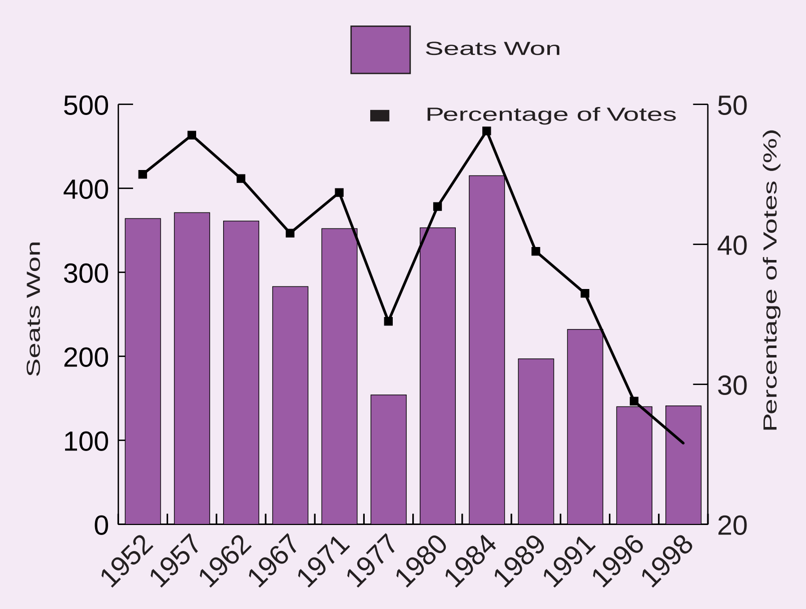

Source: CASI

Source: BJP Web Site

kept the information from the public as long as possible, ending in a conflict that claimed the lives of 1000 jawans (soldiers), and injured hundreds more.

The Kargil issue, dominating the election, may obscure but will not close the political fissures that have prevented the implementation of coherent economic policies since 1995. The BJP's formation of a 22 party National Democratic Alliance before the election, and the adoption of an election manifesto that repeats the language of the National Agenda on Governance to give reforms a "strong Swadeshi thrust" and ensure national growth on the principle that "India shall be built by Indians" suggests that the debate within the BJP, and the BJP and the Sangh Parivar, continues.

There is a possibility that Vajpayee can develop a popular constituency responsive to him, giving the National Democratic Alliance a majority in the Lok Sabha and insulating the government from the demands of the Sangh Parivar. If not, the stage could be set for another fractured coalition preoccupied with placating its own allies, and fending off attacks from the RSS and its front organizations. Similarly, the Congress (I)'s fate depended almost entirely on the vote-getting abilities of its leader Sonia Gandhi. Mrs. Gandhi had to withstand relentless attacks on her videshi (foreign) origin, and indirectly or otherwise, her Roman Catholic religion. Unless Sonia Gandhi can establish her indispensable position as a national leader above region, religion and caste, Congress (I), should it return to power, will once again have to rely on the left.

Ironically, while the Congress (I) remains convinced that the Hindutva ideology is a danger to India's integrated secular

Source: Congress (I) Web Site

state, and the Sangk Parivar holds firm to the belief that "pseudo-secularism" favoring Muslim and other minorities weakens national solidarity, the experience of the last ten years has begun to close the gap between the reformers in each major party on the approach to economic liberalization.

The slowdown in world trade and domestic recession, even as signs of recovery appeared in mid-1999, produced a more sober assessment of India's potential economic growth in the medium-term. Steady progress at 5-6 percent, as India's industries struggle with the restructuring process, has come to be considered creditable. Pro-reform ministers in the Congress (I) and the BJP alike recognized their failure to anticipate how difficult it would be to privatize public enterprises, and to break the control of the bureaucracy over infrastructure sectors while putting in place transparent regulatory regimes that could inspire confidence in foreign investors. And without growth rates of 7-8 percent, there is more concern about a stable transition within an unequal democracy, one that protects jobs, and provides investments in health and education for the poor.

There is also more skepticism about the benefits of globalization. The Confederation of Indian Industries is concentrating on strengthening domestic industry to deal with competition at the international level. Rahul Bajaj, President, CII expressed the "growing fears not only in India but other developing countries that they were being taken for a ride." India is preparing for the November 1999 WTO conference in Seattle by staking out a leadership role on behalf of developing countries for differential treatment under a number of agreements, and to oppose any further negotiations that seek to apply non-tariff barriers in the guise of environmental standards or social issues. Any successor Indian government will use the WTO machinery aggressively, to oppose anti-dumping laws, quotas and safeguard actions by the U.S. and the European Council as protectionist measures against developing countries, while using the same machinery to bring complaints of dumping in India by countries like South Korea. This assertiveness also extends to disputes with the United States arising out of the sanctions imposed in the aftermath of India's nuclear tests and its proposed nuclear weapons doctrine. India has lodged a strong protest against the U.S. Commerce Department's "Entities List" and is threatening to take the U.S. to a dispute settlement body of the WTO if the expanded ban on exports of dual-use technology is not lifted.

As the U.S. and India try to find mutual benefit from enlarging their trade and investment relations in the twenty-first century, these issues will no longer be possible to insulate from divergent perspectives on India's status as a global economic and military power determined to assert her own interests as she defines them. Economic nationalism and military strength are not the guiding principles of a single political party. They are basic assumptions of policy that provide the nucleus of a national consensus amid the unpredictability of electoral politics in India.

[1] *Finance Ministers' Budget Speeches,* Surjeet Publication: 1998, p. 1307.

[2] *Economic Survey 1998-99*, p. 1.

[3] Bharatiya Janata Party, *Election Manifesto 1998*, p.9

[4] Rohit Saran & Rukmini Parthasarathy, "Why Are Our Exports Shrinking?" *Business Today*, August 22, 1999.

[5] T.N. Srinivasan, *Eight Lectures on Indian Economic Reform*, October 1998, p. 28.

[6] E.M.S. Namboodiripad, "The Present Economic Situation, Policy Alternatives," *JANATA*, October 13, 1991.

[7] "Politics of Infrastructure Reforms: The Power Sector," *Doing Business in India*, Vol. No. 2, Spring 1998.

[8] For a detailed analysis of the Left Front Government, see *Doing Business in India*, Fall 1997.

[9] Christoffe Jaffrelot, *The Hindu Nationalist Movement in India*, Viking: 1996, p. 382.

[10] Daya Krisha, "Swadeshi View of Globalization," *Swadeshi Jagaran Manch*, 1994.

[11] *The Observer*, August 1998, p. 10.

[12] *Times of India*, August 29, 1998.

[13] Jaya Mahale, "On the wings of Change", *The Economic Times Online*, July 24, 1999.

[14] *The Hindu*, April 1, 1999.

* Except where indicated financial data comes from annual issues of the *Economic Survey* published by the Government of India.

A post-election commentary will be available on the CASI web site (www.sas.upenn.edu/casi) following the election results.