1991 – Leadership and Strategy

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Much has been written recently about the economic crisis of 1991 and the new turn in Indian economic policy since then. Most of this has been written by economists who regard themselves as the key actors in economic policy making and management. Historian Robert Skidelsky titled the volume dealing with the inter-war crisis years in his three-volume biography of John Maynard Keynes, the most influential economist of the 20th century: "The Economist as Saviour". Keynes and his fellow economists, says Skidelsky, viewed themselves as members of an "activist intelligentsia, claiming a right of direction, vacated by the aristocracy and the clergy, by virtue of superior intellectual ability and expert knowledge of society."[1] They saw themselves as "the front line of the army of progress." Ever since, economists have basked in this self-image as social saviours and commanders on the development battlefront.

However, a balanced and objective assessment of the management of the crisis of 1991 would show that the country's political leadership played an equally important role. Both Prime Minister Chandrashekhar and Prime Minister Narasimha Rao as well as Finance Ministers Yashwant Sinha and Manmohan Singh played an important leadership role in leading policy. Prime Minister Rao went a step further and introduced far-reaching reforms that went beyond crisis management and altered India's trade and industrial policy regimes.[2]

It should also be noted that the economic crisis of 1991 occurred in the context of major political and geopolitical changes that impacted India. The assassination of Rajiv Gandhi and the failure of any national political party to secure an absolute majority in Parliament provided the political context. In an 'era of coalitions' a minority government took charge and was given the responsibility to manage an unprecedented economic situation. Never before

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had India come to the point of defaulting on its external borrowing obligations. A sovereign default would have serious consequences for India's economic and, indeed, political sovereignty.

Equally important was the fact that India's key strategic ally and defence partner, the Soviet Union, was on the verge of an implosion with the end of the Cold War in Europe and the victory of the West over the East. It is in this context that PV Narasimha Rao took charge as Prime Minister.

A day after being sworn in as PM, Rao addressed the nation on television and said: "The economy is in a crisis. The balance of payments situation is exceedingly difficult. Inflationary pressures on the price level are considerable. There is no time to lose. The government and the country cannot keep living beyond their means and there are no soft options left. We must tighten our belts and be prepared to make the necessary sacrifices to preserve our economic independence which is an integral part of our vision for a strong nation."[3]

The PM then took an interesting step forward. Not restricting himself to crisis management, fiscal and balance of payments stabilisation, Rao chose to commit his government to wider economic reform. "The Government is committed to removing the cobwebs that come in the way of rapid industrialisation. We will work towards making India internationally competitive, taking full advantage of modern science and technology and opportunities offered by the evolving global economy."

In two simple sentences he declared to the nation his decision to utilise the crisis as an opportunity to shift India's trade and industrial policy from the inward-orientation of the Nehru-Indira years onto a new trajectory of globally integrated development.

The 'evolving global economy' was being reshaped by new geopolitical factors – the implosion of the Soviet Union and the restructuring of the world trading system by an assertive United States. It was the US that had helped create the General Agreement on Trade and Tariffs (GATT) in the 1950s. The purpose of GATT was to install a global trading regime that would enable the war-torn economies of Europe and Asia to rebuild themselves while creating new markets for US exports. The US believed GATT had served its purpose, helping Germany, Japan and many 'East Asian

Tigers' emerge as globally competitive economies. Their exports were now threatening the US and the sole super power wanted a restructuring of the global trading system, replacing GATT with a new World Trade Organisation.

While the immediate demands of crisis-management, especially the urgent need to avoid default on external debt repayments, required 'import compression', in months to come Rao lent his weight to trade liberalisation and the re-integration of the Indian economy with the global, especially the dynamic East Asian economies.

The government's immediate task was to avoid default. It was not just the ignominy associated with a default that India wished to avoid. The experience of every single developing country that had defaulted was no different from that of a poor peasant defaulting on a loan taken from a landlord. The creditor nations seek their pound of flesh. The loss of confidence in a country's ability to manage its economy prudently is not easily reversed.

Rao's predecessor, Prime Minister Chandrashekhar, had already decided that India would rather mortgage gold than default on external payments. Rao authorised a second round of gold mortgage. The first tranche, undertaken in May 1991, involved the shipment of 20 tonnes of gold. The second round, undertaken in July 1991, involved movement of around 46.91 tonnes of gold, valued at US $ 405 million, from the RBI vaults in Mumbai to the vaults of the Bank of England in London. Even as Dollars were earned mortgaging gold, Dollars were lost as non-resident Indians withdrew the cash deposited in foreign currency accounts in India. Given that the priority for the government was to avert external default, there was no other option but to further tighten import controls. The import squeeze began to hurt the economy which, on the one hand, slowed down, and, on the other, experienced inflationary pressure on the price level. The economy was in the throes of what economists define as 'stagflation'.

Opinion was divided within the government on whether 'import-compression' ought to be ensured through physical controls, an outright ban, or ensured through price signals, devaluation of the Rupee. Finance Minister Manmohan Singh tilted in favour of using the exchange rate rather than import bans. Over the financial year

1990-91 the Rupee had already depreciated by around 11.0 per cent, but it was now felt that a one-time sharp adjustment would stabilise the Rupee by renewing confidence in it. On 1st July the Rupee was devalued by around 9 per cent and on 3rd July there was a further devaluation by around 11 per cent, with the adjustment working out to a 17.38 per cent devaluation.

Following devaluation, the government began the process of liberalising the trade regime, moving away from India's traditional export-pessimism to a new philosophy that viewed exports as another source of growth as well as a source of foreign exchange. India is a resources-deficient economy in per capita terms, and has been vitally dependent on oil imports. It needed to finance not just essential imports but also export-promoting imports in sectors using new technologies.

Further trade liberalisation had to wait till India's balance of payments were on firmer ground. For now, a steep devaluation of the Rupee would act as a disincentive for imports and an incentive for exports. No sooner had the devaluation exercise been completed, PV authorised the ending of a highly dubious sop given to exporters called the Cash Compensatory System (CCS). The CCS was a subsidy given to exporters to compensate for all the inefficiencies of the Indian system that made exports globally uncompetitive. Devaluation was an incentive for exporters. Hence, the CCS was withdrawn.

Ignoring apprehensions of the commerce ministry, which has long regarded its *dharma* to be the defence of the interests of exporters, the PM signed the file abolishing CCS on the same day that the RBI took the second step on Rupee devaluation. On July 4th, Commerce Minister Chidambaram announced trade policy reforms that were defined by two key considerations: first, to enable India to move closer to the emerging new global trade policy architecture that was to be put in place by the yet to be established World Trade Organisation; second, to link import entitlements to export performance.

Combining devaluation with trade policy liberalisation made sense. The purpose of taking these measures was also to demonstrate to international investors and financial institutions that the new minority government was prepared to take difficult decisions. Thus the measures were aimed as much at securing access to hard currency as they were at boosting confidence in India.

A week after the devaluation exercise and on the eve of the first session of Parliament, Rao addressed the nation for a second time. In a speech televised on Tuesday 9th July, 1991 he explained to the people in simple terms the logic behind his early policy moves. You cannot import if you do not export. Trade, not aid. "Aid is a crutch. Trade builds pride. India has been trading for thousands of years." He then went on to emphasise that he intends to go beyond crisis management to bring India in line with the rest of the world. "We believe that India has much to learn from what is happening elsewhere in the world. Many countries are bringing in far-reaching changes. We find major economic transformation sweeping large countries like the Soviet Union and China....... There is a change in outlook, a change in mindset everywhere. India too cannot lag behind if she has to survive, as she must, in the new environment."

Within a fortnight of taking charge as PM, and even before the first sitting of Parliament, Rao took momentous decisions that helped restore confidence in the economy. The next major step to take, and the one that the IMF and the rating agencies were eagerly looking forward to, was a sharp reduction in the fiscal deficit. If exchange rate management was RBI's job, fiscal management was the Finance Minister's.

In fact the single most important announcement made in Singh's first budget speech, on 24 July 1991, was the reduction in the budget deficit. It was a commitment that Singh's predecessor, Yashwant Sinha, had first made in December 1990. It was now Manmohan Singh's turn to deliver on that commitment. The fiscal deficit was brought down sharply from a high of 8.4 per cent of GDP in 1990-91 to 5.9 per cent in 1991-92. The Seventh Plan average was as high as 8.2 per cent. This was, by any standard, a sharp and decisive cut.

Exchange rate adjustment and fiscal deficit reduction would in themselves have been enough to win the confidence of credit rating agencies and financial markets. However, PV went a step beyond. Intervening in the debate on the motion of thanks to the President for his address to Parliament, on 15th July, the PM claimed, “All (our) measures were really written about in newspapers, times without number……. So it is not as if the measures which we have taken have just dropped from the heaven overnight ……… People are more knowledgeable than myself on what is happening in the Soviet Union. …… We cannot keep out of this change, this complete global sweeping change that is coming.” [4]

It is with this perspective in mind that Rao instructed the Ministry of Industry (of which he was then the Cabinet Minister) to prepare a new industrial policy dismantling the infamous ‘licence-permit Raj’. The government’s first priority was to prevent default. Hence, management of the balance of payments and policies aimed at earning Dollars and conserving what was earned, was the first priority. Devaluation and trade reforms were, naturally, the first step. The second step was to enhance confidence in India’s economic management as well as to improve the competitiveness of Indian industry. Towards this end, industrial policy reforms were undertaken. The third step was to reduce the government’s debt and deficit and show an improvement in fiscal management. This was the focus of the Finance Minister’s first budget, presented on 24th July.

In the Indian sub-continent the tone for the 1980s was set by two significant developments in India’s wider neighbourhood. First, the emergence of Deng Xiaoping as China’s new leader. Second, the Soviet Union’s invasion of Afghanistan and the joint Pakistan-US led Jihadi campaign against Russia. Under Deng began the inexorable rise of China. Thanks to Soviet action and US response in Afghanistan, Islamic radicalism knocked on India’s door.

Deng blew the dust off Zhou En Lai’s ‘four modernisations’ of 1963 and launched, in 1978, his own revolution for the modernisation and transformation of China. The modernisation of agriculture, industry, national defence and science and technology were Deng’s four priorities. Deng’s assumption of power was preceded by a rapprochement between the People’s Republic of China and the United States of America. This altered the Cold War balance of power across Eurasia and the Asia Pacific region. Not only had India’s strategic environment been altered, but Indian attitudes towards nation building and modernisation began to change.

While the Charan Singh Government conveyed India's disapproval of Soviet action in Afghanistan, Indira Gandhi initially toned down the criticism on her return to power in 1980. However, by 1981 Indira Gandhi decided to send a different message out. Even as her officials let it be known that if the US director on the IMF board voted against India securing a loan, India would have no option but to move closer to the Soviets and their East European friends for economic assistance, India signaled a new willingness to work with the West. The botched Soviet invasion of Afghanistan forced India to rethink its strategic relationship with big powers.

According to the then Foreign Secretary JN Dixit, Indira sent Foreign Minister Narasimha Rao to Moscow to persuade the Soviets to withdraw from Afghanistan. Soviet Foreign Minister Andrei Gromyko called on her, asking her to "understand" what factors led to the "Soviet initiative", as he put it. Mrs Gandhi merely let him know that she had heard what had been said and had "taken note of it". She stopped short of expressing her "understanding".[5] In his diplomatic memoirs former Foreign Secretary MK Rasgotra records a conversation between Indira and Soviet boss Leonid Brezhnev. Asked by Brezhnev for advice on how to get out of Afghanistan, Indira's terse reply was, "The way out is the same as the way in."[6]

Soviet unwillingness to withdraw was no longer a sign of their strength. Rather, their brutal repression of the Afghans who opposed their presence was the sign of a new and growing weakness. External aggression and domestic political appeasement, Mikhail Gorbachev's *glasnost* and *perestroika* signaled this weakness.

The Soviet handling of the Afghan situation, Pakistani nervousness on account of its feeling enveloped by India on one side and the Soviets on the other (reviving memories of the liberation of Bangladesh), a renewed US-Pakistan alliance against the Soviets, the anger in West Asia against Soviet invasion, Pakistani support for Khalistani separatism in India and the civil war within Afghanistan, pre-occupied PV during his tenure as Foreign Minister and then Home Minister.

India's own economic aspirations and woes required it to arrive at a *modus vivendi* with the West, specially the US. Indira Gandhi reached out tentatively to US President Ronald Reagan during his first term and Rajiv Gandhi took that initiative forward, taking advantage of a new warmth in US-USSR relationship symbolised by the Reagan-Gorbachev dialogue. But, despite tentative Indian efforts there was no qualitative change in the US-India relationship during the 1980s.[7]

In this decade of flux, the external environment was far from comfortable for India. In many ways, India's unwillingness or inability to think its relationships anew, the rekindling of old suspicions with respect to the West, a new discomfort with an old friend, the Soviet Union, and the changing equations in Asia defined the 1980s. India retreated into an old comfort zone hosting the Non-Aligned Summit in 1983 and building new equations with other developing countries in associations such as the G-77 and G-15.

Her investment in South-South links and developing country partnerships were not particularly helpful when it came to dealing with a balance of payments crisis, triggered by a sharp rise in oil prices when the head of a 'friendly' oil-rich West Asian country, Iraq, invaded another friendly oil-rich West Asian country, Kuwait. Reeling under the impact of a balance of payments crisis Finance Minister Yashwant Sinha turned for help to the world's rich, the Group of Seven nations, but in vain.

His counterpart in Tokyo did not even have time to meet him. Japan was busy doing business with China. As that long decade came to an abrupt end, global geopolitics shifted rapidly. India was caught unawares, dealing simultaneously with political transition and economic crisis.

Speaking to the *Economic Times* in July 1991 on the options available to the government on the economic policy front, a chastened Yashwant Sinha observed: "The budget will mark a major departure from the kind of economic policies that have been followed since Independence. Policy will have to be viewed in the context not only of the dramatic collapse of the USSR and Eastern Europe, but also of the decisive victory of the United States in the Gulf War. The impact of these two events should not be underestimated."[8]

The implosion of the Soviet Union had more than geopolitical consequences for India. It also had profound economic implications at a particularly difficult time. In 1990 the Soviet Union and Eastern European countries that had Rupee payment arrangement for trade with India accounted for 17 per cent of India's total external trade. This share collapsed to 2.0 per cent in 1992. The sharp decline in Rupee trade and the Russian insistence on moving away from the Rupee-Rouble arrangement to hard currency payments, especially for oil, imposed further burden on India's balance of payments.

Political and economic change at home, a shift in the global balance of power and the geopolitical and geo-economic challenges of the day shaped India's ability to deal with a payments crisis, and the global response to it. The dramatic developments of 1991 demonstrated how the world had changed, and India with it. Professional economists have analysed in detail the economic challenges India faced at the time; political scientists and commentators have examined the political response to these challenges; and geopolitical analysts have written extensively about shifts in global power balances. However, it is easy to see that the politics the economics and the geopolitics of 1991 were all inter-related.

"Now the Cold War is over, there is an element of cooperation instead of confrontation." PV told the *Sunday* magazine, in an interview in September 1991, explaining the rationale of his economic policies. "It is a new situation. And we have to respond to that also. So certain policy reorientation will take place to ensure that our national interest does not suffer."

In saying this, the Prime Minister was providing both political rationale and geopolitical context to his domestic economic policy agenda. As Indira's Foreign Minister in the early 1980s, Rao saw at first hand the declining influence of the Communists in the Soviet Union and the sweeping ideological changes in the formally still Communist China. In 1988 Rao accompanied Rajiv Gandhi on his historic visit to China where he met China's Great Reformer Deng Xiaoping. Even though Rajiv kept Rao out of that meeting, this visit and earlier ones, enabled Rao to grasp the extent of change underway in Deng's China.

In December 1991 Chinese Premier Li Peng visited New Delhi. A new phase in India-China relations was quietly inaugurated and resulted in 1993 in the two Asian neighbours who had fought a war along their border in 1962 signing the historic *Agreement on the Maintenance of Peace and Tranquility along the Line of Actual*

Control in the India-China Border Areas. Whatever the continuing tensions between India and China over the years, this agreement ensured that no more lives were lost along the border in the subsequent quarter century.

By taking charge of policy in the summer of 1991, Prime Minister Rao made history. But, he made sure he took no individual credit for it, claiming that what he did is what Rajiv Gandhi would have wanted to do. He told the Tirupati session of the All India Congress Committee (AICC), in April 1992, "In the past ten months, our Government has initiated far-reaching fiscal and financial reforms. This was done in conformity with our Election Manifesto of 1991 which gives the main features of the reforms."[9]

Suggesting that there was no deviation in his policies from Nehru's vision of a 'socialist India', Rao projected his initiatives as ensuring 'continuity with change'. A country of India's size "has to be self-reliant", Rao told the AICC, but self-reliance did not mean the pursuit of import substitution as a dogma. "The very level of development we have reached has made us independent of the world economy in some respects, but more dependent on it in others."

Self-reliance in 1991, Rao redefined to mean as being "indebted only to the extent we have the capacity to pay." Reducing foreign debt, being able to avoid default, promoting exports and liberalising the economy so as to attract foreign investment and earn foreign exchange were all elements that would define the path to self-reliance. In the past, self-reliance had been defined as securing 'independence' from the world economy, now self-reliance was being redefined as creating 'inter-dependencies' that would give others a stake in India's progress.[10]

Next, Rao went on to redefine the role of the public sector, reminding his party that both the profits and the losses of public enterprises were in fact the profits and losses of the people of India. Making the public sector more efficient, so that it would cease to be loss-making, was in the interests of the people. Further elaborating the role of public and private sectors in the economy Rao claimed his policies, "do not represent the withdrawal of the State altogether, but a reconsideration of the areas in which it must be present."

Finally, Rao went on to redefine yet another Nehruvian idea that had been reduced to a shibboleth by Indira Gandhi's diplomats. Non-alignment was not just about remaining outside antagonistic military alliances. It was not about being 'neutral'. Non-alignment is "an urge for independence in judgment and action, in exercise of the sovereign equality of nations." As a non-aligned nation India could be on one side or another in international relations depending on the issue. While India chooses to be outside any alliance, it retained the freedom to work with one or the other alliance depending on its own national interest.

This was a pragmatic, not ideological, view of non-alignment. After all, in 1962 Nehru was willing to seek US military help to deal with China and in 1971 Indira sought Soviet help to deal with the ganging up of the US and China on the issue of the future of East Pakistan. The Polish economist Michel Kalecki described non-alignment as "a clever calf sucking two cows", drawing attention to the policy's pragmatic rather than ideological basis.[11]

Linking his economic policies to his foreign policy, Rao concluded, "This self-reliance must consist in trying to find solutions to our own problems primarily according to our own genius......... We reject nothing useful for its plainness, we take nothing irrelevant for its dazzle."

Rao called it "The Middle Way". Rao's 'Middle Way' is not to be confused with a 'middle path'. [12] It was not a mean or a median, a compromise between extremes. It was a path unto itself. "To interpret Nehru's middle way as being valid only in a bi-polar situation is not to understand our ancient philosophy of the Middle Way." The PM told the AICC.

Writing a few years later, in 1998 to be precise, British sociologist Anthony Giddens called it the 'third way' in his politically influential book, *The Third Way: Renewal of Social Democracy.* It was said to have inspired the politics of Prime Minister Tony Blair who was himself battling the Right and Left within the Labour Party. Rejecting top-down bureaucratic socialism, and its emphasis on public investment and controls, as well as rejecting *laissez-faire* 'neo-liberalism', Rao's 'middle way' sought to "strike a balance between the individual and the common good", as PV put it.

"The Middle Way was meant to be a constant reminder that no assertion or its opposite can be the full and complete truth. It meant that we looked for Truth in the interstices of dogmas. It means today that we will accept no dogma even if it happens to be the only dogma remaining in the field at a given moment."

It was the best expression of a liberal principle that in a different world a very different man summed up as "seeking truth from facts".[13] It was only natural that these changes at home would require readjustments in Indian foreign policy at a time when the world too was changing. The end of the Cold War, the implosion of the Soviet Union and the triumph of western capitalism forced Indian diplomacy to readjust its vision and priorities. Building bridges with the emerging centres of economic activity in Asia and with industrial powers, that still dominated global economic and political institutions, became necessary. Guiding India through a new and hitherto uncharted terrain, in that fateful year, Rao asserted the role of a political leader in a democracy. He put India on an untrodden path releasing the immense potential of Indian enterprise.

Endnotes

[1] Robert Skidelsky, *John Maynard Keynes: The Economist as Saviour, 1920-1937*, Macmillan, London, 1992. Page 406.

[2] For a detailed account of the political management of the crisis of 1991 and the introduction of new economic policies see Sanjaya Baru, *1991: How PV Narasimha Rao Made History*, Aleph Book Company, New Delhi, 2016.

[3] PV Narasimha Rao, Broadcast to Nation, *Selected Speeches, Volume I,* June 1991-92, Publications Division, Ministry of Information and Broadcasting, Government of India, New Delhi, 1993. Page 4

[4] PV Narasimha Rao, *Selected Speeches, Vol I* , (1993). Pages 8-9.

[5] JN Dixit, *India's Foreign Policy 1947-2003*, Picus Books, New Delhi, 1998. Page139.

[6] MK Rasgotra, *A Life in Diplomacy*, Penguin Viking, 2016.

[7] Dixit (1998), Page 151

[8] Yashwant Sinha, "Budget 1991 – Options", *Economic Times*, New Delhi, 1st July 1991.

[9] The full text of PV's presidential address to the AICC has been appended to this book. See *Appendix.*

[10] This is an idea that has been elaborated at length in Sanjaya Baru, *Strategic Consequences of India's Economic Performance,* Academic Foundation, New Delhi, 2006.

[11] Baru (2006), Chapter 2.

[12] Many make the mistake of thinking PV merely sought to strike a balance, pursuing a 'middle path' between the state and market.

[13] Originally a phrase used by Mao Zedong to defend his decision to liberate the Chinese communists from Stalinist orthodoxy in the interpretation of Marxism-Leninism, the guidance 'seek truth from facts' was used by Mao's successor Deng Xiaoping to challenge Maoist orthodoxy within the Chinese communist party. Narasimha Rao's interpretation of the Middle Way comes close to this dictum of basing political action on a realistic assessment of social, political and economic realities.