India’s industrial reforms of 1991: The inside story India’s industrial reforms of 1991: The inside story

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A providential promotion of a bureaucrat and a strategic ministerial portfolio allocation set the stage for the New Industrial Policy unveiled in 1991

Ankit Mital

The 1991 economic crisis, essentially a balance of payments problem, is generally seen as the overriding factor that led to the dismantling of the licence/quota raj, but that is only partly true. The lacunae of the industrial and trade policies were well documented both within and outside the government. Contrary to the perception of reforms being foisted on the government by the International Monetary Fund (IMF), these reforms were entirely “made in India”.

The New Industrial Policy saw the light of day in 1991 for a variety of reasons. Industries were struggling, but the government’s budgetary constraints in 1991 meant it could not provide funds for investment in industrial activity, either directly or through banks. Access to private capital and the de-licensing of industrial activity became necessary. As one of the senior bureaucrats involved in the process put it to me, “What would we have told the country? Hawa khao? (Eat air?).”

However, such was the nature of the crisis that it did not make industrial India’s industrial reforms of 1991reforms inevitable. The funding squeeze was temporary, after all. The government could have kicked the reform question into the long grass and still have rode out the crisis. The IMF had been pretty generous with its lending terms the previous time India had gone banging on its doors in 1981. Status quo could still have ruled.

But as the saying goes, there is nothing like a crisis to concentrate the mind—it provided an urgency to revamp the Indian economic architecture, and cover for politically difficult decisions. As in most things, luck played a crucial part. The providential promotion of a bureaucrat and a strategic ministerial portfolio allocation made sure that bureaucratic and political inertia could be overcome. Here's how it all came together.

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The intellectual impetus for deregulation came from the weight of reports commissioned by the government over several decades. From the 1960s on, there was a large body of work within the government in response to the dissatisfaction with the licensing regime. The strange thing was that while each committee had recorded the problems with the set-up extremely well, it would nevertheless recommend only a further tightening of the regime.

So, for example, the Bureau of Industrial Costs and Prices—a long forgotten advisory body that existed till the 1990s—did some very good studies on the price structures of commodities such as coal, steel, India's industrial reforms of 1991: cement, aluminium and drugs, highlighting the problems therein. But what did it recommend? Price controls.

Political resistance to reform was strong and that was reflected in the official recommendations, if not the analysis. Interestingly, there was also little academic pressure for deregulation, apart from the seminal work of Jagdish Bhagwati and Padma Desai.

That changed in the 1980s, when various committees were appointed, all of which were in the direction of liberalization, one way or another. So, the same Bureau of Industrial Costs and Prices now did a succession of reports on steel, cement, etc, each of which recommended deregulation. The success of East Asian economies had made the government more receptive to these recommendations.

When the V.P. Singh government came to power in December 1989, he wanted to differentiate himself from the Congress. During his time as finance minister to Rajiv Gandhi, Singh had acquired a reputation for being a liberal reformer. The reform process under the Congress government, however, had stalled in the aftermath of the political maelstrom caused by the Bofors scandal, which also resulted in Singh's dismissal as minister in 1987.

And so, when Singh became the prime minister, there was a renewed focus on industrial reforms. It was against this backdrop that Amar Nath Verma and Rakesh Mohan submitted a set of policy recommendations that were the basis for the New Industrial Policy. Let's go back a bit, to 1988, when Mohan, a World Bank veteran with a PhD from Princeton, joined the industry ministry as its economic adviser. At the same time, the government had a new cabinet secretary—T.N. Seshan.

As one contemporary told me, Seshan was a control freak and "wanted to see himself as a very powerful fellow who knew what was happening". He wanted all the ministries to submit presentations to him on everything they were up to—a thankless task that was generally pushed on to the advisers in each ministry, as opposed to the secretaries.

The question Mohan had to answer was fairly simple—what is India's industrial policy? However, the very process of compiling and collating all the existing industrial licensing policies, which included MRTP (the Monopolies and Restrictive Trade Practices Act), technology controls and licensing regimes was perhaps the first step towards their dismantling.

Meanwhile, the Rajiv Gandhi government's tenure came to an end and V.P. Singh came to power.

Ajit Singh was the new industry minister. The son of former prime minister Charan Singh—the most prominent farmer leader of India—he was a breath of fresh air. While today his reputation has been sullied for repeatedly and opportunistically changing parties and coalitions, he was then seen as a smart "techie". His experience in the corporate culture of the West had made him instinctively wary of the slow-moving and bewildering decision-making process in India. With the new government came a reshuffle of secretaries. Verma, the commerce secretary at the time, succeeded Otima Bordia as industry secretary. Whenever a new minister comes, the civil servants make a presentation. So, Verma and Mohan gave a brief to Ajit Singh, which was essentially a reworked version of what had been prepared for Seshan.

Living up to his image of a modern man, the minister's reaction was something to the effect of "What is this? These are stupid controls", and Mohan and Verma were given a free rein to draft an agenda for industrial reforms.

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The annual World Economic Forum summit at Davos served as a platform for developing countries eager to attract global attention and capital even then. In January 1990, V.P. Singh was keen to promote a reformist image of India and nominated Ajit Singh to lead the Indian contingent.

For Davos, a presentation of what had to be done was prepared, including a pitch for liberalization of FDI. It gave Mohan "the opportunity to see the whole picture on control mechanisms that were in place including industrial licensing, phased manufacturing, monopolies regulation, controlling capital issues and export-import controls.

Unfortunately, at the last moment, Ajit Singh was ditched and Arif Mohammad Khan, the minister for civil aviation and energy, was sent in his stead. The whole trip turned out to be a damp squib.

However, the preparations had been made and the team in the ministry kept on working on a blueprint for industrial reforms. For his part, Ajit Singh held meetings with economists and businessmen to solicit suggestions. All this hard work actually resulted in something concrete— the New Industrial Policy of 1990, a comprehensive policy statement that looked at issues ranging from the promotion of small and medium enterprises, removing "unnecessary bureaucratic shackles" and easing raw material import restrictions to de-licensing, deregulation and welcoming foreign investment.

While the draft policy made it past the cabinet, it could not survive the political backlash in Parliament and was quickly put on the back burner.

One point in particular that was seized upon by the opposition was the lack of clarity over the reservation of industries from deregulation. The policy announcement had just mentioned, in principle, that there would be a list of industries that would not be opened up. No such list had yet been prepared, though; it was supposed to be a follow-up. But it became a political flashpoint and the government quickly buried the policy.

A number of political forces—from Devi Lal's farmer agitation, to BJP's Rath Yatra as a counter to the Mandal Commission, and Chandra Shekhar's rebellion (ostensibly) over the industrial policy—combined to bring down the V.P. Singh government. Shekhar finally realized his dream to become the prime minister, with outside support from the Congress.

As one of the faces of the opposition to industrial reforms, Shekhar chose to retain the industry portfolio with the prime minister's office (PMO), a first in Indian history. But, surprisingly, when he assembled all the senior bureaucrats in that ministry, he told them, "I just have come to see you. I have become industry minister because I had disagreed with what you had done. However, I want you know I want you to keep giving me your best advice. What you think is correct. Don't worry about what I said in the past few months."

Those words, unfortunately, were as inconsequential as his premiership. The economic crisis was already afoot by then. Save for firefighting on economic and political fronts, the government was paralysed. Within a few months, Shekhar's administration bit the dust.

The new Congress government under P.V. Narasimha Rao retained many of the faces of the outgoing regime. Perhaps of most consequence was the decision to promote Amar Nath Verma from the industry ministry to the PMO as principal secretary. This made Verma the prime minister's personal enforcer and the most powerful bureaucrat, along with cabinet secretary Naresh Chandra.

Rao, like Shekhar, chose to retain the industry portfolio. Whether it was out of personal inclination or because he simply followed the portfolio allocation of his predecessor is a contested fact. According to some contemporaries, Rao’s heart was not in matters of industry, but in social, political and internal security issues.

Perhaps the new principal secretary, Verma, influenced Rao. In any case, that one of the authors of the New Industrial Policy landed in the PMO and that the prime minister chose to retain the industry portfolio turned out to be a fortunate coincidence.

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Within a few days of his appointment as finance minister, Manmohan Singh called a meeting of all the major secretaries and the chief economic adviser, and gave an outline of what was to be done over the next five years—and more importantly, over the next six weeks.

Manmohan Singh knew that a framework on industrial reforms had already been prepared—he had served as a senior adviser to Shekhar, during which time Mohan had shown him a draft of the policy—and they were included in his six-week plan.

Under Verma, a steering committee for economic reforms was created in the PMO, which met almost every day during those six weeks. The draft policy served as the basis for discussion and was refined. A cabinet committee was formed, which also met quite frequently in order to meet the six-week deadline.

The mandarins and advisers at the industry ministry were rewriting the policy every day, burning the midnight oil. In those days, few people in the government knew how to use a word processor. Mohan’s personal assistant was one of them, and he used to churn out printed draft copies every night.

It was decided that the industrial policy would be presented along with the budget on 24 July 1991. A cabinet note was prepared by the industry ministry that was to be approved by the new cabinet on 19 July. Meanwhile, a note prepared by Jairam Ramesh for the prime minister on the radical new policy measures was leaked and published in the

Hindustan Times on 12 July. The cat was out of the bag and the reaction in the cabinet meeting was predictable.

However innocuous those reforms might seem today, they were revolutionary in 1991. Years of ideological baggage was being shed. Years of rhetoric disowned. Jawaharlal Nehru and Indira Gandhi were being repudiated.

The note did not pass the cabinet. Instead, a group of ministers was set up to look into the policy proposal again and it met on the evening of 20 July to discuss an amended, toned down cabinet note. But it did little to assuage the other side. From the liberalization of industrial location policies and the relaxation of MRTP controls to “anti-PSU” measures and openness to FDI, every proposal under the policy came under attack. The meeting broke up without a final decision.

It was felt that the “political packaging” of the reforms was not right. Instead of tinkering with the policy proposals again, a long preamble to the cabinet note was prepared. Authored by Ramesh, with inputs from Manmohan Singh and P. Chidambaram, it stressed continuity of reforms, reassured that all interests would be taken care of, and was sufficiently obsequious to Nehru and the Gandhis.

The new preamble did the trick and the cabinet gave its seal of approval to the industrial reforms on 23 July. The Congress Working Committee followed suit later that afternoon. The next day, at 12.50pm, quite unceremoniously, a reluctant P.J. Kurien, a mere minister of state for industry, not even a member of the Union cabinet, stood up in the Lok Sabha and tabled the New Industrial Policy, ushering in a new India.

The events, as presented here, are based on: the author’s personal interviews with Rakesh Mohan (then chief economic adviser, industry ministry), Naresh Chandra (then cabinet secretary), Subramanian Swamy (commerce minister in the Chandra Shekhar government), and two senior economist/bureaucrats who requested anonymity; Jairam Ramesh’s To Brink And Back; Shankkar Aiyar’s Accidental India; Arvind Panagariya’s Emerging Giant; and John Elliot’s Implosion.

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He is currently writing a book on the 1991 economic crisis and liberalization.