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The Incredible Years

In less than 15 years, India has transformed itself from a near basket case to the hottest emerging market story. Blame it on luck or savvy policies, India now seems destined for economic greatness.

By Balaji Chandramouli

MILESTONES
THEN & NOW

"*The crisis in the economy is both acute and deep. We have not experienced anything similar in the history of independent India*"
Finance Minister **Manmohan Singh** on the floor of the House, presenting the Budget on July 24, 1991

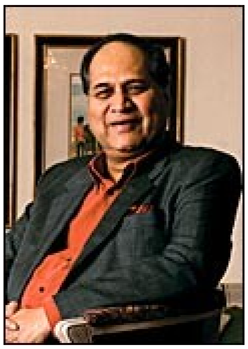
"*Today, when I look back, I am even more convinced that I was correct to observe in my first Budget speech in 1991 that the idea of the emergence of India as a front-ranking economic power house of the world economy was an idea whose time has indeed come*"
Prime Minister **Manmohan Singh**'s speech at the World Economic Forum, November 2005

A new India: Reforms have transformed the lives of many Indian families like the Bangalore-based Basrurs

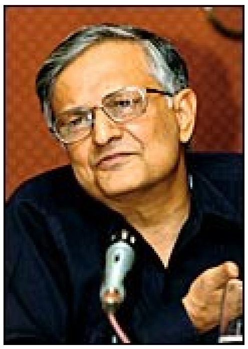
Indeed. The time has come, but what a long walk it has been. Back in 1991, on what appeared to be calm seas, the Indian economy hit a near fatal iceberg. The trigger: A 70 per cent jump in crude import bill and a drop in remittances from West Asia. Tottering on the brink of sovereign default, the country borrowed from international lenders and pledged its gold. "Internally, warning bells were ringing from as early as 1988," says Shankar Acharya, the then Economic Advisor, Finance Ministry. But many ignored it. For, the economy was indeed chugging along, with robust growth witnessed through most of the 80s. The only indicator was one of a mounting fiscal deficit-the difference between government's earnings and spending-in an environment where capital inflows into the country were tightly regulated and industries licensed.

It did not take long to put out the fire. Foreign exchange reserves rose from an all-time low of $1.1 billion to $5.4 billion by March 1992, with funds accruing from the lenders (IMF: $1.24 billion) as well as India Development Bonds ($1.63 billion). But the crisis provided a momentum for reforms that the Congress government seized upon. In 1991, licensing was done away with in 80 per cent of the industries. The next year, licensing needs for imports were removed, save a few restrictions. A volley of policy measures followed to attract foreign direct investment, portfolio capital and decontrol industries like textiles.

The rest, as they say, is history. By the end of the 90s, India was beginning to look like a very different country. Unexpectedly, services-led by the it industry, which took off following the y2k crisis-started gaining momentum, and by the early 2000s, telecom, financial services and retail had started lending a shoulder. Elsewhere in the world, investors were beginning to take note of India's surging economy. A Goldman Sachs report of October 2003, innocuously called Global Economics Paper No. 99, Dreaming With BRICs: The Path to 2050, made some stunning observations that riveted world attention to four emerging economies. "If things go right, (Brazil, Russia, China, and India) could be larger than G6 in us dollar terms...The list of the world's 10 largest economies may look quite different in 2050. The largest economies in the world (by GDP) may no longer be the richest (by income per capita), making strategic choices for firms more complex," the report said.



"Corruption levels must reduce and There has to be a level playing field"
Rahul Bajaj
Chairman/ Bajaj Auto



"Warning bells for reforms were ringing as early as 1988"
Shankar Acharya
Ex-economic Advisor/ Finance Ministry

Result: India got discovered as much for its low-cost potential as the burgeoning middle class. While global it services companies had begun to feel the heat from Indian vendors starting 2000, slower market growth and stiffer competition were sending manufacturers scurrying to China and India. Suddenly, everyone was interested in the 'India Story'. Foreign institutional investors opened the floodgates to investments in 2003, pumping in nearly $34 billion by the end of 2006. Between 1993 and 2002, FII investment had been half of that ($15 billion). Foreign direct investment surged, too, rising from $6.01 billion in 2002-03 to $6.1 billion in April-October 2006. India, it seems, is the flavour of the decade.

Fruits of a Hard Sell

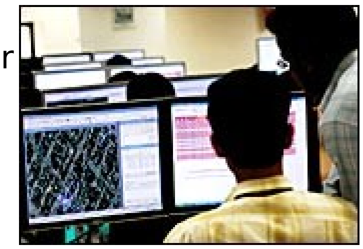
Removing the regulatory fetters wasn't easy. The government's liberalisation policies faced stiff resistance from the domestic industry, which got used to the licence permit-raj. The famed 'Bombay Club', which represented the old guard, was led by none less than the fiercely vocal Rahul Bajaj, whose two-wheeler company sold scooters that had a 10-year waiting period. While Bajaj vehemently refutes any dealings with the Bombay Club, he does not shy away from his argument. "I did and I do continue to ask for a level playing field for Indian industry. Corruption levels must reduce and infrastructure must improve," says Bajaj, now a Member of Parliament. Tossing the argument back, Bajaj asks, "What were the liberalisers doing till 1991? Although the Prime Minister is at heart a liberaliser, surely, there was no sign of this till 1991."

It was not just industry that had to learn to live with change. The banking system too was in for reforms. With new provisioning norms in place in 1991-92, bad debt that was earlier brushed under the carpet, was brought into the open. During the year, the government provisioned Rs 5,700 crore for banks to shore up their capital adequacy norms; private banking licences were issued by RBI to kick in competition in the sector.

During this period, the government's interventions were matched by its abdication.

Not only was the office of the Comptroller of Capital Issues (CCI) abolished, the Securities and Exchange Board of India (SEBI) was made a statutory body. And thus, the market regulator was born, though it was later in 1995-96 that SEBI was empowered to regulate all market intermediaries. However, the regulatory experience was patchy during the decade. The non-banking finance companies' sector, which at one point of time constituted 10 per cent of the market, became the cause of huge losses to the common man. "The mess in the NBFC sector can be traced back to the RBI's inability to act in time and appropriately," says U.R. Bhatt, a Mumbai-based investment advisor.

Notwithstanding the stock market scams and the controls (which were far from altogether removed), the economy recorded a comfortable 5.3 per cent growth in 1994-95, a vast improvement over the 0.9 per cent recorded in 1991. Industrial production, which virtually stagnated in 1990-91, grew at around 8 per cent during the year. Alongside, the small and medium enterprises (SMEs) began to raise their head. It was not easy because, for one, the government was sucking out a lot of banking credit to finance its deficit. For instance, during 1993-94, banking credit to government rose by 25 per cent, even though the previous year, it rose only 14.1 per cent. But that did not blunt the entrepreneurial spirit.



Opening up a whole new world: The IT industry has been the main driver of economic growth and has fetched India global recognition

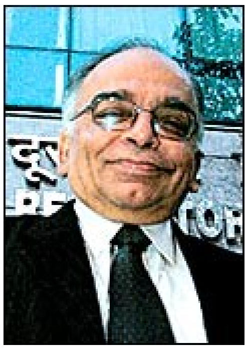
All wired up for success: Reforms have spurred growth in the otherwise stagnant manufacturing sector, though infrastructure still leaves a lot to be desired

Take the case of Ramesh Datla, who decided to buy out his uncle's PH-metre manufacturing unit, Elico Ltd, in 1998. The business was plodding along over the previous three decades, but without much gusto, when Datla decided to focus on "design and development of high technology, high value-added instruments that involve optics, fine mechanics, hardware and software". Today, his company records a turnover of Rs 25 crore per annum. Of course, there were other entrepreneurs such as Naresh Goyal and Sunil Bharti Mittal who hitched their stars to bigger opportunities in newly-liberalised industries like airlines and telecoms.

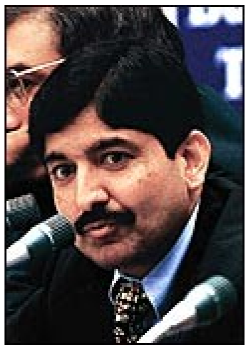
Beginning to Think Infrastructure

The stimulus for institutional building was continued in another key sector-infrastructure. Although the National Highway Act was promulgated in 1988, the organisation was born only seven years later, in 1995. Why? The political system was unwilling to let go of the reins of power. NHAI, however, did little till 2000. Says A. Bordia, former member (finance), NHAI: "During the first five years, little work was done. It was only after the National Highway Development Programme was conceived in 2000 that significant delivery began." The NHDP programme kicked off with the four-laning of highways linking the four metros. The total outlay of the highway programme till 2012 is estimated at Rs 2,20,000 crore.

On the telecom side, the government rolled out the National Telecom Policy in 1994. What ensued over the next decade was a telecom revolution with the consumer benefiting from scale and rapidly improving technology. Penetration of telephony, however, is a success story more in urban areas than in rural India. Says Pradip Baijal, former Chairman, TRAI: "Urban teledensity has vaulted from 8-9 per cent in 2003 to 35-40 per cent in 2005-06. However, this success story has not been replicated in the rural areas, where teledensity has only marginally risen over the same period."



"The Telecom success has not been replicated in Rural areas"
Pradip Baijal
Former Chairman/ TRAI



""The mess in the NBFC sector in the 90s was because RBI did not act in time"
U.R. Bhatt
Investment advisor

While the government was able to make headway in the two critical areas of telecom and highways, during the 90s, it floundered in the power sector. In the first place, its attempts to fix the problems in the sector were in the wrong end of the business-power generation. As it soon became evident, the lack of capacity addition in power generation was a symptom, not the disease. The real malaise lay in non-payment of power bills. Since power is on the concurrent list of the Constitution, the Centre could not effectively intervene even after it realised its mistake. "Central intervention in states is now being effectively delivered through the Accelerated Power Development and Reform Programme and the pace of reform has picked up," says R.V. Shahi, Secretary, Union Power Ministry.

Rationalising Taxes

The 1991 shock also brought to the fore the need to reform the tax structure to make Indian industry competitive, among other things. Consequently, tax rates dived from peak rates of 150 per cent during 1991-92 to below 20 per cent. Tax rate rationalisation towards the mid-90s cost the exchequer around Rs 4,000 crore. However, the turn of the century heralded the birth of a new economy, which yielded more resources. Information technology picked up pace and changed the lives of several middle class families. The monopoly of public sector in the air travel business was eased in 1993-94, which led to the mushrooming of domestic airlines. Services as a class of occupation began to emerge with strength.

The collective strength of reform measures touched middle class life in several manners. Take the case of Shyam Basrur, 47. For over a decade, Basrur spent 12-14 hours a day commuting and working in pre-liberalisation Mumbai, haggling with government officials and filing in sheaves of application forms to import new machinery and export finished goods as a mid-manager at Pidilite. "There was no market in India, but the government did everything it could to prevent you from going abroad," says Basrur, who remembers fighting with financial institutions for funds and with embassies to process visas to let him travel.

Just like India, Basrur is a different man today. As liberalisation set in, Basrur, who moved to India's it capital in the early 90s after living in Mumbai for decades, found that working and, in fact, setting up his own business became a feasible idea. "Procedures were simplified, forex limits were raised and banks began lending more liberally," says Basrur, who set up a family-owned enterprise, Basrur Uniseal, which manufactures non-asbestos auto components and counts the likes of Bosch, Kiroloskar and Volvo (through a foreign collaborator) as its customers. "Liberalisation has allowed me to look for foreign partners and collaborators, travel frequently and aggressively target overseas markets," says Basrur. His could be the story of thousands of other educated Indians.

Not all that fertile: Agriculture, which sustains 60 per cent of India's workforce, is stagnating. Its share in the GDP, currently at 17 per cent, is declining, which could create severe imbalances in the country

Alongside trade and tax reforms, the government's market reform measures were aimed at altering the quality of capital hitting the shores. During the 1991 crisis, foreign capital inflow was mostly by way of debt. The government then embarked on a roadmap to gradually shift to non-debt funds (like FII funds). Over the last 15 years, the FII count has risen from nil in 1993 to around 850 in 2005-06. But partial insulation from foreign market continues both ways-overseas commercial borrowings are monitored, while entry of foreign funds into the market can be channelled only through registered FIIs. Today, the situation is such that foreign direct investments exceed FII inflows, pointing to the long-term attractiveness of the country.

The Centre was not alone in pushing for foreign investments. States too undertook independent initiatives. By 1995, Haryana, Orissa, Kerala, Rajasthan and West Bengal had taken independent initiatives to invite foreign investments in their respective states. However, over the years, competitive forces kicked in, especially among states endowed with natural resources. In recent times, Jharkhand and Orissa have actively wooed investors to mine their minerals. An equally aggressive battle is being fought for setting up economic zones that provide tax sops.

While the contours of the economy have shaped up well, thanks to the forces of globalisation, the question now being debated is a daunting one: How many people are benefiting from this growth? The issue is not lost on India's political masters, with the Prime Minister constantly referring to the need to ensure 'inclusive growth'. He has reason to worry. Farm labour, which accounts for around 60 per cent of the workforce, contributes to only 17 per cent of the GDP. Importantly, this figure is gradually reducing.

Marrying politics with economics has always been a challenge that more often than not succumbs to populism-the oil sector, with its Rs 55,000-crore subsidy bill, is a standing example. Equally damaging is the power subsidy that leaves the sector resource starved. The challenge ahead lies in reining in such profligate measures and directing subsidies only to the needy. Key to this would be an efficient delivery mechanism that ensures optimal private participation. The 1990s saw the scaling down of walls that hemmed in Indian industry. The next decade will witness receding government participation in business, through public-private partnerships and privatisation (which has suffered with the Left party supporting the Centre).

The challenge ahead lies in carrying this process forward with policies that not only serve from 'poll-to-poll' but also ensure sustainable and inclusive growth. One quarter of India has gained from reforms. It's time we took care of the other three-quarters.