



# India after 1991: Economic Reforms and the Paradox of Political Economy

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## Abstract

A convergence of factors led to the implementation of capitalistic economic reforms in India in 1991. It was in sharp contrast with the development strategy that India had followed since independence where the markets were a given subservient role in the economy. With the launch of reforms, the floodgates of the economy were opened to foreign trade and investment, and domestic liberalization measures adopted to unshackle the economy from inefficient controls and regulations. In the years since, India has emerged as the fifth largest economy in the world while also surviving as a functioning liberal democracy. A growing economy has deepened the democratic roots and has also created a large aspirational class. India is currently experiencing a revolution of the rising expectations with economics having emerged as a peer competitor of politics. Capitalistic economic reforms however face opposition and they remain a contest between populist politics and *aspirational* economics.

**Keywords:** Development, economic reforms, capitalism, socialism, economic growth, globalization, elite politics, political economy

## 1. Introduction

India faced a major economic crisis on its external front in early 1990s. It had insufficient foreign exchange to support even its critical imports. The immediate cause of the crisis lay in the rising oil prices due to the Gulf War that consequently built inflationary pressure in the economy. A medium-term perspective would reveal that the crisis was in the making for quite some time. In the second-half of the 1980s pressure on the balance of payment had started accumulating. And a still longer-term perspective would show that it had to do with the development strategy India had pursued since Independence. The shortage of foreign exchange reserves had become a perennial source of concern for Indian policy makers after the adoption of the Second Five-year plan in the 1950s.

As a matter of fact, India struggled in the first three decades after independence unable to see a major economic expansion due to abysmal growth of its economy. The launch of capitalistic economic reforms put the economy on a higher growth trajectory. India has emerged as a fast-growing large economy. Accelerated economic growth has pulled millions out of extreme poverty. Besides, the economic gains the previous decades have also witnessed the rise of a new aspirational economic and political class that is more exposed to global forces of change. Economics has emerged as a peer competitor of politics and economic issues have come to dominate electoral outcomes since the 1990s. This however was not always the case.

The poor economic outcomes before 1990 were attributed to rigid social structures that were said to have inhibited the forces of modernization. It was claimed that India's elite politics and hierarchical social structures came in the way of better economic performance in the first few decades after independence. This '*paradox of political economy*' however breaks when we evaluate the performance of economy after the launch of economic reforms in 1991. The previous three decades have witnessed remarkable social transformation. Despite the major economic gains, capitalistic economic reforms face opposition from political outfits that derive their ideological inspiration from socialism.

## 2. Development before 1991

India began substantial reform of its economy in the early 1990s. It was a clear break from the past; a paradigm shift in the way India approached its economy and the world. It had remained insular for much of its independent history hardly taking any advantage of the opportunities offered by an expanding world economy. It therefore relied on domestic savings, consumption and investment to propel the economy towards faster economic growth and poverty alleviation.<sup>1</sup> Since the 1950s the overarching driving force of India's economic policy had been to modernise along socialistic pattern creating a more egalitarian society and a strong independent sovereign nation.

It attempted to achieve this objective by enacting special provision in the law to avoid concentration of economic power, and by following a policy of reservation in various sectors for special interest groups largely with a view to shield those sectors from domestic competition. Foreign trade was canalised and institutional arrangement made for exchange control. The industrial expansion sought under a strict system of licenses, permits and controls. Before the reforms were launched in 1991, a highly counter-productive web of laws, regulations and controls characterised the factor and the product market making the economy uncompetitive and inefficient. Many of these policies that dominated the economic space for the first four decades were 'virtually indistinguishable from the system of controls over production, distribution and allocation of resources prevalent during the second World War.'<sup>2</sup>

It is important to recognise that those with communist and socialist intellectual leanings find it hard to appreciate the counter-intuitive nature of the operation of a market economy. India fell a victim to its own intellectual trappings pushing the economy into a period low economic growth. One control led to another until the point that the entire system of controls became unwieldy and ineffectual. The economy could grow annually at an average rate of 3.5 percent for the first three decades which was much below expectations. The slow growth did not transform into substantial benefits for the poor.

On the back of fiscal expansion, the economy did pick up some momentum and grew at 5.5 percent annually in the 1980s which was surely better but increasing fiscal and current account deficits and deep-rooted structural flaws pushed the economy into a corner leading to a crisis on the external front. It was under these circumstances that India finally decided to do wholesale restructuring of its economic policies in various areas like trade, industries, taxation, capital market, foreign capital, banking, exchange rate etc.

## 3. Development after 1991

The structural reforms have launched the economy on a higher growth trajectory.<sup>3</sup> In a matter of decades, India has become the fifth largest in the world. The economy is more globalised today than any time in recent memory. The major indicators of embeddedness in the global economy – export and import, trade to GDP ratio, cross border flow of long-term investment and short-term capital flows, movement of people and integration with the global supply chain – have seen a rise since the opening of the economy. Even though Indian statistics pale in comparison to China, they fare better in comparison to our own economic performance in the pre-reform period.

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<sup>1</sup> Jagdish Bhagwati 1993

<sup>2</sup> Bimal Jalan 2021 p. 5

<sup>3</sup> Arvind Panagariya 2008

The noted economists Jagdish Bhagwati and Arvind Panagariya and quite a few others<sup>4</sup> have shown how economic reforms have, to use the often-quoted idiom, lifted all boats. Accelerated economic growth has benefitted all social categories and states. There has been a sharp decline in rural and urban poverty, and an increasing number of people have now come to live in cities and towns. There has also been surge in participation of women in organised sectors like banking, teaching, financial services, administration indicating a major shift in cultural attitudes towards women. Such a speedy social transformation and sustained economic upliftment would have been hard to imagine during the *Socialist Raj* when the policy space was dominated by the socialists and the Marxists advocating ever greater control and regulation of the economy for *imagined outcomes*.<sup>5</sup> The productive powers of capitalism and of economic growth is only slowly being realised by the intelligentsia and the policy wonks.<sup>6</sup>

Indian democracy has become more robust and political representation highly diversified signifying the maturing of India's democracy. The tripartite forces – democratic deepening, economic reforms and globalization of India's economy has moved in the same direction in the previous three decades. There has been alignment of good politics and good economics. Good governance is valued. Governments with good economic performance have usually been voted back to power. What we are witnessing since the 1990s is a '*new revolution of rising expectations*'<sup>7</sup> where growing prosperity encourages people to expect even more beneficial economic outcomes. It is a major shift in India's practise of democracy. It belies the anticipation of scholars who saw a '*fundamental paradox of India's political economy*'<sup>8</sup> in its development discourse.

#### 4. Paradox of Political Economy and Social Transformation

The political scientist Francine Frankel noted that India's leaders had committed themselves to bring basic changes in the structure of India's society by frontally attacking the existing social order through accelerated development. Such a social transformation however was not possible without incurring a '*political cost*' that any radical measure could bring in its wake. The elites in power were unwilling to compromise with their social status and economic interests. The radical socialists and the communists therefore attacked prime minister Nehru for his inability to press hard with far-reaching policy measures to effect such a change. In the early years after independence Prime Minister Nehru was often viewed as someone who took a more pragmatic view of socialism.<sup>9</sup>

After the adoption of the Second Five Year plan however one could find a more intrusive view of socialism practised by Nehru in his economic policies. One could even find a more assertive brand of leaders in opposition who believed that the ideals of socialist society could be achieved only through state intervention in society; and the government was not doing enough towards the attainment of that goal. In this regard, the J P Movement of the 1970s was perhaps a culmination of a more rigid and doctrinaire brand of socialist politics of opposition highly visible in the first two decades after independence. These leaders believed that it was only a more interventionist state where the government controlled the levers of economic power by limiting the role of the capitalists and the private sector that the age-old rigidities and social hierarchies could be overcome and a new social order established.

The 'paradox' raises few important questions regarding the practise of economic policies since independence. India followed a fairly interventionist policy regime since the mid-1950s that took an even sharper leftward turn after the late 1960s yet it could not make much headway in achieving the desired socio-economic

<sup>4</sup> See Bhagwati and Panagariya 2013; Panagariya 2011; Panagariya and Megha Mukim 2014 etc.

<sup>5</sup> The phrase is inspired from Benedict Anderson's *Imagined Communities: Reflections on the Origin and spread of Nationalism* (1983)

<sup>6</sup> The noted economist and India's foremost voice on economic reforms Arvind Panagariya often laments that the Indian intellectual space continues to remain infested with those who lean towards socialism. In an interview with the leading newspaper *The Times of India* he remarked that 'Nehru-era legacy of socialism is still an obstacle to progress...' (See Times of India Nov 3, 2024)

<sup>7</sup> The phrase is attributed to Anthony Lewis, 1970

<sup>8</sup> Francine Frankel 2005 pp. 5

<sup>9</sup> See Bhagwati and Arvind Panagariya 2012



outcomes. What went wrong? Was it the inadequacy of policy measures that weren't considered deep enough to effect a change or were the policy regime pursued counter-productive that resulted in low economic growth leading to poor outcomes? Is it true that the elites were not interested in pursuing policies that were considered essential for creating a more egalitarian social order but could harm their interests? And therefore, they showed little regard for them. Further, why did the 'paradox' not hold during the period of economic reforms when capitalistic economic policies were implemented? Why did the deeply hierarchical social structures and existing power relations not come in the way of economic transformation in India after the launch of capitalistic economic reforms?

The sociological and feudalistic arguments about India's failure to develop fast, and the notion that accelerated development was hard to come by due to elite dominance of politics during the socialist period before 1991 fly in the face of facts when we evaluate economic performance after the launch of reforms. In fact, the rise of the coalition politics since the 1990s when power is more dispersed among the partners who quite often serve diverse constituencies make it hard to implement reforms. Yet we have seen market-oriented economic reforms being implemented and no serious attempt has been made to reverse it.<sup>10</sup> It was superior economic performance that benefitted all social groups and geographical regions that made all the difference in the end.

Capitalistic economic forces created economic incentives for change. The subsequent high economic growth has created an aspirational middle class that is asking for even a greater share in an expanding economy and prosperity. Economics and perhaps technology too have emerged as the great leveller in the post-reform period. Capitalistic economic policies promote economic freedom, encourage entrepreneurship, and provide an opportunity to benefit from cross-border trade and investment fuelling innovation and economic growth. It is not elite politics rather the socialist economic policies which discouraged international trade, private expansion of commerce and stifled innovation and economic growth that hurt India's economic prospects in the decades following independence and thus failed to create a new social order.

## 5. Economic Reforms and the Road Ahead

It is important to recognise that there has been no large-scale ideological opposition of capitalistic economic policies except when they were launched in the early 1990s. This broad acceptance of economic reforms in the policy discourse has been the consequence of the widespread benefits that high economic growth has brought since 1991. Else the reforms would have been reversed years ago. The inference however should not be drawn that economic reforms do not find any opposition; indeed, those with socialistic ideological persuasion continue to view things differently perhaps mainly for political reasons. But even they have come to realise the importance of high economic growth for the benefits are for all to see.

As a matter of fact, economic reforms have faced numerous challenges from the start. Globalization – integration of the domestic economy with global economy via channels of trade in goods and services, flow of capital and movement of workers – and liberalization often increase competitive pressure. This may not always be good news to those who have benefitted from protectionist policies in the past. In the early 1990s, the *Bombay Club*, an informal group of Industrialists opposed economic reforms citing absence of level playing field against foreign players. Many Lefty and Marxist scholars accused Indian policy makers of succumbing to international pressures.<sup>11</sup> Many charged proponents with sell-out to global capitalistic forces. The capitalistic reforms were projected as a compromise with the socialist ideals of a more just society.

This raises fundamental questions about our prolonged fascination for socialism when the productive powers of global capitalism were recognised early by Karl Marx.<sup>12</sup> Indeed the next hundred years after the publication of the Communist Manifesto in 1848 saw tumultuous global events and growth of rival ideologies to capitalism yet the European experience has shown the efficaciousness of individual initiative, private capital and

<sup>10</sup> Ashutosh Varshney 2013

<sup>11</sup> Prabhat Pattanaik 1994

<sup>12</sup> Karl Marx and Friedrich Engels 2008

economic freedom in fostering prosperity.<sup>13</sup> In the period prior to reforms, we now understand that it was not the 'paradox' that obstructed India from delivering a better economic performance. It was rather the counter-productive economic policies that quelled individual initiative, increased the transaction cost of conducting commerce and fuelled the growth of what economist Mancur Olson called 'distributional coalitions' leading ultimately to 'institutional sclerosis.'<sup>14</sup> In the final analysis, capitalistic economic reforms have played a significant role in India's emergence on the global stage. They have been instrumental in pulling millions out of poverty and therefore remain our best bet for creating a more prosperous India.

## **Conclusion**

To conclude, capitalistic economic reforms have launched the economy on a higher growth path that has *inter alia* deepened its democracy and brought millions out of poverty by fuelling growth in lagging states. Second, the trenchant opposition surrounding the implementation of reforms in the 1990s is now nowhere to be seen. Third, in the previous thirty years various governments at the centre have implemented reforms. Some have shown greater sensitivity to the need of reforms while others have been more cautious in their implementation. Fourth, economic issues have come to dominate politics. Economics is now a peer competitor of politics in shaping intellectual discourse in the country. Fifth, good economic performance has come to be valued by the electorate signifying a major shift in voting behaviour. Sixth, the institutions of governance today are more representative and the standard of living better. India has finally arrived on the international stage. It is today the fifth largest economy in the world. Finally, capitalistic economic policies have had a transformative impact on its economy, democracy and society.

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<sup>13</sup> Sven Beckert 2025

<sup>14</sup> Jac C Heckelman and Dennis Coates 2007

6. See Arvind Panagariya interview with *The Times of India*, November 3, 2024 <https://timesofindia.indiatimes.com/home/sunday-times/all-that-matters/interview-nehru-era-legacy-of-socialism-is-still-an-obstacle-to-progress-but-im-an-optimist/articleshow/114886996.cms>
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