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REVIEW ARTICLE

SOME OVERVIEWS ON ECONOMIC REFORMS AND ITS ASSESSMENT

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Some Overviews on Economic Reforms and Its Assessment

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After Independence, the managers of the Indian economy found that the world has been sharply divided into two blocks: the one led by the capitalist economies and other led by the communist economies, primarily the then USSR. There was a cold war between these two blocs. Less developed economies had no option than to join either of the two and invite the ire of the opposite bloc. Especially those economies that were under the British Empire and won freedom during 1940's faced a difficult choice. India chose to keep a safe distance from both the blocks by inventing the idea of a mixed economy. In doing so, India invited as much favor as suspicion from both the blocks. Some economists hold the opinion that the Indian economy was pro-capitalism in its core that wore the façade of a socialistic economy. The state-managed economic endeavors facilitated capital formation in the private sector, often at the cost of the public sector and resources, preparing for a smooth transition to open capitalism in future when the conditions were ripe for such a transition.

Bardhan (1984) has given a vivid picture of this possibility. Nevertheless, the officially proclaimed management policy of the national economy of India was modeled on the socialistic pattern, primarily that of the USSR. It is relevant to note that since the 1970's, the growth rate of the USSR economy had slowed down substantially. Extensive economic development, based on vast inputs of materials and labor, was no longer possible; yet the productivity of Soviet assets remained low compared with other major industrialized countries. Product quality needed improvement. Soviet leaders faced a fundamental dilemma: the strong central controls of the increasingly conservative bureaucracy that had traditionally guided economic development had failed to respond to the complex demands of industry of a highly developed, modern economy.

Soon after independence, India adopted the path of planned development where the public sector was to play a dominant role in fostering growth at both the central and state levels. The First Five-Year Plan, which was launched in 1950-51, was based on the Harrod-Domar model and primarily concentrated on raising the level of investment in irrigation, power and other infrastructure for accelerating growth. The development strategy was changed radically in 1956 with the initiation of the Nehru-Mahalanobis model of industrial development that emphasized the development of heavy industry under the public sector. Domestic industry was protected from foreign competition through high tariff walls, exchange-rate management, controls and licences. This strategy of import substitution and heavy-industry promotion has been criticized for having created a non-competitive, inefficient, capital-intensive and high-cost industrial structure. It is further argued that this policy discriminated against labour-intensive tradable agriculture and resulted in unwarranted export pessimism because of excessive concern about self-sufficiency. The criticism, however, must be balanced against the fact that during this period India built a large infrastructure not only in heavy and machine goods industries, but also in the areas of power, irrigation, credit, higher education, scientific research and training.

The mid-1960s and early 1970s were characterized by serious economic problems. First, because of wars with neighbours, large resources were diverted towards defence, resulting in a sharp decline in public investment that adversely affected the growth of the economy. Second, the foreign exchange situation forced India to devalue its currency in 1966. Finally, food production failed to keep pace with demand and the country became increasingly dependent on food imports under the United States Government's PL 480. The situation became critical in the mid-1960s with the failure of two consecutive crops in 1964/65 and 1965/66 and the country had to import large quantities of food-grains under PL 480.

In the late 1960s, agricultural growth revived with the adoption of green revolution technology in some regions. Coincidentally, the manufacturing sector which had seen a notable deceleration in growth from

1964-65 to 1975-76, began registering far higher growth from 1977 to 1978.

During the 1980s, the Indian economy witnessed an unprecedented growth rate of 5.4 percent per annum. The 1980s was also a period when limited liberalization measures were initiated and steps were taken to modernize some of the most important industries, such as cement, steel, aluminium and power generation equipment.

Finally, in addition to the current account deficit, mounting capital account expenditures by the government and public enterprises had to be financed through public borrowing. By 1990, internal debt liabilities had increased to 53 percent of GDP compared with 35 percent in 1980, and interest payments accounted for as much as 24 percent of total government expenditure. In addition, the sources of foreign borrowing underwent some important changes, as soft International Development Association (IDA) and government-to-government loans dried up and high-cost commercial loans from the banks and non-resident Indians had to fill the gap.

As long as the international credibility of India was high, loans were forthcoming and the country could go on living on foreign borrowing. However, the combination of a number of factors, including the sharp rise in import prices of oil and the downgrading of India's credit rating, led to a loss of confidence that resulted in the drying up of short-term credit along with a net outflow of non-resident Indian deposits. Thus, in spite of borrowing from the International Monetary Fund (IMF), the foreign exchange reserves declined.

It was against this background that the new economic policy was introduced. The multilateral agencies such as IMF and the World Bank insisted that the policymakers undertake structural reforms before they agreed to salvage the country from the foreign exchange crisis.

The Economic Situation in 1990-91

The Indian economy had to face many uncertainties in 1990-91. The effects of the political situation at home, and the persistent fiscal imbalances were accentuated by the Gulf crisis which intensified strains on an already weak balance of payments position. It is a measure of the inherent strength of our economy that it withstood the effects of these shocks rather well. It is also a measure of solid gains registered by our economy during the last forty years since independence. Agricultural output and industrial production continued to grow though their sustainability came under serious doubt. It is estimated that the growth of Gross Domestic Product (GDP) in real terms during 1990-91 will be about 5 per cent. However, due to the combined impact of internal and external factors, consumers have been faced with double digit inflation and the economy is faced with a serious balance of payments crisis. On the domestic front, particular significance is attached to medium-term large and persistent fiscal imbalances which have strained the balance of payments situation and accentuated inflationary pressures in the economy. These factors have been sharply exacerbated by the third oil shock and the related dislocations caused by the crisis and the war in the Gulf during 1990-91.

Fiscal and Monetary Policy

Macro-economic imbalances characterized by high fiscal deficits and a growing revenue deficit have continued to remain a major source of concern for the Government during the past few years. These concerns have been compounded by the impact of the Gulf crisis during 1990-91. Aggregate resources of the Central Government including internal and extra budgetary resources of Central Public Enterprises were estimated to increase by 15.0 per cent in 1990-91. Aggregate disbursements, on the other hand, were estimated to increase by 9.4 per cent in 1990-91, thereby indicating some reduction in the relative size of the gap between income and expenditure of the Central Government. This also applies to the combined Budget Estimates (BE) of the Centre, States and Union Territories for 1990-91, which estimated a deficit of Rs. 8,999 crores compared with the Revised Estimates (RE) of Rs. 12,149 crores in 1989-90. Aggregate receipts were estimated to increase by 13.4 per cent while aggregate expenditure was expected to increase by 10.4 per cent.

To meet the balance of payments problems caused by the Gulf crisis the Government initiated a number of steps. First, measures were taken to reduce the rate of growth of domestic consumption of petroleum products for containing imports of POL. Second, a set of measures were taken to cut Government expenditure, particularly its import and foreign exchange component. Third, restrictions were put on the imports of components, spares and raw materials, particularly in electronics and automobiles. Thirty four items of capital goods and thirteen items of raw materials were shifted from OGL list to the licensing category, and the residual category of imports under OGL comprising unlisted items in the import policy was shifted to the limited permissible list. Fourth, measures were initiated to generate additional exports. Fifth, efforts were made to accelerate the utilization of the authorized but undisbursed external assistance. Sixth, the possibilities of obtaining credits from oil-exporting countries and further deposits from non-resident Indians were also explored. Finally efforts were made to obtain additional finance from bilateral donors and multilateral institutions.

The genesis and causes of the 1990 crisis

From 1950 to 1980, while the Indian economy was growing at a relatively slow rate of 3.6 percent, domestic investment exceeded domestic savings by only a small margin. The gap could be bridged through foreign borrowing on a small scale. However, during the period 1979 to 1990, when the growth rate of GDP accelerated to 5.4 percent, the gap between savings and investment widened substantially. The need to finance large capital expenditures and imports of machinery and raw materials, including oil, necessitated heavy borrowing from abroad. The result was a cumulative increase in foreign debt and in repayment liability. Foreign debt increased from US$23.5 billion in 1980 to $63.40 billion in 1991. In 1991, nearly 28 percent of total export revenues went to service the debt. The most important reason for the internal savings rate falling increasingly short of investment requirements was the expanding fiscal deficit of the government which had risen from an average of 6.3 percent of GDP during the Seventh Five-Year Plan to 8.2 percent by 1990-91.

The planning policies in the context of the structural adjustment programme

While studies recognize India's achievements in higher growth and increasing food security to its rising population, the huge fertilizer, irrigation, electricity, credit and consumer food subsidies eventually became unsustainable. At the same time, external trade policies, domestic regulation of agriculture and related policy distortions heavily discriminated against agriculture relative to manufacturing. Moreover, land reform failed to bring about an equitable distribution of land and, as a consequence, very large inequalities continue to exist in the countryside. Finally, the new technologies that were encouraged by the policies and regulations were more appropriate for the richly endowed irrigated regions of India.

Connection to Liberalisation

To appreciate the role of liberalization in stimulating growth in the 1980s, it is useful to begin with a brief historical background on import controls in India. In their pioneering study, Bhagwati and Desai (1970) provide the most comprehensive and systematic documentation of the wide sweep of the interventionist policies that had come to exist by the late 1960s. As they note, general controls on all imports and exports had been present since 1940. After independence in 1947, import controls were relaxed through the expansion of the Open General Licensing (OGL) list in a stop-go fashion, with the First Five Year Plan (1951–56) representing a period of “progressive liberalization” (Bhagwati and Desai, 1970, p. 282). But a foreign exchange crisis in 1956–57 put an end to this phase of liberalization and comprehensive import controls were restored and maintained until 1966. In June that year, under pressure from the World Bank, India devalued the rupee from 4.7 rupees to 7.5 rupees per dollar. The 57.5 percent devaluation was accompanied by some liberalization of import licensing and cuts in import tariffs and export subsidies for approximately a year. But by 1968, intense domestic reaction to the devaluation led India to turn inward with a vengeance. Almost all liberalizing initiatives were reversed and import controls tightened. This regime was consolidated and strengthened in the subsequent years and remained more or less intact until the beginning of a period of phased liberalization in the late 1970s. According to Pursell (1992), the severity of the controls was reflected in a decline in the proportion of non-oil and non-cereals imports in GDP from the low level of 7 percent in 10 In passing, the role of excellent agricultural performance in yielding the high overall growth rates during 1988–91 may also be acknowledged. Whereas the years 1986–87 and 1987–88 were a disaster for agriculture due to bad weather, the subsequent three years, especially 1988–89, proved unusually good. According to the data in the Economic Survey 2002–03, agriculture and allied activities (forestry and logging, fishing, mining and quarrying), which accounted for a little more than one-third of GDP, grew at an annual average rate of 7.3 percent during 1988–91.

Impact of the Reforms

The impact of reforms could be seen most clearly on trade flows. Pursell (1992, p. 441) states this succinctly and emphatically, “The available data on imports and import licensing are incomplete, out of date, and often inconsistent. Nevertheless, whichever way they are manipulated, they confirm very substantial and steady import liberalization that occurred after 1977–78 and during 1980s.” He goes on to note that imports outside of canalization and licensing (i.e., those mainly on the OGL) increased from 5 percent of total imports in 1980–81 to 30 percent in 1987–88. The share of non-POL imports in the remaining imports increased from 8 percent to 37 percent over the same period. Quite apart from this compositional change, there was considerable expansion of the level of imports during the 1970s and the second half of the 1980s. Increased growth in exports due to the steady depreciation of the real exchange rate and remittances from the overseas workers in the Middle East had begun to relax the balance of payments constraint during the first half of the 1970s, leading to the expansion of non-oil imports at the annual rate of 17.8 percent. This rapid expansion continued during the second half of the 1970s with non-oil imports registering an impressive 15 percent annual growth rate over the ten-year period spanning 1970–79. In contrast, in the subsequent five years when the real exchange rate appreciated slightly and the income growth slowed down, non-oil imports expanded only 7.1 percent per annum. Again, during 1985–90, they grew by 12.3 percent. Thus, liberalized licensing rules flexibly accommodated the increased demand for imports during the fast-growth periods.

The impact of reforms can also be seen in terms of higher industrial growth. Discussing the changes in the domestic industrial policy, Desai (1999, p. 21) noted. "The changes were complex and arbitrary, but they led to an acceleration of industrial growth from 4.5 per cent in 1985–86 to a peak of 10.5 per cent in 1989–90." Industrial growth during 1988–91 at 9.2 percent was particularly high when compared with earlier periods.

According to Goldar and Renganathan (1990), the import penetration ratio in the capital goods sector rose from 11 percent in 1976–77 to 18 percent in 1985–86. This trend appears to have continued subsequently. Malhotra (1992) notes that the incremental capitaloutput ratio, which had reached as high as 6 at times, fell to approximately 4.5 during 1980s. These observations are consistent with the finding by Joshi and Little (1994) that the productivity of investment increased during the 1980s, especially in private manufacturing.

But more systematically, Chand and Sen (2002) have recently studied the relationship between trade liberalization and productivity in manufacturing using 3-digit industry data spanning 1973–88 econometrically. They took 30 industries, which accounted for 53 percent of gross value added and 45 percent of employment in manufacturing over this period. These industries divide approximately equally among consumer, intermediate, and capital goods. They measure protection by the proportionate wedge between the Indian and U.S. price and estimate total factor productivity growth (TFPG) in the three industry groups averaged over three no overlapping periods: 1974–78, 1979–83 and 1984–88. They then relate this productivity growth to liberalization.

Chand and Sen (2002) did some further tests by pooling their sample and employing fixed-effects estimator to allow for intrinsic differences across industries with respect to the rate of technological progress. Their estimates show that on average one percentage point reduction in the price wedge leads to 0.1 percent rise in the total factor productivity. For the intermediate goods sector, the effect is twice as large. The impact of the liberalization of the intermediate goods sector on productivity turns out to be statistically significant in all of their regressions.

Das (2003) attempted such an assessment and computed effective rates of protection and import coverage as well as import penetration ratios for 72 three-digit industries for four sub-periods of the period 1980 to 2000. Although these ratios are useful they do not show the combined effect of tariffs and QRs on output prices. For that it would be necessary to estimate rates of protection based on price comparison, as had been done in the 1980s by Pursell (1988). The author concluded that the Indian level of protection remained high in comparison with several South-East Asian countries.

Pandey (2004) focused on the measurement of several trade reform variables, including the measurement of protection based on price comparisons. As to the impact of trade liberalisation on industry performance he concluded that this link appears to be weak, given the presence of other factors. Among these factors, government controls in form of industrial licensing and public sector investments are singled out, but the author also points to the well-known ambiguity between protection and growth: High protection tends to generate growth in the initial stages, but declining protection may also lead to growth through competition-induced gains in productivity and exports.

Bajpai (2002) presented a detailed account of the reforms of the 1990s and focused on areas, in which further reforms are required, in particular fiscal consolidation, the labour market, but also trade and foreign investment. These conclusions are clearly based on a positive assessment of the reform impact on economic growth in India, although the author does not present an analysis of the impact.

Industrial Policy Resolution – 1956

The Industrial Policy Resolution - 1956 was the blue print of the vision of Pt. Nehru and shaped by the Mahalanobis Model of growth, which suggested that emphasis on heavy industries would lead the economy towards a long term higher growth path. The Resolution widened the scope of the public sector. The objective was to accelerate Bombay Plan prepared by leading Indian industrialists in 1944-45 had recommended government support for industrialization, including a direct role in the production of capital goods.

The Industrial Policy Resolution - 1956 classified industries into three categories. The first category comprised 17 industries exclusively under the domain of the Government. These included *inter alia*, railways, air transport, arms and ammunition, iron and steel and atomic energy.

The second category comprised 12 industries (included in Schedule B of the Resolution), which were envisaged to be progressively State owned but private sector was expected to supplement the efforts of the State.

The third category contained all the remaining industries and it was expected that private sector would initiate development of these industries but they would remain open for the State as well. It was envisaged that the State would facilitate and encourage development of these industries in the private sector, in accordance with the programmes formulated under the Five Year Plans, by appropriate fiscal measures and ensuring adequate infrastructure. Despite the demarcation of industries into separate categories, the Resolution was flexible enough to allow the required adjustments and modifications in the national interest.

Another objective spelt out in the Industrial Policy Resolution – 1956 was the removal of regional disparities through development of regions with low industrial base. Accordingly, adequate infrastructure for industrial development of such regions was duly emphasized. Given the potential to provide large-scale employment, the Resolution reiterated the Government's determination to provide all sorts of assistance to small and cottage industries for wider dispersal of the industrial base and more equitable distribution of income. The Resolution, in fact, reflected the prevalent value system of India in the early 1950s, which was centered around self-sufficiency in industrial production. The Industrial Policy Resolution – 1956 was a landmark policy statement and it formed the basis of subsequent policy announcements.

Industrial Policy Measures in the 1960s and 1970s

Monopolies Inquiry Commission (MIC) was set up in 1964 to review various aspects pertaining to concentration of economic power and operations of industrial licensing under the IDR Act, 1951. While emphasizing that the planned economy contributed to the growth of industry, the Report by MIC concluded that the industrial licensing system enabled big business houses to obtain disproportionately large share of licenses which had led to pre-emption and foreclosure of capacity. Subsequently, the Industrial Licensing Policy Inquiry Committee (Dutt Committee), constituted in 1967, recommended that larger industrial houses should be given licenses only for setting up industry in core and heavy investment sectors, thereby necessitating reorientation of industrial licensing policy.

In 1969, the monopolies and restrictive Trade Practices (MRTP) Act was introduced to enable the Government to effectively control concentration of economic power. The Dutt Committee had defined large business houses as those with assets of more than Rs.350 million. The MRTP Act, 1969 defined large business houses as those with assets of Rs. 200 million and above. Large industries were designated as MRTP companies and were eligible to participate in industries that were not reserved for the Government or the Small scale sector.

Industrial Policy Resolution- 1991—A Bold Step for Industrial Reforms

The Industrial Policy Statement of 1991 stated that "the Government will continue to pursue a sound policy framework encompassing encouragement of entrepreneurship, development of indigenous technology through investment in research and development, bringing in new technology, dismantling of the regulatory system, development of the capital markets and increased competitiveness for the benefit of common man". It further added that "the spread of industrialization to backward areas of the country will be actively promoted through appropriate incentives, institutions and infrastructure investments".

The objective of the Industrial Policy Statement - 1991 was to maintain sustained growth in productivity, enhance gainful employment and achieve optimal utilization of human resources, to attain international competitiveness, and to transform India into a major partner and player in the global arena. Quite clearly, the focus of the policy was to unshackle the Indian industry from bureaucratic controls. This called for a number of far-reaching reforms. A substantial modification of Industry Licensing Policy was deemed necessary with a view to ease restraints on capacity creation, respond to emerging domestic and global opportunities by improving productivity. Accordingly, the Policy Statement included abolition of industrial licensing for most industries, barring a handful of industries for reasons of security and strategic concerns, social and environmental issues. Compulsory licensing was required only in respect of 18 industries.

Failurship of Industrial Policy

India today has an enviable framework for the conduct of comprehensive industrial policy in the broad sense. Many of the necessary institutions required such as the Planning Commission are in place and have broad acceptance among all the political parties and the Indian people. This is one of the reasons why this essay has not concerned itself with the normal starting point of any economic discussion of industrial policy in terms of market failures and externalities.

As Dosi et al. have noted in the introduction to this volume, when considering experience regarding achieving long-run dynamic economic efficiency, market failures and coordination problems are ubiquitous in capitalistic economies, whether developed or developing; these are not minor exceptions as is often implied in orthodox writings. That planning and industrial policy are well embedded in the Indian political economy is a major advantage compared. A main issue for the future of industry planning in India is what functions, old and new, should the Indian Planning Commission focus on in the years ahead.

CONCLUSION

The Indian economy has been moving towards closer integration with the global economy and with the leading regional trading blocs. This can be seen using three indicators: (i) Trade in goods and services as a proportion of GDP; (ii) Gross Private Capital Inflows; and (iii) Gross Foreign Direct Investment as a proportion of GDP. In all three areas, China has had the most outstanding performance and is clearly far ahead of India. However, within the constraints of democratic politics and despite being a late starter in the economic reform process, India can be seen to have done 'reasonably well' in globalizing its economy. The ratio of trade to GDP increased from 13.1 percent in 1990 to 20.3 percent in 2000. The proportion of Gross Capital Inflows to GDP during the same period increased from 0.8 percent to 3.0 percent. Gross Foreign Direct Investment as a percentage of GDP (which was zero in 1990) rose to 0.6 percent in 2000.

India's economy clearly is on the move and most certainly has the potential to emerge as a global economic power within next twenty to twenty-five years. However, this potential can be made a reality only if India mobilizes adequate political will and quickly commits itself to design and fully implement the next phase deeper 'second-generation reforms'. The concept of 'second-generation' reforms has been in the making for some years. However, these are yet to take concrete shape. Considering that India currently has no social security system in place for nearly 90 percent of its labor force employed in the unorganized sectors, India needs to evolve a well-calibrated approach to its future economic reforms.

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