Academic Script

Introduction

The beginning of the 1980's saw widespread gloom in India's macro economic performance after the emergency was officially declared over in 1977. However, during the period from 1980-90 the economy began to pick up and the rate of growth increased to 5.8 per cent and was exceeded by only eight out of 113 countries. Only after the growth accelerated in the 1980s, was there a significant downward trend in poverty.
This period was a harbinger of economic reform in India. The Industrial Policy Statement of 1980 placed an accent on promotion of competition in the domestic market, technological upgradation and modernization of industries.

Some of the socio-economic objectives spelt out in the Statement were:
1) Optimum utilization of installed capacity
2) Higher productivity
3) Higher employment levels
4) Promotion of export oriented industries
5) Removal of regional disparities
6) Strengthening of agricultural base
7) Consumer protection against high prices and poor quality

Policy measures were also announced to revive the efficiency of public sector undertakings by developing the management cadres in functional fields, namely operations, finance, marketing and information system. An automatic expansion of capacity up to 5 per cent per annum was allowed, particularly in the core sector and industries with long-term export potential. Special incentives were granted to industrial units which were engaged in industrial processes and technologies aiming at optimum utilization of energy and exploitation of alternative sources of energy. In order to boost the development of small scale industries, investment limit was raised to 2 million in small scale units and 2.5 million in ancillary units. In case of tiny units, investment limit was raised to 0.2 million.

Policy measures initiated in the first three decades since independence facilitated the establishment of basic industries and building up of a broad based infrastructure in the economy. The Seventh Five Year Plan (1985 to 1990) recognized the need for consolidation of these strengths and initiating policy measures to prepare Indian industry to respond effectively to emerging challenges. A number of measures were initiated towards technological and managerial modernization to improve productivity, quality and reduce cost production. The public sector was free from a number of constraints and was provided with greater autonomy. There was some progress in the process of deregulation during 1980s. In 1988, all industries, excepting 26 industries specified in the negative list, were exempted from licensing. The exemption was, however, subject to investment and locational limitations. The automotive industry, cement, cotton spinning, food processing and polyester filament yarn industries witnessed modernization and expanded scale of production during the 1980s. With a view to promote industrialization of backward areas in the country, the government announced in 1988, the Growth Centre schemes under which 71 growth centres were proposed to be set up throughout the country. Growth centres were to be endowed with basic infrastructure facilities such as power, telecommunications and banking to enable them to attract industries.

Major sectors of industry are divided into three segments: -

1. Mining
2. Manufacturing
3. Electricity generation

In the second half of 1980s, both electricity generation and mining indicated a more pronounced decline. Manufacturing sector, on the other side, witnessed an upward trend in growth rates, registering a growth rate of 8 to 9 per cent in the second half of 1980s. The annual growth of industries fluctuated between 3.2 per cent and 9.3 per cent during 1981–82 to 1990–91. By and large, industry maintained the growth rates of above 8 per cent for a large number of years. Among the sub-sectors, the manufacturing sector growth oscillated between 1.4 per cent and 9.7 per cent per annum. However, for a majority of number of years, it was above 8 per cent. The growth rate of mining declined sharply and that of electricity generation remained more or less stagnant. The improvement in industrial performance was due to greater pragmatism with the gradual loosening of controls and greater willingness to import technology and foreign capital to modernize the manufacturing sector. Greater realism in policy making including the stepping up of public investment infrastructure and energy production. The second half of 1980s witnessed considerable de-licensing and relaxation of controls to upgrade industrial technology. Many branches of manufacturing sector saw modernization and expansion of scales of production. The turnaround in industrial output growth in this decade has been widely attributed to liberalization, improvement in public investment and public sector performance.

The growth of total manufacturing during 1981–91 was 7.4 per cent and that of registered manufacturing was 8.2 per cent per annum. According to use-based industrial groups, intermediate goods have grown rapidly and similar was the case with consumer durable.

The real value of rupee appreciated slightly in 1981 and held steady at the same level until 1986. A process of slow and cautious liberalization of non-tariff import controls which had started in 1977–78 continued during this period, except for a tightening episode in 1980–81. This was done by expanding the number of non-competing machines, intermediate materials and 'de-canalizing' other products, i.e. removing them from the list of products which could only be imported by the various government owned or approved 'canalizing agencies'.

There was also some liberalization of domestic industrial controls, which had an indirect liberalizing impact on import controls. The main thrust of these policy changes was to ease the supply situation of important non-competitive inputs and to give manufacturing industries better and more flexible access to intermediate materials and capital equipment. The steep decline in implicit protection between 1981 and 1985, from about 85–105 per cent to 40–55 per cent suggests that this strategy was successful to some extent, since the reduction in measured protection resulted from a combination of lower domestic prices and higher international prices at a basically unchanged real exchange rate. However, domestic industries continued to be insulated from direct import competition, both by the quantitative restriction system and by prohibitively high tariffs. This situation got altered substantially in the 1990s. To sum up, the improved growth rate of manufacturing output since 1980s has not been secured merely by changes in the industrial and trade policies but may be on account of some improvements in the composition of public investment, performance of infrastructure industries, increasing use of manufactured inputs in crop production and also decline in the unfavourable inter-sectoral terms of trade. More importantly, the main objective of the macroeconomic policy stance was to facilitate higher industrial growth under relatively liberal domestic policy regime.

The changes in trade and industrial policy initiated in the 1980s have enabled firms and industries to operate in a more market sensitive manner to secure increased output and efficiency by better utilization of capacity with increased inducement to invest. Increased capacity utilization led to increase in productivity. However, the policy changes appear to have had little effect in stepping up the rate of investment in the manufacturing sector. Despite the relative liberal import of capital by a freer import of technology and capital and reduction in various physical controls, neither the rate of investment in manufacturing in general nor efficiency of capital goods sector seem to have witnessed any perceptible improvement. However, greater investments in infrastructure had positive impact on industrial growth in the 1980s.

In the late 1980s, government expenditure began to exceed its revenue by such large margins that it became unsustainable. Prices of many essential goods rose sharply. Imports grew at a very high rate without matching growth of exports. Foreign exchange reserves declined to a level that was not adequate to finance imports for more than two weeks. There was also not sufficient foreign exchange to pay the interest that needs to be paid to international lenders.

Policy changes since 1980's.

Here are some major reforms during the era:

The government introduced several export incentives after 1985, relaxing the foreign exchange constraint. 50 per cent of business profits attributable to exports were made income tax deductible; in the 1988 budget this concession was extended to 100 per cent of export profits while the interest rate on export credit was reduced from 12 to 9 per cent.

There was a steady decline in the share of canalized imports. Between 1980—81 and 1986—87, the share of these imports in total imports declined from 67 to 27 percent. Imports of petroleum, oil and lubricants imports declined increasing room for imports of machinery and raw materials by entrepreneurs.

The Open General License (OGL) list was steadily expanded. This list was reintroduced in 1976 with 79 capital goods items on it. The number of capital goods items included in the OGL list expanded steadily reaching 1,007 in April 1987, 1,170 in April 1988, and 1,329 in April 1990.

There was a relaxation of industrial controls and related reforms. Delicensing received a major boost in 1985 with 25 industries being delicensed and firms that came under the purview of the Monopolies and Restrictive Trade Practices (MRTP) Act were subject to different rules and could not take advantage of the liberalizing policy changes. Price and distribution controls on cement and aluminum were entirely abolished. Also, there was a major reform of the tax system. The multi-point excise duties were converted into a modified value-added (MODVAT) tax, which enabled manufacturers to deduct excise paid on domestically produced inputs and countervailing duties paid on imported inputs from their excise obligations on output.

The Indian government also fixed a realistic exchange rate for the Rupee. Inflation was relatively stable between 1983 to

1990 averaging 6.75 per cent recording a low of 3 per cent in early 1986 and a high of about 10 per cent.

NABARD was established on the recommendations of Shivaraman Committee, by an act of Parliament on 12 July 1982 to implement the National Bank for Agriculture and Rural Development Act 1981.

GDP GROWTH

From 1980 to 1989, the economy grew at an annual rate of 5.5 per cent or 3.3 per cent on a per capita basis. Industry grew at an annual rate of 6.6 per cent and agriculture at a rate of 3.6 percent. A high rate of investment was a major factor in improved economic growth. A high rate of investment was a major factor in improved economic growth. India, however, required a higher rate of investment to attain comparable economic growth than did most other low-income developing countries, indicating a lower rate of return on investments.
1980s.

Three important committees were set up in the early 1980s.

- Narsimhan Committee on the shift from physical controls to fiscal controls,
- Sengupta Committee on the public sector
- The Hussain Committee on trade policy

The 1980s reforms proved particularly crucial in building the confidence of politicians regarding the ability of policy changes such as:

- devaluation,
- trade liberalization
- delicensing of investments to spur growth without disruption.

GDP growth picked up by almost 6 per cent in the 1980s, it was driven mainly by a massive expansion in the country's fiscal deficit.

The growing structural imbalances in the economy - the current account deficit climbed to over 2 per cent of the GDP by the end of the 1980s and inevitably culminated in a severe balance of payments crisis in July 1991. It was this balance of payments crisis that forced India to procure an IMF loan that led to the adoption of a major reform package.

The origin of the financial crisis can be traced from the inefficient management of the Indian economy in the 1980s. We know that for implementing various policies and its general administration, the government generates funds from various sources such as taxation running of public sector enterprises etc. When expenditure is more than income, the government borrows to finance the deficit from banks and also from people within the country and from international financial institutions. When we import goods like petroleum, we pay in dollars not which we earn from our exports Development policies required that even though the revenues were we very low, the government had to overshoot its revenue to meet problems like unemployment, poverty and population explosion. The continued spending on development programmes of the government did not generate additional revenue. Moreover, the government was not able to generate sufficiently from internal sources such as taxation.

From 1980 onwards the industrial policy witnessed greater pragmatism with gradual relaxation of controls and increased willingness to import technology and foreign capital to modernize manufacturing sector. The policy framework included stepping up of public investment in infrastructure and energy production. The second oil shock was successfully met by enhancing domestic oil production and by import substitution in fertilizers. The second of the 1980s witnessed considerable de-licensing and relaxation of import controls to upgrade industrial technology. There was increased reliance on the private sector. In the 1980s, many segments of the manufacturing such as automotive industry, cement, cotton spinning, food processing, polyester filament yarn and several others witnessed modernization and expansion of scales of production. Industrial export growth increased in the second half of 1980s as import restrictions moved from the quantitative restrictions to tariffs. The turnaround in industrial output growth in the 1980s has been attributed to the liberalization, increased public investment and better public sector performance.

The 1990s crisis

In 1991, India met with an economic crisis relating to its external debt — the government was not able to make repayments on its borrowings from abroad; foreign exchange reserves, which we generally maintain to import petrol and other important items, dropped to levels that were not sufficient for even a fortnight. The origin of the crisis is directly attributable to the macro management of the economy during 1980's which led to large and persistent macroeconomic imbalances. The crisis was further compounded by rising prices of essential goods. All these led the government to introduce a new set of policy measures which changed the direction of our developmental strategies.

The widening gap between the revenue and expenditure of the government resulted in growing fiscal deficits which had to be met by borrowing at home. Further the steadily growing difference between income and expenditure of the economy as a whole resulted in large current account deficits in the balance of payments which were financed by borrowing from abroad.

The Gulf crisis in the late 1990 sharply accentuated macroeconomic problems. There was also political instability in the country at this juncture. All these developments together eroded international confidence in the Indian economy and as a result, this country's credit rating in the international capital market declined steeply. However, it has been recognized that the problems of the economy did not assume crisis proportions abruptly. Problems in the Indian economy have been there for years. Destroying the capacity of the economy to cope with any internal or external shocks. In the 1970's the Indian economy was strong enough to bear much larger and more sustained oil shocks. But by 1990 situation had changed so much that the minor oil shock made disproportionately large impact on the economy and a macroeconomic crisis erupted in the form of:

1) Unsustainable fiscal deficit
2) Unsustainable current account deficit
3) Accelerating inflation

The Fiscal Imbalance

The fiscal crisis in 1990 was not a coincidence. The fiscal situation had deteriorated throughout the 1980s due to growing burden of non-developmental expenditure. The gross fiscal deficit of the Central government which was 5.1 per cent of GDP in 1981-82, rose to 7.8 per cent in 1990-91. Since this fiscal deficit had to be met by recourse to borrowings, the internal debt of the Central government increased rapidly, rising from 33.3 per cent of GDP at the end of 1980-81 to 49.7 per cent of GDP at the end of 1990-91. This naturally made burden of servicing the debt onerous. Interest payments which were 2 per cent of GDP and 10 per cent of total Central government expenditure in 1980-81, rose to 3.8 per cent of GDP and 22 per cent of total Central government expenditure in 1990-91. How alarming this fiscal situation was, can be realised from the fact that in 1990-91 interest payments had eaten up 39.1 per cent of the total revenue collections of the Central government. This obviously was an unsustainable situation. The danger of the government falling into debt-trap was real. The government thus could not persist with its cavalier policy of growing reliance on borrowings to meet steadily increasing fiscal deficit to which unchecked growth of non-plan revenue expenditure was the major contributing factor.

Fragile Balance of Payments Situation

The balance of payments situation was highly precarious in 1991, but this was not unexpected. The current account deficit which was 2.1 billion or 1.35 per cent of GDP in 1980-81 rose to 9.7 billion or 3.69 per cent of GDP in 1990-91. These continuously growing deficits had to be financed by borrowing from abroad and as a consequence, India's external debt rose from 12 per cent of GDP at the end of 1980-81 to 23 per cent of GDP at the end of 1990-91. This steadily growing external debt led to an increase in debt service burden from 10 per cent of current account receipts and 15 per cent of export earnings in 1980-81 to 22 per cent of current account receipts and 30 per cent of export earnings in 1990-91. These mounting strains during the 1980s stretched to the breaking point in 1991 due to the Gulf crisis. The balance of payments position was on the brink of disaster as in mid-January 1991 and again in late June 1991 the level of foreign exchange reserves dropped to levels which were not sufficient to finance imports of even two weeks.

Mounting Inflationary Pressures

The price situation was apparently not alarming during the second half of the 1980s as the average rate of inflation was 6.7 per cent per annum in terms of the wholesale price index. However, the rate of inflation rose to 10.3 per cent in 1990-91. In terms of the consumer price index, the rate of inflation climbed to 11.2 per cent per annum which was certainly a cause for concern. However, the most disquieting feature of this inflationary situation was that the prices of food rose substantially in spite of three good monsoons in a row.

By that time the surge in oil prices triggered by the Gulf War in 1990 imposed a severe strain on a balance of payments it was already made fragile by several years of large fiscal deficits and increasing external debt. Foreign exchange reserves dropped in 1991, barely sufficient for two weeks of imports and a default on external payments appeared inevitable. The shortage of foreign exchange forced tightening of import restrictions, which in turn led to a fall in industrial output.

India approached the International Bank for Reconstruction and Development (IBRD), popularly known as World Bank and the International Monetary Fund (IMF) and received $7 billion as loan to manage the crisis. For availing the loan, these international agencies expected India to liberalise and open up the economy by removing restrictions on the private sector, reduce the role of the government in many areas and remove trade restrictions.

SUMMARY

The turnaround in industrial output growth in the 1980s has been attributed to the liberalization, increased public investment and better public sector performance. Policy measures initiated in the first three decades since independence facilitated the establishment of basic industries and building up of a broad based infrastructure in the economy. The origin of the financial crisis can be traced from the in efficient management of the Indian economy in the 1980s. The industrial growth dipped in 1991–92 due to crisis and adjustment problems. The economy was facing problems of declining foreign exchange, growing imports without matching rise in exports and high inflation. India changed its economic policies in 1991 due to a financial crisis and pressure from international organisations like the World Bank and IMF.
The need for reform of economic policy was widely felt in the context of changing global economic scenario, and the new economic policy was initiated in 1991 to make our economy more efficient.