Academic Script

Introduction

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 crisis was further compounded by rising prices of essential goods.

India had to procure IMF loan due to severe balance of payments crisis in July 1991 which led to the adoption of a major reform package and acted as a 'tipping point' in India's economic history. All these led the government to introduce a new set of policy measures which changed the direction of our developmental strategies.

LIBERALISATION

Liberalisation was introduced to put an end to restrictions, rules and laws which were aimed at regulating the economic activities but became major hindrances in growth and development and in the process, it opened up various sectors of the economy. Though a few liberalisation measures were introduced in 1980s in areas of industrial licensing, export-import policy, technology upgradation, fiscal policy and foreign investment, the reform policies initiated in 1991 were more comprehensive.

India's economic reforms began in 1991 under the Narsimha Rao Government and then Finance Minister of India, Manmohan Singh.

The reforms had two broad objectives: -

One was the reorientation of the economy from a statist, centrally directed and highly controlled economy to what is referred to a 'market- friendly economy'. A reduction in direct controls and physical planning was expected to improve the efficiency of the economy. It was to be made more 'open' to trade and external flows through a reduction in trade barriers and liberalization of foreign investment policies.

A second objective of the reform measures was macro-economic stabilization. This was to be achieved by substantially reducing fiscal deficits and the government's draft on society's savings.

We will now look at the background of the crisis.

BACKGROUND OF THE CRISIS

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 which we earn from our exports.

Development policies required that even though the revenues were 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. When the government was spending a large share of its income on areas which do not provide immediate returns such as the social sector and defence, there was a need to utilise the rest of its revenue in a highly efficient manner. The income from public sector undertakings was also not very high to meet the growing expenditure. At times, our foreign exchange, borrowed from other countries and international financial institutions, was spent on meeting consumption needs. Neither was an attempt made to reduce such profligate spending nor sufficient attention was given to boost exports to pay for the growing imports.

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.

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.

India agreed to the conditionality's of World Bank and IMF and announced the New Economic Policy (NEP). The NEP consisted of wide ranging economic reforms. The thrust of the policies was towards creating a more competitive environment in the economy and removing the barriers to entry and growth of firms. This set of policies can broadly be classified into two groups:

1. the stabilisation measures
2. the structural reform measures.

Stabilisation measures are short- term measures, intended to correct some of the weaknesses that have developed in the balance of payments and to bring inflation under control. In simple words, this means that there was a need to maintain sufficient foreign exchange reserves and keep the rising prices under control.

On the other hand, structural reform policies are long-term measures, aimed at improving the efficiency of the economy and increasing its international competitiveness by removing the rigidities in various segments of the Indian economy.

The government initiated a variety of policies which fall under three heads viz.,

- liberalisation
- Privatisation
- Globalisation

The first two are policy strategies and the last one is the outcome of these strategies.

Measures that the government has adopted and their impact on various sectors of the economy.

Let us study some important areas such as:

- The industrial sector
- Financial sector
- Tax reforms
- Foreign exchange markets
- Trade and investment sectors

(Which received greater attention in and after 1991)

Deregulation of Industrial Sector:

In India, regulatory mechanisms were enforced in various ways

(i) Industrial licensing under which every entrepreneur had to get permission from government officials to start a firm, close a firm or to decide the amount of goods that could be produced

(ii) Private sector was not allowed in many industries

(iii) Some goods could be produced only in small scale industries

(iv) Controls on price fixation and distribution of selected industrial products.

The reform policies introduced in and after 1991 removed many of these restrictions. Industrial licensing was abolished for almost all but product categories — alcohol, cigarettes, hazardous chemicals, industrial explosives, electronics, aerospace and drugs and pharmaceuticals. The only industries which are now reserved for the public sector are atomic energy generation and railway transport. Many goods produced by small scale industries have now been de-reserved. In many industries, the market has been allowed to determine the prices. It pushed industrial growth to a hefty 9.2 percent during the crucial high- growth period of 1988–91.

Financial Sector Reforms:

Financial sector includes financial institutions such as commercial banks, investment banks, stock exchange operations and foreign exchange market. The financial sector in India is controlled by the Reserve Bank of India (RBI). All the banks and other financial institutions in India are controlled through various norms and regulations of the RBI. The RBI decides the amount of money that the banks can keep with themselves, fixes interest rates, nature of lending to various sectors etc. One of the major aims of financial sector reforms is to reduce the role of RBI from regulator to facilitator of financial sector. This means that the financial sector may be allowed to take decisions on many matters without consulting the RBI.

The reform policies led to the establishment of private sector banks, Indian as well as foreign. Foreign investment limit in banks was raised to around 50 per cent. Those banks which fulfil certain conditions have been given freedom to set up new branches without the approval of the RBI and rationalise their existing branch networks. Though banks have been given permission to generate resources from India and abroad, certain aspects have been retained with the RBI to safeguard the interests of the account-holders and the nation. Foreign

Institutional Investors (FII) such as merchant bankers, mutual funds and pension funds are now allowed to invest in Indian financial markets.

Tax Reforms:

Tax reforms are concerned with the reforms in government's taxation and public expenditure policies, which are collectively known as its Fiscal policy.

There are two types of taxes:

1. Direct
2. Indirect

Direct taxes consist of taxes on incomes of individuals as well as profits of business enterprises. Since 1991, there has been a continuous reduction in the taxes on individual incomes as it was felt that high rates of income tax were an important reason for tax evasion. It is now widely accepted that moderate rates of income tax encourage savings and voluntary disclosure of income. The rate of corporation tax, which was very high earlier, has been gradually reduced. Efforts have also been made to reform the indirect taxes, taxes levied on commodities, in order to facilitate the establishment of a common national market for goods and commodities. Another component of reforms in this area is simplification. In order to encourage better compliance on the part of taxpayers many procedures have been simplified and the rates also substantially lowered.

Foreign Exchange Reforms:

The first important reform in the external sector was made in the foreign exchange market. In 1991, as an immediate measure to resolve the balance of payments crisis, the rupee was devalued against foreign currencies. This led to an increase in the inflow of foreign exchange. It also set the tone to free the determination of rupee value in the foreign exchange market from government control. Now, more often than not, markets determine exchange rates based on the demand and supply of foreign exchange.

Trade and Investment Policy Reforms:

Liberalisation of trade and investment regime was initiated to increase international competitiveness of industrial production and also foreign investments and technology into the economy. The aim was also to promote the efficiency of the local industries and the adoption of modern technologies. In order to protect domestic industries, India was following a regime of quantitative restrictions on imports. This was encouraged through tight control over imports and by keeping the tariffs very high. These policies reduced efficiency and competitiveness which led to slow growth of the manufacturing sector. The trade policy reforms aimed at,

(i) Dismantling of quantitative restrictions on imports and exports

(ii) Reduction of tariff rates

(iii) Removal of licensing procedures for imports.

Import licensing was abolished except in case of hazardous and environmentally sensitive industries. Quantitative restrictions on imports of manufactured consumer goods and agricultural products were also fully removed from April 2001. Export duties have been removed to increase the competitive position of Indian goods in the international markets. With a view to improving the performance of the public sector, there was a consensus on reducing its role and opening it up to the private sector. This was done through disinvestment and liberalisation measures.

PUBLIC SECTOR REFORMS:

Privatisation refers to transfer of ownership, management and control from public sector to private sector. It basically includes privatisation and dis-investment. Government companies can be converted into private companies in two ways,

(i) By withdrawal of the government from ownership and management of public sector companies

(ii) By outright sale of public sector companies.

Privatisation of the public sector undertakings by selling off part of the equity of PSUs to the public is known as disinvestment. The purpose of the sale, according to the government was mainly to improve financial discipline and facilitate modernisation. It was also envisaged that private capital and managerial capabilities could be effectively utilised to improve the performance of the PSUs. The government envisaged that privatisation could provide strong impetus to the inflow of FDI.

The government has also made attempts to improve the efficiency of PSUs by giving them autonomy in taking managerial decisions. For instance, some PSUs have been granted special status as *navaratnas* and *mini ratnas.*

In 1996, in order to improve efficiency, infuse professionalism and enable them to compete more effectively in the liberalised global environment, the government chose nine PSUs and declared them as *navaratnas.* They were given greater managerial and operational autonomy, in taking various decisions to run the company efficiently and thus increase their profits. Greater operational, financial and managerial autonomy had also been granted to 97 other profit-making enterprises referred to as *mini ratnas.*

The first set of *navaratna* companies included:-

1) Indian Oil Corporation Ltd. (IOC)
2) Bharat Petroleum Corporation Ltd. (BPCL)
3) Hindustan Petroleum Corporation Ltd. (HPCL)
4) Oil and Natural Gas Corporation Ltd. (ONGC)
5) Steel Authority of India Ltd. (SAIL)
6) Indian Petrochemicals Corporation Ltd. (IPCL)
7) Bharat Heavy Electricals Ltd. (BHEL)
8) National Thermal Power Corporation (NTPC)

9) Videsh Sanchar Nigam Ltd. (VSNL)

Later, two more PSUs—

1) Gas Authority of India Ltd.(GAIL)
2) Mahanagar Telephone Nigam Ltd. (MTNL)

—were also given the same status.

Many of these profitable PSUs were originally formed during the 1950s and 1960s when self-reliance was an important element of public policy. They were set up with the intention of providing infrastructure and direct employment to the public so that quality end-product reaches the masses at a nominal cost and the companies themselves were made accountable to all stakeholders.

The granting of *navaratna* status resulted in better performance of these companies. Scholars state that instead of facilitating *navaratnas* in their expansion and enabling them to become global players, the government partly privatised them through disinvestment. Of late, the government has decided to retain the *navaratnas* in the public sector and enable them to expand themselves in the global markets and raise resources by themselves from financial markets.

Impact of the government measures on various sectors of the economy

In economics, growth of an economy is measured by the Gross Domestic Product.

Year	*GDP Growth Rate (%)*
1991-92	1.3
1992-93	5.1
1993-94	5.9
1994-95	7.3

1996-97	7.8
1997-98	4.8
1998-99	6.5
2000-01	4.4
2001-02	5.8
2002-03	4.0

The table shows the growth of GDP in different periods.

The growth of GDP increased from 5.6 per cent during 1980-91 to 6.4 per cent during 1992-2001. This shows that there has been an increase in the overall GDP growth in the reform period. During the reform period, the growth of agriculture and industrial sectors has declined whereas the growth of service sector has gone up. This indicates that the growth is mainly driven by the growth in the service sector. The Tenth Plan (2002-07) has projected the GDP growth rate at 8 per cent. In order to achieve such a high growth rate, the agriculture, industrial and service sectors have to grow at the rates of 4, 9.5 and 9.1 percentage points respectively. However, the projection of such high rates of growth is unsustainable.

The opening up of the economy has led to rapid increase in foreign direct investment and foreign exchange reserves. The foreign investment, which includes foreign direct investment and foreign institutional investment, has increased from about US $ 100 million in 1990-91 to US $ 150 billion in 2003-04. There has been an increase in the foreign exchange reserves from about US $ 6 billion in 1990-91 to US $ 125 billion in 2004-05. At present, India is the sixth largest foreign exchange reserve holder in the world.

India is seen as a successful exporter of auto parts, engineering goods, IT software and textiles in the reform period. Rising prices have also been kept under control.

On the other hand, the reform process has been widely criticised for not being able to address some of the basic problems facing our economy especially in the areas of employment, agriculture, industry, infrastructure development and fiscal management.

Growth and Employment:

Though the GDP growth rate has increased in the reform period, scholars point out that the reform-led growth has not generated sufficient employment opportunities in the country. It is argued that reforms in India cannot be credited with higher growth because the growth rate crossed the 5 per cent mark in the 1980s, well before the launch of the July 1991 reforms. This is an incorrect reading since liberalization was already under way during the 1980s and played a crucial role in stimulating growth during that decade.

Reforms in Agriculture:

Reforms have not been able to benefit agriculture, where the growth rate has been decelerating. Public investment in agriculture sector especially in infrastructure, which includes irrigation, power, roads, market linkages and research and extension (which played a crucial role in the Green Revolution), has been reduced in the reform period. Further, the removal of fertiliser subsidy has led to increase in the cost of production, which has severely affected the small and marginal farmers. Moreover, since the commencement of WTO, this sector has been experiencing a number of policy changes such as reduction in import duties on agricultural products, removal of minimum support price and lifting of quantitative restrictions on agricultural products; these have adversely affected Indian farmers as they now have to face increased international competition.

Moreover, because of export- oriented policy strategies in agriculture, there has been a shift from production for the domestic market towards production for the export market focusing on cash crops in lieu of production of food grains. This puts pressure on prices of food grains.

Reforms in Industry:

Industrial growth has also recorded a slowdown. This is because of decreasing demand of industrial products due to various reasons such as cheaper imports, inadequate investment in infrastructure etc. In a globalised world, developing countries are compelled to open up their economies to greater flow of goods and capital from developed countries and rendering their industries vulnerable to imported goods. Cheaper imports have, thus, replaced the demand for domestic goods. Domestic manufacturers are facing competition from imports. The infrastructure facilities, including power supply, have remained inadequate due to lack of investment. Globalisation is, thus, often seen as creating conditions for the free movement of goods and services from foreign countries that adversely affect the local industries and employment opportunities in developing countries. Moreover, a developing country like India still does not have the access to developed countries' markets.

Disinvestment:

Every year, the government fixes a target for disinvestment of PSUs. For instance, in 1991-92, it was targeted to mobilise Rs 2,500 crore through disinvestment. The government was able to mobilise Rs 3,040 crore more than the target. In 1998-99, the target was Rs 5,000 crore whereas the achievement was Rs 5,400 crore. The assets of PSUs have been undervalued and sold to the private sector. This means that there has been a substantial loss to the government. Moreover, the proceeds from disinvestment were used to offset the shortage of government revenues rather than using it for the development of PSUs and building social infrastructure in the country.

Reforms and Fiscal Policies:

Economic reforms have placed limits on the growth of public expenditure especially in social sectors. The tax reductions in the reform period aimed at yielding larger revenue and to curb tax evasion, have not resulted in increase in tax revenue for the government. Also, the reform policies involving tariff reduction have curtailed the scope for raising revenue through customs duties. In order to attract foreign investment, tax incentives were provided to foreign investors which further reduced the scope for raising tax revenues. This has a negative impact on developmental and welfare expenditures.

Power sector reforms:

As a part of liberalisation, privatisation and globalisation, the government started to reform the power sector. The most important impact of these reforms has been a steep hike in power tariff. Since the power looms, on which a large number of industrial workers in cottage and small-scale sector depend, are driven by power energy, the impact of high tariff on them has been very serious. Further, while the power sector reforms have led to hike in tariffs, the power producers have failed in providing quality power to the powerloom industry. Since the wages of the powerloom workers are linked to the production of cloth, power-cut means cut in wages of weavers who were already suffering from hike in tariff. This led to a crisis in the livelihood of the weavers and fifty powerloom workers committed suicide in a small town called 'Siricilla' in Andhra Pradesh.

SUMMARY

The reforms in the 1980s must be viewed as precursor to those in the 1990s.The 1990's reforms were qualitatively different from those in the 1980s in that they represented a broad acceptance of the idea that entrepreneurs and markets were to be given priority over government in the conduct of economic activity and that govt. interventions required proper justification rather that accepted as default. The process of globalisation through liberalisation and privatisation policies has produced positive as well as negative results both for India and other countries.

Viewed from the Indian context, some studies have stated that the crisis that erupted in the early 1990s was basically an outcome of the deep-rooted inequalities in Indian society and the economic reform policies initiated as a response to the crisis by the government, with externally advised policy package, further aggravated the inequalities. Further, it has increased the income and quality of consumption of only high-income groups and the growth has been concentrated only in some select areas in the services sector such as telecommunication, information technology, finance rather than vital sectors such as agriculture and industry which provide livelihoods to millions of people in the country.

India, which started its developmental path from near stagnation, has since been able to achieve growth in savings, developed a diversified industrial sector which produces a variety of goods and has experienced sustained expansion of agricultural output which has ensured food security.