ECONOMIC REFORMS IN INDIA SINCE INDEPENDENCE

The economy of India is one of the fastest growing economies in the world. Since its independence in the year 1947, a number of economic policies have been taken which have led to the gradual economic development of the country. On a broader scale, India economic reform has been a blend of both social democratic and liberalization policies.

India has followed central planning for most of its independent history, which have included extensive public ownership, regulation, red tape, and trade barriers. After the 1991 economic crisis, the central government launched economic liberalization. India has turned towards a more capitalist system and has emerged as one of the fastest growing large economies of the world.

As of 2009, about 300 million people—equivalent to the entire population of the United States—have escaped extreme poverty. The fruits of liberalisation reached their peak in 2007, when India recorded its highest GDP growth rate of 9%. With this, India became the second fastest growing major economy in the world, next only to China. An Organisation for Economic Co-operation and Development (OECD) report states that the average growth rate 7.5% will double the average income in a decade, and more reforms would speed up the pace.

Indian government coalitions have been advised to continue liberalisation. India grows at slower pace than China, which has been liberalising its economy since 1978. McKinsey states that removing main obstacles "would free India's economy to grow as fast as China's, at 10 percent a year".

Economic reforms during the post independence period

The post independence period of India was marked by economic policies which tried to make the country self sufficient. Under the economic reform, stress was given more to development of defense, infrastructure and agricultural sectors. Government companies were set up and investment was done more on the public sector. This was made to make the base of the country stronger. To strengthen the infrastructure, new roads, rail lines, bridges, dams and lots more were constructed.

During the Five Years Plans initiated in the 1950s, the economic reforms of India somewhat followed the democratic socialist principle with more emphasis on the growth of the public and rural sector. Most of the policies were meant towards the increase of exports compared to imports, central planning, business regulation and also intervention of the state in the finance and labor markets. In the mid 50's huge scale nationalization was done to industries like mining, telecommunications, electricity and so on.

Indian economic policy after independence was influenced by the colonial experience (which was seen by Indian leaders as exploitative in nature) and by those leaders' exposure to Fabian socialism. Policy tended towards protectionism, with a strong emphasis on import substitution, industrialization, state intervention in labour and financial markets, a large public sector, business regulation, and central planning. Five-Year Plans of India resembled central planning in the Soviet Union. Steel, mining, machine tools, water, telecommunications, insurance, and electrical plants, among other industries, were effectively nationalized in the mid-1950s. Elaborate licences, regulations and the accompanying red tape, commonly referred to as Licence Raj, were required to set up business in India between 1947 and 1990.

Impact

* The low annual growth rate of the economy of India before 1980, which stagnated around 3.5% from 1950s to 1980s, while per capita income averaged 1.3%. At the same time, Pakistan grew by 5%, Indonesia by 9%, Thailand by 9%, South Korea by 10% and in Taiwan by 12%.
* Only four or five licences would be given for steel, power and communications. License owners built up huge powerful empires.
* A huge public sector emerged. State-owned enterprises made large losses.
* Infrastructure investment was poor because of the public sector monopoly.
* License Raj established the "irresponsible, self-perpetuating bureaucracy that still exists throughout much of the country" and corruption flourished under this system.

Economic Reforms during 1960s and 1980s

During the mid 1960's effort was made to make India self sufficient and also increase the production and export of the food grains. To make the plan a success, huge scale agricultural development was undertaken. The government initiated the "Green Revolution' movement and stressed on better agricultural yield through the use of fertilizers, improved seed and lots more. New irrigation projects were undertaken and the rural banks were also set up to provide financial support to the farmers.

The first step towards liberalization of the economy was taken when India started having balance of payments problems since 1985, and by the end of 1990, it was in a serious economic crisis. The government was close to default, its central bank had refused new credit and foreign exchange reserves had reduced to such a point that India could barely finance three weeks' worth of imports. India had to airlift its gold reserves to pledge it with IMF for a loan.

- **Causes and consequences**

Crisis was caused by current account deficits and currency overvaluation.

The economic crisis was primarily due to the large and growing fiscal imbalances over the 1980s. During mid eighties, India started having balance of payments problems. Precipitated by the Gulf War, India's oil import bill swelled, exports slumped, credit dried up and investors took their money out. Large fiscal deficits, over time, had a spill over effect on the trade deficit culminating

in an external payments crisis. By the end of 1990, India was in serious economic trouble.

The gross fiscal deficit of the government (center and states) rose from 9.0 percent of GDP in 1980-81 to 10.4 percent in 1985-86 and to 12.7 percent in 1990-91. For the center alone, the gross fiscal deficit rose from 6.1 percent of GDP in 1980-81 to 8.3 percent in 1985-86 and to 8.4 percent in 1990-91. Since these deficits had to be met by borrowings, the internal debt of the government accumulated rapidly, rising from 35 percent of GDP at the end of 1980-81 to 53 percent of GDP at the end of 1990-91. The foreign exchange reserves had dried up to the point that India could barely finance three weeks worth of imports.

Devaluation of Indian Rupee started in 1960s due to the wars with China (1962) and Pakistan (1965). Due to large government budget deficits, drought there was a sharp rise in prices due to inflation. The Indian Government was forced to start liberal policies in order to stabilize the economy, which in turn resulted into the huge devaluation of the Indian Rupee. Once again, the government decided to devaluate the rupee. Due to the currency devaluation the Indian Rupee fell from 17.50 per dollar in 1991 to 26 per dollar in 1992. The investor confidence also played significant role in the sharp exchange rate depreciation.

After Rajiv Gandhi became the Prime Minister, a number of restrictions on various sectors were eased, control on pricing was removed, and stress was given on increased growth rate and so on.

Economic Reforms during 1990s to the present times

Due to the fall of the Soviet Union and the problems in balance of payment accounts, the country faced economic crisis and the IMF asked for the bailout loan. To get out of the situation, the then Finance Minister, Manmohan Singh initiated the economic liberalization reform in the year 1991. This is considered to be one of the milestones in India economic reform as it changed the market and financial scenario of the country. Under the liberalization program, foreign direct investment was encouraged, public monopolies were stopped, and service and tertiary sectors were developed.

The economic reforms or liberalization in India mark a shift from socialist economy to a market economy. On 24 July 1991, the Congress government, led by P.V. Narasimha Rao, announced what was termed the "New Industrial rolicy", which paved the way for a new economic era in India by starting the process of liberalization. The policy, at one stroke, opened up the manufacturing sector by dismantling the system of licences and controls for most industries and allowed 51% foreign equity in Indian companies. Subsequent economic reforms carried out by Rao's successors I.K. Gujral, A.B. Vajpayee and incumbent Prime Minister Manmohan Singh, who was Rao's finance minister, unshackled India's potential as a magnet for foreign investment. Today, India is not only the ninth most attractive destination for foreign direct investment (FDI), it is also courted as a source of investment by foreign leaders, most recently by British Prime Minister David Cameron. However, economic liberalization remains very much a work-in-progress as India debates further opening up of sensitive sectors such as defence, multi-brand retail and aviation.

Since the initiation of the liberalization plan in the 1990s, the economic reforms have put emphasis on the open market economic policies. Foreign investments have come in various sectors and there has been a good growth in the standard of living, per capital income and Gross Domestic Product.

Due to the global meltdown, the economy of India suffered as well. However, unlike other countries, India sustained the shock as an important part of its financial and banking sector is still under government regulation. Nevertheless, to cope with the present situation, the Indian government has taken a number of decisions like strengthening the banking and tertiary sectors, increasing the quantity of exports and lots more.

The reforms progressed furthest in the areas of opening up to foreign investment, reforming capital markets, deregulating domestic business, and reforming the trade regime. Liberalisation has done away with the Licence Raj (investment, industrial and import licensing) and ended many public monopolies, allowing automatic approval of foreign direct investment in many sectors. Rao's government's goals were reducing the fiscal deficit, privatization of the public sector, and increasing investment in infrastructure. Trade reforms and changes in the regulation of foreign direct investment were introduced to open India to foreign trade while stabilizing external loans. Rao's finance minister, Manmohan Singh, an acclaimed economist, played a central role in implementing these reforms.

* In the industrial sector, industrial licensing was cut, leaving only 18 industries subject to licensing. Industrial regulation was rationalized.
* Abolishing in 1992 the Controller of Capital Issues which decided the prices and number of shares that firms could issue.
* Introducing the SEBI Act of 1992 and the Security Laws (Amendment) which gave SEBI the legal authority to register and regulate all security market intermediaries.
* Starting in 1994 of the National Stock Exchange as a computer-based trading system which served as an instrument to leverage reforms of India's other stock exchanges. The NSE emerged as India's largest exchange by 1996.
* Reducing tariffs from an average of 85 percent to 25 percent, and rolling back quantitative controls. (The rupee was made convertible on trade account.)
* Encouraging foreign direct investment by increasing the maximum limit on share of foreign capital in joint ventures from 40 to 51 percent with 100 percent foreign equity permitted in priority sectors,continuing reforms, when it was at the helm of affairs of India for five years.
* The Vajpayee administration continued with privatization, reduction of taxes, a sound fiscal policy aimed at reducing deficits and debts and increased initiatives for public works.
* The UF government attempted a progressive budget that encouraged reforms, but the 1997 Asian financial crisis and political instability created economic stagnation.

Impact of Reforms

The impact of these reforms may be gauged from the fact that total foreign investment (including foreign direct investment, portfolio investment, and investment raised on international capital markets) in India grew from a minuscule US$132 million in 1991-92 to $5.3 billion in 1995-96.

Cities like Gurgaon, Bangalore, Hyderabad, Pune and Ahmedabad have risen in prominence and economic importance, became centres of rising industries and destination for foreign investment and firms.

While the credit rating of India was hit by its nuclear tests in 1998, it has been raised to investment level in 2007 by S&P and Moody's. In 2003, Goldman Sachs predicted that India's GDP in current prices will overtake France and Italy by 2020, Germany, UK and Russia by 2025 and Japan by 2035. By 2035, it was projected to be the third largest economy of the world, behind US and China. India is often seen by most economists as a rising economic superpower and is believed to play a major role in the global economy in the 21st century.

In the revised 2007 figures, based on increased and sustaining growth, more inflows into foreign direct investment, Goldman Sachs predicts that "from 2007 to 2020, India's GDP per capita in US$ terms will quadruple", and that the Indian economy will surpass the United States (in US$) by 2043.

In spite of the high growth rate, the report stated that India would continue to remain a low-income country for decades to come but could be a "motor for the world economy" if it fulfills its growth potential. Goldman Sachs has outlined several things that it needs to do in order to achieve its potential by 2050, including improving governance, education, infrastructure and environmental quality, controlling inflation, introducing a credible fiscal policy, liberalising financial markets, increase trade with its neighbours and raising agricultural productivity.

New Economic Policy

Several major economic and political changes occurred during the 1970s and 1980s; which affected the developing countries | and paved the way for the implementation of IMF-sponsored Structural Adjustment Policies (New Economic Policy) in India in 1991. This was due to a combination of factors such as stagnant agriculture, low levels of industrial growth and diversification, inadequate capital formation, adverse terms of trade in international markets, limits to domestic resource mobilization due to a fairly narrow tax-base, loss making public sector enterprises, over regulated and controlled economy, poor industrial productivity, huge amount of fiscal deficit, huge amount of public debt, poor rating of Indian economy by international agencies,1' foreign exchange crisis etc.

New Economic Policy of 1991 includes globalization, liberalization and privatization (Disinvestment)

1. Globalization means flow capital (finance in the form of foreign direct investment (FDI) and foreign portfolio investment (FPI), technology, human resource, goods and service among countries. FDI is investment in real assets like automobile, consumer goods production, service sectors like insurance, telecommunication, air transport etc.
2. Liberalisation means freeing the economic activities and business from unnecessary bureaucratic and other controls imposed by the governments.
3. Privatisation or Disinvestment: Selling the government owned public sector enterprises to private industrialists and opening the government operating sectors for private investment.

The New Economic Policy includes reduction in government expenditure, opening of the economy to trade and foreign investment, adjustment of the exchange rate from fixed exchange rate system to flexible exchange rate system, deregulation in most markets and the removal of restrictions on entry, on exit, on capacity and on pricing.

Objectives of New Economic Policy

- To pull the country out of economic crisis
- Acclerate the rate of growth
- To make our production units more efficient and productive.
- To make use of the global resources for our own progress and development.

Positive effects of new economic policy

- Increase in foreign direct investment
- Increase in GDP growth rate
- Increase in foreign
- Outsourcing

Negative effects of new economic policy

- Growing unemployment
- Neglect of agriculture
- Growing personal disparities
- Infrastructural inadequacies
- Wide spread poverty.
- Demonstration effect (luxury goods)

India's New Industrial Policy

Tabled in both the houses of parliament on 24 July 1991

Policy objectives

The goals and objectives set out for the nation by Pandit Nehru, India's first Prime Minister, on the eve of Independence. These were:

- Rapid agriculture and industrial development of India
- Rapid expansion of opportunities for gainful employment
- Progressive reduction of social and economic disparities
- Removal of poverty
- Attainment of self reliance

In pursuit of the the above objectives, the Government has decided to take series of initiatives in respect of the policies relating to the following areas

- Industrial Licensing
- Foreign Investment
- Foreign Technology Agreements
- Public Sector Policy
- MRTP Act.

A package for the small and tiny sectors of Industry is being announced separately

Features of *Industrial Policy 1991*

1. Dereservation of Public Sector: -The role of public sector has been reduced to a great extent. The number of industries reserved for public sector was reduced to 8 industries. There was further Dereservation. At present, there are only three industries reserved for public sector which include, (a) Atomic energy (b) Railways, and (c) specified Minerals.
2. Delicensing: -The most important features of NIP, 1991 was the abolition of industrial licensing of all industries except six industries. The six industries are of social and strategic concern. The six industries are 1. Hazardous Chemicals. 2. Alcohol 3. Cigarettes 4. Industrial Explosives 5. Defence Products, and 6. Drug and pharmaceuticals.
3. Disinvestment of public sector: -The NIP 1991 permitted disinvestment of public sector units. Disinvestment is a process of selling government equity in PSUs in favour of private parties. Disinvestments aim at certain objectives. (1) To provide better customer Service. (2) To make effective use of disinvestment funds. (3) To overcome the problem of political interference. (4) To enables the government to concentrate on social development. Etc,
4. Liberalisation of Foreign Investment: -Prior to this policy, it was necessary to obtain approval from the government in respect of foreign investment. At present, 100% foreign equity participation is allowed in select industries.
5. Liberalisation Foreign Technology: -The NIP 1991 liberalised foreign technology to bring about technological improvement in Indian industry. (1) No Permission is required for hiring foreign technicians and foreign testing of indigenously developed technologies.
6. Liberalisation of Industrial Location: -The IP 1991 stated that there is no need to obtain approval from Central Government to locate industries in areas (other than cities of more than one million populations). However, industries subject to compulsory licensing, approval need to be obtained. In cities with a population of more than one million, polluting industries were required to be located outside 25 Kms of the city area.
7. Removal of Mandatory Conversion Clause (MCC): - In India, banks and FIs provide a large part of industrial finance. The banks and FIs have the option to convert the loans into equity. This may create a threat of takeover by FIs. Therefore, the IP 1991 abolished MCC.
8. Abolition of phased Manufacturing Programme: The IP 1991 has suggested for the abolition of PMP, which was in force in engineering and electronic industries.

Ongoing economic challenges

* Problems in the agricultural sector
* Highly restrictive and complex labour laws
* Inadequate infrastructure, which is often government monopoly.
* Failing education.
* Inefficient public sector.
* Inflation in basic consumable goods.
* Corruption
* High fiscal deficit