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Background of Economic Reforms in India

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ABSTRACT:

This paper is an attempt of a brief run-down of the various reforms that have taken place and its need through the broad brush of history of economic reforms which begin around 70 years before our independence in 1947 and how consequently, a whole reform process got unleashed in 1991. Further this paper speaks about the palpable performances of Indian economy after implementation of these economic reforms which speaks that where we are now. This paper seeks to provide a profile of data of various indictors like PCI, poverty literacy, life expectancy, power capacity, agriculture, industry services, GDP, saving, investment, GFD, Revenue deficit, Gross tax, interest payments, BOP, Corporate growth etc. have been tabulated in many table to show the ***consequences of economic reforms in India*** *since 1991 to 2009 which are a key ingredient of the Indian reforms process explains distinct improvement.*

INTRODUCTION:

This paper is an attempt of the various reforms that have taken place in the last 15 years before providing some evidence of their effectiveness. Over the period of time through the 1950s, 1960s and 1970s the economy had become over controlled and rigid. Consequently, entrepreneurship was heavily constrained. The import substituting inward looking development strategy that could have been relevant in the 1950s and 190s was no longer suitable in the modern globalizing world. Hence, overall reforms had to be undertaken to lay down a new framework. This paper makes a conceptual difference between macro and micro economic reforms to describe the background of economic reforms in India. Wide ranging macro reforms were undertaken along with corresponding microeconomic and sectoral reforms. Economic Reforms has been classified in two in the paper - Macro Economic Reforms and Micro Economic Reforms.

MACRO ECONOMIC REFORMS

Financial System –

Background of the tax system both for direct and indirect taxes had become very complex in India. Maximum marginal personal income tax rates were high along with a number of rates for different income ranges. The corporate tax rate was high too. Because of high rates and complexity, avoidance and evasion was naturally high. As consequence, over the whole reforms period, both the personal income tax and corporate tax rates have gradually been brought down to 30 per cent, along with considerable simplification. Similarly, in the case of indirect taxes, there were high levels of both domestic excise duties and customs tariffs, with a myriad of rates for different commodities. Again this necessitated a whole range of specific provisions and exemptions for different kinds of producers and end users, leading to great administrative complexity. A major programme of comprehensive and continuous reforms has had to be undertaken over the last 15 years. The rates in case of customs duties have been brought down from an average of 110 per cent in 1991 with highs over 400 percent to a non agricultural peak of 12.5 percent in 2006. There has been massive simplification of the excise tax structure to achieve a “central” rate of 16 per cent which is now essentially levied as a VAT so that cascading is avoided. The latest most significant measure taken is the introduction of the Fiscal Responsibility and Budget Management Ac in 2004, which enjoins the govt. to eliminate its revenue deficit and reduce its fiscal deficit to 3 per cent of GDP by 2009. Overall these fiscal reforms over the last 15 years have been truly wide ranging.

Monetary Policy –

Over the 1970s and 1980s monetary policy become almost non-existent; with a system of credit allocation, administered and different interest rate for different purposes; automatic monetization, reduction of statutory pre-emption of the lendable resource of banks and interest rate deregulation. As a result the central bank has been restored. These changes in the practice of monetary policy are manifest in its effectiveness in the significant reduction of inflation. While it was around 7-8 per cent during the first forty-five years, it has fallen to around five per cent in the recent period since the late 1990s.

External Sector Reforms –

It was the balance of payment crisis in 1991 that was the key trigger for reforms. Consequently, actions on the external sector have been of the greatest importance. Despite the existence of comprehensive quantitative trade restrictions along with high levels of tariffs, the balance of payments was under continuous pressure through the 1960s, 1970s and 1980s. Consequently, exogenous shocks such as oil price rises, or monsoon failures, invariably led to large crises necessitating resource to IMF resources. With the existence of these trade restrictions, the exchange rate was typically overvalued over a long period of time. Hence among the first reform moves was an ex ante real devaluation of the exchange rate in 1991 and a move of the exchange rate regime from that of a crawling peg towards a market determined one, through somewhat managed. The trade regime has undergone massive change with the removal of quantitative restrictions along with rationalization of the tariff structure. There has been a massive reduction in the number of tariff rates and the peak rate of tariff has been reduced from around 400 per cent to 12.5 per cent for non-agriculture products. Tariff reform for agriculture products has been constrained by the intransigence of developed countries in reducing their farm subsidies.

MICRO ECONOMIC REFORMS

Industrial deregulation, infrastructure reforms, financial sector strengthening, capital market deepening and agriculture are the major areas where micro economic reforms have taken place.

Industrial Policy –

Massive deregulation of the industrial sector, in fact, constituted the first major package of reforms in July 1991. The obsolete system of capacity licensing of industries was discontinued; the existing legislative restrictions on the expansion of large companies were remove; phased manufacturing programmes were terminated and the reservation of many basic industries for investment only by the public sector was removed. At the same time restrictions that existed on the import of foreign technology were withdrawn, and a new regime welcoming foreign direct investment, hitherto discouraged with limits on foreign ownership, was introduced. These massive reforms introduced in one stroke in 1991, & stage was set for a policy framework that encouraged new entry, introduced new competition, both domestic and foreign, which thereby induced the attainment of much greater efficiency in industry over a period of time.

Infrastructure –

A number of measures have been initiated in the development of infrastructure since 1996. Many of these reforms emanated from the recommendations of the India Infrastructure Report of the mid 1990s. We recognized that infrastructure investment had to be raised and suggested introduction of the private sector in infrastructure which had been restricted earlier. This was part of worldwide move during the 1990s. This has also necessitated other wide ranging reforms including new legislations and formation of regulatory authorities. Telecom is indeed a success story. TRAI i.e. Telecom Regulatory Authority of India, PMGSY i.e. Prime Minister's Gram Sadak Yojana or Rural Roads Programme, National Highway Development Project i.e. NHDP and Tariff Authority of Major Ports (TAMP) formed under reforms. In all these cases the response has been positive.

Financial Sector –

Financial Sector reform is another area of India's success story. A major element of the financial sector reform was the introduction of competition enhancing measures. Introduction of operational autonomy and partial disinvestment of public ownership in public sector banks, entry of new private and foreign banks and permission for FDI and portfolio investment in banking are some of the major reform measures in this area. Listing of almost all public sector banks is another major reform in this regard. Besides, prudential regulations have been strengthened in line with Basel I standards and are now in process of being updated to Basel II standards. An effort has been put in for phased implementation of international best practices such as CRAR (Capital to Risk Adjusted Assets Ratio) provisioning and income recognition norms, exposure limits and measures to strengthen risk management.

Among other segments of the financial sector, new private insurance companies have been introduced with limited foreign ownership. Subsequent to insurance nationalization in the 1950s and 1960s, all insurance was in public sector. A new regulator, the insurance Regulation and Development Authority (IRDA) has been formed to govern the insurance industry. The capital market has been revived with both policy reforms and financial infrastructure development. The Securities and Exchanges Board of India (SEBI) was formed as capital market regulator; a new modern technology oriented stock exchange was formed, The NSE. Private sector mutual funds allowed and encouraged.

THE ROAD TRAVELLED (CONCEQUENCES)

There is a need to remember where India was at the time of independence and during economic reforms and after economic reforms. This investigation turn to a menu of things that shows the consequences of the macro and micro economic reforms in gaze:

Table – 1

Some selected indicators of India's progress

Year	PCI (Rs.)	Poverty (%)	Literacy (%)
1951	3,687	45	18
1991	7,321	35	52
2008	14,626	18.7	64

Source: Central Statistical Organization

Table – 2

Indian Growth Experiences

Year	Industry (%)	Services (%)	GDP (%)
1951	5.7	4.6	3.7
1991	8.3	9.0	6.4
2009	16	17.0	8.0 (appx)

Source: Economic Survey 20003-05

Table – 3

People below poverty line

Year	RURAL AREAS %	URBAN AREAS %
1951	48.2	42.1
1991	37.3	32.8
2009	21.4	28.2

Source: Human Development Report 2009

Table – 4

Fiscal Indicators of the Central Govt.

Year	Gross Fiscal Deficit	Revenue Deficit
1991-92	5.6	2.5
2008-09	3.3	2.1

Source: Dr. Rakesh Mohan. "Economic Reforms in India", p.17

THE ROAD LESS TRAVELLED

Having outlined the major elements of India's achievement, this paper review the broad trends in some of the areas especially agricultural area we still have miles to go. Apart from agriculture management of public sector and proper implementation of the reforms are also the area which has been neglected. Agriculture is the key significant area that has not been subject to comprehensive reforms. It is not widely understood, though, that the reduction of industrial tariffs improved the domestic terms of trade significantly for agriculture. Through PDS, relaxation of restrictions under the Essential Commodity Act, Introduction of forward trading in most agricultural commodities, removal of restraints on interstate movement of food grains and removal of some marketing restrictions on crop produce are a number of significant reform but even there is no doubt, however, the agricultural development needs much more focused attention in order to revive the somewhat stagnating agricultural economy because

Table – 5

Growth in Agricultural Production (%)

Year	GDP in Agriculture	GDP in Agriculture and Allied Activities
1951	3.0	2.7
1991	3.1	3.0
2009	1.9	2.3

Source: Dr. Rakesh Mohan. "Economic Reforms in India", p.26

Perhaps there is need of second Green Revolution and White Revolution because still more than 60% population largely dependent on agriculture and fast growing service sector and industrial sector during recent years exhibited elevated their levels but since independence agriculture growth rate has been declining as shown in above table. One of the most disturbing features of the economic reforms has been that of the deceleration in management of the public sector.

CONCLUSION:

India has been posting incredible rates of growth in recent years. However, there is a disconnection between the existing regulations and India's growth. Moving forward on the second generation reforms has become critical, with a perception that policy reforms in India have stalled. Some of these reforms are administrative in nature, but broadly they require changes in the statutory framework governing the sector. Presently, we can identity some key policy reforms that are needed to address the constraints that are impeding investment and growth and generating negative sentiments.

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