Economic reforms and Policies of the Government and its Impact on Transformation of Indian Economy

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Publishing Date: April 06, 2017

Abstract

The economic reform, introduced in 24 July 1991, by Dr. Manmohan Singh mandated to emerge India a major economic power in the world. After 27 years of structural reform, India has edged itself among the 10 largest economies of the world with a GDP of more than 2 Trillion Dollars (World Bank, n.d.) but at the same time, India lags behind providing public goods like health, education, public transport and other Social Overhead Capital. There were three major promises of the reforms firstly, there should be unfetter economic growth, secondly, the growth should be accompanied by job creation, poverty alleviation and thirdly reforms should reduce corruption significantly along with removal of bureaucratic regulation. Undoubtedly, reforms have hastened economic growth but it is yet to fulfill the second and third aspects of economic reform.

India's rank in the World Bank's ease of doing business report rose by 30 positions, from 130 in the year 2017 to 100 in 2018 among 190 countries (World Bank, 2017). On the other hand, Global Hunger Index (GHI) report compiled by IFPRI revealed that India's place fell from 83 in 2000 to 97 in 2016. The remarkable achievement in the ease of doing business index was the outcome of many structural reform program undertaken by the Modi government but at the same time there should be an articulated concern from the central government of India so that India should place in the respectable position in Global Hunger Index. Thereby Indian economy will transform in a realistic manner. In this context, the objectives of the paper are to analyze the macroeconomic policy of the government and their impact on the economic transformation of Indian economy.

Keywords: *Structural reform program, Global Hunger Index (GHI), Ease of Doing Business Index, Macroeconomic policy.*

Introduction

India's rank in the World Bank's ease of doing business report rose by 30 positions, from 130 in the year 2017 to 100 in 2018 among 190 countries (World Bank, 2017). On the other hand, Global Hunger Index (GHI) report compiled by IFPRI revealed that India's place fell from 83 in 2000 to 97 in 2016. The remarkable achievement in the ease of doing business index was the outcome of many structural reform program undertaken by the Modi government but at the same time there should be an articulated concern from the central government of India so that India should place in the respectable position in Global Hunger Index. Thereby Indian economy will transform in a realistic manner.

The economic reform, introduced in 24 July 1991, by Dr. Manmohan Singh mandated to emerge India a major economic power in the world. After 25 years of structural reform, India has edged itself among the 10 largest economies of the world with a GDP of more than 2 Trillion Dollars (World Bank, n.d.) but at the same time, India lags behind providing public goods like health, education, public transport and other Social Overhead Capital. There were three major promises of the reforms firstly, there should be unfetter economic growth, secondly, the growth should be accompanied by job creation, poverty alleviation and thirdly reforms should reduce corruption significantly along with removal of bureaucratic regulation. Undoubtedly, reforms have hastened economic growth but it is yet to fulfill the second and third aspects of economic reform.

As per the Chinese experience, the benefits from economic reforms will be more if government will take more pre-reform egalitarian measures such as land reform, education and expenditures in other social infrastructure. In comparison to India, China did better in fighting poverty after reforms due to huge spending in infrastructure and public investment on agriculture and industry (Ghosh, 2010). Unlike China, which followed the classical trajectory of agriculture to manufacturing, India has shifted to the service sector, leaving millions in low-end, low productivity and employment.

Objectives of the study

- To assess economic policy of the government of India
- To find out the impact of economic policies on various macro-economic variables of Indian economy

Review of Literature

Panagariya (2004) viewed that the Indian economy was having fragile and volatile growth pattern until 1990s. But after economic reform in 1991, the economic growth was steadier and robust, exhibiting far less volatility. He suggested that India must free industry of continuing restraints if it is to maximize the benefits of what has been done to date.

Agrawal and Siggel (2009) found that the reforms were helpful by increasing access to foreign technology and making imports of capital and intermediate goods cheaper. Most of the firms felt that improvement in infrastructure and more flexible labour laws will facilitate further growth of India's manufacturing sector.

Mohan (2006) revealed that the economic reforms process carried out in India over the last 15 years has brought forth a burst of new entrepreneurial energies across the board in almost all sectors. As a consequence, the country is now recording substantial economic growth in excess of 8 per cent.

Review of Major Economic Policies of the Government of India

The economic policy of India has been laid down Directive Principles of State policies in the part IV of Indian constitution. The objective of the policy is to maximize the welfare of the people through fulfilling economic justice and equity. Basing on this, the Government of India, emphasized dominance of public sector over private sector and was in support of closed economy after the catastrophe of long British rule. However, with passing of time, Indian economy confronted many economic problems due to faulty economic policy. There was huge government regulations, almost all the sectors were dominated by the public sector undertakings; control of economic activity was pervasive and huge deficit in balance of trade.

As a result, Indian economy introduced the most important economic reform policy measures in 1991. Though India introduced Structural Adjustment Programs in early 1990s, the need for a policy shift had become evident much earlier, as many countries in East Asia achieved high growth and poverty reduction through policies which emphasized greater export orientation and encouragement of the private sector. Thereby, India, with the leadership of Mr. Rajib Gandhi, undertook some measures in this direction in the 1980s but in 1991, the government signaled a systemic shift to a more open economy with greater reliance upon market forces. The significance of reforms in economic policy can be demonstrated through the fact that the average growth rate in the ten year period from 1992-93 to 2001-02 was around 6.0 %, which puts India among the fastest growing developing countries in the 1990s and external stability despite the East Asian crisis.

However, in comparison to other developing countries, China maintained a GDP growth above 10 % since 1999 until 2007, the reason being that it ventured into the path of liberalization in the year 1979 (Lemoine, 2000, Huang, 2002) by gradually liberalizing and opening up its economy. So as per the Washington consesus[2], economic reforms have a direct impact on the growth of the economy.

INDUSTRIAL POLICY

The industrial base of Indian economy was subverted after the British colonial rule and become a huge market to the British industry resulting in stalled industrial development. After the end of the rule, the policy maker regarded industrialization as the panacea of the move towards economic self sufficiency, eradication of poverty and unemployment. The industrial policy clearly emphasized mixed economic structure where public sector was assigned a relatively broader role. As pointed out by Ahluwalia (2002) the industrial structure was highly inefficient and protective with an objective of import substitution. However, the government adopted an “outward oriented” open economy model to resurrect the Indian economy from the economic crises in 1990s.

The first ever plan for industrial development was started in the year 1938 when a national planning committee was set up under the chairmanship of Pt. Jawaharlal Nehru which recommended state control over all key industries. However, after independence, the government of India undertook the first ever industrial policy in the year 1948 which embarked upon an ambitious plan of industrial development based on the Mahalonobis Model and socialistic framework of Soviet Union. The model laid emphasis on closed economy and favored higher investments to capital goods industry which has both forward and backward linkages (Singh 2008, Jadhav 2005).

In order to protect the small and ancillary industries and to reallocate the resources from production of consumer goods into production of machine tools and capital goods the government introduced the Industrial development and regulation Act 1951.The Act applied scheduled industries listed in first schedule of the Act through which the government had full control over the approval of any proposal on capacity, location, expansion, manufacture of new product, foreign exchange expenditure on import of plant and the term of foreign collaboration. Apart from this, the government of India appointed a monopolies inquiry commission to restrict concentration of economic power in the private hands which recommended to setting up of a permanent commission on monopolies and restrictive trade practices. On this basis the MRTP Act was passed out in 1969 in order to regulate the concentration of economic power in private hands, to prohibit monopolistic trade practices and to restrictive trade practices.

With a view to regulate foreign exchange transactions and to constrained the freedom of foreign investors, the Foreign Exchange Regulation Act (FERA) was thoroughly revised and amended in 1973 which brought a great change in the foreign investment policy of the government. In addition to this, the Act approved foreign equity up to 40 % requiring large investments and advanced technology or in those that were engaged in exports. Eventually, the government took another remarkable step by setting up Secretariat for Industrial Approvals (SIA) in November 1973 in order to deal with all industrial licenses, capital goods, import licenses, terms of collaboration and etc. Taking one step ahead, the industrial policy 1977 stated that if a foreign company diluted its foreign equity up to 40 % under FERA 1973 was to be treated at par with the Indian company. Moreover, the Act issued list of industries no foreign collaboration of financial or technical nature was allowed as indigenous technology was already available and fully owned foreign were allowed only in highly export oriented and sophisticated technology areas.

On account of all the above policy regulations, the Indian economy was suffered from severe economic crisis during 1990s. Realizing this, the then government of India led by P.V. Narasimha Rao undertook drastic economic reforms by introducing new economic policy. The economic policy 1991 introduced several changes in different areas like comprehensive industrial policy, foreign investment policy, public sector and industrial licensing policy. However, the most radical changes implemented in the reform package have been in the area of Industrial Policy which removed several barriers to entry in the earlier environment. As a result, the pervasive industrial licensing which required government permission for new investments as well as for substantial expansion of existing capacity, has been virtually abolished and restricted to a small list of industries and the Monopolies and Restrictive Trade Practices (MRTP) Act have also been eliminated as well. The other most important changes occurred in the public sector policy where the list of industries reserved for the public sector has been drastically pruned and many critical areas have been opened up to private sector participation. As part of globalization process, the policy restructured radically in foreign investment where permission was automatically granted for foreign equity investment up to 51% instead of 40 % in a list of 34 industries.

FISCAL POLICY

High fiscal deficits and a growing revenue deficit continued to remain a major cause of concern for the government during the past few years for which government has been taking stringent measures to manage the public revenue and expenditure. Fiscal Policy occupies a central place in the overall macroeconomic framework of an economy as it initiates a right kind of approach to maintain fiscal discipline and assumed the responsibility of creating the capital base in the form of infrastructure to stimulate growth of the state economy. It is an observed fact that fiscal reforms have brought a new vision and mission for the government towards competitiveness and efficient mode for managing the economy. It is witnessed that due to bad fiscal management most of European countries especially Greece suffered from huge fiscal deficit and debt burden. In this context, the rating of the country depends on the control on fiscal management through which will foreign investors will be attracted.

So far as India is concern, the aim of fiscal policy was to focus on achieving greater equity and social justice but later on due to the fiscal imbalances in the1980s spilled over to the external sector resulting in the macroeconomic crisis of 1991 resulting formulation and enactment of the fiscal responsibility legislation which signaled a new dawn in fiscal consolidation.

However, the taxation policy after 1991 was based on structural reform program following the macroeconomic crisis and the recommendation from Dr. Raja J. Chelliah, the Chairman of the Tax Reforms Committee 1991. The policy aimed at augmenting revenues and removing anomalies in the tax structure through restructuring, simplification and rationalization of both direct and indirect taxes. It lowered the maximum marginal rate on personal income tax, widening of the tax base by way of a series of steps including introduction of presumptive taxes, reducing the corporate tax rate on both domestic and foreign companies, rationalization of capital gains tax and dividend tax, progressive reduction in the peak rate of customs duty on non-agricultural products and rationalization of excise duties.

FOREIGN TRADE POLICY

In the era of globalization, the role of foreign trade policy is getting a central place in the economic policy of all the countries in general and India in particular. The task is getting more complex after the global financial meltdown as the economy was hit by many economic indicators like industrial production, trade, capital flows, unemployment, per-capita investment and consumption. In order to arrest and reverse the declining trend of exports and to provide additional support especially to those sectors which have been hit badly by recession in the developed world, the government of India announced the foreign trade policy which includes measures like short term as well as long term. The short term objective of the policy is to achieve an annual export growth of 15% with an annual export target of US$ 200 billion by March 2011, around 25% per annum up to 2014 and to double India's exports of goods and services by 2014. However, the long term policy objective of the policy is to double India's share in global trade by 2020. The policy followed the host of measures like fiscal incentives, institutional changes, procedural rationalization and market access across the world and diversification of export markets improvement in infrastructure related to exports; bringing down transaction costs, and providing full refund of all indirect taxes and levies to meet the above objectives,

For India, the need of the hour is to diversify the export markets and offset the inherent disadvantage for our exporters in emerging markets of Africa, Latin America, Oceania and CIS countries such as credit risks, higher trade costs etc., through appropriate policy instruments. That is why the FTP 2009-14 endeavored to diversify products and markets through rationalization of incentive schemes including the enhancement of incentive rates, enabling competitive exports and through availing the Market Development Assistance Scheme and Market Access Initiative Scheme which would catalyze the next phase of export growth.

As part of look east policy for expanding market, the government has signed a Comprehensive economic partnership agreement with ASEAN with South Korea for enhancing market access to Indian exports. However, the most inherent part of the policy is to upgrade the technology to reduce the cost. In order to support the growth of exports the government appointed a high level coordination committee established in the Department of Commerce. For this, on the basis of their export performance, the government recognizes exporters called 'status holders', to import capital goods duty free of specified product groups. Apart from this, for the development of MSMEs and to avail their rights through trade remedy instruments under the WTO, the government proposed to set up a Directorate of Trade Remedy Measures. In order to reduce the transaction cost and institutional bottlenecks, the e-trade project would be implemented in a time bound manner to bring all stake holders on a common platform. Along with this, additional ports/locations would be enabled on the Electronic Data Interchange over the next few years. An Inter-Ministerial Committee has been established to serve as a single window mechanism for resolution of trade related grievances.

FDI POLICY

As a capital crunch nation, India always depends on other developed economies to maintain economic growth and development. Because of this India's foreign debt is increasing day by day leading to debt trap. In order to come out from this difficulties, the government of India opened its economy for foreign investors for both Foreign direct investment and Foreign Institutional Investment. However, FDI is more suitable form of investment as it is non debt and non volatile in nature. The growth and development of Indian FDI lies on the basis of the initiatives and policies undertaken by the government of India to induce foreign investments into the Indian economy.

The initial period of FDI was marked by laying down of a new Act i.e. Monopolies and Restrictive Trade Practices Commission (MRTP) in 1969, which imposed restrictions on the size of operations, pricing of products and services of foreign companies. The Foreign Exchange Regulation Act (FERA) enacted in 1973, limited the extent of foreign equity to 40%, though this limit could be raised to 74% for technology-intensive, export-intensive, and core-sector industries. Payments of dividends abroad, repatriation of capital, inward remittances and etc were subject to this stringent law which discouraged foreign investment. The FERA Act served as a tool for implementing the national policy on foreign private investment in India. The FERA empowered the Reserve Bank of India to regulate or exercise direct control over the activities of foreign companies and nationals in India. The foreign companies have to obtain permission from RBI for carrying on in India any activity of trading, commercial or industrial nature, acquiring any business undertaking in India and purchasing shares of Indian companies.

After the new industrial policy statement of July 24, 1991, which observes that while freeing the Indian economy from official controls, had liberalized the Indian policy towards foreign investment and technology. In the pre-liberalization era, the foreign participation was restricted to 40 percent and foreign investment and technology agreements needed prior approval but in the new policy FDI was allowed on the automatic route for large number of industries where no prior approval of the government/RBI is required.

Until December 1996, only 35 industries as mentioned in the Annexure III of the industrial policy statement of July 1991 were eligible for automatic approval of FDI up to 51 percent of the total equity. In 1996, the automatic approval route for FDI was expanded, from 35 to 111 industries, under four distinct categories (Part A–up to 50%, Part B–up to 51%, Part C–up to 74%, and Part D-up to 100%). However, the automatic route had subsequently been expanded very significantly up to 100 percent basing on the nature of industries.

However, Foreign Direct Investment (FDI) in India is expected to grow significantly following the implementation of recent Government of India (GOI) initiatives, including the Goods and Services Tax (GST) related reforms, enactment and implementation of the Insolvency and Bankruptcy Code (IBC), demonetisation, and other ease of doing business reforms rolled out recently by the central government. These reforms have boosted India's image as a preferred destination for foreign investment, with many sectors being fully available to foreign investors for making investments without any restrictions.

These reforms resulted in India, for the very first time, figuring in the top 100 in the World Bank's 'Ease of Doing Business' global rankings, on the back of sustained business reforms by the Narendra Modi-led government. The World Bank's report also recognizes India as one of the top 10 improvers in last year's assessment, having implemented reforms in eight out of 10 'Doing Business' indicators. On the "distance to frontier metric," India's score has also witnessed a significant jump, which reflects improvements in India's business regime in the last year itself. The upcoming foreign direct investment policy (FDI policy) 2018 presents another such opportunity to further boost investor confidence. The FDI policy 2018 presents an excellent opportunity to ride on the recent wave of reforms initiated by the Modi government. It is hoped that FDI policy 2018 will be investor-friendly and encourage foreign investments in India.

Impact of Economic Policies on Macro Economic variables

Since the inception of new economic policy 1991, Indian economy has been changing very fast barring couple of years in between. Certainly, good economics does pay in long run. Most importantly, the Narendra Modi led NDA government made an earnest attempt to bring transparency in implementation of government schemes from last 4 years since it assumed office from 26 May 2014. PM Modi undertook many radical structural economic reforms including ease of doing business, inflation, fiscal deficit, revival of manufacturing sectors and huge inflow of Foreign Direct Investment. Internationally, Indian economy has been well reckoned as the Modi government put India to top 100 nations club in terms of business friendly as perceived by World Bank. For the first time, India has jumped to 30 positions to become the top country in terms of ease of doing business ranking this year. As per Mr. Annette Dixon, Vice President, South Asia Region, the significant achievement of this year is the result of Indian government's consistent effort on bold reform agenda of past years to improve the business environment and to strengthen its position as a preferred place to do business globally.

The table-1 reveals the significant achievement of Indian economy after the economic reform-1991 and includes different macro economic variables like Gross Domestic Product, employment, inflation, fiscal deficit, exports, imports, FDI and Ease of Doing Business Index.

Table1: Macro Economic Indicators of Indian Economy

Year	GDP_{Fc} (Bl.Rs)	Employment (In Millions)	Inflation (WPI)	Fiscal Deficit (Billion Rs)	Exports (Billion Rs)	Imports (Billion Rs)	FDI (Billion Rs)	Ease of Doing Business Index
1991-92	6135.28	36.76	207.8	**363.25**	**440.42**	**478.51**	4.09	NA
1992-93	7037.23	36.28	228.7	401.73	536.88	633.75	10.94	NA
1993-94	8179.61	36.69	247.8	602.57	697.51	731.01	20.18	NA
1994-95	9553.85	36.74	112.6	577.03	826.74	899.71	43.12	NA
1995-96	11185.86	37.43	121.6	602.43	1063.53	1226.78	69.16	NA
1996-97	13017.88	39.14	127.2	667.33	1188.17	1389.20	96.54	NA
1997-98	14476.13	40.09	132.8	889.37	1301.01	1541.76	135.48	NA
1998-99	16687.39	40.37	140.7	1133.49	1397.53	1783.32	123.43	NA
1999-00	18582.05	41.34	145.3	1047.16	1595.61	2152.37	103.11	NA
2000-01	20007.43	42.00	155.7	1188.16	2035.71	2308.73	107.33	NA
2001-02	21752.60	41.17	161.3	1409.55	2090.18	2452.00	186.54	NA
2002-03	23438.64	41.39	166.8	1450.72	2551.37	2972.06	128.71	NA
2003-04	26258.19	40.46	175.9	1232.73	2933.67	3591.08	100.64	NA
2004-05	29714.64	39.35	187.3	1257.94	3753.40	5010.65	146.53	NA
2005-06	33905.03	41.47	104.5	1464.35	4564.18	6604.09	245.84	NA
2006-07	39532.76	39.97	111.4	1425.73	5717.79	8405.06	563.9	116
2007-08	45820.86	39.11	116.6	1269.12	6558.64	10123.12	986.42	134
2008-09	53035.67	38.15	126.0	3369.92	8407.55	13744.36	1428.29	120
2009-10	61089.03	38.83	130.8	4184.82	8455.34	13637.36	1231.2	122
2010-11	72488.60	40.17	143.3	3735.91	11429.22	16834.67	973.2	133
2011-12	81069.46	44.49	156.1	5159.90	14659.59	23454.63	1651.46	134
2012-13	92026.92	46.80	100.0	4901.90	16343.18	26691.62	1219.07	132
2013-14	103631.53	48.26	106.9	5028.58	19050.11	27154.34	1475.18	132
2014-15	114817.94	NA	112.5	5108.17	18964.45	27370.87	4490.72	134
2015-16	124586.42	44.85	113.9	5327.91	17163.78	24902.98	2085.79	142
2016-17	136699.14	NA	109.7	5342.74	18540.96	25668.20	2893.94	130
2017	NA	NA	NA	NA	NA	NA		130
2018	NA	NA	NA	NA	NA	NA		100

Source: Hand Book of Statistics on Indian Economy, RBI 2016-2017

The data mentioned in the table has been represented through trend analysis. Each variable is fitted with trend lines. Again in each variable, the value of R squared is derived to see how close the data are fitted with regression line i.e. linear or exponential. The high R-square indicates that the model explains all the variability of the response data around its mean. In other words, the higher the R-squared, the better the model fits your data. The fig-1 shows that GDP is increasing in exponential manner as the R-square value is 0.996. In the same way fig-2 shows fiscal deficit has increased exponentially. But it increases less in comparison with increase in GDP.

Trend Analysis of Major Economic Variables

Fig-1

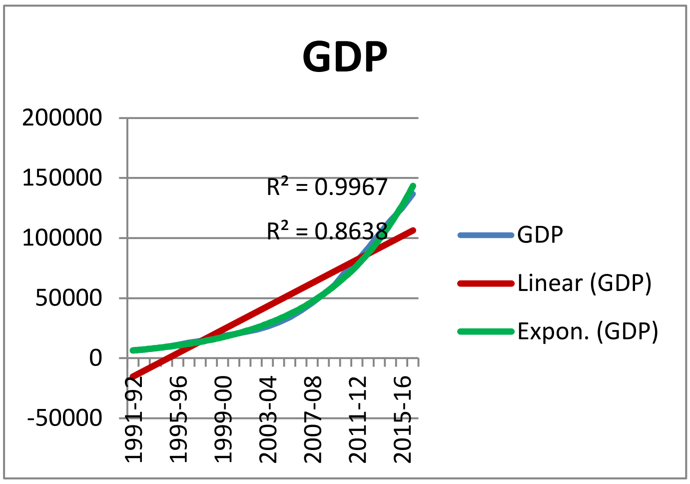


Fig-2

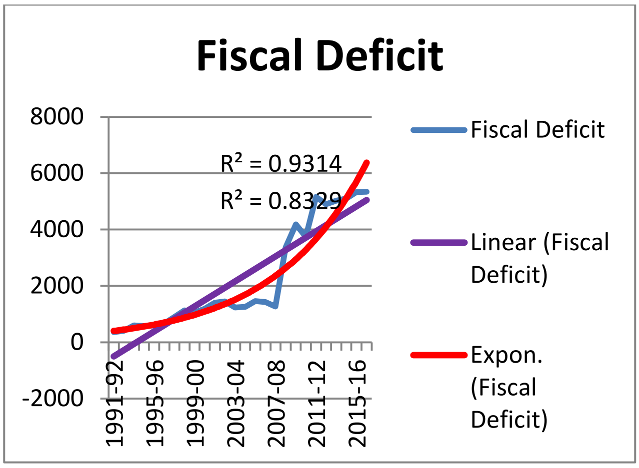


Fig-3

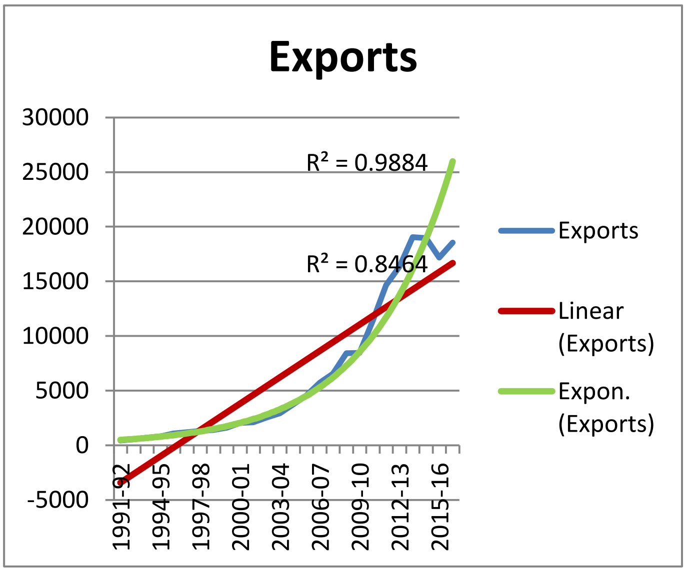
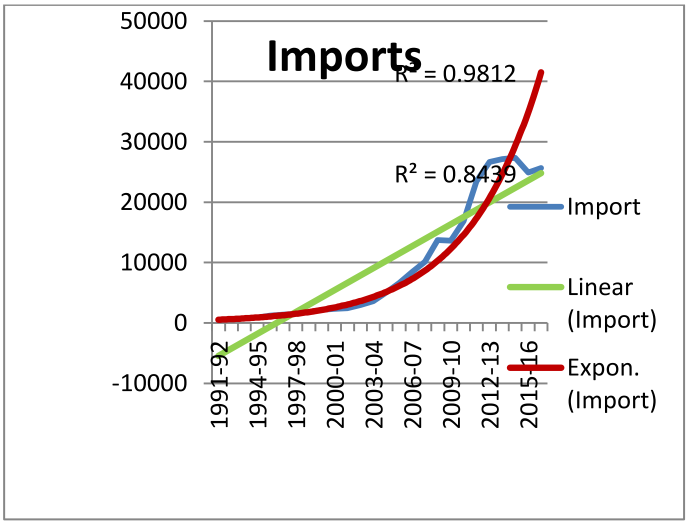


Fig-4



In the same way both exports and imports (Fig-3 & Fig -4) increased in exponential way as the R square value is 0.988 and 0.981 respectively. However, the growth rate of exports has been more than imports. So far as FDI is concern, it shows an exponential growth after the economic reform program but it increases more than double after 2013. Inflation decreases throughout the years in linear manner. There are no significant changes in the employment rate as it increases with very slower rate.

Fig - 5

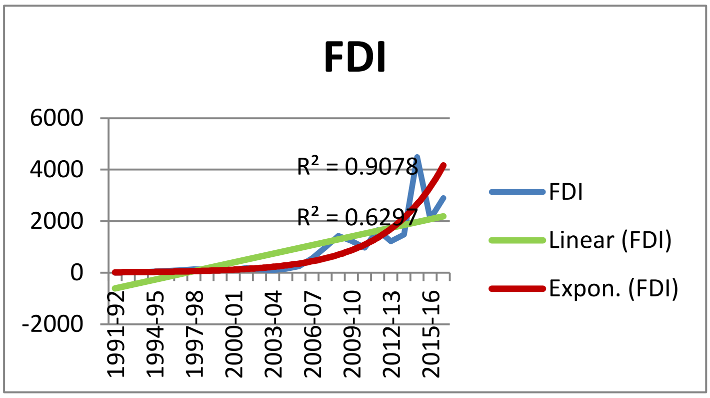


Fig - 6

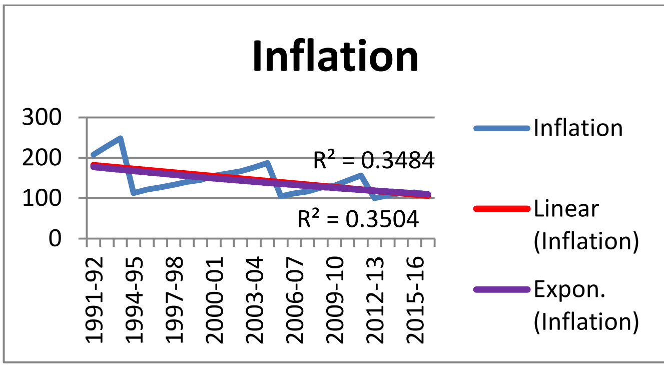
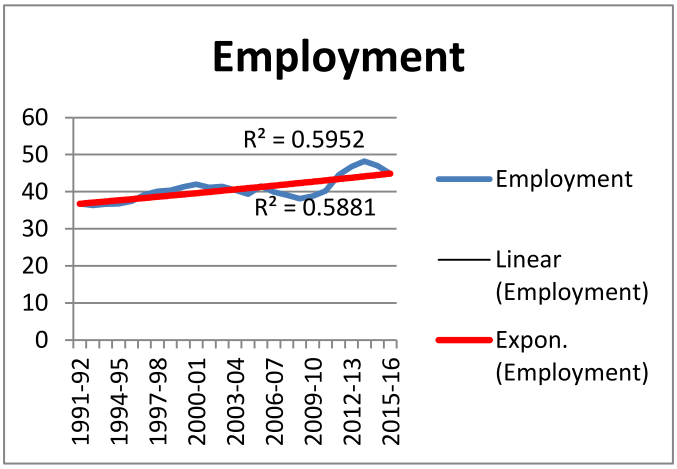


Fig - 7



The R-square values are more or less same in exponential and linear trend i.e.0.595 and 0.588 respectively. Lastly, due to continuous reform, the ease of doing business index improves year to year which shows that India is more preferred place to do business. Especially the rank changes to 30 positions in 2018 due to concerted effort of the NDA government.

Conclusion

The economic reforms process carried out in India over the last 26 years has bought forth a burst of new entrepreneurial energies across the board in almost all sectors. As a result, the nation is achieving substantial economic growth. This growth could possibly be constrained by lack of both quality and quantity of public services supplied by the government so that India will achieve inclusive and sustainable growth.

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