The Impact of Economic Reforms on Indian Economy

An Assessment

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Abstract- *The Economic reforms in India started with the Liberalisation of the Indian economy on 24th July 1991. After the Independence in 1947, India concentrated on socialism policies in the beginning but the attempts to liberalize the Indian economy were made in the year 1966 and 1985. India introduced a series of economic reforms due to the acute balance of payment crisis that it faced. Realising the poor health of the financial sector, series of reforms were implemented which includes easing of the interest rates, reducing the control over the private and the foreign banks, elimination of the associations lending requirements, easing of the bank branch licensing, entry of the private sector mutual funds and welcoming more and more foreign institutional investors. The present paper attempts to assess how the Indian economy has responded to these policy measures and the resultant changes in the business conditions in a long run perspective. The paper finds that although the rate of growth of the Indian industry sector has not accelerated following economic reforms probably due to slow growth in agriculture and industrial productivity, investment in general and FII and FDI in particular have shown considerable increase. Export orientation has increased across the industries significantly signalling enhanced global competitiveness of Indian firms, although imports have risen faster than exports. As economic reform deepens and competitive pressures build up, an analysis of these interactions would provide useful insights for understanding corporate behaviour and for making policy choices.*

Key Words: Economic reforms, GDP, Fiscal deficit, corporate sector, strategies, FDI, FII.

Introduction

Indian economy featured by licence raj and red tapism faced severe financial crisis during 1990-91 which forced the Indian government to initiate the economic reforms and liberalise the Indian economy. India had to make a solemn promise of 20 tonnes of gold to Union Bank of Switzerland and 47 tonnes of gold to Bank of England. The IMF (International monetary fund) also required India to take a series of reforms regarding the economic structure of India. India opted for the neo- liberal policies to put an end to the unrestricted or unfettered capitalism also known as the' license raj' and adhered more to the laissez-faire doctrine .The reforms inclined at easing restriction on firms' activities and enhancing the competition in the market by putting an end to the 'license raj'. Indian market has also been opened for the foreign trade and investment. Deregulation and privatisation alongwith reformed tax regime. P.V. Narashimha Rao has been held as the pioneer for the Indian economic reforms. His committee members included Manmohan Singh and many others who carried out his path of liberalisation. The financial sector also experienced a lucrative opening due to these reforms. Realising the poor health of the financial sector, series of reforms were implemented which includes easing of the interest rates, reducing the control over the private and the foreign banks, elimination of the associations lending requirements, easing of the bank branch licensing, entry of the private sector mutual funds and welcoming more and more foreign institutional investors. The financial reforms are practiced to pull out India of its fiscal deficit. Indian economy enjoyed major growth of five years during the period (2003-2008). It is during this period that India enjoyed a growth rate of 9% per year until it was disturbed by 2008

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global financial crisis. The crisis which emerged due to greed and poor management of financial activities by the developed economies posed a serious threat to the emerging economies. Some people argued that it is the result of market reforms and excessive liberalisation of the economy. But keeping aside this argument it was decided to move ahead with the structural reforms and domestic upliftment. The crisis gave an alarming call against the hazard of the uncurbed capital inflows. It has been decided to concentrate on the protection of the domestic economy and institutions against the whimsical financial globalisation. After the financial crisis of 2008 the growth of the following two years (2009-2010) was managed by i) Liberalising the credit at low interest rates and ii) expanding the public sector expenditure that raised the fiscal deficit by 2.5% of the gross domestic product in 2007-2008 to 4.8% in 2011-2012[1].

As the Indian economy was stranded and imbalances prevail in the macroeconomic variables, the main concern was to focus on how this crisis could be overcome. With the corporate sector mostly mired in over–leverage, the most sensible alternatives left was to boost up investment in public infrastructure to encourage investment and expansion of the bank credit facility on easy terms to the informal sector and agriculture, which have been neglected during the booming, season. The global recession of 2009 cause a sharp decline in the global economic market and there was a sharp drop in the market in the September 2008. Initially the central bank had to restrain the flow of liquidity in the market. The impact of global recession on Indian economy was adverse and it sustained for a couple of years. The IT sectors that provide services to a majority of the US based IT firms suffered a huge set back due to this global downfall as they generate 75% of their revenue Decline in exports during the end of October 2008 also create a sharp decline in its economic structure. The decelerating export rate also lowered its GDP. Though India was more prone to make domestic developments but the exports of merchandise goods add good value to the GDP of the country . when value of exports dropped down it affected the Indian economy leading to joblessness, and restlessness in the Indian economy. As a result government intervene to introduce various series of reforms and expansion of the private sector. Towards the end of the 2011, government increased the intervention of Foreign Direct Investment by 51% but due to coalition of other parties it did not succeed. Governments' initiatives to keep the prices of diesel low for a long time also undergone a change with change in the market price. The new reforms to meet the financial crisis is that government welcomed foreign investors like Wal-Mart to operate in the Indian market but the twist introduced in the policy is that it left to the Government of the individual states to decide what is going to happen in their own territory. Further it was added that larger cities will be the fortunate to experience the super-markets first. In addition to the above the foreign investors are required to improve the logistic chains. With a view to curb the inflation and benefit the Indian consumers better logistics, competitive shops, foreign expertise and technology are been introduced. Farmers are also been able to get the benefits of the supermarket as it reduces the long chain of intermediaries. The restriction on 'single brand investors' was relaxed. Foreigners can now go for outlets without any local partners; however they are required to source their raw-materials from the local market. Foreign investors are also allowed to invest in sectors like 'India's power sector' (trading exchanges), in domestic broad casting and domestic aviation.

Objectives of the study

The basic objective of the study is to find out the impact of the economic reforms on the performance of Indian economy since 1991. The particular objectives of the study are-

1. To review the different economic reforms undertaken by the government.
2. To examine empirically, the impact of reform measures on the trends in the Indian economy in terms of selected indicators.

Data Collection and Methodology

The study is primarily based on the secondary data collected from the different publications of RBI, websites of National Stock Exchange,

Bombay Stock Exchange and SEBI and various books and articles. The sample period of the study spans from 1991 to 2013.

This study has been organized in three parts. Section I reviews the significant economic reforms undertaken by the Indian government. Section II focuses on the impact of economic reforms on Indian economy through selected market indicators. The concluding observations are made in the last section of the study.

Key dimensions of economic reforms:

There was no doubt in it that gradual approach was followed in 1991 to reform India which was different from the incremental approach to reforms of the 1980s. Whereas the current reforms are far different from the previous ones, they are over a vast area and are much clear in identifying the objectives and specific needs of the distinct areas .The new era reforms help to merge with the global economy through trade, technological advancements, and investments and so on. The perspective towards introducing the new reforms is that it must not be concentrated to any particular area but it must be spread to all the sectors so that the economy is benefitted from all the angles and sub angles.

Fiscal Consolidation

In the development of Indian economy fiscal reforms plays an important role. Why India only, for the development of any other economy, development of fiscal condition is very important. During the eighties the fiscal deficit has had reached around 8.4% of GDP in 1990-91 for the central government and together with the state government it has reached to 10% GDP, which was very high. So steps were taken to reduce the fiscal deficit of the central government that took into account the abolition of the export subsidies in 1991-1992, fertiliser subsidies were restructured in 1992-93. Government's loan to provide support to the loss making public Sectors are been phased out. Development expenditures including the developments on social and economic expenditure are also been restricted. With these reforms the government was able to reduce the fiscal deficit from 8.4% of the GDP in 1990 to 5.9% in 1991-1992 and further to5.7%in 1992-93. In 1993-1994 while it was expected that the fiscal deficit will get reduced by 4.65% of the GDP but the target did not met and the fiscal deficit stands out to be 7.3% of the GDP. The cause for this slippage was due to shortfall of the tax revenues as compared with the targeted budget. Customs revenues were under the set target as the imports were much less than the exports. Collection from the exercise duty was also below the standard because the Industrial did not responded to the reforms as was expected.1994-1995 However it experienced a fiscal deficit of 6% of GDP, which was a significant improvement as compared to 1993-1994. The reform that brought down the fiscal deficit was the introduction of the limit or ceiling to the government's borrowing from the RBI. During 1999-2000 fiscal deficit gone up for a high of 9.8% of the GDP which was considered to be a crisis period. During 1995-1996 the fiscal deposit declined by about 3% of the GDP.

YEAR	Fiscal Deficit (as a percentage of GDP)
1990-1991	8.4
1991-1992	5.9
1992-1993	7.3
1993-1994	6
1994-1995	3
1995-1996	6.4
1996-1997	7.3
1997-1998	8.9
1998-1999	9.8
1999-2000	9.1
2000-2001	7
2001-2004	7.3
2004-2005	6.6
2005-2006	5.3
2006-2007	5.3
2007-2008	6.2
2008-2009	6.6
2009-2010	4.7
2010-2011	5.8
2011-2012	4.9
2012-2013	4.8

Source: www.rbi.gov.in

The fiscal factors along with others such as industry deregulation and foreign trade proved beneficial for the industry to prosper and took the domestic investment to a domestic peak of 26.5% of GDP in 1995-1996. During the period 1999-2000 the growth was around 6% and it accelerated in 2000-2001. Inflation became moderate and the fiscal deficit was around 1% of GDP. Economy experienced private capital inflows because of the industrialisation. Short term external debts that accounted for 10%of the total debt in 1990-1991 and counted four times of the stock of external reserves came down to a level of around 4.4%of the total debt. The Indian economy has slowed down to around 5% for the fiscal year 2010-1011, which was 6.2 % of the previous fiscal year. In 2003 it was a far worse situation for Indian rupee had hit a low of as against the US dollar. The Indian government as a result control the outflow of money put a restriction on foreign investment for both corporates and individuals. India has recorded a GDP growth rate of 9.3% in 2010-2011, while in 2013 the GDP growth rate has been recorded as 4.8% in march 2013 which was almost half of what was experienced in 2010-2011.while the government being always optimistic forecasted a growth rate 6.1-6.7% for the year 2013-2014. Adding more to the worse condition fiscal deficit in 2013-2014 was 4.8% of the GDP that further worsens the situation for India.

Industrial growth and investment

One of the most important impacts of the reforms is the industrial growth and development. The barriers that earlier caused hindrances to the industrial growth, were eliminated by the series of reforms. The prevailing industrial Licensing that proved to be epidemic for the industries was substantially abolished. Licensing was now meant for small list of industries and that too for the reason of environmental and pollution considerations. Monopolies and Restrictive trade practices (MRTP) act that allows large industrial houses to control over investment and expansion was also eliminated. The list of industries reserved for the investment of the public sector has been trimmed and new areas have been opened up for more and more private sectors. Electric power generation has been opened up for private sectors state governments are now also negotiating with the private investors for setting the private power plants. Exploration of petroleum sector has also been given to the private sectors. Aviation industry which previously has the monopoly of the public sectors has been opened up for the private sectors. Tele-communication sectors has also been opened up to the private sectors in the fields of cellular telephones. Investment allowance of Rs 15 crore was allowed to the manufacturing companies who invest more than Rs 100 crore in plant and machinery during the year 2014 -2015.

Foreign Investments

The controls over the domestic investors have also been reduced. They are now allowed to directly communicate with the foreign investors. The unfriendly policy that was previously followed by the government was changed. the percentage of ownership allowed in term of equity to the foreign investors was restricted to 40% except in certain high technology areas and foreign investment was earlier discouraged in consumer goods sector unless it is accompanied by strong export Commitments. The reformed policy is very supportive in term of foreign investments. 51% of equity share is granted to the foreign investors to a large list of 34 countries. Various restrictions that were applied to the companies with foreign equity of 40% or more have been eliminated under the Foreign Exchange Regulation act and each and every company irrespective of the foreign alignment are treated alike. The corporate sectors are also in the list of beneficiaries of those reforms. Liberal approach towards the decentralisation of the power to the regional and the state offices made the decision making much faster and speed up the business. Entry of the multinational companies

increases the competition for the domestic Companies. As a result they are keen to raise their standards against the global benchmark. Easing of the policies helps the companies to get listed on the foreign exchanges, and opt for more acquisitions. The FII investments over the years are as given below:

Financial year	Equity	Debt	Total
1992-93	13	0	13
1993-94	5,127	0	5,127
1994-95	4,796	0	4,796
1995-96	6,942	0	6,942
1996-97	8,546	29	8,575
1997-98	5,267	691	5,958
1998-99	-717	-867	-1,584
1999-00	9,670	453	10,122
2000-01	10,207	-273	9,933
2001-02	8,072	690	8,763
2002-03	2,527	162	2,689
2003-04	39,960	5,805	45,765
2004-05	44,123	1,759	45,881
2005-06	48,801	-7,334	41,467
2006-07	25,236	5,605	30,840
2007-08	53,404	12,775	66,179
2008-09	-47,706	1,895	-45,811
2009-10	110,221	32,438	142,658
2010-11	110,121	36,317	146,438
2011-12	43,738	49,988	93,726
2012-13	140,033	28,334	168,367
2013-14**	33,311	-62,898	-29,587
Total	**661,692**	**105,569**	**767,257**

Source: SEBI

** As on October 31, 2013

Reforms in trade and exchange rate policy

Trade and exchange sectors are also not lagging behind from the impact of liberalisation. Keeping the policies for the final consumer goods intact, trade policy for all has under gone a substantial change. The complex trade regime that was followed earlier has been reversed, and the imports of all kinds of raw materials and capital goods have been liberalised. Imports of capital goods have been limited to the subject of permission and against special import license which are only given to certain categories of exporters. Although there were restrictions on the import of consumer goods but for all sectors quantitative restrictions have been limited. This proceeded with lowering of the customs duties. The highest customs duty recorded was 200% 1991, which has been lowered to 65% in 1994. Other custom duties have also been lowered from their peak points. Duties on capital goods have been lowered to 20%-40%.inspite of this reductions India's custom duties are still high and the government are positive to reduce this custom duties in order to be at with the other developing countries. Export subsidies were devalued and instead of that, export incentives were given to the exporters that allowed them to import items that were otherwise restricted . Those license are freely tradable and depending upon the market demand export incentives also can be earned. The adjustment to the new market condition took to cost cutting, improvement in the quality of the products and design. Increase in the capacity of the firms also took place in response to these reforms whose consequence is the increase in the exports and domestic market.

Taxation

Tax reforms is also an important relevant part of the economic reforms in India. It includes both the direct and indirect taxes. The taxation reform committee recommended for simpler system of direct taxation with moderate rates and fewer exemptions. The Committee recommended for a rational domestic exercise taxes on industrial production with a change from imposing specific rates to ad valorem taxes. Substantial attempts have been made to lower the exercise duties. In the 1990's decade the central government's earnings through tax revenues declined from about 10% of GDP in 1991-1992 to 8.7% to what

was estimated in the budget. This was a consequence of the fact that the revenues generated from the state had declined to about 7.8% of GDP. Government had to reside to reduction in tariff rates. Income from the customs duties and the exercise duties were reduced from 7.5% of GDP to 5.7% of GDP in 1999-2000. The personal income- tax rates were also to be reduced. Till 2000-2001 budget sectors like agriculture, small scale industry and services are not fully integrated in to the taxation system. Land tax prevailed but virtually and agricultural incomes remain largely outside the consideration of taxation. Almost half of the governments' income collected through medium of taxation is spend on payments for public debts, defence outlays and transfers to the state governments. The scenario for the tax revenues of FY2013-2014 is different. The government proposed to make a tax reclaim of 11.9 per cent of tax GDP ratio. As achieved in 2007-2008. No alterations were made to the personal income tax as the government apprehended that even the slightest alterations in the tax level would throw hundreds of tax payers out of the tax criteria. Securitisation of tax is proposed to be exempted from income tax. Indirect taxes include 12% for exercise duty and service tax. And no change has been introduced on the 10 % rate of customs duty on non-agricultural products. But an considerable concession has been proposed for the Air-crafts repair, Maintenance and overhauling industries. Exercise duty put a relief to the ship building Industries but at the same time 18% has been imposed on cigars. The income tax rates for corporate s which used to be51.75% for a public listed company and 57.55 for a closely held company have been reduced to 46% and this rates includes the 15% surcharge rates, without this surcharge rates the rates will be 40% which is just at par with tax on personal incomes.

Financial sector reforms

This sector includes reallocation of the resources in the best possible way So that it can be to the most efficient uses. Considering the banking sector reforms started based on the report on the financial system. The introduction of the high reserve requirements by the bank in terms of S LR(statutory liquidity ratio) or CRR (cash reserve ratio) has been made to support the Government borrowings . Further there is compulsion in making investment in the government securities by the banks, where the interest rates are market determined. Regulation of the interest rates has also been rationalised. Earlier what the RBI used to do was that it has kept different rates for different types of maturities and also different prescribed lending rates for different classes of borrowers but now this has been withdrawn and only single deposit rate has been made. Banking system has been made opened for competition and licenses to several new banks are been granted. Competition has also increased due to the branches of the foreign banks. The central bank of India RBi formulates all the rules and regulations of the banking system in India and it also help the other banks in recovering the debts from the default borrowers by special debt recovering tribunal. Although there was various measures taken to reform the capital market in India with the help of reforms in the banking sectors India's stock exchanges suffered due to lack of transparency in trade practices. For this reason SEBI (The Securities and Exchange Board Of India) has been established as a independent statutory authority for controlling and supervising and formulating the rules and regulation of trading practices of the brokers, underwriters, merchants bankers, mutual funds etc. Portfolio investment is another reform that has been introduced in the capital market. In this portfolio investment the investors are given the opportunity to become a part of the foreign market. Indian investors are allowed to access and operate in the foreign market by issuing equity in the foreign market via Global Depository Receipts. Capital inflow in to the Indian market has been allowed by granting foreign institutional investments. The

foreign investors manage the pension funds and to encourage this investors favourable tax treatments have been introduced by the governments. These Foreign Direct Investments and Foreign Institutional Investments gain their popularity when international fund managers are more keen to invest in the emerging economies and India has never disheartened them . on estimation it was found that in 1993-1994 the return from international equity issues was about $2.5 billion while FII itself has invested about $1.5 billoin in the domestic markets.

Conclusion

Some of the Reform initiatives taken by the government since 1991 brought the structural changes in the Indian economy. Though the global financial crisis destabilised the Indin economy as reflected through negative foreign flows, increased fiscal deficit, increased inflation, reduced tax-GDP ratio and adverse import export situation, but the Indian government is trying hard to come on track. A large number of reform initiatives taken by the government in the recent past have started delivering the results. The stricter import of gold, partial liberalisation of fuel pricing, set up of coal regulator and focus on increased public expenditure are a few reforms which will bring India back on high growth trajectory.

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