

ECONOMIC REFORMS IN INDIAN ECONOMY

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In order to improve the situation of the economy, the economic reform package was introduced in 1991-92, though it was first commenced on a modest scale in 1985. To transform India from a controlled closed economy into a fairly open economy, the process of liberalization, privatization and globalization was started. In this process, a large number of measures were undertaken in the sphere of trade, commerce and industry which replaced the earlier regime of control and regulation. In addition, the measures were also undertaken to accelerate the growth of the economy through development of infrastructure, flow of foreign capital from abroad, developing a strong and healthy financial and capital market. Economic reforms like abolition of import licensing, removal of quantitative restrictions on consumer goods and agricultural products, liberalized foreign direct investment (Ahluwalia, 2002), introduction of faster trade reforms (Mukherjee, 2000) were designed. India's economic reforms began in 1991 when a newly congress government facing an exceptionally severe balance of payments crisis, embarked on a programme of short term stabilization combined with a longer-term programme of comprehensive structural reforms. The reforms initiated in 1991 were different precisely because they recognized the need for a system change, involving liberalization of government controls, a larger role for the private sector, and greater integration with the world economy.

The surge in oil prices triggered by the Gulf War in 1990 imposed a severe strain on a balance of payments already made fragile by several years of large fiscal deficits and increasing external debt. Coming at a time of internal political instability, the BOP problem quickly ballooned into a crisis of confidence which intensified in 1991 even though oil prices quickly normalized. There was a flight of capital in the form of withdrawal of NRI deposits from the banking system and an unwillingness of international banks to extend new loans. Foreign exchange reserves dropped to dollar 1.2 billion in June 1991, barely sufficient for two weeks of imports and a default on external payments appeared imminent. The shortage of foreign exchange forced tightening of import restrictions, which in turn led to a fall in industrial output. In November 1991, the government entered into a stand-by arrangement under which the IMF would provide dollar 2.3 billion over a two-year period and there was definite expectation on both sides that the stand-by arrangement may need to be followed by recourse to the ESAF facility because adjustment was expected to take longer than two years.

If we talk of planning, 8th Plan (1992-1997) looks to be more successful than earlier plans. Worsening Balance of Payment position, rising debt burden, widening budget deficits, recession in industry and inflation were the key issues during

the launch of the 8th Plan. This plan undertook drastic policy measures to combat the bad economic situation and to undertake an annual average growth of 5.6% through introduction of fiscal and economic reforms including liberalization under the Prime Ministership of Shri P V Narasimha Rao.

Some of the main economic outcomes during the eighth plan period were rapid economic growth (highest annual growth rate so far – 6.8), high growth of agriculture and allied sector, and manufacturing sector, growth in exports and imports, improvement in trade and current account deficit. High growth rate was achieved even though the share of public sector in total investment had declined considerably to about 34%. This shows that economic reforms especially fiscal reforms leads to macroeconomic stability and overall growth of the country.

Financial markets in India, in the period before the early 1990s, were marked by administered interest rates, quantitative ceilings, statutory pre-emptions, captive market for government securities, excessive reliance on central bank financing, pegged exchange rate, and current and capital account restrictions. As a result of various reforms, the financial markets have transited to a regime characterised by market-determined interest and exchange rates, price-based instruments of monetary policy, current account convertibility, phased capital account liberalisation and an auction-based system in the government securities market. While balancing the goals of efficiency and stability in introducing reforms, the Reserve Bank has moved towards deregulation of interest rates, promoted development of markets, and strengthened the legal infrastructure to facilitate better enforcement of financial contracts.

“We can accelerate growth and improve welfare only if we effectively implement wide ranging economic and governance reforms.” – D. Subbarao (Governor of Reserve Bank of India)

In 1991 in the reform programme undertaken to stabilize the economy in the wake of the crisis, correcting the fiscal imbalances was accorded a high priority. Measures taken in the initial years of reform produced some positive results and the combined Fiscal Deficit came down to around 6 percent in the mid-nineties. But the deficits crept up again, crossing 9 percent in 1999-2000. The current account deficit, which had expanded to 3.2 per cent of GDP in 1990-91, was brought down to a comfortable 0.4 per cent level in 1993-94. Foreign exchange reserves were built to a respectable level of 8.6 months of imports by the end of 1993-94. Inflation, which had reached 13.7 per cent in 1991-92, declined to 8.4 percent in 1993-94.

Fiscal reform was the key component of the economic reform programme which targeted reforms in taxation structure, expenditure pattern and reforms in borrowing process. In August 1991, in the process of fiscal reforms the Government of India constituted a Tax Reforms Committee (TRC) to recommend a comprehensive reform of both direct and indirect taxes.

In this process, on the taxation front, modified value added tax (MODVAT) was introduced in 1986. It was renamed as central value added tax (CENVAT) in 2000. This process of reforms continued and in 1994, service tax was introduced. Bringing private sector equity into public enterprises and reducing the government's stake is also one of the reforms. This involves disinvestment as well as issue of new equity. Funds from disinvestment are used to cover government deficit (Chelliah, 1999). In order to garner resources to bridge the budget deficit, Disinvestment Commission (DC) was appointed in August, 1996 (Shastri, 2000; Lahiri, 2000). Following the reforms process, statewide value added tax (VAT) was introduced to replace Sales Tax on 1 April, 2003. Important step taken by the government on the expenditure front toward the reform of expenditure was introduction of Expenditure Reforms Commission which was set up in February, 2000. In the same process, debt swap scheme was started by Eleventh Finance Commission (FC). To improve the situation, the government further enacted the Fiscal Responsibility and Budget Management Act (FRBMA), 2003. In the budget of 2007-08, finance minister has prepared a roadmap for introducing a national level Goods and Services Tax (GST) with effect from April 1, 2010 (which has now been postponed to April, 2013).

Whereas the central government has continued with the reform process since 1991, the states have been slower in initiating tax reforms and expenditure reforms.

Due to the reforms, the Indian Economy has been able to achieve significant achievements on many fronts. The economy achieved a higher rate of growth, rapid growth of secondary and tertiary sectors, sustained increase in exports and imports and improved balance of payments, increase in inflow of foreign capital, increase in foreign exchange reserves, rise in value of the Rupee, less reliance on foreign borrowing and overall development of the economy.

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