
UNIT 7 MAJOR DEVELOPMENTS IN POST ECONOMIC REFORMS PERIOD

Structure

- 7.0 Objectives
- 7.1 Introduction
- 7.2 Features of Reforms
- 7.3 Assessment and Prospects
- 7.4 External Sector: Positive Aspect
- 7.5 External Sector: Negative Aspects
- 7.6 Internal Sector: Positive Aspects
- 7.7 Internal Sector: Negative Aspects
- 7.8 Explanations for Failures
- 7.9 Second Generation Reforms
 - 7.9.1 Need of the Hour
 - 7.9.2 Progress
- 7.10 Let Us Sum Up
- 7.11 Exercises
- 7.12 Key Words
- 7.13 Some Useful Books
- 7.14 Answers or Hints to Check Your Progress Exercises

7.0 OBJECTIVES

In Unit 6, you were introduced to economic reforms in India and its impact on Indian economy. After going through this unit, you will gain knowledge on:

- the various developments in Indian economy in the post reforms period (post 1991);
- key challenges on the road to India's development; and
- need for second generation reforms and its key features.

7.1 INTRODUCTION

It has been a little over two decades since the implementation of the economic reforms. It is a fairly moderate period to assess the major developments in the Indian economy during the period. After presenting a brief outline of the features of reforms introduced during this period, we will attempt a critical assessment of the reform policy as it has affected the different aspects of the economy. Most of these steps were undertaken in the initial phase of the reforms programme. But, we could not complete the whole menu.

7.2 FEATURES OF REFORMS

Some of the important feature of the reforms process have been as follows:

- 1) The approach towards reforms has been cautious, with an appropriate sequencing of measures, complementary reforms across sectors (for example, the monetary, fiscal and external sectors) and the development of financial institutions and markets.
- 2) The pace and sequencing of liberalisation has been responsive to domestic developments, especially in the monetary and financial sectors, and the evolving international financial architecture.
- 3) The approach to reform was ‘gradual but steady’ rather than a ‘big bang’ approach.
- 4) The major thrust driving the reform process was the quest for higher growth and efficiency, along with macro-economic stability. At the same time, the reforms had to be ‘inclusive’ in the sense that the benefits of reforms were to be shared by all sections, in particular the vulnerable ones.

7.3 ASSESSMENT AND PROSPECTS

Researchers use different methodologies for evaluating the impact of reforms. Generally speaking, two approaches are followed:

- 1) Model-based counterfactual simulations which attempt to contrast actual outcomes under alternative reforms scenarios.
- 2) ‘Before and after’ approach.

We will make use of the latter approach to make an assessment of the impact of reforms.

The least that can be said about the achievements of the economic reforms is that the economy has been saved from the massive heart attack it suffered in 1990-91. But that is not all. There is no doubt that the economic situation has changed compared to what it was in June 1991.

In the new economic environment, the vocabulary itself has undergone a change. Earlier, the key words/phrases were control of commanding heights, nationalisation, employment generation, protection of domestic industry, indigenisation of technology, appropriate technology and public monopoly. Today, the key words and phrases are international competitiveness, efficiency, profitability, technology upgradation, foreign capital, globalisation and golden handshake. Let us recount some of the major changes.

7.4 EXTERNAL SECTOR: POSITIVE ASPECTS

It is gratifying to record that over the last two decades the management of the external sector has been characterised by a judicious combination of ‘outward orientation’, investment liberalisation, and vigilance in the matter of convertibility of rupee. The principal result has been that extreme bouts of volatility which disrupted currency markets throughout globe left little of their ravaging impact on India.

Some of the other positive gains can be counted as follows:

- 1) A remarkable pick-up in our export performance has reinforced the perception that 'Made in India' concept is slowly but surely coming in its own. The available data suggests that the export intensity of the private corporate sector (manufacturing exports per unit of sales) has almost doubled from 13.37 per cent in 1998-99 to 24.23 per cent in 2008-09. Moreover, the export to sales ratio of 50 large business houses as also the foreign-owned and government companies has also improved during the period. Further, the returns on investment of corporates work out to be higher on sales than in the domestic market. This position is in sharp contrast to the pre-liberalisation period, as also during the early days of liberalisation, where the narrow differential in profits made sales in the protected domestic market a much more attractive proposition.
- 2) The product composition of our exports is undergoing a gradual but decisive transformation towards technology-intensive and high value products. This is indicated by a surge in auto exports which has even exceeded export of software in the current decade. This has made India's entry possible into 'upmarket' and 'niche' destinations.
- 3) The import intensity of corporate exports measured in terms of import per unit of exports has declined from 114.35 per cent in 1998-99 to 86.86 per cent in 2008-09 suggesting that companies are becoming more economical in the use of imports. Indeed, corporates are adding more value to the imported product since the first decade of the new millennium. This is despite a rise in the proportion of imported raw material in total raw material expenses and a surge in capital goods imports per unit of gross fixed assets between 1998-99 and 2008-09.
- 4) Another major surprise is that, unlike in the past, corporates are emerging as net foreign exchange earners of the country. The net foreign exchange inflow rate of private sector has effected a turn around from a negative 14.35 per cent in 1998-99 to a positive 13.14 per cent in 2008-09. This shift is even more pronounced among the top 50 business houses where the figures have grown from (-) 41.3 per cent to 17.5 per cent in the same period. All this indicates that corporates are penetrating the export market not because of the incentives offered by the government but due to the prospect of efficiency gains from exports.
- 5) The 'hawala' rate of exchange has almost disappeared. Foreign exchange reserves which had declined to less than \$ 1 billion in June 1991 have reached over \$ 300 billion. Foreign direct investment approvals over the last twenty years (between 1991-92 and 2011-12) have crossed \$ 100 billion. This compares with a maximum of \$ 20 million in any one year during the 1980s . Foreign institutional investments initially came bucketfuls: during 1993-2009 alone these are estimated to be \$ 40.0 billion. This is to be seen in the background of nil amounts in earlier years.
- 6) The number of companies achieving international quality standards by obtaining certification from ISO 9000 series today stands at over 5,000 compared with less than 5 only seven years ago.
- 7) Foreign investment is no longer a one-way street. Corporate India has begun going global through joint ventures, acquisitions and licensing arrangements. Various factors had facilitated this process: low asset prices in the developed

world, excess liquidity in world financial markets and low interest rates on dollar funds, depreciating dollar, generation of cash needed for global expansion by strong domestic growth in the economic cycle that was peaking. Outward FDI flows exceed \$ 15 billion annually. It may be too early to speak of Indian multinationals, but they are on the horizon-being described as the first step in a Global Indian Takeover.

- 8) The IMF has selected India for its Financial Transactions Plan, which bails out troubled countries. So, we are now creditors to the IMF, rather than borrowers.

The achievements in the external sector appear to be more creditable. This is perhaps because the measures taken have been coherent, taken together and were so far-reaching. For example, all trade is now under the same payment regime (there are no 'hard,' 'soft', and 'rupee' trade areas); the unified exchange rate is more reflective of the real value of the 'rupee' convertibility on current account, abolition of restrictions on most imports and exports; dramatic reduction in import tariffs, liberalised imports of gold and silver, were some other measures. A clear export-incentive system with tax-breaks is in place instead of the old clumsy replenishment and advance licence, cash compensation and subsidy schemes. The almost complete removal of restrictions on foreign investments has been the other positive feature of the new economic policies on the external front. These changes have been fundamental.

Check Your Progress 1

- 1) State in brief the features of reform measures taken in India during the last two decades.

.....

.....

.....

.....

- 2) What are the different criteria to make a balanced assessment of reform measures.

.....

.....

.....

.....

- 3) Mention, in brief, the positive gains in India's external sector due to various reform measures.

.....

.....

.....

.....

7.5 EXTERNAL SECTOR: NEGATIVE ASPECTS

On the flip side, it is being argued that the vulnerability of the economy on the external front is becoming increasingly manifest.

It is being contended that the globalisation of the Indian economy is like integrating a mouse into a herd of elephants.

- 1) Achievements on the export front have to be tempered for a variety of considerations:
 - There is no evidence that a breakthrough of any kind has been achieved in exports which would be reflected in a rise in the country's share of world exports. This is to be more critically observed on two fronts: (a) the composition of exports has hardly undergone any change, and (b) the performance of the corporate sector shows little evidence of any stepping up of the tempo of exports.
 - The trends in some of the country's crucial exports have been anything but heartening, e.g., readymade garments, leather manufactures, etc.
 - From the perspective of exports, the reforms remain incomplete on several fronts, including the distorted excise duty structure, cumbersome procedures of export and import activity, labour market reforms and poor banking and insurance services.
- 2) The post reforms period has seen a sharp rise in India's external liabilities. The large increase in forex reserves witnessed during the last decade may not prove adequate in the ultimate analysis.

Moreover, the rising reserves are more a sign of what was once called the Dutch disease (but should have been renamed the Thai disease after 1997). The increase has taken place not on the current account but the capital account and consists of hot to very hot money that can leave the country at a short notice.

- 3) FDI is generally perceived to be an investment that creates physical assets and is associated with a degree of stability, in particular due to managerial skills. However, new types of FDI flows through private equity funds and venture capital funds may not necessarily have a direct link with investment in physical assets and could contain a volatile component at the margin.
- 4) Similarly, inflows to acquire existing stakes or expanding foreign stakes in Indian companies are classified as FDI, but they do not add to the further creation of physical assets.
- 5) FIIs in their own account are generally long-term investors with little or no interest in managerial control. However, investments under the category of FIIs in India have a significant part of portfolio flows through participatory notes and sub-accounts. Capital flows, particularly the portfolio flows, can easily reverse their direction and it is difficult to invoke the "rules of origin" with regard to such capital flows.
- 6) India has relied heavily on imported technology designs and equipment through foreign collaborations and FDI with far too little attention and effort at building indigenous capability. The consequence of this approach in an unequal world

will be to seriously erode the extent of autonomy that the country can have in shaping its development priorities consistent with equity and sustainability.

- 7) As private equity and hedge fund investments grow, shareholder activism will become more pronounced. There are already signs of foreign investors demanding conditions that could hurt the Indian economy. At a micro level, they insist on mechanisms that would enable them to gain greater share of local demand than industry. At macro level, there is already pressure for India to further liberalise imports. Within the WTO, India has so far had the option of keeping tariff barriers on a large number of items on the plea of having an adverse BOP. There is now pressure in India, from countries representing foreign investors to surrender this exemption.
- 8) Of the total income that has accrued to the services sector in the post-globalisation period, as much as one-third of this has been the earnings of foreign nationals. The reverse process – our obtaining a share of the global income – has been proportionately much less. In other words, we have opened up the opportunities for foreigners to eat into our economy.

On the whole, what we are witnessing is a further fortification of the enclave economy which we already have a small, modern and technologically advanced economy which is connected more to the outside world than to the rest of India. But such an enclave economy is not sustainable. In time, either the ramparts of this enclave will be scaled by those on the outside or its foundation will be hollowed out by social conflict.

- 9) The role of capital inflows in placing India on a new growth trajectory also makes growth process fragile for reasons that have become clear in more recent times. One source of this fragility was the continued appreciation of the rate of exchange of the rupee despite the efforts of the RBI to stall such appreciation. Rupee appreciation was reducing the competitiveness of India's exports and weakening the export stimulus that contributed to an improvement in both services and manufacturing growth.

The other potential source of fragility is the threat of a liquidity crunch because of an outflow of foreign capital for reasons unrelated to India's economic performance. Dependence on foreign capital flows has made India vulnerable to the contagion effects of financial crisis elsewhere. A consequence of a crisis is a tendency by foreign investors to sell out assets acquired in India and repatriate the receipts so as to cover losses and meet commitments elsewhere.

- 10) Though the market value of volatile foreign capital deployed in the country is uncertain, the current magnitude is likely to exceed India's forex reserves by a significant margin. Even if the authorities follow conservative fiscal and monetary policies, the country can still face a BOP crisis. Moreover, the foreign exchange drain, highly volatile and mainly on account of profit-taking by FIIs, is currently very high in relation to India's GDP, prompting a comparison with the tribute extracted by the British during the latter part of the colonial era.

7.6 INTERNAL SECTOR: POSITIVE ASPECTS

Phenomenal success has been achieved by the Indian economy during this period through corporate restructuring, cost rationalisation, productivity improvements,

reducing capacity overhangs. Multiple transitions are happening simultaneously, from farm to non-farm, rural to urban, analog to digital, manual to tech-driven and domestic-focus to exports. Some of the positive achievements can be briefly stated as follows:

- 1) The trend rate of growth of GDP at 6.9 per cent during the 1990s and 2001-10 was distinctly higher than 5.5 per cent recorded in the 1980s. In term of average rate of growth, the performance in the 1990s (6.5 per cent) and 8.0 per cent during 2002-10 was better than that recorded in the 1980s (5.8 per cent).
- 2) The domestic manufacturing sector has shown remarkable resilience and the ability and ingenuity to rediscover its comparative advantage and re-engineer production capacities in response to import competition and changing macro conditions. The country is seeing the manufacturing sector in a phase of significant capacity and technology upgradation. This is generating investments demand at home and at the same time driving domestic firms to foreign markets in search of frontline technologies.

There has been a surge in productivity. It means fewer workers are delivering more. The surge in productivity stems from advances in technology, the implementation of processes, and the need to satisfy demanding employers and choosing consumers. Wage increases can be seen both as a cause and effect of increased productivity. Nevertheless, India still has a long way to go before it catches up with systems and processes often taken for granted in the West.

- 3) After an initial deceleration from 2.6 per cent per annum in 1983 to 1993-94 to 1.2 per cent in the 1993-94 to 1999-00 period, the rate of employment growth has picked up fast to go up to 3.8 per cent during the period 2000-01 to 2004-05. This rate is more than double the rate at which population has been increasing. Besides, real wages are rising both in rural and urban India.

The real wage growth in the post-liberalisation period (1993-94 to 2004-05) has been faster than in the pre-liberalisation one (1983 to 1993-94). The trend continues thereafter also. All categories, rural, urban, regular and casual benefited from this rise. However, regular workers did marginally better than casual and rural areas did better than urbans. Wage differentials between regular and casual workers has been rising within both urban and rural areas and it has declined between regular and casual workers in rural areas.

- 4) Corporate results show that while the net profits have been rising, the gross profit margins have been declining, meaning thereby that the consumer is getting a better deal. So we have a win-win situation in which both the producer and consumer have benefited, and this is precisely what the reforms ought to achieve by encouraging competition through delicensed production and liberalised imports.
- 5) Growth impulses are now widely distributed across the economy; all sectors of the economy are experiencing the 'rhythm of growth', as one observer puts it, from fiction to fashion everything is on move.
- 6) The Indian business cycle of the liberalised regime is significantly less volatile

than that of the controlled regime. Liberalisation has created an environment of risk-sharing for the economic agents. While the economy is more vulnerable to external shocks after economic openness, the ways to counteract output fluctuations in the wake of liberalisation have become available to policy-makers in a greater amount than before.

- 7) The customs duty structure has been rationalised to a large extent and there are signs of the inverse relationship between tax rates and tax collections really becoming a reality today.
- 8) Industrial relations have shown remarkable recovery; during the last ten years, industrial disputes have declined by about one-third, and man days lost by about 20 per cent.
- 9) High growth rate yielded a bonanza of revenue for the government. The government went for major social initiatives including the Mahatma Gandhi National Rural Employment Guarantee Scheme, Bharat Nirman, Sarva Shiksha Abhiyan, and the Right to Education Act. Next on cards is a Right to Food Law, providing families with 35 kg. of highly subsidised grain per month. A new law for tribal rights has been enacted, but not fully implemented.

On top of all these what is more important is the fact that economic reforms have resulted in a change of mindset. An emerging new middle class is now driving the chariot of liberalisation and reforms.

These indicators testify to a remarkable turnaround, in a relatively short time. However, that does not prevent us from having a look at the failures also.

7.7 INTERNAL SECTOR: NEGATIVE ASPECTS

After an initial euphoria, the reforms seemed to have lost momentum. There has been what is called 'irrational exuberance' surrounding the Indian economy. The kind of growth that we have witnessed for the last few years could lead to a situation where people think this is here to stay forever. Without higher level of investment and the productivity for that investment, sustaining things is difficult. Without further reforms, it is impossible to increase inclusiveness. Some of the important failures may be noted here:

- 1) The New Economic Policy (NEP) has not brought about any change in the structure of the economy, as is brought out by various indicators. **One**, the share of the industrial sector in the GDP presently is the same as it was in 1989-90. During the five years, prior to that, this share had continuously increased. **Two**, the pace of decline in the share of agriculture has been appropriated by the services sector. But a higher share of services in the economy has not led to any improvement in the quality of services. The rapid structural transition of Indian economy in favour of services sectors without comprising the corresponding changes in the employment share has wider implications not only for the sustainability of this growth pattern but also for poverty, inequality and productivity.
- 2) There are greater fluctuations in a large number of key macro-economic variables, including GDP and its various components in spite of the stabilising influence of a long spell of good/average specially with financial sector liberalisation and opening up of the economy. Such trends have engendered

greater economic uncertainty which is not conducive to long-run growth and forces economic agents to remain more liquid.

Neither fiscal nor monetary policy in India stabilises the business cycle. As a consequence, in the event that a slowdown comes about, the downside risk for India is greater than that found in mature market economies.

- 3) Given that the performance of the agricultural sector is more or less exogenous in the short run and the medium run and that the services sector has its own momentum of growth, it is the rate of growth of the industrial sector that is a better measure of the pulse of the economy than of the overall GDP.

Industrial performance across all the sector has been slower in the post-reforms period as compared to that in the pre-reforms period. There are at least three complementary reasons: one, due to labour laws, industry in India is increasingly outsourcing its activities so that growth in industry is actually being counted in growth in services. Two, due to some key binding constraints in areas of labour laws and power, large-scale firms are still unwilling to enter the market. Finally, large fiscal deficits continue to crowd out private investment. Furtheron,

- Value added growth in the registered manufacturing sector in the post-reforms period has not been able to surpass that achieved during the first 15 years of planning or that achieved during the second and third five-year plans, when a conscious attempt was made for the development of basic and heavy industries.
 - The industrial base of the country has become shallower.
 - For the registered manufacturing sector as a whole, labour intensity has decreased progressively during the period. Labour intensity has gone down not only in the capital-intensive goods but also in the labour-intensive goods.
 - Labour productivity increased steadily between 1990-91 and 1995-96, but has stagnated since then. Capital productivity increased marginally till 1995-96. Since then there has been a decline.
- 4) The structural deterioration in the composition of output and also that of exports ; as a recent World Bank report points out that while some heavy manufacturing sectors like machinery and equipment and oil and gas have contracted sharply, other more labour-intensive industries like apparel and light manufacturing have witnessed an expansion.

In other words, inconsistent with the dynamics of economic growth, India is emerging as a producer of resource-intensive goods rather than the hi-tech and capital goods. This has led to a progressive and sustained decline in the share of hi-tech and capital-intensive goods in total manufacturing, value added and employment. This is certainly not a desirable scenario.

- 5) The NEP seems to have overlooked the dynamics of exclusion, i.e., the processes that have led to the exclusion of the excluded. Along with the rising economic growth rates, the economy has experienced deceleration and deterioration in many areas related to poverty and human development. To start with, there is a clear deceleration in the rate of decline in the incidence of poverty in the post-economic reforms period. Poverty has declined by

0.74 per cent per year in spite of the high rate of growth of the economy.

Again, the achievements in human development in terms of increase in literacy, decline in infant mortality, improvements in child health and nutrition and decline in maternal mortality, etc. have been very small as compared to the same during the decade before the reforms.

There is an absolute deterioration in some fields like juvenile sex ratio. Again, there are poor achievements on the employment front: on the one hand, there is a slow rate of growth of employment in spite of a higher growth of GDP, while on the other, there has been informalisation of labour market, resulting in the deterioration of quality of employment on a large scale.

Clearly, the growth process under the neo-liberal policies has not generated enough employment in the economy. It has not really included the un/underemployed labour force in the purview of productive employment. (It would be interesting to note that China defines a growth rate at which employment fails to keep up with new entrants into the labour market as “economic stagnation”.)

Further, employment has been generated more for the educated labour force than for the poor with lower levels of human capital, during the current phase of economic expansion. What would be worrying is that such skewed growth of employment tends to widen inequality. It is, thus, no surprise that agriculture continues to be primary source of employment for more than half the population and the share of manufacturing has experienced a marginal rise over the past two decades. The report also underscores the fact that the shift away from agriculture did not lead to significant increase in the manufacturing’s share of employment. Rather, even at low levels of per capita income, the share of services in employment and value addition rose. Thus the corollary, the shift in India is away from agriculture and more towards services than manufacturing. Details in this respect have been provided in Unit 12.

- 6) The other areas of deceleration and deterioration have been: (i) environmental resources, which have degraded and depleted, and (ii) inequalities of income and growth across regions and different socio-economic groups, including men and women. The Eleventh Five Year Plan has also drawn attention to the rising inequalities in the economy by providing the relevant data.

The ratio of output per works in non-agricultural sectors to that in agriculture has increased from about 2:1 in the 1950s to nearly 4:1. Similarly, per capita private consumption expenditure in urban areas is substantially higher and its ratio of rural per capita consumption has risen progressively from about 1.28 in the mid-1970s to 1.47 by 1999-2000. Another manifestation of growing inequalities is that while the share of corporate profits in GDP has been continuously going up, that of wages has been moving downwards.

- 7) All important consequence of the neoliberal policies is the financial crunch of the government, caused by the compulsions of the model. This has led to the reductions in social sector expenditures or to an inadequate social expenditure on the one hand and rising costs of public services to the poor on the other. The public private partnership (PPP) model in basic public services, and privatisation of basic services under the established model will add to the crisis in human development. This shrinking of its basic responsibilities by the government under the model will definitely harm the interests of the excluded.

- 8) Quantitative expansion in basic social amenities – education, health care, water supply and connectivity – has benefited both rural and urban areas, and rural urban disparities in access have also been narrowed, but rural areas depend far more on public services where quality is perceived to be both unsatisfactory and deteriorating because of institutional and budgetary constraints. Private provisioning, which is costlier better equipped and managed, has expanded rapidly but mostly in rural areas. Overall disparities in access, costs and quality of these services are therefore likely to have increased. All this lends credibility to the increasingly widespread feeling among the rural population that they have not benefited, nor are likely to benefit, much from rapid growth in terms of incomes, employment opportunities and quality of life.
- 9) As the Multi-national Corporations (MNCs) and their subsidiaries gain control in new markets and they get more entrenched in their pursuit of swift profit maximisation, apprehension is expressed that their clout is most likely to grow formidably with their fast-growing money power, further jeopardising the capacity of the State's policy of pursuing social welfare goals.
- 10) Economic logic dictated that industries should have been dereserved first and globalised later. What happened is the reverse. While vested interested reforms of the SSI sector, a bigger interest, that of the industrialised countries seeking market access, came along and pushed them aside. As a result, transition to the WTO regime is going to be a good deal more painful than it need have been.
- 11) In the worst case scenario, high-cost economies cause industrial migration, even services migration. Businesses today are so global – Dell, for instance, sources components from 35 countries and Boeing aircraft are put together with assemblies from 72 countries – and so complex that uncompetitive economies force en masse emigration of businesses, human resources and capital, leaving trails of despair, unemployment and rundown factories in ghost towns. India's reputation of being a low – cost nation was built around low-wage costs. That explains why human-intensive sectors led by IT took off in India while manufacturing floundered. But that advantage is near over in businesses such as financial services and R&D, and is rapidly disappearing in other areas such as IT. To this, one may add the rising costs of realty and interest rates. The sum total is that India is turning out to be a high-cost economy.
- 12) The government is unable to control or regulate the impact of shocks (external or internal) since it lacks the policy instruments or has given up some of them or they are greatly circumscribed by the requirements of NEP precisely at a time when the economy has become far more complex and is subject to more of external shocks.
- 13) New technologies, new investors and expansion into new overseas markets have opened the doors to new forms of fraud. The extent to which industries experience corporate fraud varies according to the nature of business. Companies that deal with physical assets are more likely to suffer from the theft of physical assets or supplier fraud. Those that operate in the "knowledge economy", such as professional services or technology, are more likely to be concerned about information on theft or intellectual property issues.

A recent study on the subject gives 38 marks out of 100 to the whole process of economic reforms, so far.

In short, there is a clear weakening of the linkages between economic growth and poverty reduction, economic growth and human well-being/human development, economic growth and employment, etc. and, therefore, between economic growth and inclusiveness of development. The country's poor performance in terms of human development is clearly visible as countries with per capita GDP far below India's have fared better. While there is no comparison with China which flaunts better performance in many respects, India rubs shoulders with Ethiopia, Burundi and Chad.

Clearly, there is something wrong with the dynamics of growth processes, the growth model that has been adopted under the neoliberal policies. In other words, there is a need to modify the growth process, the growth model based on neoliberal policies, so as to make it inclusive. Inclusion calls for changes in the macro-economic model, as exclusion has its roots in the development model itself. This also implies that designing special schemes and programmes, that tinker with the system will not be adequate. Such pro-poor, pro-women or pro-excluded programmes will have only a temporary and limited impact. Things will not change unless the dynamics of growth changes in a way that strengthens the links between economic growth and human development.

For entities exposed to commodity cycles or international competition, any deterioration in the global economic environment may cause some erosion in their credit metrics, especially in a scenario in which Indian rupee strengthens further and duty protection levels decline. Entities with significant short-term funding or currency mismatches may also experience higher stress.

Check Your Progress 2

- 1) State, in brief, the negative effects of economic reforms on the external sector of the economy.

.....

.....

.....

.....

- 2) Mention in brief the positive effects of economic reforms on the external sector of the economy.

.....

.....

.....

.....

- 3) Mention in brief the negative effects of economic reforms on the internal sector of the economy.

.....

.....

7.8 EXPLANATIONS FOR FAILURES

Jean Dreze offers the following explanations for the limited success of the NEP in India, so far:

- 1) The scope of reforms has been much more limited than what the advocates or critics of the new policies claim. There has, no doubt, been a significant liberalisation of international trade. But the role of international trade in the economy is quite small as things stand, so that a little change in the exchange rate or import tariffs can hardly be expected to lead to a rapid economic takeoff. As far as the domestic economy is concerned, the policy framework remains much the same in many fundamental respects. Also, just as the scope of the reforms is often exaggerated, so is the reach of bureaucratic controls prior to the reforms.
- 2) There has been a lack of preparedness of the Indian economy for the kind of economic takeoff that has followed market-oriented reforms in countries such as China and Vietnam. Here, the contrast with China is particularly relevant. At the time of embarking on its own programme of market-oriented economic reforms in the late 1970s, China had already achieved a number of goals that played a crucial role in the post-reform economic success. These include extensive land reforms, near-universal literacy in the younger age groups, high levels of nutrition and health, social security arrangements and a well-developed rural infrastructure. These goals are nowhere near being achieved in India today, and the potential of market-based economic reforms has to be assessed in that light.
- 3) China has had some kind of a minimum rural safety net, made possible to a large extent by an egalitarian distribution of land cultivation rights that followed the de-collectivisation of 1978. In most parts of India for the poor, there is no similar rural safety net. Household-level survey data suggest that Indian land (and in general wealth) distribution is much more unequal than that in China even after a quarter century of China's long march on market-system. In addition, the more severe educational inequality in India (The Gini coefficient of inequality in years of schooling in the adult population is 0.56 for India and 0.37 for China) makes the absorption of shocks in the industrial labour market more difficult (to the extent that education and training provide some means of flexibility in readjustment). So the resistance to the competitive process that market reform entails is much stiffer in India.
- 4) The recent economic growth has failed to achieve a participatory and widely-shared character. One reason for this uneven pattern may be that the reforms have led to rising expectations and demands among the organised classes, which are out of tune with the progress of the economy. These rising aspirations find expression in vocal demands for wage increases in excess of the growth of labour productivity. The burden of these inflationary pressures is borne by the unorganised classes.
- 5) There have been growing economic disparities in the post-reform period. The lack of any significant impact of the reforms in rural areas contrasts with the

boom of consumerism in metros and other large cities. To promote this boom, rural lands are increasingly being grabbed, with the active connivance of the State, resulting in what Amit Bhaduri has called 'developmental terrorism' — a situation in which the government becomes a ruthless promoter of the corporate interests in search of higher growth, irrespective of how it affects the interests of the ordinary people.

- 6) The increasing concentration of deprivation has created a situation in which the poor are ill placed to take advantage of new opportunities in sectors that were artificially protected prior to reforms. Thus the poor do not have much stake in the success of the economic reform programme. In a democracy, it means that political parties advocating pro-reform policies may not necessarily win elections. This has emerged as a significant constraint on rapid economic growth.
- 7) Reform programme has remained preoccupied with issues of fiscal and trade policy, financial markets and capital account convertibility, and constraints on corporate investment. Reform would have been more popular if it were equally and simultaneously concerned with reform in the governance structure in the delivery of basic social services for the poor that we have in large parts of the country (in education, health, drinking water, child nutrition, etc.). In our euphoria with the high growth rates of recent years, one should, for example, keep in mind that the atrocious condition in our health sector is worse than in even some African countries. The administration set-up for many years has functioned as an inert, heavy-handed, corrupt, over-centralise, and uncoordinated monolith.

To the above, following Shome and Mukhopadhyay, we may add non-sustainability of reforms. After the initial set of actions in rationalisation of the tax structures, financial sector reforms slowed down, and only short-term macro-economic policies, and that too inadequate, have been used. Non-sustainability has been the characteristic feature of Indian economic policy. India seems to have shown a deep capacity to absorb and tolerate bad policy even in the past. Its ability to avoid desperate crisis – even as of the recent east Asian variety – has meant that it has never had to face the need to make fundamental changes, or to upset powerful socio-economic groups. This avoidance of basic and long-lasting policy reforms, with its concomitant fallout effect, have simply continued.

After nearly two decades of reforms, the government has not unlearned dirigisme. A World Bank report provides a disturbing account of how various administrative procedure make it difficult to start, run and close a business in India. Policy makers continue to be hostages to bureaucrats unwilling to shed control, and influence. If this continues, the outlook for reforms is bleak. Business cannot afford the homeopathic scale on which bureaucracy operates, and the cycle of reform announcement, guidelines, clarification, simplification and streamlining has to be compressed drastically.

To conclude, there is a case for less excitement about the current reforms, and greater attention to what they have undone. There are lessons to be learned from those countries that successfully broke out of their poverty traps (e.g., South Korea). According to the 2008 report of the Growth Commission, these countries did as follows.

One, they integrated into the world economy to gain access to markets and knowledge.

Two, they maintained macro-economic stability.

Three, they could push up savings and investments rates.

Four, they let markets allocate resources.

Five, they had committed, credible and capable governments.

7.9 SECOND GENERATION REFORMS

7.9.1 Need of the Hour

Unlike the first-generation reforms that were crisis-ridden, the second generation reforms are known as consensus-ridden aimed at improving the existing bottlenecks in the road towards development. The agenda for second-generation reforms can be identified as below:

1. Fiscal reforms

Steps like reducing the revenue and fiscal deficits so as to limit the public and foreign debt, improving the transparency and quality of governance, encouraging privatisation of non-strategic public sector enterprises, reduction of short-term and long-term real interest rates in the economy have been proposed as major ingredients of fiscal reforms.

2. Promoting competition in product markets

Encouragement to private players, foreign investments, improved quality of products at local markets can enable India to reap efficiency gains from the product markets.

3. Reforms in factor markets

Flexibility in labour markets, amendments in laws related to bankruptcy and corporate control, policies oriented towards self-employed workforce, innovations in social safety nets and creation of human capital particularly through enlargement of education facilities are the much awaited reforms in factor markets.

4. Financial sector reforms

Technology induction especially computerisation of banking facilities has been a remarkable achievement of India's globalisation quest. However steps like technology-diffusion in rural banks, cooperative banking sector, small and medium enterprises (SMEs), strategic planning for fuller capital account convertibility can help improve the credibility of India's financial sector.

5. Reforms in Agriculture

The recent spurt in farmer suicide cases and the grave dependence of this sector on monsoons indicates that productivity is volatile in India's agriculture sector. Keeping in view these facts and the economically weak situation of Indian farmers, steps like creation of a comprehensive safety net system, expansion of rural credit, debt-waiver policies, hedging and mitigation of risks, fixing of market support prices, agricultural marketing, dealing with issues on agriculture at WTO are the key policy areas proposed for second generation reforms.

7.9.2 Progress

Substantial second-generation reforms have been implemented in bits and pieces. The Fiscal Responsibility and Management Acts of the Central and State Governments have reduced the overall fiscal deficit from around 10 per cent to about 6 per cent and once-bankrupt States now have cash surpluses of Rs. 25,000 crore. Import duties have been brought down to Asean levels for most items, creating healthy competitive environment. Bank reforms have liberalised interest rates, slashed non-performing loans, and helped banks move towards Basel II norms. Agricultural barriers such as the Agricultural Produce Marketing Committees Act have been eroded if not abolished in many States, paving the way for corporates to buy produce directly from farmers cutting out intermediaries and creating a retail revolution. Telecom-reforms have sparked a revolution: India has the lowest tariffs in the world and 7 million new connections per month are being sold. The latest telecom reforms will facilitate penetration of rural areas by private players. The electricity sector has witnessed slow, halting reform but open access is now a reality, and the new bidding process for ultramega power plants has brought in cheap power. Model agreements have facilitated infrastructure deals. The railways are in surplus, have privatised container traffic, and are planning dedicated freight corridors to speed up traffic. Bharat Nirman is finally bringing infrastructure to rural India. The States have adopted VAT; the country is moving towards a universal Goods and Services Tax. Tax administration has been computerised and is bringing in much more revenue. The old fiscal discrimination against mill-made textiles has gone and the number of items reserved for small scale industries has been pruned.

These reforms are systemic and conceived as a package of coordinated action in several areas. They are based on the realisation that the benefits from reforming one sector could be limited if other related sectors are not also reformed. The pace of the second generation reforms has been described as the “Homoeopathic rate of reforms”, implying thereby that while reforms are happening slowly, they are addressing the ills of the economy in more fundamental manner. However, it needs to be added that the government should not get afflicted by **MAFA** articulation for action.

Check Your Progress 3

- 1) Account for the New Progress of economic reforms measures in India.

.....

.....

.....

- 2) What do you mean by second generation reforms?

.....

.....

.....

- 3) What progress has been made in second generation reforms in India?

.....

.....

.....

7.10 LET US SUM UP

It is important to note that the resilience of Indian economy has improved over the years from what it was in 1990-91. A journey of two decades has strengthened India enough to withstand two major shocks in the immediate past last three years: (i) a collapse in world growth, finances and trade with the onset of the global financial crisis in 2007-09, whose ripple impact continued into 2009-10 and persisted into 2010-11 (especially in Europe), and (ii) domestically, following a year of negative growth in agriculture and allied sectors in 2008-09, erratic monsoons resulted into a severe drought in 2009-10 along with the unseasonal erratic rains affected the winter crop in 2010-11. The current period of economic distress has tested the nation and its people and a major development of the post-economic reform period has been the increase in the resilience of India's economy to bear the outwardly and inwardly shocks.

In the post-economic reforms period, India has experienced several key developments noteworthy among which is the changing structure of India's economy and its implications in the long-run. India's tertiary sector is leading the economy in its march towards higher economic growth, globalisation and liberalisation. However, a near stagnation in the secondary sector and sharp decline of contribution of primary sector is a matter of concern, mainly because of the quick and uneven transition of the Indian economy, almost surpassing the benefits of industrialisation. Two key implications are the rising inequalities in growth and lack of sufficient employment. That's why the main challenge for India's economic development is not just growth, but inclusive growth with people's development i.e. inclusive growth and improvement of social indicators.

Second-generation reforms are another key development and requirement for making growth balanced and equitable across all sectors and regions. Lessons from the pit-falls of first round of economic reforms in 1991 point out the main agenda of second-generation reforms as — fiscal reforms, promotion of competition in product markets, reforms in factor markets, agriculture and financial sectors.

7.11 EXERCISES

- 1) Identify the key challenges on the road to India's economic development. Which policy measures would you like to advocate to meet these challenges?
- 2) Critically evaluate the impact of economic reforms on the external sector front.
- 3) What do you understand by the term 'exclusion'? How has the economic reforms have deepened the process of exclusion.
- 4) What are constituents of second generation economic reforms? To what extent the second generation reforms will tackle the current challenges of India's development.

7.12 KEY WORDS

GDP: Gross Domestic Product	: GDP refers to the market value of all final goods and services produced within a country in a given period.
Gini Coefficient	: The Gini coefficient is a measure of statistical dispersion developed by the Italian statistician

and sociologist Corrado Gini. The Gini coefficient is a measure of the inequality of a distribution, a value of 0 expressing total equality and a value of 1 maximal inequality.

ICTs

: ‘Information and communications technology’ or ‘information and communication technology’ is usually abbreviated as **ICT**. ICT consists of IT as well as telecommunication, broadcast media, all types of audio and video processing and transmission and network based control and monitoring functions.

7.13 SOME USEFUL BOOKS AND LINKS

Dhingra, I.C. (2012): *Indian Economy*, Sultan Chand and Sons. New Delhi.

OECD Economic Surveys INDIA, *June 2011*, Academic Foundation, New Delhi.

Papola, T.S. (2011): ‘*Structure of India’s Economic Growth: Trends and Implications*’, Lecture delivered at IGNOU.

Planning Commission, Government of India, *Eleventh Five year Plan (2007-12): Inclusive Growth*, Volume I, http://planningcommission.nic.in/plans/planrel/fiveyr/11th/11_v1/11th_vol1.pdf

Planning Commission, Government of India, *Eleventh Five year Plan (2007-12): Social Sector*, Volume II,

http://planningcommission.nic.in/plans/planrel/fiveyr/11th/11_v2/11th_vol2.pdf

7.14 ANSWERS OR HINTS TO CHECK YOUR PROGRESS EXERCISES

Check Your Progress 1

- 1) See Section 7.2
- 2) See Section 7.3
- 3) See Section 7.4

Check Your Progress 2

- 1) See Section 7.5
- 2) See Section 7.4
- 3) See Section 7.7

Check Your Progress 3

- 1) See Sub-section 7.9.2
- 2) See Section 7.9
- 3) See Sub-section 7.9.2