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Impact Of Economic Reforms On Indian Economy – A Study With Reference To P.V. Narasimha Rao

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ABSTRACT

Although there has been much theorising on the impact of India's economic reforms of 1991 on Indian economy, there is hardly any previous study that has taken up the task of actually asking the manufacturing and service sectors as to what the true impact of economic reforms has been on them. Moreover, the economic reforms in India refer to the neoliberal policies implemented by the P.V. Narsimha Rao government in the year 1991, when India was experiencing a severe economic crisis the revenues generated by the government were insufficient to cover the expenses. As a result, it was forced to borrow heavily from foreign banks in order to repay the debt. Economic reforms are defined as policy changes that aim to improve a country's economic efficiency. Economic reforms are primarily required to address distortions caused by international regulations or by the government. Economic reforms occur when there is deregulation or when the size of the government is reduced. It is also accomplished by removing or reducing market distortions in specific sectors of the economy. Since, the above analysis leads to the conclusion that the economic reform period failed to improve the compound annual average growth rate in various development sectors, the number of industrial units increased after economic reforms, but the production level does not increase proportionately to the proportionate increase in number of units. While the employment was showing a slowing trend in the post-liberalization period, the small-scale industries have been unable to ensure their supplies at reasonable prices because the majority of them have been unable to upgrade their machinery and equipment due to the high cost of borrowing. At this point, the authorities should feel an urgent need to review policy measures not only to improve export growth but also to strengthen existing units to meet global competition.

Keywords: Economic reforms, impact, Indian economy

Introduction

The Indian economic reforms of the early 1990s have stimulated much research and a host of academic papers. As soon as P.V. Narasimha Rao became the Prime Minister of India in 1991, Rao immediately began efforts to restructure India's economy into a free-market system. Assuming power over an ossified, quasi-socialist economy burdened by inefficient industrial behemoths, Rao was instrumental in driving through a broad set of liberalizing economic reforms that transformed India (Vinay Sitapati, 2018). It is common to attribute India's accelerated growth to the reforms. An aspect that has remained relatively

unclear is which policy changes within the reforms have led to which consequences for employment, incomes and poverty. There is also debate about which further policy changes are required to sustain the increased growth and to strengthen the diffusion of progress to the lower-income segments of the population. Most studies have analysed the reform impact on macro aggregates, which leaves it unclear how different policies have worked. In order to examine this aspect it is useful to investigate at the firm level how different industries were affected by specific policy changes.

The main objective of the present paper is to examine how the economic reforms brought by Sri P.V. Narasimha Rao during his tenure of Prime Minister and how they are impacted on the Indian economy. For that purpose a thorough review has been done on various earlier studies and reports formed by various organizations. The present paper reports the analysis and discusses of those studies in the light of other findings, in particular the findings from the previous studies are analysed under various sectors. Several earlier studies have attempted to analyze the impact of the economic reforms of 1991 on the economy and industrial sector of India. In one of the earlier studies Nambiar et al. (1999) started from the expectation that trade liberalization "encourages economic activity and hence raises production and employment"; he then asked whether this was also true in the Indian case. Although this expectation may be justified in the longer run, it seems somewhat unrealistic to expect immediate benefits since trade liberalization always implies increased foreign competition, which in turn may lead to the closure of less competitive firms and therefore job losses and income reduction in the initial phase following trade liberalization. One may argue, however, that by 1999 it was possible to expect the longer-run impact of increased productivity, competitiveness and accelerated growth. This raises questions about the timing of the reforms and about the time lags necessary to achieve the longer-run changes. In spite of the accelerated growth figures of the mid-1990s being already available, Nambiar et al. (1999) concluded that "trade has over the years shrunk India's manufacturing base, both in terms of value addition and employment". Although the authors admit that "this 'high protection-high cost-poorquality' syndrome needed to be corrected by import liberalisation", their assessment ofthe reform impact is rather pessimistic.

Literature review

Siggel (2007) has stated in his study that industry competitiveness had found the outcomeof the reforms was more beneficial to the industries, their exports and employment. The third section reports the industry perceptions, first of the reform impact on the enterprises' business performance and then on issues of taxation and the business environment. The fourth section reports some of the industry-specific issues and compares them with our earlier findings based on aggregate data. The fifth sectionsummarizes the main conclusions of the paper. Another study done by Chauduri (2002) also reported that the expectations of rapid and sustained growth of output and employment generation found after economic reforms in India in the year 1991, but they have not materialized. The author concluded that value added growth in the 1990s was inferior to that in the 1980s, that the industrial base had become shallower, that employment growth in the 1990s was negative in five out of nine years and that the labour productivity stagnated after 1995/96, after having increased in the early 1990s. Here again no attention is paid to the changes in protection, prices andcosts that resulted from the reforms.

A much more positive picture was drawn by Panagariya (2004), who argued that growth in the 1990s was more robust than that of the 1980s and that it was achieved through important policy changes. The main policy changes held responsible for accelerated growth are the liberalization of foreign trade, the reduction in industrial licensing and opening to foreign direct investment. Balasubramanyam and Mahambre (2001) attempted to relate different aspects of the reforms with changes in industry performance, in particular with productivity change. They first observed a decline in debt/equity ratios in the majority of industries, especially in new firms, which was seen as a consequence of financial reform. The observed changes in productivity were mainly attributed to trade and licensing reforms. The authors concluded that in spite of declining productivity the industrial sectorhas benefited from the reforms by expanding its capacity.

Ahluwalia (2002) characterized the Indian reforms as gradualist, but less so by design than as a consequence of political constraints. He concluded that their cumulative impact was substantial and created the basis for accelerated growth. Although trade and industrial reforms were the most visible, the author cautioned that tariffs in India are still much higher than in China and other countries in Southeast Asia. Similarly, he also foundthat foreign investment had a much more limited impact in India than in China and Southeast Asia. The one area in which the trade policy reforms were most successful in his view is the sector of information technology-related services. Areas, where the reforms were found to need further progress are the labour market, agriculture, infrastructure and the management of fiscal balance. In his study Das

(2003) attempted an assessment and computed effective rates of protection and import coverage as well as import penetration ratios for 72 three-digit industries for four sub-periods of the period 1980 to 2000. Although these ratios are useful they do not showthe combined effect of tariffs and QRs on output prices. In this study the author concluded that the Indian level of protection remained high in comparison with several South-East Asian countries.

Pandey (2004) focused in his study on the measurement of several trade reform variables, including the measurement of protection based on price comparisons. As to the impact of trade liberalisation on industry performance he concluded that this link appears to be weak, given the presence of other factors. Among these factors, government controls in form of industrial licensing and public sector investments are singled out, but the author also points to the well-known ambiguity between protection and growth: High protection tends to generate growth in the initial stages, but declining protection may also lead to growth through competition-induced gains in productivity and exports. Bajpai (2002) presented a detailed account of the reforms of the 1990s and focused on areas, in which further reforms are required, in particular fiscal consolidation, the labour market, but also trade and foreign investment. These conclusions are clearly based on a positive assessment of the reform impact on economic growth in India, although the author does not present an analysis of the impact.

One of the expected effects of trade liberalisation is the reduction of profit margins following increased competition from imports. This hypothesis was examined byseveral authors with differing results. While Srivastava et al. (2001) and Kambhampati & Parikh (2003) did not find substantial evidence of this competitive effect on Indian industries, Krishna & Mitra (1998) and Goldar & Aggarwal (2004) concluded that the tariff reduction and removal of quantitative import restrictions had a significant and profit-reducing impact. However the latter authors also found that the reduction in cost- price margins was mitigated by a reduction of labour's share in value added, which they attributed to declining union power.

Closely related to the competitive effect of profit decline is the economic reform impact on productivity. While two studies of Unel (2003) and TSL (2003) had found an acceleration of productivity growth in Indian industries found after economic reforms introduced by PV. Narasimha Rao government in the year 1991. Moreover, Goldar (2004) has concluded in his study that trade liberalization had a positive influence on productivity, but this was counter-acted by a decline in capacity utilization and a declining growth in agricultural production. The study of Topalova (2004) is more supportive to the findings of of Goldar (2004) and also adds a distinction between private and publicly owned enterprises, with the former showing clearly more productivity growth than the latter. Similar conclusions as for productivity were reached for real wages by Goldar (2003), who connected the adverse effect of trade liberalization on real wages with the reduction of rents and the weakening of trade union strength. Banga (2005) also examined the reform impact on wages, but focused on wage inequality. Analysing the impact of three reform targets, FDI, trade and technology, on labour productivity and wage inequality, the author concluded that all three reform components contributed to the Indian economy in various aspects.

Impact of economic reforms of 1991 on Indian economy

Thus the existing studies suggest that a variety of impacts are possible but do not come to any uniform conclusion regarding the impact of economic reforms of 1991 on the Indian economy. Given this situation, it should be of considerable interest to survey the manufacturers themselves and find out what they felt was the impact of the economic reforms on their firms and what further changes in economic policies they feel are needed to maintain the high growth of the Indian economy and industry. This is the purpose of the this paper which initiate the impact of economic reforms on Indian economy with reference to PV. Narasimha rao, the 9th Prime Minister of India.

Impact of economic reforms of 1991 on Indian economy

The Economic Reforms encompass changes in economy-wide policies such as tax and competition policies. These Reforms are centered around bringing economic efficiency and not geared towards eradicating other issues like unemployment or equity growth. Indian domestic market opened up for foreign companies and was integrated with the global market. It raised competition for Indian companies, but at the same time, it brought a flow of foreign money to India in the form of investments. Globalization worked two ways, i.e., Indian companies could also get into foreign business and invest in other countries.

Trade liberalization

Trade liberalization has the immediate impact of increasing imports of products that compete with domestically produced products. These imports may be either cheaper at similar quality or similarly priced with superior quality attributes. In either case the domestic producers are likely to face increased competitive pressure, to which they can respond in various ways, mainly by reducing their own prices and profit margins.

Taxation

The Indian taxation system is known to be complex and to differ regionally. While income and corporation taxes, as well as the value-added tax (replacing the excise tax), are administered by the Central Government, the states and municipalities levy their own taxes and provide discretionary exemptions to attract investment (KPMG, 2005). Excise and sales taxes vary even more, especially according to enterprise location as they are determined by the states. Although the reforms have led to attempts of simplifying and reducing the tax burden, the survey conveyed the impression that more transparency and equity are desirable for internationalcompetitiveness. The most important challenge in restructuring the tax system in the country is to evolve a co-ordinated consumption tax system. Although tax assignment between different levels of government follows the principle of separation, as these separate taxes levied by the centre (excise duties), states (sales taxes, state excise duties, taxes on motor vehicles, goods and passengers), and local governments (octroi) fall on the same tax base, we end up in a chaotic situation with tax on tax and mark up on the tax.

Domestic reforms and the business environment

Three aspects of the business environment are considered here, first the bureaucratic side of doing business, then the supply of infrastructure and utilities, and finally policies furthering technological progress. One of the typical aspects of India's traditional business environment has been far-reaching regulation. Various authors have referred toit as the "licence raj" and identified it as an obstacle to faster growth and development. In spite of these changes, the regulatory arm of the government is still strong and very present. In the area of infrastructure and utilities manufacturing industries rely very strongly on the availability at low cost of energy (petroleum and electricity), transportand communication. It is one of the governments' important tasks to generate an enabling environment, in which these goods and services are available at competitive costs. Finally, one of the instruments of industrial policy in liberal economies is technology policy. It can take the form of subsidies for research and development or of investment incentives.

Industrial sector

The primary goal of economic liberalization in India is to increase productivity growth and competitiveness in the industrial sector. These reforms aimed to make SSI in India more efficient and technologically advanced, with the goal of achieving higher and more sustainable growth. On the one hand, the process of liberalization and market reforms has resulted in numerous opportunities for development of SSI's. Simultaneously, the changing global scenario has posed new challenges to the small-scale sector's very survival. As a result, the appropriate strength of the industrial sector could adapt to beat the competition and grow excellently. Over the last five decades, the government has developed policies to protect the interests of India's SSI sector while also facilitating rapid growth. These policy formulation and implementation were related to the development of the SSI sector through support agencies and various programmes such as modernization, technological advancement, marketing assistance, and fiscal incentives, among others (Chaudary, 2014). The development of this sector is an essential component of our country's overall economic, social, and industrial development.

Automobile and automotive parts

This industry is one of the most interesting ones because of its visibility and the attention it has recently received by the government. One of the striking features of domestic consumption is the appearance of new automobiles on Indian streets since the 1990s, which has accelerated in the new millennium. The industry has attracted significant amounts of foreign investment and has become an exporter of automotive parts and a limited number of cars. According to a recent statement of the Government, the industry is targeted as global manufacturing hub for small cars in the next 3 to 5 years (Srinivasan, 2006). The reform impact was viewed quite differently by the participating firms, depending on whether the respondents were connected with foreign firms or not. The foreign-linked firms described the impact as favourable due to their access to new technology. The firms that are not connected to foreign firms saw the impact as unimportant or negative, due to diminished protection, increased competition and falling profits. The main obstacles to business were identified by the respondents as electricity supply failures, infrastructure deficiencies, rigid

labour laws and access to and cost of credit.

Conclusions

Economic reforms in India refer to the neoliberal policies implemented by the P.V. Narsimha Rao government in the year 1991, when India was experiencing a severe economic crisis. The revenues generated by the government were insufficient to cover the expenses. As a result, it was forced to borrow heavily from foreign banks in order to repay the debt. Economic reforms are defined as policy changes that aim to improve a country's economic efficiency. Economic reforms are primarily required to address distortions caused by international regulations or by the government. Economic reforms occur when there is deregulation or when the size of the government is reduced. It is also accomplished by removing or reducing market distortions in specific sectors of the economy. Since, the above analysis leads to the conclusion that the economic reform period failed to improve the compound annual average growth rate in various development sectors, the number of industrial units increased after economic reforms, but the production level does not increase proportionately to the proportionate increase in number of units. Employment is also showing a slowing trend. In the post-liberalization period, the compound average growth rate of employment was slightly lower. Only the exports show a general upward trend. So far, policy support has acted as a catalyst in promoting this sector. Small-scale industries have been unable to ensure their supplies at reasonable prices because the majority of them have been unable to upgrade their machinery and equipment due to the high cost of borrowing. Small scale industries' competitiveness has suffered greatly as a result of this situation. At this point, the authorities should feel an urgent need to review policy measures not only to improve export growth but also to strengthen existing units to meet global competition.

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