CHAPTER I

INTRODUCTION

Trickle-down theory—the less than elegant metaphor that if one feeds the horse enough oats, some will pass through to the road for the sparrows.

- J.K. Galbraith

Economic development of India since independence is unique in several ways. In an innovative effort, the founding fathers adopted the middle course of a mixed economy, assigning a pivotal role to public sector and economic planning. This new approach to socio-economic growth was set within a framework of parliamentary democracy guaranteeing universal franchise. India followed an inward-looking import-
substitution strategy of economic development during the period 1950-1980. Beginning 1980’s, policy makers started realizing the drawbacks of this strategy, which inhibited competitiveness and efficiency, produced a much lower rate of growth than expected and inferior quality of domestic production with high cost, as compared to world prices. By mid 1980’s, it was clear that a drastic shift in policy was needed to speed up the rate of growth. Economic reforms were set in motion, though on a modest scale, in 1985. Since then, successive governments have carried forward the reforms in industrial, financial, fiscal and external sectors.

The trigger for economic reforms in 1991 was the serious conjunctural imbalances that faced the economy. Government finances were out kilter, represented by the large fiscal deficits. India’s external account was under severe pressure. Inflation was around 17 per cent, which was perhaps the highest recorded for a long time.

After three decades of sluggish growth of about 3.5 per cent per annum in the post-independence period, the Indian economy attained an impressive growth rate of nearly 6 per cent over the 1990’s are now known as the period when India moved from the Hindu rate of growth to a higher growth trajectory. Interestingly, although the average Gross Domestic Product (GDP) growth rate for the two decades was almost
identical, the policy paradigm during the 1980’s was distinctly different from that of the 1990’s.

There were some changes in the policy direction in the second half of the 1980’s with partial liberalisation, but it was only in the early 1990, that a complete paradigm shift took place. These included significant industrial and trade policy reforms with most of the controls in these sectors being dismantled and the state making a conscious effort to reduce its activities. The crux of these reforms was a greater thrust on privatization and globalization of the Indian economy.\(^1\) India is the seventh largest and second most populous country in the world. A series of ambitious economic reforms aimed at deregulating the country and stimulating foreign investment has moved India firmly into the front ranks of the rapidly growing Asia Pacific region and unleashed the latent strengths of a complex and rapidly changing nation.

An almost obsessive preoccupation with ‘liberal’ and ‘global’ seems to have gripped the world since the end of the cold war. This has been accompanied by the

ascending of the neo liberal ideology; also known informally as the Washington Consensus that points emphatically in the direction of freer market and reduced states.²

Globalisation is the new buzzword that has come to dominate the world since the nineties of the last century with the end of cold war and the break-up of the former Soviet Union and the global trends towards the rolling ball. The frontiers of the state with increased reliance on the market economy and renewed faith in the private capital and resources, a process of structural adjustment spurred by the steady influences of the World Bank and other international organizations have started in many of the developing countries.

India opened up the economy in the early nineties following a major crisis that led by a foreign exchange crunch that dragged the economy close to defaulting on loans. The response was a slew of domestic and external sector policy measures partly promoted by the immediate needs and partly by the demand of the multilateral organizations. The new policy regime radically pushed forward in favour of a more open and market oriented economy.³

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The year 1991-92 was an exceptionally difficult year for the economy with the deepening of the crisis, which began in 1990-91, had reached crisis proportions by June 1991. A severe import squeeze introduced in the course of 1990-91 in response to the shortage of foreign exchange, disrupted industrial production, which began to decline early in the year 1991-92, reached a peak level of 16.7 per cent in August 1991. The new Government, which assumed office in June 1991, took a series of corrective measures to bring the situation under control. These included short-term measures aimed at crisis management as well as long-term measure of structural reform aimed as improving efficiency and productivity and putting the economy back on the path of sustainable growth with equity and social justice.\(^4\)

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With the two aims of achieving economic advancement and establishing “the socialistic pattern of society”, India under a highly interventionist state in 1956 launched a gigantic and overly ambitious Imports Substitution Industrialization (ISI) programme, the hallmark of which was the heavy industry strategy under the aegis of the public sector. Influenced significantly by the Soviet model and powerfully attracted by the notion of economic independence as a necessary complement to and foundation of political independence, India’s economic planners sought to install a regime of economic autarky that delinked or disassociated the national economy from the world economy. The strategy, which was structurally biased against agriculture and exports essentially, entailed a “command and control economy” that relied on physical controls and was restrictive toward the private sector.

While India succeeded in setting up a complex and diversified industrial system through this strategy, for a long time, it was stuck with economic stagnation in the form of an annual economic growth rate of around 3.5 per cent, the so-called “Hindu rate of growth”. It also became economically marginalized in the world economy, with a secular decline in its share of world trade. Dissatisfied with this level of performance, the government eventually jettisoned the strategy in favour of moving to economic liberalization and with it reintegration with the world economy.\(^5\)

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Macro Economic Reforms

By the time the crisis of 1991 occurred, there was considerable support among key figures in and out of government for the view that a thorough going reform was necessary to pull the economy out of the morass it had gotten into.

The reform package outlined by Manmohan Singh in 1991 had three distinct components:

Fiscal stabilization to check the growing fiscal deficit and contain it at a much lower level in such a manner that public investment in basic, social and economic infrastructure could be substantially stepped up without generating inflationary pressures;

Internal liberalization to increase competitive pressures leaving enterprises free to make their production and investment decisions in the light of market conditions and enlarging the scope and freedom for private enterprise;

Consequences, Vistas Publications, New Delhi, p. 8.
Integration with the global economy by removing controls on foreign trade and exchange rates, lowering tariffs and rationalizing their structure and substantially relaxing regulations regarding external capital flows and a proactive policy for attracting foreign direct investment. This view prevailed and has come to be accepted by successive governments since then.

The policy change brought into force since July 1991 falls broadly into two categories. The first set of measures is part of what is normally known as Stabilization reform policies. The second set of measures comes under the category of Structural reform policies. As the former finance commission chairman Rangarajan rightly points out, while the stabilization policies were intended to correct the lapses and put the house in order in the short term, the structural reform policies were intended to accelerate economic growth over the medium term. Structural reform policies cannot succeed, unless a degree of stabilization has been brought about. But, stability by itself will not be adequate, unless structural reforms are undertaken to avoid the recurrence of the problems faced in the recent period.\(^6\)

**Structural Adjustment and Growth**

An important issue in the development policy has been whether the economic growth should be promoted by adopting planning and controls or through free market system in which private sector and foreign investors are permitted to play an important role. In the fifties and sixties, this issue was resolved in favour of planning and regulation of the private sector. It was felt that intervention by the Government was essential to initiate the process of development and thereby to break the vicious circle of poverty. However, in the eighties, it was felt that excessive regulation and control of the private sector by the Government and high importance given to the public sector in the strategies of development of the developing countries were obstructing economic growth and promoting inefficiency. As a result, there was a slowdown in growth of these countries and further they experienced serious problems of large fiscal deficit resulting in a high rate of inflation and deficits in the balance of payments resulting in heavy indebtedness of the developing countries. To overcome these problems some economists I.M.D. Little, Jagadish Bhagavati, Bela Balassa who had been advisors to the World Bank and International Monetary Fund (IMF) argued for the adoption of the policy of economic liberalization by the developing countries to promote economic growth, check inflation and solve the problem of balance of payments. They advocated that free markets and greater role of private sector (including foreign investors) would ensure efficiency by encouraging competition. However, to evolve a long-term solution to promote price stability, to bring about equilibrium in balance of payments and, above
all, to ensure higher rate of economic growth, the then government with Dr. Manmohan Singh as Finance Minister adopted in 1991 what is popularly called New Economic Policy (NEP) the Government had to prune down its expenditure so as to rescue budget deficits for achieving price stability. But more important element of new economic policy is the adoption of what are called Structural Adjustment Reforms, which sought to change the nature of Indian economic system by ultimately establishing a free market economy. Under the structural adjustment programme, the role of public sector in economic development had been diluted and that of private sector enhanced and expanded.

**New Economic Policy and Trade**

As indicated earlier, not long ago odds were heavily loaded against us on the economic front. The balance of payment was close to disaster, inflation seemed to be pervading and uncontrollable, the foreign exchange reserves had become so low that these were nearly sufficient to meet about three weeks imports. The, then government in fact had taken the extra ordinary step of pledging gold to meet the country’s foreign exchange requirements. The Government of India approached the World Bank and the IMF for additional loans. The request was acceded, but with a major stipulation that India will opt, for a free market economy which meant dismantling its regulated regime.
The advocates of New Economic Policy had mounted the rostrum to save the country. Their confidence in the IMF inspired logic was complete. The country was to be rushed to the newly invented purgative of the Structural Adjustment Programme (SAP). All that the country had done since independence was mostly wrong. Market fundamentalism had to be installed as a new deity. We were called upon to worship at this temple.

The new economic policy had serious implications in the trade aspect of the country. When London Economist wrote that India was like freed tiger, freed from the jail of control, regulation and licenses, the policy makers realised the great potential. Above all, while the tiger has been released, it urgently needed help to enjoy new found freedom restored for the first time. The tiger continued to think it was still within the four walls of the jail.  

**Economic Reforms on Indian Economy**

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The entire world economy has been experiencing dramatic and momentous changes during the decade of the eighties and nineties. Various countries of the world are now favouring economic reforms, because it promises rapid and more sustained economic growth. The countries like Mexico, Chile, Spain and Greece have carried out far-reaching economic reforms seriously and thereby realized the benefits of reforms ultimately and India was no exception. Substantial market friendly reforms initiated in 1991 created a favourable economic reform. The term economic reforms broadly indicate the necessary structural adjustment to external events.8

A Gradualist Approach

An important feature of India's reform programme, when compared with reforms underway in many other countries, is that it has emphasised gradualism and evolutionary transition rather than rapid restructuring or "shock therapy". This gradualism has often been the subject of unfavourable comment by the more impatient advocates of reform both inside and outside the country. Before considering the contents and design of the Indian reform programme, it is useful to review some of the main reasons why India's reforms have followed a gradualist path.

One reason for gradualism is simply that the reforms were not introduced in the background of a prolonged economic crisis or system collapse of the type which would have created a widespread desire for, and willingness to accept, radical restructuring. The reforms were introduced in June 1991 in the wake a balance of payments crisis that was certainly severe. However, it was not a prolonged crisis with a long period of non-performance. On the contrary, the crisis erupted suddenly at the end of a period of apparently healthy growth in the 1980s, when the Indian economy grew at about 5.5 per cent per year on average. This may appear modest by East Asian standards, but it was much better than India's previous experience of 3.5 per cent to 4 per cent growth and was also better than the average growth rate of all developing countries taken together in the same period.

Not only did economic performance improve in the eighties, this improvement was itself perceived to be the result of a process of evolutionary reform. By the beginning of the decade of the eighties, it began to be recognized that the system of controls, with a heavy dependence on the public sector and a highly protected inward oriented type of industrialisation, could not deliver rapid growth in an increasingly competitive world environment. The sustained superior performance of East Asian countries was evident to all by the mid-eighties, and this helped to create a perception that India could and should do better, but the approach remained one of evolutionary change. Several initiatives were taken in the second half of eighties to mitigate the
rigours of the control regime, lower direct tax rates, expand the role of the private sector, and liberalise licensing controls on both trade and foreign investment. However, these changes were marginal rather than fundamental in nature amounting more to loosening controls and operating them more flexibly rather than a comprehensive shift away from a regime of controls. Since the economy was seen to have responded well to these initiatives, with acceleration in growth in the 1980s, it created a strong presumption in favour of evolutionary change.

Finally, gradualism was the inevitable outcome of India's democratic and highly pluralistic polity in which economic reforms can be implemented only if they are based on a sufficiently wide popular consensus. The favourable experience of liberalisation in the 1980s had created an intellectual climate for continuing in the same direction, and the crisis of 1991 certainly "concentrated the mind" in favour of bolder reforms, but the pace of reforms had to be calibrated to what would be acceptable in a democratic polity. This consideration was all the more important in June 1991 since the new Government did not at that time have a majority in Parliament.

The Scope and Coverage of the Reforms

The reform programme initiated in June 1991, though gradualist in its approach was nevertheless very different from the incremental approach to reforms of the 1980s. As far as objectives are concerned, the current reforms are based on a much clearer recognition of the need to integrate with the global economy through trade, investment and technology flows and for this purpose to create conditions which would give Indian
entrepreneurs an environment broadly comparable to that in other developing countries, and to do this within the space of four to five years. As far as instruments are concerned, there is clear recognition that the reforms cannot be limited to piecemeal adjustments in one or other aspect of policy but must bring about system changes affecting several sectors of the economy. The comprehensiveness of the reforms was not perhaps fully evident at the very beginning, when the primary focus was on restoring macro-economic stability, but as the reforms proceeded, the scope and coverage of the reform effort was more clearly outlined. The main elements of the reform are summarised in this section, which also indicates differences in the pace and sequencing of individual elements in the package.

Fiscal Stabilization

If the recent literature on sequencing of reforms yields one firm conclusion, it is that fiscal stabilization is an essential precondition for the success of economic reforms. The design of India's reform programme was fully in line with this conclusion and fiscal stabilization was given the highest priority, especially in the initial phase of crisis management when the current account deficit was high and inflation in double digits.

The Central Government fiscal deficit had expanded steadily during the eighties and had reached a peak level of 8.4 per cent of GDP in 1990-91. Allowing for deficits of the State Governments, this meant an overall Government fiscal deficit of around 10
per cent, which is high by any standard. A reduction in the Central Government's fiscal deficit was therefore critical for the reforms to take off. The first year of the reforms saw a substantial reduction in the Central Government fiscal deficit from 8.4 per cent of the GDP in 1990-91 to 5.9 per cent in 1991-92 and further to 5.7 per cent in 1992-93. Some of the reduction in the fiscal deficit in the first two years was achieved by systemic improvements, which permanently strengthened the fiscal situation, such as, for example the abolition of export subsidies in 1991-92 and the partial restructuring of fertiliser subsidy in 1992-93. Another important systems change was the announcement that budget support to loss making public sector units in the form of Government loans to cover their losses would be progressively phased out. However, part of the fiscal adjustment in the first two years was also achieved by restricting development expenditure, including expenditure on social and economic infrastructure. Despite this limitation, the success achieved in fiscal consolidation in the first two years was commendable, with the fiscal deficit being reduced by 2.7 percentage points of GDP. In this respect the management of reforms in the first two years was entirely in line with the prevailing consensus on sequencing.

It is also true that the overshooting of expenditure in 1993-94 was to some extent tolerated in 1993-94 because the economy was suffering from underutilisation of capacity. Public sector investment, especially by the States, was held back by fiscal constraints and private sector investment was also restrained as the corporate sector
re-adjusted its investment plans in line with the new, much more competitive economic environment. The prevalence of excess capacity in parts of the economy, combined with a surprisingly easy external payments position, and a sharp reduction in inflation to less than 6 per cent in mid-1993 led to a willingness to accept a more expansionary fiscal policy. The unexpected increase in the fiscal deficit in 1993-94 is understandably a cause of considerable concern among observers of the reform programme.

An important new initiative in the 1994-95 budget is the announcement that there will be a pre-determined cap on the extent of monetisation of the Government deficit, which did not exist earlier since the Government could borrow from the Reserve Bank without limit. It is now proposed to operate a ceiling on Government borrowing from the Reserve Bank by authorising the Reserve Bank to auction Treasury Bills at market rates whenever the pre-determined ceiling is breached for more than a specified period.

Industrial Policy and Foreign Investment

Perhaps the most radical changes implemented in the reform package have been in the area of Industrial Policy removing several barriers to entry in the earlier environment. The system of pervasive industrial licensing prevalent earlier, which required Government permission for new investments as well as for substantial expansion of existing capacity, has been virtually abolished. Licensing is now needed
only for a small list of industries, most of which remain subject to licensing primarily because of environmental and pollution considerations. The parallel but, separate controls over investment and expansion by large industrial houses through the Monopolies and Restrictive Trade Practices (MRTP) Act have also been eliminated. The many inefficiencies of this system - carefully documented by economists as early as 1970 - are now truly a part of history as far as the Central Government is concerned. A comprehensive restructuring of the Companies Act is also underway which aims at simplifying and modernising this aspect of the legal framework governing the corporate sector.

One area where licensing controls remain in place relates to the list of industries reserved for the small-scale sector. Doubts are often expressed on whether reservation, which prevents larger units from entering the reserved areas to compete with small-scale industries, is a desirable instrument for promoting the small-scale sector.

The list of industries reserved for the public sector has been drastically pruned and many critical areas have been opened up to private sector participation. Electric power generation has been opened up for private investment, including foreign investment, and several State Governments are actively negotiating with various foreign investors for establishing private sector power plants. The liberalisation of controls over domestic investors has been accompanied by a radical restructuring of the policy towards foreign investment. Earlier, India's policy towards foreign investment was
selective and was widely perceived by foreign investors as being unfriendly. The percentage of equity allowed to foreign investors was generally restricted to a maximum of 40 per cent, except in certain high technology areas, and foreign investment was generally discouraged in the consumer goods sector unless accompanied by strong export commitments. The new policy is much more actively supportive of foreign investment in a wide range of activities. Permission is automatically granted for foreign equity investment up to 51 per cent in a large list of 34 industries. For proposals involving foreign equity beyond 51 per cent, or for investments in industries outside the list, a high level Foreign Investment Promotion Board processes applications. The Board has established a record of speedy clearance of applications and the total volume of foreign equity approved in the first 24 months amounts to $3 billion. This compares with annual levels of approvals of only about $150 million only a few years earlier. Various restrictions earlier applied on the operation of companies with foreign equity of 40 per cent or more have been eliminated by amendment of the Foreign Exchange Regulation Act (FERA) and all companies incorporated in India are now treated alike, irrespective of the level of foreign equity.

India has joined the Multilateral Investment Guarantee Agency (MIGA) and has concluded a bilateral Investment Protection Agreement with the United Kingdom. Similar bilateral agreements are being negotiated with other major investing countries.

**Trade and Exchange Rate Policy**
Exchange rate policy has gone through a series of transitional regimes since 1991, leading to a total transformation at the end of three years. The reforms began with a devaluation of about 24 per cent in July 1991 in a situation in which extensive trade restrictions were still in place. The devaluation was accompanied by an abolition of export subsidies to help the fiscal position, and an offsetting increase in export incentives in the form of special incentive licenses (Exim scrips) given to exporters which could be used to import items which were otherwise restricted. These licenses were freely tradable and commanded a premium in the market depending upon the excess demand for restricted imports. The system was modified in March 1992 by the introduction of an explicit dual exchange rate system simultaneously with the dismantling of licensing restrictions on import of raw materials, other inputs into production and capital goods. These items were made freely importable against foreign exchange obtained from the market at a market determined floating exchange rate. Imports of certain critical item's such as petroleum, essential drugs, fertiliser and defense related imports were paid for by foreign exchange made available at the fixed official rate, and the demand for foreign exchange at the official rate to pay for these imports was met by requiring exporters to surrender 40 per cent of their export earnings at the official rate. The remaining 60 per cent of export earnings was available to finance all other imports, all other current transactions and debt service payments, at the market rate. This dual exchange rate system was again a short-lived transitional
arrangement to a unified floating rate, which was announced in March 1993. After a year's experience with the unified rate, the Government, in March 1994, announced further liberalisation of payment restrictions on current transactions and stated its intention of moving to current account convertibility. Capital controls however remain in place.

Thus, in the short space of two and a half years the trade and payment system has moved from a fixed and typically overvalued, exchange rate operating in a framework of substantial trade restrictions and export subsidies, to a market determined exchange rate within a framework of considerable liberalisation on the trade account and the elimination of current restrictions. The transition is by no means complete, since consumer goods remain subject to quantitative restriction and tariffs are still high, but the changes made thus far are certainly substantial. The fact that they have been successfully managed has created the confidence necessary for an easy transition through the remaining stages.

The continuation of controls on the capital account is broadly in line with the current consensus in the literature on sequencing which holds that liberalisation of the current account and an effective management of such a liberalised system should precede liberalization of the capital account.

**Tax Reform**

Reform of the tax system has been an important element in the Government's
reform programme with major changes contemplated in both direct and indirect taxes. The broad directions of tax reform have been spelt out in the Report of the Taxation Reforms Committee (Chelliah Committee). The Committee has recommended a move towards a simpler system of direct taxation with moderate rates and fewer exemptions, a progressive reduction in the level as well as the range of variation of customs duties and a rationalisation of the domestic excise taxes on industrial production with a switch from specific to advalorem rates, fewer duty rates and a drastic reduction, if not elimination of exemptions. Substantial progress has been made in these directions in the first four Budgets. The longer-term objective of the Government is to move to a Value Added Tax (VAT), which it involves integration of the taxes on production, which under the Constitution are levied by the Central Government, with taxes on sales, which are levied by State Governments. The adoption of Value added tax in recent times is a positive step in this direction.

These reforms in the tax system go a long way towards the objective of creating a system, which avoids economic distortions, and ensures adequate buoyancy of revenues to support the task of fiscal consolidation. The changes in tax structure will have to be accompanied by major improvements in tax administration to realise the full potential of reforms in this sector. The Government has indicated that this is high on its agenda.

Public Sector Policy
Reform of the public sector is a critical element in structural adjustment programmes all over the world and is also included on India's reform agenda. However, this is an area where changes are being implemented slowly. Unlike the case in many other countries, where public sector reform has involved explicit programmes of outright privatisation of public sector units combined with closures of unviable units, the approach adopted in the Indian reform programme is more limited.

Instead of outright privatization, the Government has initiated a limited process of disinvestment of Government equity in public sector companies, with Government retaining 51 per cent of the equity and also management control. The disinvestment helps to provide non-inflationary resources for the Government Budget, without adding to the fiscal deficit. However, this is not the only objective. The emergence of private shareholders in public sector units and trading of public sector shares in the stock markets are both expected to make public sector managements more sensitive to commercial profitability. This is especially so since the Government has decided not to use budgetary resources to finance public sector investment in industry. Public sector companies have been given a clear signal that in future their investment plans must be financed either by internal resource generation or by resources raised from the capital markets - both alternatives being bound to encourage and reward efficiency and commercial orientation. A number of public sector units have resorted to the capital
markets to raise resources to finance their investment plans and this trend is certain to accelerate in future.

**Financial Sector Reform**

The reforms in the real sector aim at creating a new set of incentives, which will encourage reallocation of resources towards more efficient uses. This process needs to be underpinned by a parallel process of financial sector reform, which will enable the financial sector to mobilise savings and allocate them in a manner, which supports the process of restructuring in the real economy. Several initiatives have been taken in these areas covering both the banking system and the capital markets.

As far as banking system reform is concerned, the Government has announced a package of reforms to be implemented over a three-year period based on the report of the Committee on the Financial System (Narasimham Committee). The high reserve requirements applicable to banks in the form of the Statutory Liquidity Ratio (SLR) and the Cash Reserve Ratio (CRR) were essentially designed to support Government borrowing at below market rates of interest and constituted a hidden tax on financial intermediation. Parallel with the reduction in the requirements for compulsory investments by banks in Government securities, the interest rates on Government
securities are increasingly market determined. Interest rate regulation in the banking system is also being reduced and rationalised.

Prudential norms relating to income recognition, provisioning and capital adequacy applicable to banks have been brought in line with Basle Committee standards and these norms are phased in gradually and in force by March 1996.

The new norms reveal that the nationalised banks, which account for about 90 per cent of total deposits, have a much higher proportion of non-performing assets than was earlier supposed. Full provisioning for these assets will inevitably lead to substantial impairment of capital and this means the nationalised banks will require extensive injection of fresh capital to meet the new capital adequacy norms. The Government has announced a programme of contributing fresh capital to the nationalised banks, which involves a substantial burden on the Budget.

The banking system is also being opened up to competition from new private banks and several new banking licenses have been granted. Branches of foreign banks have also been expanded to increase competition. All these policy changes will be supported by improved supervision by the Reserve Bank of India (RBI) and strengthening of the management systems within the nationalised banks. The Government has also set up special Debt Recovery Tribunal to help facilitate recovery by
banks from defaulting borrowers. The end result of these initiatives should be a much more efficient banking system which would support greater efficiency in the real sector.

An important initiative taken as part of the reforms is the opening up of the capital market for portfolio investments. Indian companies have been allowed to access international capital markets by issuing equity abroad through the mechanism of Global Depository Receipts (GDRs). Foreign institutional investors managing pension funds or other broad based institutional funds have been allowed to invest directly in the Indian capital markets. Favourable tax treatment has been granted to such investments to encourage capital inflows through these routes. These initiatives have come at a time when international fund managers are diversifying their portfolios by investing in "emerging capital markets" and India has benefited from this trend along with other developing countries.⁹

Statement of the Research Problem

Faced with rising inflation and a balance of payment crisis in mid-1991, India’s then government introduced a fairly comprehensive, orthodox policy reform package

⁹Montek Singh Ahulwalia, This paper is based on the author’s address inaugurating the Seminar on India’s Economic Reforms at Merton College, Oxford, June 1993 updated to include developments upto March 1994.
with currency devaluation as its centerpiece. A sudden drying up of inward remittances and the West Asian markets because of the Gulf war, and the collapse of the Soviet economy-then India’s largest trading partner-were the proximate economic causes of the crisis. Moreover, domestic political instability accentuated the economic troubles, as critical decisions got postponed and fiscal discipline loosened. Collapsed Soviet Union and rapidly advancing Chinese economy with a greater use of market co-ordination formed the international background for initiating these policy changes. Long time critics of India’s development strategy widely welcomed this change. For example, for Behrman and T.N. Srinivasan, the reforms meant getting rid of an internationally discredited statist development paradigm.

Over the last 19 years, these initiatives have generated an intense debate and considerable popular resistance. The desirability of the reforms and their effects remain contentious issues, and opinions continue to be divided. To illustrate, Kirit Parikh thinks, “... the reform has put the Indian economy on a higher growth path. Simple market forces will not automatically bring about economic development. However, sensible policies, we have an opportunity to accelerate our growth further and take off into a higher growth trajectory”. However Arun Ghosh believes “… in no sector or manner has the NEP (new economic policy) succeeded”.¹⁰ This study tries to assess some aspects of economic reforms, focusing mainly on a few macroeconomic indicators, like Foreign investment, Foreign exchange reserves and External debt.

K.S. Jacob is of view that the liberalisation of the economy resulted in tremendous progress, sustained growth and increased wealth. Yet, the incredible indices of development mask inequality and human costs of progress. For millions of Indians, hunger is routine, malnutrition life, employment insecure, social security non-existent, health care expensive and livelihoods are under threat.\(^\text{11}\)

**Objectives of the Study**

1. To analyse the impact of economic reforms on Fiscal Performance of Indian Economy.
2. To examine the influence of economic reforms on Foreign investment, Foreign exchange reserves, Disinvestment receipts and External debt.
3. To assess the impact of economic reforms on Balance of Payments with special emphasis to the role of invisible items in Balance of Payments.
4. To study an Overview of Macro Economic Performance of Indian economy after the initiation of economic reforms in India.

**Hypotheses of the Study**

1. \( H_0 \): There is no structural change in the fiscal performance of Indian economy.

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\(^{11}\) K.S. Jacob, “capitalism: regulate, rework, transform” *Hindu*, dated 22.1.2010, p.10
2. $H_0 =$ There are no structural changes in the performance of Indian economy in respect of Foreign investment and Foreign exchange reserves in the liberalization era.

3. $H_0 =$ There are no structural changes in the Balance of Payments of Indian economy due to the introduction of new economic policy.

Limitations of the Study

1. The present research study is macro in its nature, portraying the picture for the whole of India, which becomes the unit of the study, and hence comparisons at the micro level might not be feasible.

2. As the study had been completely based on the available secondary data, the limitations pertaining to the secondary data such as inadequacy and the lack of reliability would equally apply to this study also. The twenty-nine year data and the results obtained from them might become applicable to those particular years only.

3. The study covers only certain important aspects in the behaviour of macro economic variables observed in the economy, like Fiscal Performance, Foreign direct investment, Foreign exchange reserves, External debt, and Balance of payments.

4. The impacts of only few macro economic variables alone are considered for the study.
Layout of the Study

The present study “An Analysis of the Impact of Economic Reforms in India on Selected Macro Economic Variables” has been presented in seven chapters.

The first chapter presents the Introduction, Macro economic reforms, the scope and coverage of the reforms, Statement of the research problem, Objectives, Hypotheses of the study, Limitations of the study along with Layout of the study.

The second chapter deals with the Review of literature of earlier studies and the Methodology followed in the present study.

The Third chapter analyses the impact of economic reforms on the Fiscal Performance of Indian economy.

The Fourth chapter examines the influence of economic reforms on Foreign investment, Foreign exchange reserves, Disinvestment receipts and External debt scenario.
The Fifth chapter studies the impact of economic reforms on Balance of payments with special significance to the role of invisibles in balance of payments.

The Sixth chapter presents an overview of Macro performance of Indian economy under liberalization era.

The Last chapter presents the summary of findings, suggestions and conclusion of the study.

CHAPTER II

REVIEW OF LITERATURE AND METHODOLOGY

The second chapter has been divided into two sections; section A and section B. Section A is related to Review of literature and section B is related to Methodology followed in the study.

Section - A

REVIEW OF LITERATURE

Review of literature