CHAPTER IV
THE NEW PHASE OF PLANNING: NEW ECONOMIC POLICY OF 1991

Introduction

In this chapter an attempt is made to analyse the economic and political background of the New Economic Policy adopted by the Government of India in 1991 and its various components.

As explained in the previous chapters, through planning Indian economy made considerable achievements in the half century since independence. Though the population has more than doubled, agricultural production has tripled and this prevented the occurrence of large-scale famines. The industrial base became much more diversified than what it was in 1951, while the volume of industrial production increased more than 15 times. And the per-capita income of Indians has increased more than twice ever since 1950-51. Life expectancy rate has almost tripled as a consequence of the substantial fall in the Death Rate and improvements in the standard of living of the people.
However, a realistic assessment of the result of planning calls for a rigorous comparison of what was promised and what has been delivered through the plans. It is true that the colonial rule suffocated the economy and successive governments of independent India had promised concrete achievements in terms of mitigating the sufferings of the common masses of India who were living in poverty. Statistics show that the promises were largely belied. As per official statistics in 1993-94, almost 320 million Indians were deemed to be living in poverty. This is not much less than the entire Indian population of 360 millions in 1950-51. India is now home for 14 per cent of the world’s population but it has 28 per cent of the world’s poor.¹

Table 4.1
Estimates of Poverty

<table>
<thead>
<tr>
<th>Year</th>
<th>Per cent Below Poverty line</th>
<th>Reduction from Previous survey (per centage points)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>All-India</td>
<td>Rural</td>
</tr>
<tr>
<td>1973-4</td>
<td>54.9</td>
<td>56.4</td>
</tr>
<tr>
<td>1977-8</td>
<td>51.3</td>
<td>53.1</td>
</tr>
<tr>
<td>1983</td>
<td>44.5</td>
<td>45.7</td>
</tr>
<tr>
<td>1987-98</td>
<td>38.9</td>
<td>39.1</td>
</tr>
<tr>
<td>1993-4</td>
<td>36.0</td>
<td>37.3</td>
</tr>
<tr>
<td>1999-2000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>30 day recall</td>
<td>26.1</td>
<td>27.1</td>
</tr>
<tr>
<td>7 day recall</td>
<td>23.3</td>
<td>24.0</td>
</tr>
</tbody>
</table>

The nation-building programme that India started 55 years ago was a model for other countries freeing themselves from colonialism. However, as is now well known a number of them have outstripped India in providing their people with a higher standard of living. Further, while many strides have been made in literacy and health, close to half of all Indians still cannot read or write and at birth Indians on the average can expect to die 10 years earlier than the Chinese, the Indonesians and the Thais.²

Table 4.2

<table>
<thead>
<tr>
<th>Year</th>
<th>Life expectancy at birth (years)</th>
<th>Infant mortality rate (death per 000 live births)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1951</td>
<td>32.1</td>
<td>146</td>
</tr>
<tr>
<td>1971</td>
<td>45.6</td>
<td>129</td>
</tr>
<tr>
<td>1981</td>
<td>54.4</td>
<td>114</td>
</tr>
<tr>
<td>1991</td>
<td>55.9</td>
<td>80</td>
</tr>
<tr>
<td>1997</td>
<td>62.4</td>
<td>71</td>
</tr>
</tbody>
</table>


In the midst of the current pressure on the state to withdraw from economic activity, it is easily forgotten that on the eve of Independence there were demands on it to take up the job of developing the industrial base. The recommendations of both the National Planning Committee of
the Thirties and the Bombay Plan of the Forties (authored by the leading industrialists of the day) were for strong state intervention. This was a clear indication that at independence India’s private sector simply did not have either the resources or the enterprise to industrialise the economy on its own.

Further, industrialisation which was seen as the key to faster growth, required a high rate of investment. In a backward and largely agrarian economy, it delved on the state to mobilize savings that would be directed towards industry. The challenge initially was to increase the rate of investment which was then a paltry 10 per cent of the gross domestic product (GDP).

Table 4.3

<table>
<thead>
<tr>
<th>Period</th>
<th>Agriculture</th>
<th>Industry</th>
<th>Services</th>
<th>GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>1951-79</td>
<td>2.24</td>
<td>5.18</td>
<td>4.55</td>
<td>3.50</td>
</tr>
<tr>
<td>1980-91</td>
<td>3.42</td>
<td>5.32</td>
<td>6.18</td>
<td>5.04</td>
</tr>
</tbody>
</table>

Source: Manoj Panda (Chapter 2)
Both tasks demanded a strong intervention by the state. With Jawaharlal Nehru’s fascination for planning inspired by Soviet experience, the stage was set for the development of planned economy with the lead taken by the state. (There was never any shortage of optimism. The First Plan (1951-56) projected a doubling of the per capita income within 27 years. But it was not until 1990-91, four decades later, that the target was achieved. A major turning point in the post-independence development of the economy was marked by the drought and stagnation of the mid-Sixties. Public investment declined (partly on account of the higher defence spending following the 1962 and 1965 wars with China and Pakistan) and industrial growth stagnated. This was to some extent compensated by the Green revolution, but there was all round recognition that the economy was in trouble.

**Economic Background to the New Economic Policy**

The economic background to the reforms may also be recalled. Planned economic development since independence, in which the state took an active role to stimulate economic growth through a more active utilisation of the human and physical resources, had made perceptible differences in the economy. The country had overcome the chronic threat of inadequate foodgrains to meet the needs of a rapidly growing population, and had become practically self-sufficient as far as consumer
goods were concerned. The industrial base had expanded and become substantially diversified. Infrastructural facilities had vastly improved though they were still inadequate in some crucial aspects.

However, in the early 1980s, after three decades of largely state-directed development, there was general thinking that the time had come to allow the private sector of the economy to play a more active role in the development process. Since agriculture was almost entirely under private auspices, the change was to be reflected essentially in the industrial sector. In particular, it was felt that controls and regulations that were considerably necessary when the economy was weak and were hindering productive activity under the particularly new circumstances. A shift from planning the economy to the management of the economy was considered necessary and possible.

Initially the thrust of the policy was to let the more affluent sections in the country influence the pattern of industrial production by exercising their purchasing power and to enable industry to respond to such indications. There was a sudden spurt in industrial production, mostly in the sphere of consumer durables, and a corresponding “consumer boom”. For a while it appeared that the Indian economy was on a new growth path, but it was rather short-lived. The annual rate of growth, which had moved to the vicinity of 5.5 per cent -considerably above the average growth rate of
about 3.5% can't attain during the 1950-1980 period, suddenly came down in 1989-90, industrial production being the biggest casualty.³

The short-lived industrial boom of the second half of the 1980s, however, gave rise to at least two major problems. The first was a colossal increase in public expenditure and the deficits of the governments, especially the Central Government. The total expenditure of the central Government was about Rs.17,800 crore in 1979-80. It moved to 22,000 crore in 1980-81 and to a massive Rs.82,000 crore in 1989-90. Since reduction of taxes was part of the NEP, the increase in expenditure could be met only by a sharp increase in public borrowing and by an equally sharp increase in deficit financing. Even the revenue account of the budgets of the Central Government which till the early 1980s showed a modest surplus available to finance capital expenditure, turned out to be in deficit from the mid-1980s. The overall (fiscal) deficit touched an all time high of 9.0 per cent of gross domestic product (GDP) in 1986-87, and though it declined a bit thereafter remained still critically high⁴.
Table 4.4

Trends in Central Government Finances

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest Payments</td>
<td>606</td>
<td>2604</td>
<td>21,498</td>
<td>1,00,667</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Subsidies</td>
<td>94</td>
<td>2028</td>
<td>12,158</td>
<td>26,949</td>
<td>29,801</td>
<td></td>
</tr>
<tr>
<td>Defence Expenditure</td>
<td>1052</td>
<td>3278</td>
<td>11,442</td>
<td>54,461</td>
<td>62,000</td>
<td></td>
</tr>
<tr>
<td>Market borrowings net of repayment</td>
<td>238</td>
<td>2679</td>
<td>8001</td>
<td>76,521</td>
<td>74,718</td>
<td></td>
</tr>
<tr>
<td>Capital expenditure</td>
<td>2494</td>
<td>8358</td>
<td>31,782</td>
<td>51,987</td>
<td>64,657</td>
<td></td>
</tr>
<tr>
<td>Capital outlay</td>
<td>942</td>
<td>3073</td>
<td>12,130</td>
<td>NA</td>
<td>NA</td>
<td></td>
</tr>
<tr>
<td>Development Expenditure 1,34,637</td>
<td>NA</td>
<td>NA</td>
<td>13,327</td>
<td>58,645</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Non-Developmental Expenditure 2,13,580</td>
<td>NA</td>
<td>NA</td>
<td>9867</td>
<td>49,349</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total Expenditure 3,48,217</td>
<td>5624</td>
<td>3,75,223</td>
<td>23,194</td>
<td>1,07,994</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Revenue Deficit (-)</td>
<td>163</td>
<td>78,821</td>
<td>2037</td>
<td>18,562</td>
<td>77,369</td>
<td></td>
</tr>
<tr>
<td>Gross Fiscal Deficit 1,11,972</td>
<td>1408</td>
<td>1,16,314</td>
<td>8299</td>
<td>44,632</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total Liabilities 11,79,793</td>
<td>NA</td>
<td>13,15,949</td>
<td>59,749</td>
<td>3,14,558</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Government of India Ministry of Finance, Economic Survey Various years

Table 4 shows the trends in government finances during the last three decades. It will be seen that there was revenue surplus before 1970-71 but by 1980-81 there occurred a revenue deficit of Rs 2037 crores. The revenue deficit shot up to Rs18,562 crores in 1990-91 on account of rising non-developmental expenditure which rose from Rs 9867 crores in 1980-81 to Rs 49,349 crores in 1990-91 or a five-fold increase within a decade.
Economic reforms have not reserved the process. On the other hand, revenue deficit in 2000-2001 is estimated at Rs. 77,369 crores or a more than four-fold increase in a decade. Non-developmental expenditure also witnessed a more than four-fold increase during the nineties. During 1980-81 to 2000-2001 while developmental expenditure increased ten-fold, non-developmental expenditure increased more than twenty one times. This forced the government to more borrowings. Market borrowings net of repayment were only Rs 238 crores in 1970-71; these increased to Rs 2679 crores in 1980-81 and further to Rs 8001 crores in 1990-91. Economic reforms have only accentuated the intensity of the borrowings. The figure was Rs 76,521 crores in 2000-2001 registering a nearly ten-fold increase in a decade. Higher borrowings led to higher interest payment which registered an eight-fold increase during the eighties and nearly five-fold increase in the nineties. Interest payment at Rs 112,300 crores now takes away 69 per cent of the Centre’s tax revenue. It is more than the total annual Plan expenditure of the Government.

An idea of the debt and interest burden of the government can be had from the fact that during 2001-2002 (BE) while revenue receipts of the Central Government are slated at Rs 231,745 crores interest and debt repayment is slated at Rs 238272 crores. Fiscal deficit has been constantly increasing. Between 1980-81 to 1990-91 it rose five fold and in the
nineties it has risen about three fold. It is trumpeted that economic reforms have resulted in a decline in fiscal deficit from 6.6 per cent of GDP in 1990-91 to 4.7 per cent in 2001-2002 (BE). This has been achieved by a per centage decline in the capital expenditure from 4.7 per cent of the GDP in 1991-92 to 2.6 per cent in 2001-2002. As capital expenditure also includes repayment of loans, so what is significant is only that part of the capital expenditure which goes to improve the productive base which is known as capital outlay. Capital outlay in 1999-2000 was Rs 24,400 crores out of a total expenditure of Rs283882 crores. The decline in aggregate public investment from eight per cent in the early nineties to less than seven per cent in the later period has impacted on the growth rate of GDP which has marginally declined in recent years. The overall growth rate of GDP declined from 7.3 per cent in the 1995-96 to 5.3 per cent in 2000-01.

What is more disconcerting is the decline in agriculture and allied sectors where the growth rate has declined from seven per cent in 1998-99 to 0.9 per cent in 2000-2001 despite normal monsoon. Foodgrains production is stationary around 200 million tonnes which has resulted in declining per capita production. Per capita per day availability of foodgrains was lower by 40 grams in 2000 -2001 than what it was in 1990-91. In fact the availability has been in all the years, since then although rainfall has been normal in all the years.
The sudden increase in industrial production was made possible by pushing up the growth of imports far more than could be covered by exports, necessitating foreign borrowings at rates of interest far higher than what obtained till the early 1980s. This was a reflection of changed conditions in the international financial markets. India’s external debt was little less than $20 billion in 1980, reached $40 billion in 1985 and shot up to $82 billion in 1990, giving the country the dubious distinction of being one of the top debtor nations in the world. It also meant that about 40 per cent of export earnings had to be devoted entirely to the servicing of the debt. In order to meet international commitments short-term loans had to be frequently resorted to between 1987 and 1990, a signal to lenders and depositors that a crisis was imminent.

Growth did accelerate in the Eighties, a decade which saw the first stirrings of liberalization and a movement away from planning and licensing. (Planning, by itself, had lost its primacy in the late Sixties and while the Five Year Plans continued to be formulated, they were no longer as important as they were in the Fifties and Sixties.) But the faster growth in the second half of the Eighties under the stewardship of Rajiv Gandhi was fed by reckless external borrowing and irresponsible fiscal expansion at home. The wages of such mismanagement had to be paid in the early
Nineties, when the balance of payments crises of 1991 became the occasion to make sweeping changes in economic policy.

It was at this time that the World Bank’s Report of October 1990 advocated a 20 per cent devaluation of the rupee to correct the balance of payments problem. There is not enough evidence to suggest that it was meant as a warning to depositors, but a flight of capital, especially from the Foreign Currency Non-Resident accounts started immediately thereafter. The flight, which amounted to a little over $100 million on October 1990, slowed down in the next few months, but was $370 million in April 1991, $230 million in May and $330 million in June 1991.5

There was a crisis and that was what Narasimha Rao and Manmohan Singh set out to redeem. But they have been attempting more than that. For, the reforms have been meant not only to solve a temporary crisis, but purportedly to correct many of the economy’s long-term maladies also. A noble attempt, indeed, except that the problems now detected were caused by the economic policies of the 1980’s, which were the policies of their party and in the formation of which they have played an active role. Stranger still, they found it possible in a matter of a very short period or a few days, so to say to figure out what was wrong with the Indian economy and what had to be done to rectify it. Unprecedented changes were set in motion with practically little preparation to support it.
The economic reforms announced by the Government in June 1991 amounted to a “U-turn” in economic policy. Export promotion as against import substitution, reliance on the market in place of direction by the state, prominence for the private sector instead of dominance by the public sector, openness to the international economy and to foreign capital rather than accent on protected domestic activities. It is proper to discuss the various components of the NEP

**Claimed Advantages of the New Economic Policy**

The New Economic Policy, claimed to be an attempt to alter the basic parameters of economic policies since Independence and to restructure the economy drastically, was launched a few days after the formation of the Government subsequent to the 10th general elections of May June 1991. The then Finance Minister Man Mohan Singh claimed many other advantages and objectives of the NEP.

First, the new NEP will meet the crisis of balance of payments and fiscal deficits.

Second, it will release industries from the shackles of unnecessary controls and regulations which have become hurdles in the way of industrial growth.
Third. in the light of the general trend towards globalisation, the Indian economy cannot remain isolated and therefore has to be globalised to take advantage of global finances and technology.

Fourth. the Indian industries will be subjected to market discipline both internally and externally.

Fifth, it will encourage large scale private foreign investment through incentives provided by budgetary and non-budgetary policies.

Sixth. Indian industries instead of remaining isolated, artificially protected and divided will now be obliged to become more competitive, cost conscious and efficient. The public sector which has proved to be a drain on the national resources as it has been incurring massive losses will get rationalised either through internal efficiency or by semi-privatisation, i.e. participation of the private sector in its equities and management.

Seventh. India will be able to get long term and short term loans from the World Bank and the IMF to meet the balance of payment deficits and thus save itself from the humiliation of default.

Eighth. it shall be possible to mobilise large sums of money held by the NRIs and thus avoid dependence on the international financial system.
Ninth, a lot of black money can be mopped up through India Investment Bonds and investment in housing without any questions being asked about the sources of money.

Finally, inflation will be controlled by the introduction of fiscal reforms.\(^6\)

**Reforms in the Industrial Sector**

Industrialization through import substitution and public sector production with emphasis on heavy industry has been a very important objective of our planning for development. In the post independence period, even prior to the establishment of the Planning Commission in 1950, the Industrial Policy Resolution of 1948 (later amended and elaborated in 1956) had set the broad outlines of our industrial development strategy by distinguishing industries according to the end use of their outputs (capital, intermediate and consumer goods), their ownership (public, cooperative, private, and joint) and their size or technology (cottage, village, small-scale, and organized). In particular an important distinction was made among industries to be developed exclusively by the public sector, those reserved for the private sector, and those open to development by either or both sectors. The resolution was motivated by the idea that infrastructure and industries supplying key raw materials constituted what Lenin had described as the ‘commanding
heights' of an industrial battlefield. It was believed that by controlling these, the course of development of all industries, in the private and public sectors, could be made to follow in socially desirable directions. At its most expansive and inclusive, the system involved the following: *industrial licensing* under which the scale, technology, and location of any investment project other than relatively small ones were regulated and permission from the government was needed to expand, relocate, and change the output or input mixes of operating plants.

**Figure 1**

*Industrial Growth Rates of India by Use Categories*

The controls taken together were far more restrictive than each of them individually. The actual performance of the public sector enterprises
(PSEs) has not conformed to the role envisaged. Thus by and large, the public sector has acted as a brake on private sector development. The choice of location, technology employment, and pricing policies of the public sector had become, and continue to be, politicized so that efficient development was precluded. Far from generating resources, the public sector had become a monumental waste and liability for taxpayers. It is true that the industrialization strategy did generate a diversified industrial base and a capability for designing and fabricating industrial plants and machinery.

The reforms of 1991 abolished industrial licensing, except in a few industries for locational reasons or for environmental considerations, and import licensing, except in the case of most consumer goods. Restrictions under the Monopolies and Restrictive Trade Practices Act were eased. Entry requirements (including limits on equity participation) for foreign direct investment were relaxed, private (domestic and foreign) investment were allowed into sectors such as power which had been reserved for public sector investment only. Disinvestment of equity in the public sector was also initiated. The reforms, by focusing primarily on the private sector and not addressing the problems of PSEs, have exacerbated them: while the PSEs can no longer except their deficits to be financed through the budget, the case of entry of private units in sectors that were public sector
monopolies before the reforms has worsened their deficits. Also paradoxically even though industrial licensing has been abolished for most industries.

**Reforms in the Agricultural Sector**

Agriculture is the most important sector of the Indian economy from the perspective of poverty alleviation and the related goal of employment generation. Nearly two-thirds of our labour force depends on agriculture for gainful employment. Casual agricultural labourers, tenants and share-croppers, and marginal and small farmers together account for a large share of the rural poor.

The trend rate of growth of agricultural output of the country as a whole has remained constant since the 1950s at about 2.5 per cent to 3 per cent per annum. However, the constancy of aggregate growth masks several significant changes. First, the contributions of area expansion and yield growth to the growth of output have changed significantly during the last five decades. Between 1950-1 and 1970-1 before the Green Revolution, technology based on high yielding varieties of cereals introduced in the late sixties, made much headway, area under all crops grew by 30 per cent and the index of yield per unit area grew by 43 per cent. But between 1970-71 and 1996-67 are growth shrunk to just 11 per cent while yield growth shot up to 61 per cent, reflecting primarily the
effects of the Green Revolution (Government of India 1998, Tables 1.9, 1.10 and 1.11, pp. S.13-S.15).

Table 4.5

Average Annual Growth Rates of Index of Agricultural Production

<table>
<thead>
<tr>
<th>Year</th>
<th>All crops</th>
<th>Food grains</th>
<th>Non-food grains</th>
<th>Oilseeds</th>
<th>Cotton</th>
<th>Sugarcane</th>
</tr>
</thead>
<tbody>
<tr>
<td>1981-91</td>
<td>3.5</td>
<td>2.9</td>
<td>4.8</td>
<td>7.0</td>
<td>2.8</td>
<td>2.6</td>
</tr>
<tr>
<td>1992-99</td>
<td>2.6</td>
<td>2.7</td>
<td>2.5</td>
<td>1.9</td>
<td>3.2</td>
<td>2.4</td>
</tr>
</tbody>
</table>

Source: *Manoj Panda (chapter 2)*

According to the World Bank, in agriculture, growth in total factor productivity (TFP), which is a comprehensive measure of technical progress, has turned to a negative 0.59 per cent per year in the first half of the 1990s, as compared to a healthy (and positive 1.39 per cent annual average in the 1970s which accelerated to 1.99 per cent in the 1980s.

Almost all governments in the world intervene in markets for agricultural commodities. In India, with overlapping jurisdiction over the agricultural sector between the centre and the state, there have been a large number of policy interventions. There is no evidence that these interventions have been coordinated to achieve a well-defined set of policy objectives. Quite the contrary— it would not be difficult to cite examples of mutually inconsistent policies being pursued. Also, policies relating to
foreign trade, exchange rates, and industry have had not only large but also
offsetting effects on agriculture. Again, World Bank estimates suggest that
during 1970-85, agricultural policies disprotected agriculture as a whole by
4.0 per cent, which turned to positive protection at the rate of 7 per cent
during 1985-91. Yet disprotection from economy-wide policies remained
constant at around 25 per cent, so that disprotection of agriculture fell from
about 30 per cent in the first period to 18 per cent in the second. Post 1991
reforms have vastly reduced the disprotection from economy-wide policies to
only 3 per cent during 1994-95. However, agricultural policies are
disprotected to a large extent, so that total disprotection is still 10 per cent.

Reforms in the Fiscal Sector

Until the early 1980s India’s macroeconomic policies were
conservative. Current revenues of the central government exceeded current
expenditures so that there was a surplus available to finance in part the
deficit on capital account, a deficit that is normal for a developing country.
In the early 1980s fiscal prudence was abandoned, with the consequence
that current revenue surpluses turned into deficits. This meant that the
government had to borrow at home and abroad, not only to finance its
investment as would normally be the case in a developing country, but also
its current consumption.
In the 1980s, the government also resorted to borrowing from abroad on commercial terms, both from the capital market and non-resident Indians. In 1983-84, out of $22.8 billion of public and publicly guaranteed external debt, roughly 17 per cent was owed to private creditors. On the eve of the macroeconomic crisis in 1990-91 external debt had tripled to $69.3 billion of which around 30 per cent was owned to private creditors. Thus debt to private creditors grew fivefold in seven years. The balance of the gross fiscal deficit, after taking into account the domestic and external borrowings, small savings, and provident funds, was monetized through the ad hoc sale of treasury bills to the Reserve Bank. For example, in 1988-89 and 1989-90, before the crisis year of 1991, the gross fiscal deficits of the centre and states together was rupees 35,668 and 45,196 crores respectively, and nearly 17 to 25 per cent of these sums, namely 6,244 crores and 10,911 crores respectively, were financed by the issue of ad hoc treasury bills.

The reckless fiscal expansionism of the 1980s was unsustainable. But accompanied by some liberalization in the form of delicensing of some industries and permitting flexible use of capacity through changes in product-mix within the licensed capacity under the so-called ‘broad banding’ and relaxation of some import restrictions, generate growth. Indeed there was a mini-industrial boom during 1985-99. The average annual rate of growth of real gross domestic product (GDP) in the sixth and
seventh plans which covered the 1980s was 5.5 per cent or 5.8 per cent respectively, much higher than the Hindu rate of growth of 3.5 per cent of the earlier three decades. The 1980s covered the major part of the period of a steep reduction in the proportion of poor in our population from 51.3 per cent in 1977-78 to 38.9 per cent in 1987-88. Needless to say the reduction in poverty achieved during a period of unsustainable debt-led growth could not have lasted. When the macroeconomic crisis hit in 1990-91, the gross fiscal deficit had grown to about 10 per cent of GDP at market prices. If one includes the losses of the non-financial public sector enterprises, the consolidated public sector deficit stood at around 12.3 per cent of GDP in 1990-91. More than a third of this deficit, nearly 4.8 per cent of GDP, was for interest payments on domestic and external debt. An analysis by William Buiter and Urjit Patel (1992) showed that unless corrective steps were not taken, India faced fiscal insolvency. It is no surprise therefore that one of the major objectives of Dr. Manmohan Singh’s reforms was to reduce the central government’s fiscal deficit from 8.3 per cent of the GDP in 1990-91 to around 4 per cent or lower in three years or so. In fact, he did achieve a significant reduction to 5.9 per cent in 1991-92, his first full year as Finance Minister, and further to 5.7 per cent in 1992-93. But then it ballooned to 7.4 per cent in 1993-94. The deficit is estimated at 6.1 per cent in 1997-98 and was budgeted to come down to 5.8 per cent in 1998-99.
The states are constitutionally barred from borrowing in international financial markets and need the centre’s consent for any borrowing in the domestic market, if they are indebted to the centre or have an outstanding loan guaranteed by the centre. Since all states are indebted to the centre, this constraint is binding on all of them.

The economic reforms of 1991 have radically altered the options open to the states—they can now compete for private capital. But the states will be unable to attract private capital without good quality infrastructure, particularly power and roads, an educated labour force, and efficient, business-friendly bureaucracy. Improvement in the quality and an increase in the quantity of infrastructural services depend on reforms of the operation, pricing, and regulation of the PSEs as well as on additional investment that would require substantial resources.

**Reforms in the International Trade Sector**

India’s insulation from world markets until the reforms of 1991 stemmed from a long-standing distrust of markets and international trade in general and the fear that greater involvement in foreign trade would inevitably retard India’s industrialization. More than six decades ago Sir M. Visveswaraya, asserted that India may be an industrially developed country or it may be a market for manufactured goods from outside and not both.¹²
With the establishment of the Planning Commission in 1950, and the formulation of successive Five Year Plans, and the frameworks for the centralized management of the economy, controls over agriculture, industry, foreign trade, and indeed economic decision-making by individuals and enterprises became the norm. The First Five Year Plan went so far as to claim that controls provide the appropriate incentive structure for rapid development.

Table 4.6

Growth of India’s Exports (million US$) and Decadal Growth Rates

<table>
<thead>
<tr>
<th>Year</th>
<th>Exports, f.o.b.</th>
<th>Net Inv.</th>
<th>Total (exports + inv.)</th>
<th>Decadal growth rate of exports (per cent per year)</th>
<th>Growth rate of exports + net inv. (per cent per year)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1970-71</td>
<td>1890</td>
<td>-49</td>
<td>1841</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1980-81</td>
<td>8445</td>
<td>5063</td>
<td>13,510</td>
<td>16.1</td>
<td>22.1</td>
</tr>
<tr>
<td>1990-91</td>
<td>18,477</td>
<td>-243</td>
<td>18,234</td>
<td>8.1</td>
<td>3.0</td>
</tr>
<tr>
<td>1999-2000</td>
<td>38,285</td>
<td>12,935</td>
<td>7.6</td>
<td>10.9</td>
<td></td>
</tr>
</tbody>
</table>


While world exports grew at a rapid pace of 8 per cent per year from 1951 until the first oil shock of 1973 and at more modest rates thereafter (average rate of 2.6 per cent per year during 1973-85 and 5.7 per cent during 1985-96. India’s share in this growing world market dwindled from a high of 2.1 per cent in 1951 to a low of 0.4 per cent in 1980. It has
climbed slowly since to about 0.6 per cent in 1977. Interestingly, China whose share in world exports also declined in its pre-reform period from a high of 2.7 per cent in 1959 to a low of 0.7 per cent in 1977, has regained what had been lost and gained. In 1997, China’s share was 3.2 per cent. The share of India’s foreign trade in GDP remained virtually unchanged, around 12 per cent to 14 per cent of GDP during the four decades prior to the reforms of 1991.  

Though the exchange rate is by and large market determined, it would be more accurate to say that we have a regime of managed, rather than cleanly floating, exchange rates. The real effective exchange rate had depreciated by about 48 per cent in 1995 relative to its value in 1990. This depreciation, together with the reduction of import duties and restrictions, brought about a very modest increase in India’s share of world exports from 0.53 per cent in 1990 to about 0.62 per cent in 1997. With the slowing down of reduction in tariffs since 1995, no change in non-tariff barriers, and some appreciation of the real effective exchange rate since 1995, it is not surprising that our export share has gone up from by 0.02 per cent to 0.62 per cent between 1995 and 1997. In absolute terms, India’s exports at $33 billion in 1988 were less than Thailand’s post-crisis figure of $54 billion. In the last two years, export growth has slowed down considerably. The share of total trade (using data from the Department of Commercial Intelligence and
Statistics) in GDP has, however, increased from 15.8 per cent in 1990-91 to 19.5 per cent in 1997-98. However, if we look at the balance of payments data of the Reserve Bank of India which report higher levels of exports and imports (particularly the latter), the share of trade in GDP went up from 17.4 per cent in 1990-91 to 22.4 per cent in 1997-98.

First, turning to consumer goods imports, as a signatory of the Uruguay Round Agreement we are committed to a phase-out of our quantitative restrictions. But our major trading partners filed a complaint against us in the World Trade Organisation (WTO) on the ground that our scheduled phase-out was too slow. We negotiated bilateral settlements on the pace of the phase-out with Australia, Canada, the European Union, Japan, New Zealand and Switzerland. However, the US pursued its complaint and the WTO’s Dispute Settlement Body (DSB) has ruled that we can no longer use the Balance of Payments (BOP) provision of GATT-WTO for continuing with our quantitative restrictions. We have appealed against this ruling on the ground that the DSB has no jurisdiction for deciding whether the BOP provision could be invoked and only the Bop committee of the WTO can decide. The appeal is pending. In the meantime, tentative steps, by transferring around three hundred and fifty items from a list of restricted imports to the Open General Licence (OGL) categories have been taken, but many of these items are of limited
significance. I would urge that we immediately convert the remaining QRS on consumer goods imports into tariffs and announce their reduction fairly rapidly.

Our policy with respect to private foreign capital of all types (foreign direct investment (FDI), portfolio investment, and debt) had been as restrictive, if not more, as the case of trade in goods and services before the 1991 reforms. Prior to 1991, restrictions on foreign direct investment included limits on entry into specified priority areas, an upper limit of 40 per cent on equity participation, and requirements on technology transfer, phased manufacturing, and export obligations. According to an estimate of Chopra (1995) government approvals for private investment were needed for 60 per cent of new investment in the industrial sector during the pre-1991 policy regime. According to Chopra FDI averaged only around $200 million annually between 1985-91 with most of capital flows consisting of foreign aid, commercial borrowing, and deposits of non-resident Indians (NRIs). The reforms of July 1991 affected FDI only to a limited extent.

As a consequence of the limited liberalization, FDI increased from $233 million in 1992 to an estimated $3.3 billion in 1997. India’s share of total FDI in all developing countries increased from 0.5 per cent to 2.2 per cent over the same period. However, over this period China attracted
massive flows of FDI amounting to $194.4 billion (cumulative) compared to $9.4 billion for India. India's share in the total portfolio investment for all developing countries increased from 6.2 per cent in 1994 to 8.7 per cent in 1996 and declined to 5.1 per cent during 1997 - the year of the East Asian Currency Crisis. Portfolio investment is volatile; fluctuations in the absolute amount of net flows were sharp $5.3 billion in 1994 $1.4 billion in 1995, $4.6 billion in 1996, and $2.8 billion in 1997.

Second Generation Reforms

The economic reforms initiated by Government of India in 1991 is now at the second stage according to the exponents of the reform measures.

The present government has introduced the new package known as second generation reforms, under the aegis of which the system of controls and subsidies in agriculture is being dismantled, the huge Indian public sector undertaking, once commended as holding and occupying the commanding heights of the nation's economy, are being privatized through a policy of disinvestments (irrespective of whether these PSUs are sick or profit-making) and the state is being rolled back which is but a euphemism for the state abdicating its social commitments and responsibilities.
Table 4.7

Yearwise Receipts from Disinvestment of PSUs

<table>
<thead>
<tr>
<th>Year</th>
<th>Disinvestment Receipts</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Budgeted estimate</td>
<td>Actual</td>
</tr>
<tr>
<td>1991-1992</td>
<td>2,500</td>
<td>3,038</td>
</tr>
<tr>
<td>1992-93</td>
<td>2,500</td>
<td>1,961</td>
</tr>
<tr>
<td>1994-1995</td>
<td>3,500</td>
<td>-48</td>
</tr>
<tr>
<td>1995-1996</td>
<td>4,000</td>
<td>5,607</td>
</tr>
<tr>
<td>1996-1997</td>
<td>5,001</td>
<td>455</td>
</tr>
<tr>
<td>1997-1998</td>
<td>4,800</td>
<td>912</td>
</tr>
<tr>
<td>1998-99</td>
<td>9,600</td>
<td>5,376</td>
</tr>
<tr>
<td>Total</td>
<td>38,307</td>
<td>18,698</td>
</tr>
<tr>
<td>1999-2000</td>
<td>10,000</td>
<td>2,600</td>
</tr>
<tr>
<td>2000-2001</td>
<td>10,000</td>
<td>2,500</td>
</tr>
</tbody>
</table>


All governments at the centre-advocated the sale of public sector equity or disinvestment as a means of public sector reforms since 1990. Equity sale, as the industrial policy statement of July 1991 argued, was a means of ensuring financial discipline and improving performance. Fiscal convenience was the prime mover of such disinvestments. Reducing or doing away with fiscal deficits is the prime mover behind disinvestment policy. Sale proceeds of PSUS to be a useful source of revenue to window dress budgets. The thrust of public sector reforms was almost entirely concentrated on the sale of equity. The budgetary target for disinvestment
was progressively increased each year from Rs.2500 crore in 1991-92 to Rs.12,000 crore in 2000-2001 even though actual receipts were well below targets in almost all the years.

Over the years, the nature of privatization resorted to also changed. Initially the emphasis was on disinvestment of a part of equity, with the controlling power still being with the government. Now the government is for the strategic sale of public sector units to the private sector. Most such privatization involved under valuation of public assets. Initially there was a talk of disposing off of burdensome loss making public units. Now Government is even for transferring the profit making public units to the private sector. There is no theoretical justification or empirical validation of these move. The public enterprises which were established with public funds transferred to the private hands is against the national interests.

Conclusion

Over the decades, the Indian model of development has created what is called the dual economy. On the one hand an enclave of large urban industries based on modern technology was created both in the private and public sectors, which remain tied to foreign aid and technology. On the other hand, there was the rest of the economy of the poor which was left to fend for itself. The fiscal and trade systems were also designed to enclave
the economy. The new economic policy will certainly strengthen this duality and do something wasteful also, which is obviously anti-poor.

On behalf of the new industrial policy it is claimed that it will release the Indian industry from unnecessary bureaucratic shackles by reducing the number of clearances required from the Government. Mainly, there are two concessions: The proposed policy allows foreign investment up to 1 per cent to 100 per cent equity on automatic basis subject to some restrictions on imports of capital goods. This concession is meant only for the foreigners or those who collaborate with Indian counterparts. In other words this provision will strengthen the hold of the foreign companies on Indian Industry. The second concession is for the Indian entrepreneurs and relates to technological imports. The policy provides no defense against adverse impact on the domestic capital goods industry. There is no selectivity in the policy in the sense that import should not be allowed in those cases where domestic market is in a position to supply capital goods in adequate quantity and quality. There is no appropriate industry plan with appropriate industrial mix, technological selection on the basis of priorities.22

The sudden shift from import substitution to export promotion misses both the complementarity and the sequence. It also misses the need to remove massive distortions, dependency and the ruptures between the
two. The basic criterion determining import substitution and choosing industrial projects has so far aimed at saving foreign exchange in the short and medium periods. Some projections were made for long-term foreign exchange requirements but there was little consideration given to the fact that short-term gains in foreign exchange secured through setting up of all kinds of priority as well as non-priority industries either for limited export or import substitution might lead to greater dependence on the world market and foreign capital and this push India into a more serious external financial crisis. Of course, not all industries set up were that kind. Quite a few, particularly the basic and raw material producing projects, had long term beneficial effects but a still larger number did not fall in this category. Indeed, reliance on foreign collaboration and capital and technology as well as world market and world monopolies have led both to greater dependence on outside as well as greater and expanding influence of external capital on Indian industry, particularly the new industries, which were set up with the avowed purpose of creating economic independence. What came as an unintended consequence of old policy will now be accentuated as a consequence of NEP.23

The new policy is totally silent on employment. During the eighties, when the industrial growth increased from five per cent to eight per cent, employment elasticities uniformly declined in all, except in the services
sector. Unemployment is now becoming politically unacceptable and already leading to massive social unrest. One expected of the Government to make a clear statement on the employment objective, particularly when there is going to be a massive shift towards inviting foreign capital which will be invested only in capital-intensive industries. Modernisation and export promotion will intensify capital intensity as well as import-intensity which is also biased in favour of capital and against labour.

The agricultural sector of the economy is adversely affected by the New Economic Policy. Our farming community is now at the mercy of multinational corporations. They were now facing two types of problems. On one side the cost of cultivation is increasing as a result of withdrawing subsidy by the government to farm inputs, and the other side they were not getting remunerative price for their products. The neglect and problems of a sector which provide livelihood to more than 60% of the population is disastrous to the Indian economy. Most of the agricultural crops shows a declining growth rate after the adoption of the New Economic Policy.

The economic or, more specifically financial crisis is not fully autonomous. It is linked, both as a cause and effect with many other crisis. The whole society is caught with many fold social convulsions. The NEP is a desperate plunge to meet some immediate economic threats. It may or may not succeed. It has positive aspects which are welcome but there are
many others which may deepen the crisis. If massive investment in the public sector and import substitution failed to make India self-reliant how can private sector, including foreign investors and export promotion achieve self-reliance under imposed external constraints? So it is logical to concludes that the direction of the economy has to change. There ought to be paradigm shifts towards a more self reliant, sustainable and just development model whose goal will also be basically different: not more production of material affluence but the creation of a new individual and society- a contented prosperous community based on a set of values Gandhi propagated and worked for viz., co-operation sharing participation mutual empowerment non-violence and peace.

References and Notes

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14 World Bank Report Annex table 7
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