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Economic reforms for transformation, inclusion, sustainability: new economic policy

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Abstract
Economic Policy and economic reform over the last few decades has been motivated by need to accelerate growth – The present paper mainly stress on growth of Indian Economy increase in competitiveness, efficiency & productivity due to new economic policy . The decade preceding economic reforms announced in July 1991, had seen an acceleration in economic growth, but the relatively high rate of growth of GDP was also associated with macroeconomic imbalance. These imbalances increases the fiscal deficits and current accounts deficit of balance of payment which gave rise to public debt, inflation. To control all these same stabilization measures were used and government of India formulated and implemented a new Economic policy. But this policy does not make any reference to India's problems of unemployment, poverty, illiteracy, ill health. The major emphasis is a privatization, liberalization, increased exports and enhanced foreign aid. So in this paper, an attempt has been made to study the impact of economic reforms.

Keywords: Privatization, LERMS, India, Economic Reform.

1. Introduction

Reform is a combination of two words, re and form which means a change for the better. In the sense of economic reform it means to bring a change in the economy.

Economic reforms refer to reforms in economic policies of the government through which economic activities in the economy are coordinated, guided or controlled so that the economy moves in the direction decided by the government. Ever since Independence, the public sector Wits given the pride of place in the economic set-up and controls and regulations of die private sector were rigidly implemented through licences, permits, quotas, etc. However, all these policy measures over the three decades of development between 1951-91 resulted in slow and uneven growth and made the Indian industry uncompetitive in the international market. So, in 1991, comprehensive changes were made in the policy" and barriers to growth of trade and industry were virtually removed. All these policy measures that were announced in July 1991 for improving efficiency, productivity, competitiveness and growth of the Indian economy are called Economic Reforms of the New Economic Policy.

2. Components of New Economic Policy

The New Economic Policy has two broad components, viz. (i) Macroeconomic Stabilization and (ii) Structural Adjustment. The two terms, 'stabilization' and 'structural adjustments' are frequently, but mistakenly taken to mean either the same or at least similar things. Though the two are related, yet they are distinctly different.

The stabilization policies are short or medium run in nature, designed to deal with such problems as high inflation, low capacity utilization and large current account deficit in the balance of payments. These problems may be the result of faulty monetary or fiscal policies.

The structural adjustment policies and programmes are long run in nature and are intended to pull the economy out of the low level equilibrium trap and set it on a higher growth path. These policies are designed to promote fuller capacity utilization, capacity creation in relatively much efficient activities and sectors, and enhance factor productivities. In addition, increased integration with the world economy or globalization may also be an important objective. Under the structural adjustment programmes, reforms are also made in

administrative or bureaucratic decision-making processes to eliminate unnecessary delays and faulty decision-making.

(a) Macroeconomic Stabilisation or Fiscal Correction

The origin of the recent macroeconomic crisis was closely linked to the imbalances in the fiscal sector. The Central Government's gross fiscal deficit was around 7 percent of GDP at current market prices in 1990-91 as against around 5 to 6 percent during the 1980s and 3 to 4 percent in 1970s. Gross fiscal deficit shows the excess of Government expenditure over fiscal receipts, i.e. revenue receipts plus non-debt capital receipts like grants. It excludes the capital receipts such as loans raised internally as well as externally. The growing fiscal deficit and the consequent borrowings have increased the size of the public debt. The debt servicing burden of this huge debt accounts for a significant portion of Government expenditure. A part of this increased burden of expenditure is met by raising new loans through market borrowings, which further widens gross fiscal deficit. The other part of the gross fiscal deficit, which is met through deficit financing or borrowing from the Reserve Bank of India of the Central Government causes excess liquidity in the system and generates inflation.

It is against this background that the Government set before itself the medium-term objective of reducing gross fiscal deficit to 3 to 4 percent of GDP. During 1991-92 the fiscal deficit was reduced to about 4.7 percent of GDP. The reduction in gross fiscal deficit was made possible by cutting down expenditure on subsidies, non-plan grants to States, moderation in defence expenditure and economy in administrative expenditure. Resources were also raised through disinvestment in the equity holdings the public enterprises. The later budget carried forward this fiscal programme and reduced goes fiscal deficit to abort K1 percent of GDP in 1995-96. Almost the entire part of this adjustment was made through arresting of the expenditure growth. Major reforms in the tax structure were also initiated in accordance with the recommendations of the Chellah Committee on tax reforms. However, since deficit has continued to fall. It was 5.9 percent of GDP in 2011-12. In the revised estimates for 2012-13, the gross fiscal deficit is placed at 5.2 percent of GDP. The budget for 2013-14 aims at reducing it to 4.8 percent.

(b) Structural Adjustment

Structural reforms comprise measures as industrial deregulation, liberalization policies relating to foreign direct investment, public enterprise reforms, reforms of taxation system, trade liberalization, financial sector reforms, etc. which aim at radically restructuring the economic system.

- **Deregulation of Industries**

In the area of industrial deregulation, the Government has virtually abolished the requirement of industrial licensing except for a short list of 18 industries. The concept of monopoly with regard to big business houses as contained in the MRTP Act has also been done away with and now there are no limits on die big industrial houses to undertake new investments. The sphere of reservation of industries for the public sector has been narrowed down to only a small list of 6 industries even where private sector may be allowed to establish units if need arises

- **Liberalized Policy Towards Foreign Investment:**

In the field of direct foreign investment, the new policy has laid down that automatic approval will be granted for foreign equity capital up to 51 percent in selected high-priority and high-technology sectors. The foreign technology agreements have been made simpler and their approval made automatic subject to some stipulations. Foreign Investment Promotion Board has been set up with the specific purpose of inviting, negotiating and facilitating foreign investment. The limit of foreign investment has been raised to 74 percent, and in many cases up to 100 percent of equity capital. The use of foreign brand names and trademarks on goods for sale within the country has been permitted.

- **Reduced Role of Public Sector**

Under the New Economic Policy, the sphere of operations of the public sector has been severely curtailed. From 29 industries reserved for the public sector, its operation has been reduced to only four sectors. Disinvestment by the Government in the public sector is being done to open up this industry to competition that is so necessary for efficiency and development.

- **Privatization**

The scope for expansion of the private sector has been considerably enlarged under the programme of structural reforms. There are many areas that had been hitherto reserved for the public sector have now been thrown open to the private corporate sector and even multinational corporations. Rules regarding the collaboration of domestic private sector enterprises with foreign companies have been liberalized. There are also some signals in the new economic policy which indicate that the Government may even hand over some public enterprises to the private managements.

- **Liberalized Exchange Rate Management System:**

It was necessary to effect a sizeable adjustment of the rupee value due t**o** two main reasons: first, to dampen market anticipations so as to offer incentives for remittances and capital inflows; and secondly, to treat exchange rate adjustment as a part of major stabilization and structural reforms programme

An important measure in the realm of exchange rate policy was the introduction of Liberalized Exchange Rate Management Systems (LERMS) with effect from March 1, 1992 under which the rupee was made partially convertible and later made fully convertible on current account in 1993-94 Budget Under this system, ail foreign exchange receipts on current account transactions (exports of goods and services, remittances, etc.) can be converted into rupee at the market-determined rate. The market rate is now determined by the free play of the forces o[r] demand and supply in die foreign exchange market.

3. Financial Sector Reforms

Consequent to the submission of the report of (Narasimham Committee) on Financial Systems, the Government and the Reserve Bank of India have initiated the follow-up action on a number of recommendations. The Committee made wide-ranging recommendations with a view to ensuring that financial sector operates on the basis of operational flexibility and functional autonomy, thereby enhancing efficiency, productivity and profitability.

The Committee recommended that the Reserve Bank should consider progressively reducing the Cash Reserve Ratio (CRR) from its present high level. The Committee also made a

number of recommendations with regard to strengthening of the capital market structure.

4. Assessment or Evaluation of New Economic Policy

New Economic Policy (NEP), in brief, is the policy of Liberalization, Privatization and Globalization. The policy of economic liberalization was, in fact, initiated by the late Prime Minister Rajiv Gandhi during mid-eighties when with a view to increasing investment and efficiency in the economy he opened up more areas to the private sector, simplified licensing system and provided more facilities to foreign capital to give a big boost to the modernization of the economy. But the measures adopted were by and large piecemeal and half hearted. It was only in 1991, under the Prime Minister-ship of P.V. Narsimha Rao that concrete efforts were made in this direction By abolishing requirements of industrial licensing (except for a short list of 6 industries related to security, strategic and environmental concerns), removing restrictions on expansion of large industrial houses under MRTP, allowing unfettered entry of private sector, etc. the Government has moved towards greater liberalization of the economic activity.

The New Economic Policy seeks to encourage gradual privatization of the economy. Privatization may mean many things such as induction of private ownership in public sector industries, induction of private management (with or without private ownership) in publicly owned industries. It is in general a process that involves the private sector in the ownership and operation of state enterprises. Denationalization of public enterprises is another way to privatization.

The New Economic Policy aims at globalization of the Indian economy. Globalization means integration of the national economy with the world economy. Ever since Independence, we had protected our domestic industries against foreign competition through a variety of devices such as tariff and quota restrictions, import licensing. Over the years these controls and restrictions, were so much tightened that the cost and quality structure of Indian products became highly in-competitive. Our goods could not be sold in the world market without the crutches provided by export subsidies and credits. Our domestic buyers had no option except to purchase the high-cost, low-quality goods produced by obsolete technology used by the inefficient and unimaginative producers who were well protected from the outside competitions. Of course, to make the Indian goods more competitive and capture export markets, exchange rates will be suitably, adjusted to prevent any currency overvaluation. Efforts will also be made to achieve full convertibility of the rupee.

5. New Economic Policy: Long Term Gains

The New Economic Policy has brought in an era of market-oriented system which is different from the one that prevailed in the past. The private sector has been assigned a larger role while the public sector no more holds the commanding heights of the economy.

Removal of controls coupled with lure of private profits is channeling flow of capital into more efficient uses. Hence, more economic use of capital ensures greater flow of output and faster growth of the economy. Not only this, with controls, licenses and permits abolished much of the time and energy that are wasted in fulfilling cumbersome formalities and governmental requirements will now be fruitfully used for productive activities.

Removal of import restrictions is bound to make the domestic industry more competitive through efficiency improvements because tariff protection and other shelters from foreign competition is no more available to producers. Specific trade policies like convertibility of the rupee, would boost exports and create more employment and income.

The overall effects of the liberalized economic philosophy embodied in the NEP are helping the economy by improving its growth rate and reduce pressure on the balance of payments. However, such improvements take time to become visibly significant. In the short run, some problems are being faced as some shortfalls may occur in "production and employment when the economy tries to adjust to the new system. But the things are bound to look up over time as the economy will move faster in the future.

6. Second-Generation Reforms

The economic reforms initiated in 1991, now called First Generation Reforms were aimed to meet the crisis situation caused by persisted balance of payments deficits, threat of default on foreign-loan obligations, slow pace of development and industrial growth, continued high fiscal deficit, etc. Now, having achieved a reasonably high growth rate, improved industrial efficiency, some success in reducing fiscal deficit, it is time to implement some more reforms that would speed up development, employment generation and poverty-alleviation. Such reforms that are needed to take the task of development further are called 'Second-Generation Reforms'. Some such reforms are:

1. Social sector reforms such as reforms in education and health sectors.
2. Further reduction in fiscal deficit to 3 percent of GDP
3. Achieving zero revenue deficit
4. Bringing down and ultimately abolishing all subsidies
5. Reducing public debt and lowering debt-service expenses
6. Making people pay user charges on government services
7. Widening tax base
8. Encouraging further capital by opening up more areas for foreign investment
9. Reforming labour laws

The Government has removed or reduced many subsidies such as those on petroleum, gas, etc. It is moving towards widening the area of investment open for FDI, which has now been permitted in some sectors. However, some key reforms such as reform in labour laws is still not being contemplated due to the pressure of labour unions.

7. Conclusion

In brief, it can be said that the new economic policy is helpful in achieving short term stabilization. It does not make any reference to India's endemic problems of unemployment, poverty mercy, ill health, environmental degradation, etc. Its major emphasis is on deregulation of domestic industry, privatization, liberalization, increased competition, reduction in regulation of foreign trade, increased exports and enhanced foreign aid. Success stories of Japan, Taiwan and South Korea are cited by the economists in support of their contention that foreign aid and investment are a must for India's rapid economic development However, what we completely ignore is that much of the success in Japan and South Korea was due to their strong governments**,** tightly protected and regulated domestic markets, complete control over technology, sound capital base and highly skilled and enterprising human resources. Dismantling of controls and regulations to create a competitive market and promote economic efficiency is indeed desirable from stricter economic point of view. But in a

country where over a third of population is still below the poverty line,

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