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Role of Economic Reforms in the Growth of Indian Economy

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ABSTRACT

This article is based on the growth of Indian economy after economic reforms. Economic reforms in India were set in motion, though on a modest scale, when controls on industries were reduced by the 1985 industrial policy. The economic reforms programme got a big boost when the Government announced a new industrial policy in the Indian Parliament on July 24, 1991. Since then, it is liberalisation, privatisation and globalisation all the way and the process is underway. In the new liberalised industrial and trade environment, the Government is progressively assuming the role of a promoter, facilitator and catalytic agent instead of a regulator and controller of economic activities.The Indian economy has responded well to the economic reforms initiated since 1991. The Approach Paper on the Eleventh Five Year Plan (2007-12) released by the Government in November 2006 has indicated 7.2 per cent growth rate during the Tenth Five Year Plan (2002-07). Though this is below the target of 8 per cent, it is the highest growth rate achieved in any Plan. The growth rate for the Eleventh Plan has been fixed at 9 per cent. In short, the Indian economy is in a much stronger position than it was a few years ago. The economy, therefore, has shown that it is capable of achieving high growth rates in response to the implementation of appropriate economic reform policies.

1. INTRODUCTION

At the time of India's independence India had large foreign exchange reserve in the form of sterling balance. India's plan led to huge adverse balance of payment. On one side, there was considerable increase in imports, particularly of machinery and raw material. On the other hand, exports had not increased proportionately because of the increased demand with in the country due to rapid rise in population income and standard of living. Export being a key source of foreign exchange reserve plays an important role in development process. Planning authority in India has adequately recognized the need and importance of augmenting exports. Process of export growth in India is influenced by a number of internal and external factors. Recent economics reforms have created new challenges before India's exports.

After India's independence, the pattern of India's foreign trade has undergone radical changes mainly as results of industrial progress during five years plan. The volume of India's foreign trade has increased considerably during the planning period.

Indian economy had faced major economic crisis in early 1991. This problem did not develop suddenly. The fiscal situation had deteriorated throughout 1980,s mainly due to expanding non-development expenditure. Four deficits are used to measure fiscal imbalance: Revenue deficits, Budgetary deficits, Monetized deficit and Gross fiscal deficit. Of these, gross fiscal deficit is the only complete measure of fiscal imbalance (Gross fiscal deficit = Total government expenditure – Total government revenues). It got accumulated over a long period. Indian economy witnessed a gap between public revenue and expenditure, continuously for a number of years. This gap has been steadily growing with the passage of times. It was financed partly be borrowings from abroad and partly by issuing new currency notes. It caused internal imbalance in fiscal situation and external imbalance in payment situation. It pushed the economy into a deep economic crisis.

During this tenure, there was also political instability in the country. As a result of all these developments, international confidence in the Indian economy started to shapen and credit rating of India in the international capital market declined steeply. These problems continuing for years destroyed the capacity of Indian economy to bear internal and external shocks.

In India, the new economic reforms were initiated in 1991 and a number of policy incentives taken by the government. Firstly effort was made to set up exports so that a major part of the import .Bill is paid for through exports. Secondly, with a view to bring about technological up gradation, imports were libralised. Along with this, in place of debt creating inflows of capital, non-debt creating inflows such as foreign direct investment (FDI) as well as portfolio investment were encouraged.

Devaluation of the rupee in July 1991 was intended to away with the artificially controlled overvalued exchange rate of the rupee and to bring it down to its realistic level in terms of domestic price level and the world price level. The rupee has also been made fully convertible. However the finance minister Mr. P. Chidambaram said ,"India is not close at all in making the rupee fully convertible on the capital account as it dose not feel any compulsion to do so. He added," the importance of the issue was overstated and that of for certain important capital account transactions the rupee was already convertible. We have to wait for a suitable time, when we have gained greater mastery over balance of payment and until the reserves have reached highly comfortable level."

Indian economy has moved decisively to a higher growth phase. Till a few years ago, there was still a debate among informed observers about whether the economy had moved above the 5 to 6 per cent average growth seen since the 1980s. There is now no doubt that the economy has moved to a higher growth plane, with growth in GDP at market prices exceeding 8 per cent in every year since 2003-04. The projected economic growth of 8.7 per cent for 2007-08 is fully in line with this trend. There was acceleration in domestic investment and saving rates to drive growth and provide the resources for meeting the 9 per cent (average) growth target of the Eleventh Five-Year Plan. Macroeconomic fundamentals continue to inspire confidence and the investment climate is full of optimism. Buoyant growth of government revenues made it possible to maintain fiscal consolidation as mandated under the Fiscal Responsibility and Budget Management Act (FRBMA). The decisive change in growth trend also means that the economy was, perhaps, not fully prepared for the different set of challenges that accompany fast growth. Inflation flared up in the last half of 2006-07 and was successfully contained during the current year, despite a global hardening of commodity prices and an upsurge in capital inflows. An appreciation of the rupee, a slowdown in the consumer goods segment of industry and infrastructure (both physical and social) constraints, remained of concern. Raising growth to double digit will therefore require additional reforms.

2. PER CAPITA INCOME AND CONSUMPTION

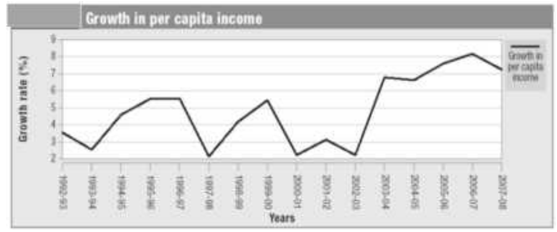
Growth is of interest not for its own sake but for the improvement in public welfare that it brings about. Economic growth, and in particular the growth in per capita income, is a broad quantitative indicator of the progress made in improving public welfare. Per capita consumption is another quantitative indicator that is useful for judging welfare improvement. It is therefore appropriate to start by looking at the changes in real (i.e. at constant prices) per capita income and consumption. The pace of economic improvement has moved up considerably during the last five years (including 2007-08). The rate of growth of per capita income as measured by per capita GDP at market prices (constant 1999-2000 prices) grew by an annual average rate of 3.1 per cent during the 12 - year period, 1980-81 to 1991-92. It accelerated marginally to 3.7 percent per annum during the next 11 years, 1992-93 to 2002-03. Since then there has been a sharp acceleration in the growth of per capita income, almost doubling to an average of 7.2 per cent per annum (2003-04 to 2007-08). This means that average income would now double in a decade, well within one generation, instead of after a generation (two decades). The growth rate of per capita income in 2007-08 is projected to be 7.2 per

Per capita income and consumption (in 1999-2000 prices)

	Income		Consumption	
	Rs.	Growth(%)	Rs.	Growth(%)
IX plan avg.	19245	3.4	12392	3.0
X plan avg.	24156	6.2	14677	4.3
2002-03	20996	2.2	13352	1.1
2003-04	22413	6.8	13918	4.2
2004-05	23890	6.6	14413	3.6
2005-06	25696	7.6	15422	7.0
2006-07	27784	8.1	16279	5.6
2007-08	29786	7.2	17145	5.3

Income is taken as GDP at market prices.
Consumption is PFCE.
Per capita is obtained by dividing these by population.

cent, the same as the average of the five years to the current year. Per capita private final consumption expenditure has increased in line with per capita income. The growth of per capita consumption accelerated from an average of 2.2 per cent per year during the 12 years from 1980-81 to 1991-92 to 2.6 per cent per year during the next 11 years following the reforms of the 1990s. The growth rate has almost doubled to 5.1 per cent per year during the subsequent five years from 2003-04 to 2007-08, with the current



year's growth expected to be 5.3 per cent, marginally higher than the five year average. The average growth of consumption is slower than the average growth of income, primarily because of rising saving rates, though rising tax collection rates can also widen the gap (during some periods). Year to year changes in consumption also suggest that the rise in consumption is a more gradual and steady process, as any sharp changes in income tend to get adjusted in the saving rate.

3. ECONOMIC GROWTH

GDP at current market prices is projected at Rs. 46,93,602 crore in 2007-08 by the Central Statistical Organisation (CSO) in its advance estimates (AE) of Gross Domestic Product. Thus, in the current fiscal year, the size of the Indian economy at market exchange rate will cross US$ 1 trillion. At the nominal exchange rate (average of April-December 2007) GDP is projected to be US$ 1.16 trillion in 2007-08. Per capita income at nominal exchange rate is estimated at US$ 1,021. According to the World Bank system of classification of countries as low income, middle income and high income, India is still in the category of low income countries. The (per capita) GDP at purchasing power parity is conceptually a better indicator of the relative size of the economy than the (per capita) GDP at market exchange rates. There are, however, practical difficulties in deriving GDP at PPP, and we now have two different estimates of the PPP conversion factor for 2005. India's GDP at PPP is estimated at US$ 5.16 trillion or US$ 3.19 trillion depending on whether the old or new conversion factor is used. In the former case, India is the third largest

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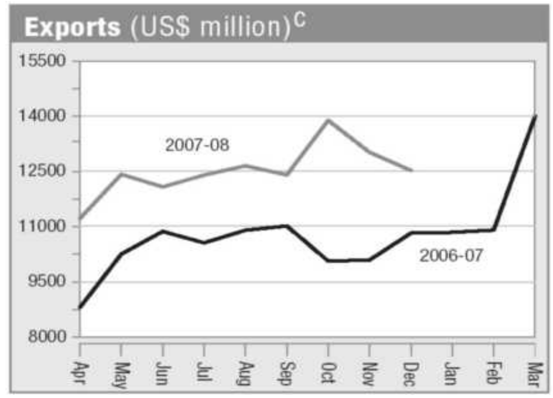
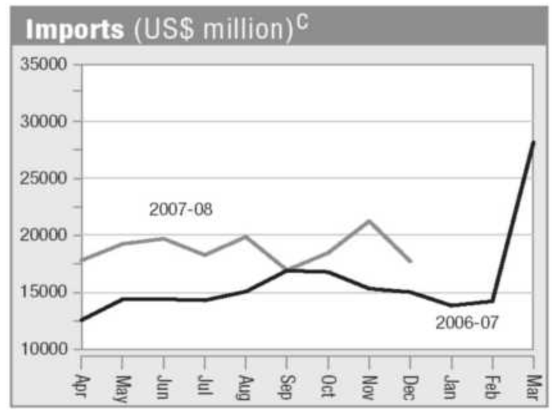
economy in the world after the United States and China; while in the latter it is the fifth largest (behind Japan and Germany). GDP at factor cost at constant 1999-2000 prices is projected by the CSO to grow at 8.7 per cent in 2007-08. This represents a deceleration from the unexpectedly high growth of 9.4 percent and 9.6 percent, respectively, in the previous two years. With the economy modernizing, globalizing and growing rapidly, some degree of cyclical fluctuation is to be expected. This was taken into account while setting the Eleventh Five Year Plan (2007-08 to 2011-12) growth target of 9 percent (both in the approach paper and in the NDC approved plan). Given the over 9 per cent growth in the last two years of the Tenth Five Year Plan it was argued that the Eleventh Five Year Plan target could be set at 10 to 11 percent as 9 percent had already been achieved. Maintaining growth rate at 9 per cent will be a challenge and raising it to two digits will be an even greater one.





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