

India's Increase in Economic Growth After 1981

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India saw a remarked change in its growth rate during the decade 1981-1999, with the GDP growing at 5.6 percent per annum on average. This showed a divergence from the Hindu rate of growth which had stood between 3 and 3.5 percent over the period 1950-1980, characterised by the highly criticised Five-Year Plans. The neo-liberalist argument is that the move away from India's traditional industrial policy in 1991 towards liberalisation, deregulation, and market orientation brought a new era of faster economic growth. They credit the increase in growth to the reduction in government controls and the greater openness of the India economy – to external trade and investment. The reforms symbolised a move away from import-substitution-industrialisation (ISI) towards an export-led growth strategy. While the general contention sides with the view that the focus on the market and the adoption of neo-liberal policies following the reforms of the 1980s and, specifically, the early 1990s, can account for the accelerated growth, other views put less emphasis on policy, instead stressing the importance of the shift in attitude during the 1980s (DeLong, 2003 and Rodrik, 2003). I argue that both neo-liberal reforms including deregulation such as delicensing, a relaxation of import controls and tariffs, and export promotion in addition to a growing confidence in entrepreneurial activities and participation in the global market produced the increase in India's rate of growth after 1981.

Many argue that the rise of neo-liberal policies began with the 1991 reforms. However, looking at the Indian economy, it is clear that the turning point came in the early 1980s. This was at a time where the Indian government had made a deliberate change in their attitudes towards business, globalization and trade, and the degree of state intervention. Rajiv Gandhi embarked on a number of reforms in the 1980s which would come to change the structure and growth path of the Indian economy. Although these early reforms were not as comprehensive as the reforms of the 1990s, they embarked upon changing views over globalisation and the appropriate level of state intervention in the economy. The shift in policy began in the 1980s, so subtle that initially it was not easily recognisable. Rodrik and Subramanian (2005) argue that the acceleration in Indian growth came long before the liberalisation of 1991, which is commonly referred to as the beginning of the period of reforms that resulted in higher economic growth. Specifically, they highlight 1980, a full decade before economic liberalisation, as the start of Indian growth transition. Growth did increase above the Hindu rate of growth during the 1980s, however, this growth period was unsustainable. It culminated in the balance of payments crisis of 1991 where growth plummeted to 0.5 percent. Since positive growth has been stable following the 1990 reforms, more weight must be placed on the impact of the 1990 reforms.

Deregulation

In order to assess the impact of the new liberal policies that Indian government adopted in the 1980s, an understanding of the policies in place prior to the change is necessary. Before 1980 the Indian economy was characterised by numerous industrial and financial controls which stifled business and therefore growth. Industrial licensing was one tool the government used to ensure the private sector conformed to the requirements of the five year plans. It consisted of a great deal of red tape which acted as a barrier to new entrants and rendered businesses highly uncompetitive and inefficient. Any change an enterprise wished to make required they obtain a license from the appropriate authority. Industrial delicensing reforms for certain industries affected the domestic market and were a major development in the 1980s and 1990s. Chamabargwala and Sharma (2007: 2) remark that 'Delicensing meant freedom from constraints on output, inputs, technology and location as well as free entry into delicensed industries.' Without quantitative constraints firms could benefit from economies of scale. The 1984 licensing reform of Rajiv Ghandi boosted domestic firms by increasing competition as more firms entered as a result of free entry into delicensed industries. Greater competition was significant in improving entrepreneurship as it provided firms with incentives which do not exist in a planned economy. Firms became more innovative, productive and efficient. Although the reforms were modest, they resulted in significant gains. The largest increase was observed in the statistics on total factor productivity (TFP). TFP for the period 1967/68 – 1980/81 was 0.7 percent per annum. This rose to 2.0 percent in 1981/82 – 1990-91 and was followed by a small increase in the ensuing decade to 2.6 percent. In 1981/82 – 1990/91 TFP explained 37.7 percent of growth. Thus, licensing improved the competitiveness and efficiency of Indian firms which contributed towards the increase in economic growth after 1981.

Reduction in Import Controls

The government controls prior to the 1980s were perceived in an entirely negative way for several reasons. Not only did the controls imposed on industry and trade result in an inefficient allocation of resources, and therefore market failure, they have even been labelled as 'extremely detailed, dysfunctional and corruption-breeding' (Acharya, 2007: 2). The restrictive regime was a large factor in why the economy was operating below its potential growth. External liberalisation took off in the 1990s whereas the 1980s saw a change in policies which affected domestic firms. The relaxation of government control over imports also improved the productivity and competitiveness of Indian firms. The period saw a substantial expansion of the Open General License. The subsequent increase in the number of goods which could be freely imported or exported which in turn benefitted growth. Import liberalisation granted faster industrial growth which had been held back by the previous strict government control. Tseng and Cowen (2013) attribute the emergence of the liberalisation phase due to two facts, one being that industrialists themselves began to find the controls counterproductive. By increasing allowed imports, firms gained access to goods they needed to manufacture their product. Import controls reduced competition and therefore were detrimental to growth. A result of opening the Indian market up to foreign competition was that firms had to increase productivity to lower their costs and compete on price, or adopt non-price competition such as innovation and a higher quality of product. Therefore, the

reduced government intervention in trade contributed towards the increased growth after 1981.

Export Incentives

Export incentives were introduced after 1985 and helped 'expand imports directly through ties to exports and indirectly by a relaxation of the foreign exchange constraint.' (Tseng and Cowen, 2013: 181). Replenishment (REP) licenses were given to exporters, allowing them to import items on the restricted list. This is important in explain the rapid growth and increase in exports. Other export incentives were introduced between 1985/86 and 1989/90. These reforms encouraged the shift towards export-led growth. Firstly, the government incentivised firms to export via an income tax deduction. This stood at up to 50 percent of the business's profits following the 1985/85 budget and increased to up to 100 percent of profits in 1989. The lower tax on exporter's profits made exporting more attractive to firms. The government also made it easier for firms wishing to export by reducing the interest rate on export credit from 12 percent to 9 percent, making it relatively easier to fund. These reforms in conjuncture to the widening of the OGL list and the greater freedom of access to imported goods given to exporters, led to a greater involvement of Indian enterprises within the global market.

Declining Trade Barriers

India's five year plans exhibited several inefficiencies. One stemmed from the fact that they had adopted an inward-looking policy stance at a time when the world trade and trading partnerships were expanding rapidly. India was previously known for its inward-oriented and regulated economy and has responded to globalisation in an exemplary way by opening the economy to international trade. The reduction of trade barriers saw spectacular growth in both exports and output, showing support for export-led growth. Liberalisation, argues Paul and Das (2012), played an important role in this growth. The greater degree of openness of the Indian economy was a necessary condition for sustained rapid growth. Bhat (2011: 9) states that 'In the mid-1980s, there was a renewed emphasis on export promotion.' As discussed previously, this included a number of policies which benefitted the exporter. In addition, significant progress on reducing tariffs on capital goods was made. Prior to the reforms of 1991 the import-weighted average rate of tariff for all imports was as high as 87 percent, with the rate of tariff on consumer goods imports at 164 percent, essentially barring entry from the market. The high trade barriers hindered economic growth. By opening the economy up to international trade, Indian firms could sell their goods to a wider market. In addition, advocates of globalisation argue that the transfer of knowledge and technology enabled developing countries to experience higher rates of growth.

Foreign Direct Investment

Sriniugsan (2001: 2) noted that India's past attitude towards foreign capital inflows, particularly foreign direct investment (FDI) 'was one of suspicion, if not outright hostility.' Before 1991 there were a number of restrictions imposed on FDI. The external sector reforms since 1991 included the liberalisation of restrictions on capital inflows. Trade liberalisation

had a positive short-term impact on the flow of FDI to India. However, it does not appear that FDI has made as significant an impact on growth as the changes in the way the market is regulated. Chakraborty and Basu (2002) argue that the direction of causality between the two flows from GDP to FDI for without high levels of growth, investment in the country would appear unattractive to foreign companies. Chakraborty and Nunnenkamp (2008) discuss the issue of FDI's impact on growth in India. They emphasise the importance of the structure and type of FDI, for not all contribute towards economic growth. The reforms of 1991 did give rise to FDI, but what type of FDI India attracted would determine its impact on growth.

Attitudinal Change

According to DeLong (2003), India's acceleration of growth may not be held accountable to the reform program of the early 1990s. Alternatively, he supports the notion that deeper changes, specifically, the shift in official attitudes and the rise of entrepreneurial activities held a greater deal of importance than any individual policy reform. While DeLong's sceptical stance has been criticised by a number of scholars such as Panagariya (2004), nonetheless, it contains several convincing arguments. Although the growth in the 1980s was unsustainable and ended in a crisis, the minor reforms symbolised a growing consensus over a need for change in India's growth strategy. Arguably, without the change in attitude towards encouraging entrepreneurial activities and pursuits, the reforms of the early 1990s may not have been pursued, or at the very least not as aggressively. The gradual liberalisation movement and the success of the reforms in the 1980s gave policymakers the confidence to widen their neo-liberal policies in the 1991 budget. Furthermore, although he stresses the importance of the change in attitude a decade prior to the 1991 reforms, DeLong does not suggest that the reforms of the 1990s did not contribute towards economic growth. It is likely that the increase in growth rates would not have been sustained had the reforms not occurred. The increase in growth after 1981 can instead be accounted as a shift in attitude reflected in the policies enacted by the government. Rodrik and Subramanian's (2005) position coincides with DeLong. They add that the growth was triggered by an attitudinal shift of the national government towards a pro-business appropriation.

Conclusion

The reforms of the 1980s laid the foundations for a change in attitude towards a more pro-business and export-oriented growth strategy. The reforms of the 1990s widening the scope and deepened the sectors which were liberalised. Neo-liberal policies adopted by the Indian government such as delicensing, a reduction in import controls and barriers to trade, made it easier for new firms to enter the market and prosper. The reduction in government intervention, which previously prevented India from reaching its economic potential, let the market operate in a more efficient manner. Increases in total factor productivity accounted for much of the growth after 1981 as firms gained access to more imports, and globalisation and public spending led to increases in education, investment, and physical capital. Technological developments improved the quantity and quality of Indian products. The rise in economic growth, essentially, can be attributed to the shift in control from the public sector to the private sector. Government monopolies and command economies are widely acknowledged

to be inefficient. By deregulating and liberalising the economy, India saw large gains in productivity which led to significant increases in output.

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