

# India on the Pathway of Transitional Economy Since 1991: EAFM Department, Rajasthan University, Jaipur

Dr Rachna Yadav

**Abstract:** India is an emerging economy since independence and has gone through various phases of transitions. From being a socialistic economy to a liberalized one since 1991 and further strengthening of the newly laid policies again in 2000 has led it on a path of development. Being one of the third largest landscapes of Asia it has seen some major changes in its Socio –Economic structure which has made it one of the major players in world economy. India with its reforms has slowly but steadily professed to be a free market economy. It has taken giant leaps in the area of manufacturing, technology and IT. It has transited from a low income country to a middle class economy in a span of 25 years.

**Keywords:** Indian Economy, Transitional economy, Globalization, growth and reforms

## 1. Introduction

India's performance in the last two decades and a half has taken a new dimension due to the rigorous economic reforms. Most of the countries have opened its borders to trade and foreign investment this giant step towards being one world has happened due to globalization. The continued reforms adopted by India in the field of export import policy, fiscal policy and decentralization policy have led to sustained high growth of the economy. The reforms also offer the promise of a faster transformation of the economy. According to IMF The Economy of India is the seventh-largest economy in the world measured by nominal GDP and the third-largest by purchasing power parity (PPP). India's new industrial policy and the fast growth in the industries has also categorized the country as , one of the G-20 major economies, a member of BRICS and a developing economy with an average growth rate of approximately 7% over the last two decades and a half . According to the Economic survey of 2014-2015 conducted by Government of India, Ministry of Finance, Inflation has declined by over 6 % since late 2013. The current account deficit has come down from a peak of 6.7 % of GDP to an estimated 1.0 % in the Fiscal year 2014-2015.

India laid the foundation of Indian Economy by majorly studying the economic structure of the then Soviet Union as it had major affiliation with the super power then. The planning commission was introduced with an objective of planning regarding all the aspects of micro economics for 5 years. The objective of setting up a planning commission of India was to be self-reliant and to be equal to all and to reduce poverty. The government was to be for the people, by the people and to the people so a democratic setup was established where both the Private and the Public sector coexisted, but the heavy industries were in the hands of the government so that wealth could be distributed evenly among the nationals. With certain reforms introduced by Moraji Desai and Rajeev Gandhi did little to revive the stagnant economy which was heavily dependent on agriculture which constituted 71 % of dependence of the population on it. But due to the gulf war in the nineties and Indian economy in major debts a revamping of the economy

was inevitable. The reforms thus laid the foundation of new economic reform and structure which led to major transformation in the Indian Economy. The reforms had two broad objectives. One was the reorientation of the economy from a statist, centrally directed and highly controlled economy to 'market friendly economy'. A reduction direct controls and physical planning was expected to improve the efficiency of the economy. It was to be made more 'open' to trade and external flows through a reduction in trade barriers and liberalization of foreign investment policies. A second objective of the reform measures was macro-economic stabilization. This was to be achieved by substantially reducing fiscal deficits and the government's draft on society's savings.

*The Gross Domestic Product (GDP) in India was worth 2095.40 billion US dollars in 2015. The GDP value of India represents 3.38 percent of the world economy. GDP in India averaged 484.96 USD Billion from 1960 until 2015, reaching an all-time high of 2095.40 USD Billion in 2015 and a record low of 37.68 USD Billion in 1960.*

India economic journey since Independence has not been an easy ride but still it has prevailed. Let's look at the map of Indian Economy.



## 2. Transitional Economy its Meaning

IMF defines transitional economy as the replacement of an economy system by another. According to the fund the economics of transition is the creation of the market and market based institute along with forces of supply and demand through the privatization of formerly government owned assets and corporation and thus in turn leads to the development of a market economy. Transitional Economy is an economy that is shifting from a planned market to a free market economy. There are certain phases that an economy needs to go to develop market based economy. It affects every element of the society.

### Transitional economy: Transition Phase v/s phase of India after 1991:

Let us compare the phases of transition as mentioned by IMF of a transitional economy to that of to that of India's reforms that were implemented after 1991 which categories India as Transitional Economy.

1) *The first phase is Liberalization of economic ventures, prices and market operations along with reallocating resources to the most effective and efficient use.* When thereforms of Liberalizationwere introduced in the Indian Economy it laid the foundation of market oriented policies along with emphasis on expanding the role of Private and Foreign investment. The main focuses of the reforms were to abolish the critical policies like License raj, reduction in tariff and interest rates which were effecting the growth of the economy. The government had a strong hold on the Public sector industries and the major step take during the framing of the Liberalization policy was to attract private player in the public sector domain

Before 2015 India grew at slower pace than China another country whose economic step up was similar to ours. But in year 2015 India surpassed China in terms of GDP growth rate. The McKinsey Quarterly states that removing main obstacles "would free India's economy to grow as fast as China's, at 10% a year". The impact could be seen majorly in the total FDI which grew from a minuscule US\$132 million in 1991-92 to \$ 31 billion in first half of 2015. According to the *Financial Times*, in 2015 India overtook China and the US as the top destination for the Foreign Direct Investment. In first half of the 2015, India attracted investment of \$31 billion compared to \$28 billion and \$27 billion of China and the US respectively this is a great leap forward. India was at the 15th position, only a few years back. To quote the A T Kearney Study, "India's strong performance among manufacturing and telecom & utility firms was driven largely by their desire to make productivity-enhancing investments in IT, business process outsourcing, research and development, and knowledge management activities". The major reforms that were introduced are as follow

- a) Abolition of Industrial Licensing. The number of industries in the public sector domain was reduced from 17 in 1991-92 to 3 by 200-01.
- b) Relaxations of restriction of FDI, many stringent trade barriers werereduced.

- c) The Monopolies and Restrictive Trade Practice (MRTP) act of 1969 was amended in 1991-92, which were renewed. The threshold of assets in respect of application of MRTP and dominant undertakings.
- d) The Competition Bid incorporating a modern competitive law was introduced in Parliament in 2001.
- e) A significant change in Personal and Cooperate taxes along with major reduction in the custom duties were introduced.
- f) Import licensing was abolished but safeguard measures in the adjustment of tariffs, imposition of temporary QR, safeguarding of duties, anti-dumping duties and restricting imports of certain agriculture products.
- g) The exchange rate was unified and a system of managed flow was introduced in 1992-93. The rupee was also made convertible for current account transaction in 1994.
- h) Foreign capital inflows were also introduced.

2) *The second is Privatization which involves effective enterprise management and economic efficiency through the involvement of private sector.*

Privatization is a process by which the government transfers the productive activity from the public sector to the private sector. Indian Economy is a mixed economy where both the public and private companies co-exist. After Independence most of the public sector activitieslike irrigation, power, railways, ports, communications and some departmental undertakings were controlled by the government so has to maintain balance in the society and provide benefits to all. The government has made a suo-motu statement in both houses of Parliament in December 2002, laying out the objectives of disinvestment as "to put national resources and assets to optimal use and in particular unleash the productive potential inherent in our public enterprises" (GOI 2003, p. 150).

The procedure to disinvest in the Public sector started immediately started afterthe governmentintroduced the reforms and immediately set up disinvestment commission which looked into the matter of Public Sector Undertakings. The government started involving the private sector through (i) selling of shares in select PSUs, and (ii) strategic sale of a PSU to Private Sector Company. The major changes were introduced in the Petroleum sector where BPCL & HPCL were introduced, in telecom in Videsh Sanchar Nigam Limited and in automobile manufacturing in Maruti Udyog Limited. This was just the beginning and private players were invited to invest in Banking, Infrastructure, Insurance, and Power. Rail and Roadways and Airports. Government is recently offered privatization in power and railways.

3) *Legal and institutional reforms:*

While India was facing a mammoth task of liberating and disinvesting its economy the task of legal and institutional affair was also one area which needed immediate attention. The main task was to make domestic reforms and making the political arena transform, along with micro economics stabilization, basic structural reforms along with it; it was important to have laws that with protect the interests of the parties and will go in hand with the transitional phase. Some

early judicial reforms were framed which tend to focus on creating an independent and depoliticized judiciary free from state control

Legal and judicial institutions play a central role in the functioning of market economies. In working to define and enforce laws, resolve disputes among private parties or between citizens and the state, and oversee and counterbalance the power of the executive, they help to define the investment climate in which firms operate and the legal setting in which social and human rights take shape. The laws are needed to redefine the role of the state in economies, establish the rule of law, and introduce appropriate competition policies. India adopted the Common Law System after achieving independence. It has made slow but steady progress in institutionalizing legal systems which supports its calm rule of law and acceptance of international laws and standards. Corporations in India, or with interests in India, can sue the government of India, or any Indian state, if they feel any decision by the government violates any provision of any legal agreement to which the foreigner is a signatory. Good examples of the above are provided by the actions of Kentucky Fried Chicken (KFC) and Enron Corporation. A KFC outlet was ordered closed by a state government for a flimsy reason. KFC approached the court and had the order revoked. Enron Corporation, too, was set to challenge an order by another state government, but an out-of-court settlement was reached and the matter didn't go to the judiciary. The judiciary in India is independent of the government (<http://www.indiaonestop.com>). Judicial activism has been practiced in India, and the Supreme Court and the High Courts in various states are free to ask the government to look into and rectify a certain matter even though no one has brought it to the attention of the courts. Judicial activism as explained above has caused some friction between the Courts and the Parliament. In the event of a showdown, the Parliament prevails (<http://www.indiaonestop.com>).

Rule of law refers to the perceptions about the incidence of crime, the effectiveness and the predictability of the judiciary and the enforceability of contracts (Mitra, 2003). India's score on the rule of law is .23 on a scale of -2.5 to +2.5, which is reasonable to evoke the confidence of investors who are seeking opportunities in the emerging economies. The Indian judiciary has in its judgments consistently preserved as unassailable the economic and industrial policy of the Government of India. It is evident from an analysis of these decisions that in the event of any *mala fides*, arbitrariness or gross illegality in any decision or order concerning FDI policy issued by the Government, investors have resorted to filing appropriate legal proceedings, including writ petitions in the High Courts and appropriate legal relief has been sought. It is hoped that some of the legal conundrums that do arise in the interpretation of the FDI policy and FEMA can and are resolved by a proper, just and fair interpretation and adjudication by the Indian Courts.

#### 4) *Developing indirect, market oriented instruments for macroeconomic stabilization*

The sustained reform process in the macro economy has been accompanied by gradual reforms in the financial sector through the whole period since the early 1990s. The efficient

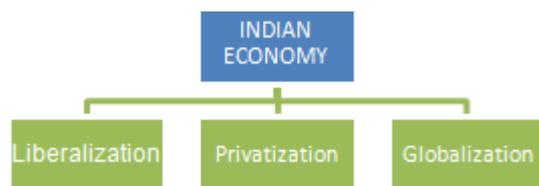
allocation of resources is helped greatly if interest rates are market determined and reflect the opportunity cost of money appropriately. The earlier period had been characterized by a plethora of administered interest rates, a system of credit allocation, and automatic monetization of fiscal deficits. The process of interest rate deregulation was carried out gradually, and banks were given increasing autonomy in decision making along with the cessation of credit allocation. The monetization of fiscal deficits was first reduced and then eliminated, with government financing being done increasingly through debt auctions entailing the discovery of risk free interest rates in the economy

#### 5) *Imposing hard budget constraints which provide incentives to improve efficiency*

A hard budget constraint implies that the local government has to take more autonomy and is asked to balance their budget and no year-end help by the central government to be given for the deficit. For hard budget to be effective feature of the intergovernmental fiscal policy the higher level government should be mostly committed to a non-bail out strategy and to shy away from year end deficit grants. A hard budget constraint is not always a central tenet of decentralization. India illustrates some of the perils of putting too much detail about intergovernmental fiscal relation in the constitution. In particular, the decision to specify revenue assignment between the union and the states in the constitution has resulted in inflexible and out mode revenue structure for India. The Indian Constitution assigns to the states among others, the tax on the sale and purchase of goods (but not service) and tax on agriculture income and wealth (but not incomes from the sector). Any tax residuary powers are vested with the central government. This means that the sales of goods are taxed at the state level and sales of services can only be taxed at the federal level.

### 3. How Globalized World played a role in Uplifting Indian Economy

The term "globalization" has acquired considerable emotive force. Some view it as a process that is beneficial—a key to future world economic development. Others regard it with hostility, even fear, believing that it increases inequality within and between nations, threatens employment and living standards and thwarts social progress. Indian economy saw a major policy changes in the decade 1990-2000. The economic reform paved new wave of development in the sector of industry, trade, financial sector. The new reforms were categorized under Liberalization, Privatization, and Globalization (LPG).



Braibant (2002) says that the process of globalization not only includes opening up of world trade, development of advanced means of communication, internationalization of financial markets, growing importance of MNC's, population migrations and more generally increased mobility of

persons, goods, capital, data and ideas but also infections, diseases and pollution.

After the reforms introduced by Finance Minister Manmohan Singh 1991, a new wave of growth and economic transition started which was made on the principle of Self-Reliance and socialistic policies of Economic Development?

Globalization offers extensive opportunities for truly worldwide development but it is not progressing evenly. Some countries are becoming integrated into the global economy more quickly than others. Countries that have been able to integrate are seeing faster growth and reduced poverty. Outward-oriented policies brought dynamism and greater prosperity to much of East Asia, transforming it from one of the poorest areas of the world 40 years ago. And as living standards rose, it became possible to make progress on democracy and economic issues such as the environment and work standards.

The crises in the emerging markets in the 1990s have made it quite evident that the opportunities of globalization do not come without risks—risks arising from volatile capital movements and the risks of social, economic, and environmental degradation created by poverty. This is not a reason to reverse direction, but for all concerned—in developing countries, in the advanced countries, and of course investors—to embrace policy changes to build strong economies and a stronger world financial system that will produce more rapid growth and ensure that poverty is reduced.

#### 4. Conclusion

India is a fast growing market and has gone a dramatic transition in the economic reforms in the last 25 years. It has opened its market to foreign direct Investment and has also improved its competitiveness and magnetism for the foreign investors. Indian government is taking all steps to reform its political, legal and economic infrastructure to make it lucrative for the companies to invest.

On the eve of Indian independence, Nehru said that what we have achieved is a step, an opening of opportunities to great triumph and achievements which awaits us. He said that country has a great task ahead which included the ending of poverty and ignorance and disease and inequality of opportunity. The planning process' objective which was planned as an initial step was to develop a strategy which was to establish a socialistic pattern of society through economic growth with self-reliance and social justice and alleviation of poverty. The objective was to be achieved within a democratic framework. , where both private and public sector co-existed. Planning commission was established whose aim was to present plans for 5 years and to raise domestic saving for growth and to help economy resurrect itself from colonial rule. India modernization and the green revolution could only contribute a meager 3.4 % average annual rate of growth between 1956 and 1974, the economic growth to a rate higher than 5 % between 1975 and 1990 and then after to 6 % after 1992 and as of today in 2016 it is 6.60 %. India gradually deregulated private sector

investment after 1975. This phenomenon was consolidated in the 1980s. It was after the balance of payment crisis of 1991 that substantial economic deregulation favoring the private sector possible to grow.

India at the same time has to also focus on its government policies and social trends. It has to develop a global marketing expertise along with major companies. A lot of research and development need is to be done by investing companies in the societal acceptance by the country.

The phases that are mentioned in the phases of Transitional economy of Capitalist economy to Mixed market economy. On the other hand India was a Socialistic Economy but greater control on the market was in the hands of the government so to a great extent the steps taken by the Indian Government post 1991 fulfills the tenet of a transitional economy my as mentioned by IMF . Indian government has not only made remarkable reforms but also has shown substantial growth in the GDP. The government has bought in many political, judicial reforms and has opened the market to the world.

The first major achievement is the establishment of a market-based economy. The transition to a market economy has been associated with increased political freedom in most countries. Second, a commitment to macroeconomic stability appears to have taken hold, with inflation brought under control in most cases. Third, many of the basic structural underpinnings of market economies have been put in place These include bankruptcy procedures, competition policy and anti-monopoly regulations, improvements in accounting standards, and legislation for regulating financial markets.

In the countries new avatar the, commitment to macroeconomic stabilization came along with the implementation of structural reforms. India has joined the ranks of middle-income countries and can claim to have transitioned.

The changes were introduced. Firstly, to renew focus on macroeconomic and financial stability in the country, to rein in persistent deficits and increasing debt, and to address rising levels of bad loans in banks and other financial institutes.

Secondly the reforms also addressed, the pace and depth of structural reforms in areas such as business and investment, access to credit, public expenditure prioritization and tax administration. But most of the initiatives started from the central government

#### References

- [1] *"India's economy: What's holding India back?" The Economist. 6 March 2008.*
- [2] *"India outpaces China in 2015 economic growth - BBC News".*
- [3] *"The McKinsey Quarterly: India—From emerging to surging" (PDF). The McKinsey Quarterly. 2001.*
- [4] *"HSBC GLT FrontPage". Retrieved 22 August 2008.*

- [5] Local industrialists against multinationals. Ajay Singh and Arjuna Ranawana. *Asia week*. Retrieved on 2 March 2007.
- [6] International Journal of Business Research **Publisher:** International Academy of Business and Economics **Audience:** Academic **Format:** Magazine/Journal **Subject:** Business, international **Copyright:** COPYRIGHT 2007 International Academy of Business and Economics **ISSN : 1555-1296**
- [7] **Sequencing Fiscal Decentralization** By Roy W. Bahl, Jorge Martinez-Vazquez

### Author Profile



**Dr Rachna Yadav** received her PhD from University of Rajasthan; Jaipur .She has done her B.Ed. from IGNOU. She is a professional currently working with Pearl academy as a Dy-Registrar.