Economic Reforms - Lessons from India

Book Review: "Backstage-The Story Behind India's High Growth Years" by Dr. Montek Singh Ahluwalia

Transformation of India

In the face of a deep balance of payments crisis in the 1980s, a recession was triggered in India in 1991. Prices for necessities were soaring, the unemployment rate was rising, and the public's despondency deepened while facing shortages of nearly everything. The future looked very bleak for many. While some people got onto the streets out of desperation, another group of smart individuals who were passionate about getting India's economy back on track, worked relentlessly to find solutions to their economic issues, which had transformative effect on India to become the regional powerhouse it is today.

This group of economic reformers emphasized the importance of export orientation and highlighted the key role played by the private sector to generate a methodical shift towards a more open economy, that set the stage for its rapid economic liberalization, which led to the development of a market-oriented economy. The reforms implemented during the two-year period from 1990-1991 propelled the Indian economy to grow at an average growth rate of about 6.0 per cent for the subsequent ten years from 1992/93 to 2001/02, which in turn, led to a substantial reduction of poverty levels. This is a remarkable story narrated by Dr. Montek Singh Ahluwalia on how India overcame its largest economic crisis; through the reforms that were designed and implemented BACKSTAGE. BACKSTAGE encapsulates the process that went into identifying these reforms and driving their implementation, which were a part of the structural adjustment programme supported by the World Bank and the International Monetary Fund (IMF).

Objectives of the Reforms

India's continuous fiscal imbalances were the primary cause of the country's balance of payments crisis. Therefore, reducing the fiscal deficit has been given priority in the reforms. Overall, the reform agenda strived to address the numerous fiscal shortcomings in both the central government and the states, since they impacted the reduction in public investments. The high amount of public borrowing had also crowded out private investments.

The Indian reforms' revenue strategy included lowering the tax rates, expanding the tax base, increasing the tax ratio while eliminating loopholes, modernizing the tax system, and limiting the extent of small-scale unit exemptions. Another crucial element had been taking corrective action on the state's overall urban property taxes, agricultural income tax, land revenue, and sales tax systems. Overall, the goal of the revenue strategy was to reduce central government subsidies by enacting reasonable user charges on services like the postal system, higher education, and the railroads. The key to cutting costs included addressing overstaffing in the state sector and wastefulness in state government organizations like irrigation, road transportation systems, state electricity board, and water supply.

BOP Crisis

Evidently, the crisis had been foreseen. It had been Saddam Hussain's invasion of Kuwait in August 1990 that led the price of crude oil to double from $17 per barrel in July 1990 to $34 per barrel by November 1992 that triggered the Balance of Payments (BOP) crisis in India. The external current account deficit had also been severely impacted by the decline in remittances from the Gulf as India had to recall 150,000 trapped residents from Kuwait. The current account deficit had been 1.5 per cent

of GDP, on average, during the first half of the 1980s, ballooning in the second half, hitting 2 per cent by end of the decade. Even when import restrictions were tightened, there had been little chance of success in the absence of significant attempts to curb domestic demand. The external borrowings by India continued to rise, while its international reserves, declined drastically to an all-time low of $1.1 billion by June 1991; barely adequate to cover imports for two weeks. India was downgraded by Moody's, which made it even more difficult to obtain loans from foreign banks, that it was forced to reach out to the IMF. The Indian government obtained $682 million from the IMF's reserve tranche in 1990, which was akin to applying bandages on a severe wound. The Indian government had to borrow a further $777 million from the IMF in January 1991 for a three-month period through the first credit tranche facility, which had a few conditions. A further $1,009 million was taken from the Fund's low condition compensating and contingency lending facility.

All of this was taking place as the domestic political climate was also deteriorating. When the Ministry of Finance declared that foreign currency was in short supply, the Ministry of Commerce began to restrict imports by issuing licenses, compelling consumers to turn to domestic sources of supply; demonstrating that restrictions on imports tend to benefit those who produce import substitutes for the domestic market. The likelihood of a devaluation became inevitable in the absence of an effective adjustment strategy with guaranteed financing, as importers started accelerating payments for imports, exporters started delaying the submission of export receipts. These considerable and challenging external sector uncertainties put significant pressure on the BOP in the short term, similar to speculative capital outflows.

The Indian Government made a risky judgment to avoid default and negotiated for putting up 47 tons of gold from the gold reserves as collateral for loans from the Bank of England and the Bank of Japan for $600 million. Clear of mental cobwebs, it generated a range of creative solutions to overcome its economic woes. As soon as the government signaled its willingness to look beyond conventional remedies like merely reducing the fiscal deficit, to take on more innovative actions that had been long overdue, the wheels of reform were put into motion. In the end, this action not only established credibility that India may take severe measures, if necessary, but also paved the incredible path to its rapid economic development, which earned the tagline INCREDIBLE INDIA. The Indian government took advantage of the crisis to carry out extensive structural changes that enabled the integration of the Indian economy with the rest of the world. The Indian Rupee was devalued, a new FDI policy was formulated, domestic investment restrictions were removed, and trade policy was liberalized.

Devaluation of Indian Rupee

The initial response to the crisis was the announcement of the 9 per cent devaluation of the Indian Rupee. A second devaluation two days later brought the total depreciation to nearly 19 per cent, a much more realistic solution to the BOP crisis. This two-step procedure has been unofficially given the code name "Hop-Skip & Jump" in order to safeguard the secrecy of such politically sensitive decision-making processes and to avoid endless and fruitless arguments.

In the days of fixed exchange rates, devaluation was a politically delicate decision in most nations since the worth of the currency in foreign exchange was frequently equated in the public eye with national honor. Devaluation was also a hotly debated topic because many people were not aware of how it helped resolve a problem with external payments. Due to the "expenditure switching effect", this caused domestic demand to shift from non-tradables to tradables, resulting in a rise in exports and a decrease in imports. Eventually, the impact of this relative price adjustment on the composition of demand minimizes the degree to which private consumption must be reduced in order to reduce the current account deficit.

As such, devaluation made Indian exports more competitive in the international markets. A significant portion of the higher revenues obtained in the export sector was used to purchase goods and services made within the country, creating additional employment opportunities. Because the price of imports inevitably increased with the devaluation, it was considerably simpler to abolish import licensing. Hence, the 1991 two-step devaluation was considered essential to the success of the accompanying trade policy reforms.

Radical Trade Policy Reforms

There were many quantitative limits imposed on international trade, i.e. imports of all manufactured consumer products were prohibited. Although some capital goods, raw materials, and intermediates were freely allowed to be imported, import permits were required for the majority of these products, in the prevalence of domestic equivalents. This import licensing system hurt the economy, particularly exports.

A new license called "Eximscrip" was introduced to replace the licenses given to exporters to meet their import needs. While the licensing process covered the actual import value of each export, eximscrips were earned by the exporters at a standard rate of 30% of the value of exports. These were open to free market exchange. If the demand for imports exceeds the supply of eximscrips, imports are permitted to be more expensive and import demand was controlled by raising the license premium. Since the value of imports permitted through this channel was capped at the total value of eximsrips generated by exporters, imports were automatically contained at an acceptable level. Goods that could only be imported by specific government agencies, such as crude oil, petroleum products, fertilizers, metals, and ores, were allowed to be imported while consumer goods were banned or remained restricted. Given the small number of domestic producers and the positive response from the Indian industry, removing quantitative limits on imports of capital goods and intermediates had been relatively simple. However, it had been much harder in the case of final consumer goods, because so many domestic producers were impacted.

The reduction in tariff protection had been the second component of the trade strategy. The Indian government strived to go forward with the goal of liberalizing imports in accordance with the recommendations of a Special Committee for the rationalization of the country's tariff structure. Although the government intended to employ the exchange rate devaluation mechanism in a similar aggressive manner to how economies like South Korea and China had, the concept that the BOP issue could be resolved by carefully reducing nonpriority imports, had also been strongly challenged. Furthermore, it was noted that since markets believed the exchange rate to be unsustainable, it was preferable to shift it to a level that was more credible rather than risking a run on the currency that would lead to a payment default.

Finance Minister, Dr. Manmohan Singh's political leadership attempted to win over the bureaucracy while respecting opposing viewpoints on the suggested reforms. The exceptional trade policy measures implemented in July 1991, were approved by political authorities in a remarkably short period of time. One of the key figures behind India's economic reforms in 1991, Dr. Montek Singh Ahluwalia, claimed that they were able to change the trade policy in just eight hours. He described this as a remarkable feat given the time constraints at the time and maintained that the approval process yielded significant lessons for the future. First, "a crisis requires swift and sensible reactions". Second, "getting everyone to agree isn't always possible. The ability to trust your officials is important for accelerating action".

Industrial Policy Reforms

The most significant change has been in industrial policy, where the majority of central government industrial regulations have been eliminated. In terms of industrial strategy, the goal had been to foster

an environment where investment, technical advancement, and modernization are attractive business ventures. Except for a few industries, industrial licensing was abolished, and FDI regulations were considerably relaxed. To provide direction to the bureaucracy and express a more welcoming stance towards foreign investments, a new Foreign Investment Promotion Board (FIPB) was established and placed in the Prime Minister’s Office (PMO).

The 18 key industries exclusively reserved for the public sector, including iron and steel, heavy plant and machinery, telecommunications and telecom equipment, minerals, oil, mining, air transport services, and electricity generation and distribution, etc. were drastically condensed to just three: defense aircraft and warships, atomic energy production, and railway transport. Central government licensing of industries was eliminated except for a few businesses that are considered hazardous or environmentally sensitive. To prevent the concentration of economic power, the Monopolies and Restrictive Trade Practices Act's requirement that large industrial houses obtain a separate clearance before investing was repealed. The benefits of pursuing sound policies have grown because of liberalization's higher degree of competition, elevating the significance of state level action. Deficits in the infrastructure were expected to take time and money to fix, but with enough political will, shortcomings in governance were to be resolved more rapidly.

Budgetary Support

Efforts were taken to minimize the weight of adjustment on the poor. It increased the corporate tax rate from 40 per cent to 45 per cent and increased the excise duty rates on appliances like refrigerators and air conditioners but lowered the maximum rate of customs taxes from 300 per cent to 150 per cent through the Budget, which signaled the need for a long-term, steady reduction in customs duties. Two committees were formed in the budget speech of 1992–1993 in order to develop a plan for financial system and tax reform. The government's strategy of gathering the best experts in the nation to examine these complex issues and create a multi-year road map of reforms that would be made public to solicit feedback and then gradually implemented over time, was mirrored in the establishment of these committees with specialists.

To eliminate the fertilizer subsidy, the price of fertilizers was increased by 30 per cent. The conversion of the Securities and Exchange Board of India (SEBI) into a statutory entity for regulating the operations of the capital market was one of the major capital market reforms proposed in the Budget. Additionally, Unit Trust of India (UTI), which had previously enjoyed a monopoly, would be open to competition from private sector mutual funds. Through the Budget of 1991–1992, it was made clear that structural reforms, such as liberalizing trade and industrial policies, were necessary in addition to crisis management to free the private sector of India. The economy needed to be exposed to competitive pressure, which required opening up to imports and foreign investment. The Finance Minister, Dr. Manmohan Singh, had ended his budget speech by quoting Victor Hugo; “No power on earth can stop an idea whose time has come.” He continued “I suggest to this august House that the emergence of India as a major economic power in the world happens to be one such idea. Let the whole world hear it loud and clear. India is now wide awake. We shall prevail. We shall overcome.” This has proven to be surprisingly predictive and recognized as a primary driver of world growth. The success in overcoming the crisis has been greatly aided by all these initiatives. The current account deficit, which was at 3% of GDP in 1990–1991 had decreased to 0.4% by 1991–1992. However, import restraints continued to be in effect for the first half of the year and growth had decreased to 1.4% in 1991–1992. In 1992–1993, growth bounced back to 5.6%, while the current account deficit increased to 1.4% of GDP. Although the crisis had abated by 1994, the officials have continued to work towards the longer-term goal of structural reform.

Tax Reforms

The 1992–1993 tax reforms persisted for a number of years afterwards; including the reduction in the number of personal income tax slabs from four to three, elimination of the wealth tax on financial assets, reduction of the maximum customs duty from 150 to 110 per cent, and the customs duty for new projects and general machinery from 80 to 55 per cent. Other significant aspects of these reforms included a regime of moderate direct taxation rates, an expansion of the tax base, low to moderate customs duties, a more straightforward system of excise taxes with fewer rates, and a long-term objective to transition towards a VAT system. During the subsequent three years, a lot was accomplished in this direction. The top rate of personal income tax (including the surcharge) decreased from 56 per cent in 1990–1991 to 44.8 per cent in 1992–1993 and finally to 40 per cent by 1994–1995. Although corporate tax rates were increased to 45 per cent in the first Budget, subsequently, in 1994–1995 they were reduced to 40 per cent.

Financial Sector Reforms

Learning from international examples where liberalization of the capital account in the presence of financial weaknesses had resulted in serious banking crises, India had been determined not to suffer the same fate as these countries. India ensured that financial sector reforms played a significant role in the reform agenda. Both, the Statutory Liquidity Ratio (SLR) and the Cash Reserve Ratio (CRR), which were previously at extremely high levels, were reduced and banks were allowed more flexibility to set interest rates on loans based on how risky they were perceived to be. Ten new banks received banking licenses with the opening of banking licenses for new private sector banks. The Bank Nationalization Act of 1969 and the State Bank of India Act of 1955 were amended to increase bank capital and to dilute the government share to 51 per cent of the total equity. The Reserve Bank of India (RBI) established a separate department for supervision of banks, which is overseen by a Board of Financial Supervision chaired by the Governor.

Ending the RBI's detrimental practice of automatically financing the budget deficit, which had been in effect for more than 40 years, since 1955, holding monetary policy captive to fiscal policy, was another crucial reform carried out in 1994. In order to finance its deficit, the government would therefore need to borrow from the open market at market interest rates. Meanwhile, a legal mandate to regulate the stock markets was granted to the SEBI.

Exchange Rate Reforms

One of the most important changes India was able to implement was the adoption of a flexible exchange rate, which guaranteed the availability of the foreign currency needed for the additional imports. By encouraging exports, which increased the availability of foreign exchange, the Eximscrip mechanism had offered some flexibility. Eximscrips, however, were only issued in relation to the export of goods. They did not include other sources of foreign exchange income, such as tourism. The system was also subject to delays because Eximscrips were only provided after verification that export earnings had been remitted. An interim report detailing the proposed changes to foreign exchange rate management, known as the "Liberalized Exchange Rate Management System (LERMS)," was delivered to the finance minister soon before the 1992–1993 budget was unveiled.

A committee that comprised representatives from the Ministry of Finance and the RBI attempted to reform the exchange rate in two stages: the abolition of Eximscrips and the implementation of a flexible exchange rate. A dual exchange rate system would take the role of Eximscrips in the first stage, requiring all foreign exchange earners to surrender a percentage of their earnings to the RBI at a set exchange rate. This has been stressed in order to demonstrate that the exchange rate should account for the value of scarcity in foreign exchange. State agencies would utilize this to import necessities like

crude oil, petroleum goods, fertilizers, etc. at the set exchange rate. All other permitted imports of goods, services, and remittances might be covered by the remaining foreign exchange, which could be sold on the open market. A shift in the free-market exchange rate caused by excessive demand for foreign currency would discourage imports and promote exports.

The committee then helped the country to transition to the new dual exchange rate regime, with effect from March 1 of that year, with minimal volatility; with the market exchange rate prevailing at a rate that was almost 20% greater than the official rate. In late 1992, discussions for merging the two exchange markets began. As a result, the switch to a single exchange rate was made public in the Budget Speech for 1993–1994 and took effect on March 1 of that year. As anticipated by the committee, the currency rate has behaved exactly as projected. Prior to unification, the official exchange rate of the Indian Rupee (INR) was INR 26.2 = US$1 whereas the free-market rate was roughly INR 32.6 = US$1. The market exchange rate settled at INR 31 = US$1 in March 1993, the first month of the unified rate, and remained roughly at that level for the following 12 months.

The reform had benefited from the smooth transition, which was accomplished without excessive volatility in the foreign currency market. Indian authorities had been able to notify the IMF that the INR was completely convertible on the current account a year later. The management of the foreign exchange shortage had demanded import licensing. The authorities' ease in letting go of these restrictions and allowing the exchange rate to deal with the foreign exchange shortage demonstrated that the concerns were unjustified. This specific reform went much beyond what the IMF had sought as a prerequisite for its support. It has been a wholly homegrown element of the reform effort.

The end of Crisis

The World Bank hosted the Aid India Consortium meeting in Paris in June 1992 to examine India's economic performance and their need for development assistance. This was the first review after India had signed the loan agreements for crisis management with the IMF and World Bank. The World Bank's officials noted the effectiveness of the Indian reforms in their final remarks, stating that "if this pace of reforms is maintained over the next three to four years, India might become one of the most dynamic economies of the world in the second half of the 1990s and beyond." A total of $7.2 billion has been offered by the donors, an increase from the $6.7 billion offered the year before. As a result, the formal end of the BOP crisis was signaled when the government declared that India would no longer be seeking financial help after exports rose significantly in 1993–1994 and efforts to attract private international capital started to yield some dividends. After finishing the 1993 Consortium, the Indian government continued on the path of reform and no longer needed to approach the IMF and soon, the Aid India Consortium was replaced by the "India Development Forum".

Evolving Financing Strategy

The Indian government developed a financing plan that would draw net capital flows of 2 per cent of GDP, or around $6 billion annually. There were approximately $3 billion in annual regular foreign aid flows (excluding emergency funding), but this amount was anticipated to decrease since India's eligibility for the International Development Association (IDA), was being challenged. It had set a target for mobilizing $3–4 billion per annum in other flows; identifying external commercial borrowing, portfolio flows, and FDI as potential sources. For each of these, a new policy has been developed.

As external commercial borrowing was a volatile source of funding, it had implemented rather strict controls on these flows. A $2 billion annual cap was placed on the total amount of external commercial borrowing authorizations. The net inflow would be much lower after subtracting the payback of earlier borrowings from the actual disbursements. Short-term debt was discouraged. To prevent Indian businesses from borrowing money abroad at excessively high costs, interest rate caps were also

implemented. As it was assumed that very few Indian companies would be able to raise long-term debt, borrowing that is longer than 10 years had been exempted from any caps. The Government of India, which was unable to obtain a loan without sending its gold abroad 7 years earlier was able to set the stage for a private Indian company called Reliance Industries, to float a $100 million, 100-year bond in 1997 to become the first Asian corporation to issue a 100-year bond. This demonstrated the extent to which India's successful reforms had advanced the country.

Portfolio investment liberalization had also made it possible for Indian businesses with a solid record for corporate governance to seek foreign money through new offerings. A new regulation allowing qualified Foreign Institutional Investors (FIIs) registered with SEBI to invest in listed firms on the stock market was announced in September 1992. The National Stock Exchange (NSE) was founded in 1993, which was a significant move that aided in luring institutional investors. Using VSATs (Very Small Aperture Terminals) and leased lines, the NSE was the first exchange in India to offer electronic trading, enabling brokers who met the requirements to trade on the exchange from anywhere in the country. With the electronic matching of buy and sell orders and the presentation of all trade prices on an electronic screen, it significantly boosted transparency.

FDI, the most reliable and favored source of capital input, had undergone a revolution with the Industrial Policy, which had been unveiled in 1991. In certain industries, FDI was automatically approved up to 51% of equity, with a higher percentage requiring special permission.

Public Sector Reforms

One of the most significant decisions made as part of the reforms of 1991 was to cut the number of industries designated for the public sector from 18 to 8. Without privatizing any Public Sector Undertakings (PSUs), this stimulated private investment in industries including steel, aviation, telecommunications, and petroleum refining, boosting the private sector's share in these industries.

Insurance companies and pension funds are the principal source of long-term debt in developed markets. The committee established for this purpose has proposed a two-stage reform procedure to solve the long-overdue problem of the lack of a market for long-term capital for financing infrastructure development. The Life Insurance Corporation (LIC) and the General Insurance Corporation (GIC), which functioned as unregulated government monopolies, supervised only by the Ministry of Finance, had to be brought under the authority of a statutory regulator for insurance before they could be integrated. New private sector insurance companies were allowed to enter the market once the regulator was established. There was no cap placed on the amount of FDI in this industry and the committee advised that foreign insurance companies be permitted to operate in collaboration with Indian promoters.

Political Leadership

An extremely ineffective system of regulations that hindered the growth of the Indian economy over several decades, was gradually dismantled and replaced with one that is better suited to an open, market-driven economy. Due to the vastly expanded selection of high-quality products, consumers have benefited. The ability to extend and advance technology was made possible by the removal of countless micro controls, which was advantageous for businessmen. Reduced protection for industry improved the conditions of trade for agriculture, which benefited farmers. Soon, the worries that opening up would harm the economy were dispelled.

It is interesting to note that the average GDP growth rate during the 1990s (1990-91 to 1999-2000) was only 5.8%, a figure that was only slightly higher than the average GDP growth rate for the 1980s of 5.6%. The crisis years of 1991–1992, when growth fell to 1.4%, and 1997–1998 are part of the decade,

as is the year 1997–1998 when the East Asian crisis caused growth to drop to 4.3%. If these two time periods are omitted, the average growth rate was 6.6% during this period; far higher than it had ever been during the previous eight-year span. However, since reform policies tend to gradualistic in nature, typically taking considerable time to show their full impact, the effects materialized only during the following decade, when average growth reached 7.2%.

The Indian success story has benefited from upfront political leadership, which was always accompanied by risk. The Minister of Finance during this crucial time had been very explicit in his public statements about the reforms; that they were required to unleash India's potential for productivity. The Minister at one time stated that, "without the Prime Minister's backing, the Finance Minister would be a zero. It is the Prime Minister’s (Mr. Narasimha Rao) backing that puts a one before the zero, making it a 10.” This reflects the importance of political leadership in addressing economic crisis in a decisive manner.

Continuity of Reforms

The performance of the India’s economy depends on several factors beyond the Budget, including the state of the monsoon and its impact on agriculture and conditions in the world economy. There were many reasons why the economic successes of the Indian Government could not be translated into political gains in 1996. One of the hallmarks was continuity of the reforms. The reforms in the banking system were taken forward by the following governments resulting in further progress in decontrolling some interest rates, a gradual reduction in the SLR and a tightening of prudential norms. The establishment of the National Securities Depository Limited (NSDL) in 1996 is another instance of continuity. The Government transformed the 1995-adopted Depositories Ordinance into an Act in August 1996, making it possible for the NSDL to dematerialize paper securities and maintain all ownership records electronically in the depository. Opportunities for Foreign Institutional Investors’ (FII) investments were also boosted by allowing them to invest up to 10% in any company's equity, including debt instruments and stocks of unlisted companies. These steps gradually enabled capital inflows to boost the Balance of Payments.

Lessons from other Crises

The Indian Government also learned from other countries that had previously encountered economic and financial crises.

India had learned the value of keeping a healthy distance from excessive exposure to short-term foreign debt. India, which experienced Balance of Payments difficulties in 1991, took deliberate steps to lower its exposure to short-term debt. As a result, compared to East Asian nations, the short-term debt as a percentage of GDP, was substantially lower. The need to enhance the banking system, particularly in terms of its capacity to manage foreign exchange exposure, was the broader lesson. The RBI attempted to cushion the collapse in the rupee by using reserves they had accumulated earlier, but this only served to cause the Indian Rupee to depreciate gradually. The interest rate had been the only tool available to avoid a self-fulfilling panic. In January 1998, the bank rate increased by 2 percentage points. The Cash Reserve Ratio (CRR), which had previously decreased from 10% to 9.5% was increased to 10.5%, and the interest rates applicable on bank loans to finance imports was also increased. By April 1998, the situation had sufficiently stabilized, and political stability had reached a certain level, allowing the bank rate to be lowered back to 10% and the CRR to fall in line.

Privatization

A later-appointed Government played a significant role in the Indian economy by initiating the divestment of Government equity in public sector enterprises. About 35 percent of the industrial value

added in India was produced by the public sector. Although privatization has been a key element of economic change in many other nations, India had not been completely on board with the idea. At the beginning, the Government used a limited strategy of "disinvestment" that involved selling a small part in public sector enterprises while retaining management control. While there was some expectation that private owners would boost the commercial orientation of public sector firms, the primary goal was to raise money for the budget.

Going below a 51% shareholding was recommended for some businesses by the Disinvestment Commission while the Government had established a new rule that, while it continued to retain majority stake in PSUs in strategic sectors, "in the majority of circumstances", it would reduce its shareholding to 26% and hand over administration of all central public sector firms to private investors who bought in a significant commercial stake, except for a small number of crucial sectors. In 1999, the first of these privatizations took place when Hindustan Lever, an Indian affiliate of the Anglo-Dutch multinational Unilever, purchased 74 percent of the equity of Modern Foods India Ltd., a public sector bread-making company with 2000 employees, triggering numerous additional sales with management changes, including those at the following businesses: BALCO, an aluminum company; Hindustan Zinc; Computer Maintenance Corporation; Lagan Jute Machinery Manufacturing Company; several hotels; VSNL, a major petrochemicals unit; IPCL, a major telecommunications service provider; and Maruti Udyog, India's largest automaker, which was a joint venture with Suzuki Corporation and has since acquired full control over management. In 1992, as part of the reforms, the private sector was allowed to invest in the production of electricity, and both the central government and the state governments were eager to induce foreign investors to build electricity-generation facilities so they could sell electricity to state-owned electricity distribution boards.

The decision to allocate the earnings of privatization to support increased expenditure on social sector development and for the retirement of public debt was a significant innovation that boosted public acceptance of privatization. Although privatization does not support the development of long-term revenue source, it removed the ongoing burden of funding losses from these primarily loss-making firms, which are highly unlikely to generate considerable revenues and assisted to bridge significant revenue shortfalls in the next five to ten years while longer-term budgetary problems are addressed.

Hitting Peak Growth

Although government policies, projections for future policies, and the state of the global economy, etc. had a significant impact on private investment and the very favorable climate around the world helped the rapid acceleration of economic expansion in India, the investment boom during this time was led by the private corporate sector. The rate of private enterprise investment jumped from 6% of GDP in 2003–04 to 14.3% of GDP in 2007–08, the year before the financial crisis. Although it decreased to 10.3% in 2008–09, this drop was countered by an increase in investment by the household, farm, and informal sectors (largely, investment in housing). Domestic total fixed investment grew from 24.5% of GDP in 2003–2004 to 32.3% in 2008–09.

In the first four years of the United Progressive Alliance (UPA), the political coalition that was created following the 2004 general election, which had been officially supported by the National Common Minimum Program, fiscal discipline was a significant accomplishment. The budget deficit of the central government decreased from 4.3% of GDP in 2003–2004 to reach a new low of 2.5% in 2007–2008. The combined deficit of the Center and the States decreased by 4.3% of GDP, making funds that were previously required to cover the fiscal deficits of the Central and State Governments available to support private investment. All of this occurred during a time when domestic savings were also healthy, rising from 29% of GDP in 2003–04 to 36.8% of GDP in 2007–08, the highest level ever, before declining to 32% but remaining high in the year of the financial crisis.

Another element enhancing investor confidence was a favorable perspective on FDI. The ceilings on foreign equity holdings increased from 49% to 74% in telecommunications sector, from 40% to 49% in civil aviation sector, and from 26% to 49% in insurance sector. Within a few months, the expansions in the telecommunications and civil aviation sectors were put into place, and they received substantial inflows. However, since it required passing legislation, raising the FDI cap for insurance to 49% posed a challenge. Political resistance had emerged in support of the essential legislative amendment, as a result of which enactment was deferred for ten years, for strictly political reasons; and the Bill was finally approved in 2015, permitting greater FDI in the insurance sector.

The Eleventh Five Year Plan

The eleventh five-year plan (11th FYP) spanning from 2007 to 2012 targeting an investment goal of $500 billion which was focused on infrastructure development, became India's blueprint for economic growth. Dr. Manmohan Singh, who was India's Prime Minister at the time, announced the plan in December 2007. The 11th FYP's primary goal was to create faster more inclusive and sustainable growth. Under this plan, the Services Sector achieved 9.7% growth: resulting in a change in the economy's sectoral composition over time. The service sector currently accounts for more than half of Indian GDP. This was a critical period in India's growth story as it helped lay the groundwork for the country's continued advancement in the years to come.

The Global Financial Crisis

When Lehman Brothers declared bankruptcy in mid-September 2008, triggering the global financial crisis, the issues with US mortgage-based financing had been boiling for some time. The financial markets were shaken, and no one could predict which bank would fail next. Interbank lending was frozen, and credit was tightened, bringing an end to the previously stable global economic climate. Since India had become considerably more integrated with the global economy; the transition was very concerning. Although the Indian capital account was not fully open, which prevented funds from leaving freely, it had received substantial amounts of portfolio capital that could theoretically leave. India also relied on external commercial borrowing, and in this case, new flows could suddenly cease while ongoing debt repayments had to be serviced.

The RBI was prompted by the Finance Ministry to declare that any bank under liquidity pressure would be given assistance. These circumstances had compelled the authorities to issue a public statement assuring depositors that their money was secure. Not only was the RBI able to prevent a bank run, but it also made the public aware that while globalization of the financial markets had many advantages, it also created risks and vulnerabilities. Markets had responded favourably to the apparent coordination with the RBI and the Government. While maintaining the RBI's independence, markets find it much more reassuring when all relevant government agencies are perceived to be working together at times of crisis.

Agricultural Reforms

It is frequently said that India's economic reforms have neglected agriculture in favour of an overly industrialized and trade-focused approach, highlighting the slow growth in the agriculture sector in the second half of 1990. However, changes to trade policy have benefited agriculture through shifts in relative pricing by boosting agricultural exports, mainly as a result of the removal of industry protections and the currency depreciation. In the decade from 1991 to 2001, the index of agricultural prices in comparison to manufactured goods increased by about 30%. In contrast to the ten years prior to the reforms, India's agricultural exports increased from 1.1 percent in 1990 to 1.9 percent in 1999, accounting for a larger percentage of global exports of the same commodities.

Although changes in trade policy have benefited agriculture, it has also suffered in other ways, most notably, from a fall in public investment in infrastructure needed for agricultural growth, such as irrigation and drainage, soil conservation and water management systems, and rural roads, since the 1980s. As private investment in agriculture increased after the reforms, it more than offset the loss in public investment in the sector. It is clear, however, that funding for infrastructure related to agriculture is essential for increasing productivity, and this investment is most likely to come from the public sector. In fact, if public investment in these crucial areas is not boosted, it might affect the rising trend in private investment in agricultural pursuits. The decline in state government finances and the potential for politically appealing but ineffective and even unfair subsidies to substitute more productive investments were the main causes of the decrease in public investment in rural infrastructure.

Another tool to promote agricultural growth has been increasing farmers' access to credit. Credit to agriculture doubled within the first two years and has continued to rise quickly since then because of public sector banks' encouragement to increase lending to the sector. Unfortunately, despite the increase in financing to farmers, the poor 2007 monsoon affected them badly; and the Indian government had to waive off the agricultural loans.

Reduction of Poverty

The approach for guaranteeing inclusivity comprised a push to aid the underprivileged through a variety of agriculture-based initiatives. Pro-poor measures garnered much more political attention than larger agricultural expansion as these were seen as directly benefiting the target group, as opposed to the indirect benefits of enhanced agricultural output. In addition to the seven flagship programs offered to promote diversity, a new initiative had been introduced to improve city infrastructure and improve service delivery. A portion of the funding was supplied by the Indian government, that was contingent upon several state- and local-level reforms. The percentage of the people living in poverty decreased every year between 1993-1994 and 2004-2005, by an average of 0.8%. Considering the population growth, the absolute number of the poor rose by 7 million over that time. It was determined that the percentage of persons living in poverty would be reduced over the time by 10% points, or 2% yearly.

Significantly higher GDP growth resulted in a construction boom which caused labour in agriculture to move to other industries, which raised the salaries in rural areas. The increase in the agricultural GDP growth rate from 2.5% between 1993–1994 and 2004–05 to 3.2% between 2004–05 and 2009–10 also helped increase income in rural areas. Between 2004–05 and 2011–12, the percentage of individuals living in poverty decreased from 37% to 22%. In absolute terms, the number of the poor declined from 407 million in 2004–05 to 269 million in 2011–12. Lifting 138 million people out of poverty was seen as a significant success for inclusivity on a global scale. However, many people were worried that if they went above the poverty line, they would lose eligibility for programs that aid the poor. To address this problem, the Food Security Act refrained from setting poverty line from its eligibility conditions; rather, everyone in the poorest "x" percent could obtain the entitlements.

Infrastructure Developments and PPPs

Rapid economic growth requires strong infrastructure, notably in the areas of electric power, connectivity via roads and trains, telecommunications, air transportation, and efficient ports. Although investment in infrastructure was a crucial part of its development plan, the government's resources for infrastructure development were restrained by competing demands from the health and education sectors, as well as by programs that benefited the poor. India was thus forced to implement a strategy that relied on private funding for infrastructure development, through Public-Private Partnership (PPP) models. The private sector had been encouraged to invest in infrastructure, including overseas investments since around the 1990s. Investments that were typically off-limits to the private sector,

including the production of energy and civil aviation, were opened up, enabling new businesses to emerge and operate on an equal footing with existing market players. The Indian government emphasized the importance of foreign investment, that received an enthusiastic response from business. The goal was to encourage private sector investment through efforts in nation-building. Since the government "has no business to be in business," it has been emphasized that its responsibility is to meet the needs of the poor, notably by providing them with food, shelter, and clean water, through PPP models. An important factor in India's success in the information technology sector is the fact that the telecommunications sector had to actively drop prices to keep a stranglehold on the market. Two other industries that benefited from these improvements are the ports and civil aviation sectors. High productivity criteria were included in several of the newest private sector-owned port facilities. The majority of India’s sizable road network is of poor quality, which presents a significant challenge for locations in the interior. The revenue from a tax imposed on gasoline in 1998 that was later expanded to diesel is utilized to develop state roads, national highways, and rural roads while a few toll roads and bridges in busy areas have been awarded development rights to the private sector. The implementation of public-private partnerships (PPPs) in infrastructure was fundamentally slowed by the absence of investors. According to data from the World Bank, India received the highest PPP investments between 2008 and 2012.

India's shift to rapid growth was possible due to the strategic policy decisions made by individuals who firmly believed that change was necessary. In a nation as complex as India, changing policies required much more than simple expressions of intention. Businesspeople and other stakeholders were allowed to criticize the government and call attention to what is not functioning in an open society. It required a group of technically competent experts who can comprehend economic concerns and provide the political class with straight forward counsel. Further, it required a political elite that is able to balance the unavoidable demands of adversarial politics with efforts to establish broad agreement on economic policy direction. Overall, growth resulted in a structural change in the economy; propagating further economic changes at an accelerated rate; which in turn, gave rise to new challenges that were dealt with immediately, resulting in rapid reform. With globalization expediting the spread of technical change, technology is developing even more rapidly, enabling policy changes to be implemented more quickly than in the past. These policy changes were viewed as viable strategies by the younger generation of Indians, who were less committed to outdated ideologies and more interested in implementing change in a transparent manner. For example, if privatization is done transparently, the younger generation is likely to be far less resistant than they were in the past.

Lessons to Sri Lanka from India

Sri Lanka, which suffered its worst economic crisis as a result of a set of circumstances that caused the foreign exchange reserves to be exhausted and was forced to severely to restrict outflows and restructure its debt to come out of this situation, has much to learn from how India tackled its economic crisis in 1991, which transformed the country to a global economic powerhouse. To prosper, an open economy requires macroeconomic stability, a credible monetary policy, fiscal sustainability, and prudent exchange rate management. The Central Bank of Sri Lanka, which oversees the financial sector, needs to be independent of political influence. In a highly connected and turbulent world, managing the exchange rate will also be challenging. Typically, political and social instability causes delays in decision-making, which paves the way for investors to lose faith in the market. Thus, to take corrective actions, a stable and effective government is essential. In the best interest of society and considering the urgency to achieve stability, all political agendas and propaganda must be set aside, atleast temporarily, to make decisions collectively at times of crises. The government must make urgent and possibly unpopular reforms under strong political direction to achieve fiscal sustainability.

The economy must be managed in a way that puts domestic producers as well as service providers, including those in the public sector, under competitive pressure to modernize their operations and maintain their competitiveness in the global market. Only if the economy is kept open to both foreign trade and FDI will this be possible. This has been the consistent thrust of the reforms pursued by successive governments, but Sri Lanka has not succeeded in this regard.

In the face of similar economic circumstances, India has overcome their issues through the implementation of difficult reforms that paved the way for it to become a major global economic powerhouse today. We could also emulate similar strategies and overcome the challenges brought about by this economic crisis and make every effort to restore paradise to this beautiful island. An important lesson for Sri Lanka from India's reform implementation process is the importance of constant messaging by policy makers to enhance public understanding of the issues and to need to have patience, because implementing reforms would be difficult and costly in the short term; but are bound to enable the public to reap the benefits over the medium to long run.

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