India’s 1991 liberalisation leap and lessons for today

What is the issue?

- It is three decades after India embarked upon the path of economic liberalisation in 1991.
- In this context, here is an assessment of the decision and the results of the reforms.

How were the pre-reforms years?

- The private sector was not allowed to invest in a number of sectors thought to be critical for development.
- Key sectors were reserved for the public sector despite its lacklustre performance.
- Where the private sector was allowed, it could invest only after getting an industrial licence.
- That was especially hard to get for “large” industrial houses.
- Over 860 items were reserved exclusively for small-scale producers.
- These included many items that had very high export potential.
- So, imports were more strictly controlled than in almost any other developing country.
- This was because it was felt necessary to conserve scarce foreign exchange.
- Consumer goods simply could not be imported, so domestic producers faced no import competition.
- Producers could import capital goods and intermediates needed for production.
- But this again required an import licence.
- This was given only if the government was satisfied that the import was essential and domestic substitutes were not available.
- Finally, the import of technology was controlled and Foreign Direct Investment (FDI) was discouraged.
- Clearly, it was not a system geared to encourage enterprise or innovation.
- Efforts were made in the 1980s to liberalise the system but these were incremental changes.
- By 1990, it was clear that drastic change was needed.

What have the 1991 reforms achieved?

- The reforms were aimed at unleashing the energies of the private sector to accelerate economic growth.
- This was to be done in a manner that ensured an adequate flow of benefits to the poor.
- The reforms certainly succeeded in this objective.
- The full benefits took time to materialise because a gradualist approach was adopted.
- But the results are dramatic if seen in a longer time frame.
- The GDP growth averaged 7% in the 25 years from 1992 to 2017.
- The preceding ten years had an average of 5% and the preceding 20 years, 4%.
- Importantly, as growth accelerated, poverty declined.

What are the shortcomings though?

- Some of the reforms begun in 1991, especially in the financial sector, are yet to be completed.
- Also, in the health and education sectors, what have been done is much below the potential and need.
- Environmental concerns have not been adequately built into the development strategy.
- India is still at the lower end of the middle-income group of countries.
- Many more reforms are needed to get to the top of the group.
- The need for labour market reforms was recognised.
- But attention was given first to get the industrial, trade and financial sector reforms, and take up labour market reforms later.
- **Employment** - There was a fall in employment in agriculture after 1991.
- But it was accompanied by sufficient growth in total employment in non-agriculture sectors.
- Also, total employment actually increased.
- The disappointing thing was that employment in manufacturing did not increase as rapidly as one would have liked.
- This was because Indian was not able to replicate the East Asian experience of rapid growth in the export of labour-intensive manufactures.
- Also, most of the increase in employment, including in manufacturing, was not regular contractual employment but informal non-contractual employment.

What about import tariffs?

- India progressively lowered import tariffs from an estimated 57.5% in 1992 to 8.9% in 2008.
- But this trend has been reversed over the past few years.

- This appears to be in line with rising protectionism globally.
- But increasing the import tariffs will hamper India's stated ambition to become part of global supply chains.
- Indian industry has legitimate complaints about poor infrastructure, poor logistics and time-consuming trade procedures, which reduce its competitiveness.
- But the solution lies in addressing these problems directly.
- Raising import duties, which will only raise costs in the economy, is not the right solution.
- The government should engage with Indian industry and other experts.
- Moving to an average duty rate of about 7%, gradually narrowing the range of variation across products and eliminating duty reversals would be the right approach.

What lies ahead?

- Geopolitics is forcing major countries to reduce dependence on China.
- India cannot expect to replace China.
- But, it can reasonably expect to become a major player in non-China-dominated supply chains.
- In this context, RCEP membership would help, as it will reassure partners that trade policy will not be arbitrarily changed.
- In the RCEP context, as far as unfair competition from China is concerned, the solution lies in a faster method of imposing anti-dumping duties on China, not raising import duties across the board.
- Also, working on agreements with important groups bilaterally than multilaterally seems to be a better option for assuring market access.
- The economy is clearly recovering from the contraction induced by the pandemic, but how quickly it will recover is uncertain.
- Once the pandemic is brought under control and 2019-20 level of production is back, the government should look at what caused the slowdown before the pandemic.
- A set of mutually supportive policies that will counter these forces and lead to higher growth and higher employment will be crucial.

Source: The Hindu