

INDIA'S ECONOMIC REFORMS

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Origins of Reforms

- Failures of pre-reform strategy of planned development through:
 - Industrialization based on import substitution across the board, emphasis on heavy industry
 - Dominant role for the state in the economy with extensive discretionary and intrusive controls, that is “Licence-Permit-Raj”
 - Anemic growth – average 3.5% per year during 1950-80 – the “Hindu rate of growth”
 - Extensive administrative and political corruption

Origins of Reforms (cont'd)

- Piecemeal reforms of the 1980s – some relaxation of industrial and import controls, exchange rate depreciation
- Fiscal profligacy
- Domestic and external borrowing at increasing cost: external debt tripled in the 1980s and debt to private creditors grew fivefold
- Crisis of 1991

Origin of Reforms (cont'd)

- Fiscal deficit grew to 9.4% of GDP in 1990-91 from a low of 5.9% in 1981-82
- External reserves hit a low of \$0.47 billion in June 1991, less than two weeks worth of imports
- External debt climbs to \$84 billion by the end of March 1991
- Debt service: 35.3% in 1990-91

Origin of Reforms (cont'd)

- At the end of March 1991, short-term debt at \$8.5 billion/reserves at \$5.8 billion: 146.5%
- Inflation reached a peak of 15% in August 1991
- Collapse of the Soviet empire
- Rapid growth of China since its external opening and market orientation after 1978

Contents of Reforms

- Fiscal consolidation
 - Tax reforms
 - Expenditure reform
- Industrial deregulation
 - Reduction in industries reserved for public sector
 - Abolition of industrial licensing
 - Reduction of tariffs
 - Removal of quantitative restrictions

Contents of Reforms (cont'd)

- Relaxation of restriction on capital inflows (portfolio, FDI and debt)
- “Market” determination of exchange rate after devaluation
- Reduction of short-term debt
- Repeal of FERA and enactment of FEMA
- Rupee convertible on current account

Financial Sector

- Considerable relaxation of financial repression
- Reductions in CRR and LRR
- Greater freedom for intermediaries to set interest rates
- Allowing private (domestic and foreign) entry into insurance unto certain limits

Financial Sector (cont'd)

- Relation of restraints on foreign banks
- New private banks allowed to enter
- Reduction in public equity in publicly owned banks
- CRARs set
- National stock exchange setup
- New financial products

Infrastructure

- Power: private sector (domestic and foreign) invited to invest in generation and distribution—“fast track”
- Unbundling of generation, transmission and distribution
- Setting up regulatory commissions at centre and state

Infrastructure (cont'd)

- Telecommunications
 - Significant privatization
 - Creation of TRAI
- Roads and ports
 - Entry of private sector
- Sectors no part of major reforms
 - Railways, agriculture, social sectors

Assessment of Reform Outcomes

- Successes
 - Telecommunication
 - Roads
 - Foreign debt management
- Partial success
 - Foreign trade and investment
 - Financial sector
 - Industrial sector

Assessment of Reform Outcomes (cont'd)

- Failures
 - Fiscal consolidation and reform
 - Power: with the passing of Electricity Bill in June 2003, the situation is expected to improve
 - Urban infrastructure
 - Social sector

GDP Per Capita (1990 International Dollars): 1700-1998

	1700	1820	1870	1913	1950	1973	1998
China	600	600	530	552	439	839	3117
India	550	533	533	673	619	853	1746

Source: Maddison, Angus. 2002. Growth and Interaction in the World Economy: The West and the Rest over the Past Millennium, *OECD Observer*.

Real GDP Growth

Period	1950-1980	1980-1990	1991-1992	1992-1997	1997-2002	2002-2003	2003-2004
Average Annual Growth Rate (%)							
Real GDP	3.50	5.9	1.3	7.1	5.5	4.0	8.1
Population	2.2	2.0	1.9	1.7	1.7	1.7	1.7
Real GDP per capita	1.3	3.9	-0.6	5.4	3.8	2.3	6.4

Fiscal Deficit and Public Debt (% of GDP)

	Centre	States	Consolidated	Net Public Debt
1990-91	6.6	3.3	9.4	63.8
1996-97	4.1	2.7	6.4	53.8
2002-03	5.9	4.7	10.1	77.6
2003-04	4.8	n/a	n/a	n/a

External Sector

	1948	1983	1993	2002
Share in World Merchandise Exports	2.2 (0.9)*	0.5 (1.2)*	0.6 (2.5)*	0.8 (5.2)*
Rank				30 (5)*
Share in World Commercial Services Export				1.5 (2.5)*
Rank				19 (10)*

*Figures in parentheses refer to China

Foreign Capital Inflows and Reserves (US\$ Million)

	1990- 1991	1997- 1998	2001- 2002	2002- 2003
FDI	97	3557	3904	4555
Portfolio	6	3312	2021	944
TOTAL	103	6133	5925	5499
Reserves	1000*	29367	75428	108000**
External Debt (Total)	83801	93531	98488	104551
Short Term	8544	5046	2745	4569
Debt Service (%)	35.3	17.8	14.1	

* August 1991

** End of February 2004

Savings and Investment Rates

	1990-1991	1995-1996	2001-2002	2002-2003
Gross Domestic Savings	23.1	25.1	23.5	24.2
Public	1.1	2.0	-2.8	-1.8
Household:	19.3	18.2	22.8	22.6
Financial	8.3	8.9	11.2	10.3
Physical	11.0	9.3	11.6	12.3
Corporate	2.7	4.5	3.5	3.4
TOTAL PRIVATE	22.0			
Gross Domestic Investment (Adjusted)	26.3	26.9	23.1	23.3
Public	10.4	7.6	6.0	5.8
Household	11.2	9.4	12.0	12.6
Corporate	4.6	9.9	5.1	4.9
TOTAL PRIVATE	15.8	19.3	18.1	17.5

Table 1. Comparison of Macroeconomic and Financial Indicators for India and Other Sovereigns, Moody's, 2003 1/
(In Percent)

Indicator	India (Ba1 Foreign Currency Ba2 Domestic Currency)	Similarly Rated Sovereigns (Developing Countries Rated Ba1 to Ba3)	Lower-Rated Sovereigns (Developing Countries Rated B1 to C)
General government financial balance/GDP	-11.6	-3.9	-4.5
General government revenues/GDP	19.8	21.9	26.0
General government debt/GDP	85.7	61.2	89.8
General government debt/ general government revenue	430.0	289.0	372.0
General government interest payment/general government revenue	34.0	20.0	21.0
General government currency and foreign currency-indexed debt/general government debt	7.8	63.5	72.2
Current account balance/GDP	0.4	-2.3	-3.3
External debt/GDP	20.7	50.6	76.6
External debt/current account receipts	120.7	130.4	219.4
M 2/foreign reserves	5.0	3.2	5.6
Debt service ratio (interest + current year repayment of principal/current account receipts)	18.0	18.3	27.8
External vulnerability indicator (short-term debt/foreign reserves)	54.6	61.8	134.2
Liquidity ratio (relative to BIS banks)	33.0	32.9	42.3
Dollarization vulnerability indicator (liability dollarization in banks)	10.1	44.4	91.4
Gross investment/GDP	24.0	20.4	19.7
Gross domestic savings/GDP	24.3	15.5	16.2
Openness of the economy (sum of exports and imports of goods and services/GDP)	31.7	75.9	68.2

Source: Moody's Statistical Handbook, Country Credit, October 2003.

1/ All 2003 figures are estimates, but very similar figures are obtained for most indicators based on actual 2002 figures.

Table 2. Balance Sheet Vulnerabilities in India and Crisis Countries
(In percent, unless otherwise indicated)

	Mexico/ 1994	Korea 1997	Thailand 1997	Indonesia 1997	Malaysia 1997	Russia 1997	Brazil 1998	Ecuador 1998	Pakistan 1998	Ukraine 1998	Turkey 2000	Argentina 2001	Uruguay 2001	Brazil 2002	India 2003
Stock Imbalances															
Liquidity/Rollover Risk															
Short-term foreign debt/reserves	203	777	493	175	94	255	126	181	189	327	246	184	320	142	55
M2/reserves		13.5	5.4	4.7	4.8	6.2	5.7	2	14.7	7.8	3.9	5	3.3	3.1	5
Country Solvency Risk															
External debt/GDP		33	72	58	44	35	31	68	68	29	60	52	81	41	21
External debt/exports		94	143	NA	51	140	369	267	347	66	203	380	365	300	121
Sovereign Solvency Risk															
Government debt/GDP	35	13	45	25	32	53	48	67	103	41	53	54	38	73	85
Government debt/revenue	155	65	249	262	137	148	143	486	646	113	203	282	191	211	430
Currency Mismatch Risk															
Net foreign currency external debt/GDP	Medium	Medium	Medium	Medium	Medium	Medium	Medium	High	Medium	Medium	Medium	High	High	Medium	Low
Foreign currency government debt/ total government debt	53	NA	13	100	14	60	NA	NA	52	68	50	90	83	25	8
Dollarization vulnerability indicator (Liability dollarization in banks)	NA	NA	5.7	68	5	56	0	High	168	64	96	215	132	0	10
Capital Structure Mismatch															
Equity-FDI/foreign liabilities FDI/GDP	Medium	Low	Medium	Medium	High	Low	High	Medium	Medium	Medium	Low	Low	Low	Medium	Medium
		-0.3	2.6	2.1	5.1	0.4	3.7	3.7	0.7	1.8	0.1	1.3	1.7	3.7	0.7
Flow Imbalances															
Current account deficit/GDP 2/	-7.1	-4.4	-7.9	-3.2	-4.4	0.5	-4.3	-8.6	-3.6	-3.1	-4.9	-1.7	-2.6	-1.7	0.4
Fiscal balance/GDP	-0.2	1.2	-2.7	-0.4	2.4	-7.6	-6.3	-4.1	-6.2	-2.7	-10.4	-3.3	-4.4	-5.2	-11.6
Primary balance/GDP 2/ 3/	2.1	0.6	2.6	2.9	4.7	-2.8	0	-1.3	0.5	-0.4	5.4	-1	-2.2	3.9	-4.3
General government interest payments/ general government revenue		NA	1	15	10	13	20	29	40	7	62	20	13	21	34
Other Relevant Issues															
Fixed exchange rates	Soft Peg	Soft Peg	Soft Peg	Soft Peg	Soft Peg	Peg	Peg	Managed & float	Heavily managed	Heavily managed	Quasi Currency B.	Currency Board	Peg	Managed Float	Managed Float
Currency overvaluation	High	Modest	High	Modest	Modest	High	High	Modest	Modest	Modest	Modest	High	High	No	Modest
Banking Sector Fragility															
Government debt/bank assets		<10	<10	<10	<10	31			30	14		21			35
Liquidity ratio relative to BIS banks		140	406	291	110	218	76	70	48	58	141	70	39	49	27.6
Overall banking system fragility	High	High	High	High	Medium	High	Medium	High	Medium	Medium	High	High	High	Medium	High
Political/electoral instability	High	Medium	Medium	High	Medium	High	Medium	High	High	Medium	High	High	Medium	High	Medium
Domestic financial repression	Low	Low	Low	Modest	Modest	Low	Low	Low	Significant	Significant	Low	Low	Low	Low	High
Capital account controls (Before the crisis)	Open regime	Open regime	Open regime	Open regime	Open regime	Open regime	Open regime	Open regime	Open regime	Capital controls	Capital controls	Open regime	Open regime	Open regime	Strict controls

Current Macroeconomic Scene: Some Disquieting Aspects

- Revival is feasible with concrete and timely action on:
 - Fiscal consolidation and deepening and extension of reforms
 - Further external opening including a firm commitment to open capital flows at a specified but not too distant future date
 - Physical and social infrastructure
 - Aggressive privatization