Unit 21
Liberalisation and Structural Adjustment Programme

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Learning Objectives

In the previous unit we have dealt with the various dimensions of globalisation. While dealing with the economic dimensions of glabalisation, we have highlighted the significance of the structural adjustment programme in the emerging economic order. In this unit we shall discuss the various aspects of this programme to enable you to:

- explain the terms liberalisation and structural adjustment;
- examine the crisis which have led to liberalisation ; and
- examine the implications for revenue and issues in external sector liberalisation.

21.1 Introduction

In the previous unit we have already learnt what is globalisation and the economic, social and cultural dimensions of globalisation. It was mentioned there that in India globalisation process received an increased impetus in the early 1990s with the adoption of New Economic Policy (NEP) and the Structural Adjustment Programme (SAP) at the behest of international financial institutions. This increased the intensity of liberalisation and privatisation of Indian economy. In this unit we will be discussing the policies of liberalisation and structural adjustment programme in relation to Indian context. We will be tracing the various conditions, which have prompted the adoption of structural adjustment policies and liberalisation. In the following sections we will also be talking about the various implications the liberalisation policies have for the economy and consequently for society.

The most significant change that has occurred in the Indian economy since 1991 concerns the relative roles of the markets and the state. Since the programme has run itself through more than a decade and the medium-term outcomes of these economic decisions are available to us now, it is possible to take a stock of what we have achieved and what the future is likely to be. The former would ofcourse determine the latter.

One method of evaluating the reform programme would be to "interrogate" the outcome and to examine the current status of economic indicators. What

economists are not in agreement about is the set of variables to judge the reform process. In this unit, however, we will restrict ourselves to examining the macroeconomics of the reform programme and look at some of the variables around which the debate on economic reforms has evolved.

21.2 Defining the Terms

Let us start by defining what we understand by "liberalisation". In common parlance liberalisation is the loosening up of controls, which the government exercises on economic forces. According to Ghosh (1998: 295), liberalisation means, "reducing government regulation of economic activity and the space for state intervention (except in the all-important matter of guaranteeing private property rights) and allowing for the unfettered operation of market forces in determining economic processes." This could mean an opening up of the economy to external flow of goods and services or the relaxation of domestic controls. It is theoretically possible to undertake liberalisation in only one of the areas – domestic or external – but in most instances, as in India, both domestic and external fronts are simultaneously opened up.

Structural adjustment, on the other hand, relates to changes which have sectoral implications – tax rates, deficit and debt ratios, levels of subsidy, intervention of the public sector in provision of goods and services, etc. "Structural adjustment policies may be defined as policy responses to external shocks, carried out with the objective of regaining the pre-shock growth path of the national economy. Regaining the growth path, in turn, will necessitate improvements in the balance of payments following the adverse effects of external shocks, since a country's balance-of-payments position constrains its economic growth. ... A broader definition will also include adjustments to internal shocks which may find their origin in inappropriate policies." (*Balassa 1982 cf Chandrashekhar undated*: 1). Does this mean the economy left to market forces or does the government regulate the functioning of the market? Does it directly intervene with public expenditure and taxes to ensure outcomes in a manner that a social planner would like to? What are the areas that government expenditure gives priority to? What is its approach to deficits and social sectors? Are the interest rate and exchange rate market determined or institution determined? The answers to these questions would broadly define the structure of the economy. Once again, theoretically it would be possible to have structural adjustment without liberalisation and vice versa.

In the Indian economy, however, we have seen both a programme of liberalisation – domestic and external – as well as structural adjustment in the period since 1991, which marks a defining break in the way our economy has been managed.

The devaluation of the rupee in July 1991 was a landmark in Indian economic development since such a drastic devaluation had been done only once before in 1966. The rupee was devalued by 18% in nominal terms and this meant a fall in the value of the rupee by 12.4% in real terms (Virmani 2001: 31).

Prior to 1991, the Indian economy had a fixed official exchange rate, and the Reserve Bank of India (RBI) maintained the foreign currencies at stable values. The disadvantage of a fixed official exchange rate is that it does not maintain parity in purchasing power of the currency in the international market. If the rate of inflation in India, for example, is higher than in the USA, this would reduce the purchasing power of the rupee vis-à-vis the dollar and therefore the amount one should pay to buy a dollar in rupees should go up. This did not happen under a fixed exchange rate regime.

Logically, there would be a profit involved in buying the dollar cheap from official sources and selling it in the grey market. The government would exercise control in this scenario by severe restrictions on foreign currency withdrawals. However, there was a very active grey market for foreign exchange, which reflected the true value of the rupee in the world market.

However, this was the culmination of a series of developments that originated long before the actual devaluation (Martinussen 2001). Let us look into the internal and external factors that lead to the genesis of this 1990-91 crisis.

21.3 Internal Political Crisis

In 1989, the general elections saw the defeat of Rajiv Gandhi-led Congress party and the installation of a coalition government led by former Congressman Mr V.P. Singh. However, the inner wrangling within the coalition government saw Mr V.P Singh lose majority support in Parliament and Mr. Chandra Shekhar became the Prime Minister with the help of the Congress, which had been his political adversary till then. His government collapsed by the end of 1990 and general elections were declared as no single party or leader could muster a majority in the House. In May 1991, the Congress became the largest parliamentary party in an election, which witnessed the assassination of Rajiv Gandhi during the election campaign. Narasimha Rao became the Prime Minister and it was his ministry that brought in significant changes in the policy framework of the Indian economy.

21.4 External Crisis

The political uncertainty within the country was matched by turbulence in the international arena of which two were of critical importance to the Indian economy. The first was the break-up of the Soviet Union into its constituent nationalities and sub-nationalities. The Soviet Union and its Eastern European neighbours had very strong trade links with India, which were on a rupee account, i.e., trade with the former USSR was not in hard currency like the dollar. This meant that trade between these countries and India did not require hard currencies and was mutually beneficial. The surplus of Indian exports to Eastern Europe partly financed the capital equipment and defence supplies India imported. By 1991-92 these arrangements had broken down imposing a further crunch on the limited hard currency available to India.

As if this was not enough, our woes on the external account were further compounded when Iraq decided to attack Kuwait in August 1990. India is largely dependent on crude oil imports from the Gulf to meet its domestic demand for petroleum products. In the five-month period between August 1990 and January 1991, crude oil prices rose by 65% and India's import bill on the oil account rose by a similar degree. The impact of this on India was double because its long-term oil import contracts with both Iraq and Kuwait became infructuous and India had to buy oil in the world spot oil market at substantially higher prices (Virmani 2001: 4).

Reflection and Action 21.1

Discuss the political and economical circumstances that compelled India to adopt economic structural programme planned out by international financial institutions.

21.5 Liberalisation and the Current Account Deficit

India had a persistent current account deficit since oil shocks (see box 21.1) in 1973 and 1979 but some believe that the situation worsened from the mid-1980s when the Rajiv Gandhi government relaxed import restrictions on many items. The trade deficit grew rapidly in the 1980s and it was felt by some commentators that the trade liberalisation initiated in the mid-80s needed to be reversed to check the growing current account deficit and to avoid a foreign exchange crisis (Ghosh 1991).

However, politico-economic developments in 1989-91 made the trade deficit unsustainable and the Indian currency was perceived to be grossly overvalued. Remittances by Indian workers abroad were major source of foreign exchange for the country. However, these remittances declined both due to the international disruptions that followed the Iraq war and uncertainties in India. In June 1991, the finance ministry was put on "red alert" as the supply of foreign exchange reserves with the Reserve Bank of India dwindled to barely $ 1 billion – enough to finance only 6 weeks of imports. The fiscal deficit, which measures the shortfall of the government's revenues vis-à-vis its expenditures, was at an all time high nearing 8% as a proportion of GDP. Inflation in the economy was in double digits (about 12%). India was also close to defaulting on its debt service commitments on earlier loans, which it had obtained in the '80s to finance a growing trade deficit.

Box 21.1: The 1973 and 1979 Oil Shocks

The first world oil shock began soon after Yom Kippur or Arab Israel War in 1973 when the Arab members of teh Organisation of Petroleum Exporting Countries (OPEC) announced that they would no longer ship petroleum to nations that had supported Israel that is to United States and its allies in Western Europe. At around the same time. OPEC-member states agreed to use their leverage over the world price-setting mechanism for oil to quadruple world oil prices. Real oil prices peaked well above $43 per barrel in 1974.

Almost exactly five years after the first oil shock, the second began. it came in teh aftermath of the Iranian Revolution. The upheaval in Iran has meant an interruption of oil supply and a loss to world production already as great as that from the 1973 embrago. With Iranian oil exports curtailed from late 1978 to the fall of 1979, the oil price nearly tripled— rising from $13 to $34 per barrel. This price disturbance hit a world economy that was only about three years into recovery from the first oil shock. The second oil shock hit a world that was trapped in a vicious inflationary spiral. Both these oil shocks were comparatively persistent taking 3-5 years until real price of fell back significantly affecting the economies of almost all nations around the globe.

In these circumstances, India was forced to approach the International Monetary Fund to help it tide over the external account problem (Acharya 2001, Pinto and Zahir 2004). The foreign exchange crisis, it is widely believed, paved the way for initiating the process of liberalisation and structural adjustment as part of the multilateral conditionalities on the loan sanctions (similar to the ones in Latin America and Africa). The domestic government justified the acceptance of these conditionalities citing the delicate forex reserves status.

Numerous changes in the Indian economy followed under the direction of the then Finance Minister, Dr Manmohan Singh. Industrial delicensing and trade liberalisation along with fiscal "consolidation" were the main focus areas of the reform process.

Questions that were debated at that time were: what should the sequencing of reforms be and which sector should take priority? With a bunch of domestic problems needing to be tackled urgently – rising inflation, fiscal deficit, trade deficit, and low forex reserves – many argued that liberalisation should be secondary to the needs of fiscal stabilisation.

What do we mean by stabilisation? When there is a shock to the economic system, economic activity can deviate from a historically established level – growth may slow down, unemployment may rise and despite deflationary pressures inflation may go up. This could develop into a vicious cycle feeding on each other and derail any growth prospects of the economy.

How does this work? Let us say there is an oil price rise because of a shock in the international market (like a war or natural calamity), and this leads to an increase in the price (cost) of production, which reduces demand. When demand falls, producers feel that in the next period too there will be further

decline in demand and therefore reduce their investment and also the number of people they hire. The reduction in number of people in the employed pool reduces consumption expenditures leading to a further fall in aggregate demand thereby creating a vicious cycle.

In such circumstances, the only way an economy can recover is by the intervention of an autonomous agency and pushes up the demand in the economy. Since no individual rational agent in the economy has any incentive to increase its demand, the state is the only autonomous agent that has an interest and a mandate to ensure the recovery of the economy and to break this vicious circle. If the intervention is large and sustained, it would stabilise the economy and many economists argue that stabilisation must precede the liberalisation programme. If liberalisation is undertaken, then it must be to meet the stabilisation targets of reducing inflation, a fiscal and trade deficit, and to increase foreign exchange reserves.

21.6 The Official Crisis Management Schema

In the aftermath of the 1991 oil shock that was followed by Kuwait invasion by Iraq were, the immediate tasks at hand – reduce inflation, cut fiscal and trade deficit, increase forex inflows and bring the economy out of depression, especially industrial recession. The view amongst the economic managers of Dr. Singh's team was that the high fiscal deficit was leading to an over-heating of the economy – it was increasing the aggregate demand in the economy, causing an increase in prices which was also spilling over to the external account and increasing the trade deficit. The increased fiscal deficit meant higher borrowing by the government to finance its expenditures. This raised interest rates in the economy, and "crowded out" private investment.

A reduction of the fiscal deficit, on the other hand, would have a positive impact – it would bring down the interest rate, reduce the interest burden, have deflationary pressures which would bring down prices and help close the trade gap. Since, one single variable (the fiscal deficit) was held responsible for all this, it is but obvious that the target of adjustment policy was the reduction of the fiscal deficit (Acharya 2001: 21).

The three commonly used measures are: Revenue deficit = Revenue expenditures – Revenue receipts; Fiscal deficit = Revenue deficit + Net capital disbursement; and Primary deficit = Fiscal deficit – Disinvestment receipts – Gross Interest payments. Prior to the economic reforms, the most common measure of the government's balance was the "budget deficit". However, this was found to be too narrow a measure of the government's overspend and therefore the fiscal deficit was adopted as the standard measure of the government's over-spend.

There are two related questions that come up here – this single-minded effort to reduce fiscal deficit, (a) is it justifiable and (b) has it yielded results?

The neo-liberal economic doctrine described above that was propagated by the World Bank and IMF linked all ills of the economy to the rise in fiscal deficit (see for example Acharya 2001 for the official position). However, Rakshit (1998) found that the empirical evidence in support of the structural adjustment programme was weak — rate of inflation and the export-import gap had little to do with the level of fiscal deficit calling into question the very justifiability of the structural adjustment programme. Ghosh (1998) felt what was required to stabilise the economy was not further trade liberalisation but agrarian change, since the bulk of the Indian population was dependent on this sector.

In the first two years of the reform programme, the Centre introduced severe budgetary cuts, which were directed at reducing subsidies, social sector

spending and capital expenditures. As a consequence of this, revenue deficit as well as the fiscal deficit declined briefly (see Table 1). But by the mid 90s, these returned to the pre-reform level. In fact, the revenue deficit persistently exceeded the 1990-91 figure by 1998-99. The share of the revenue deficit in the fiscal deficit grew from below 50% to 78%. This means that excess government spending was not for asset creation but for consumption purposes. From Table 1 as you can see, it seems that the fiscal deficit itself has been declining. And that should be reason to cheer.

Table 21.1: Trends in deficits of Central Government (All items as a proportion of GDP)

Year	Revenue Deficit	Primary Deficit	Fiscal Rev. Deficit	Deficit as a proportion of Fis. Deficit
1990-91	3.3	2.8	6.6	49.4
1991-92	2.5	0.7	4.7	52.7
1992-93	2.5	0.6	4.8	51.7
1993-94	3.8	2.2	6.4	59.2
1994-95	3.1	0.4	4.7	64.6
1995-96	2.5	0.0	4.2	59.2
1996-97	2.4	-0.2	4.1	58.2
1997-98	3.1	0.5	4.8	63.5
1998-99	3.8	0.7	5.1	74.8
1999-00	3.5	0.7	5.4	64.6
2000-01	4.1	0.9	5.7	71.7
2001-02	4.4	1.5	6.2	71.1
2002-03	4.4	0.5	5.3	82.2
2003-04(Prov.)*	3.6	0.1	4.6	78.0

Source: Economic Survey 2004-05. Table 2.1 and 2.2 pages 19-20 and previous issues

However, a closer look at the data tells another story. The Centre's deficits are only a part of the overall deficit of the Centre and states combined. Table 3 clearly shows that the revenue deficit has increased persistently and fiscal deficit has hovered around the pre-liberalisation figure. So, despite the fairly robust growth of the economy, and the wide-ranging fiscal changes that have been undertaken, we continue to have a government that invests too little and consumes too much. Further, the Centre very quietly is passing on its fiscal responsibilities to the states so while the Centre seems to be improving its fiscal performance, it is the states which have to suffer the fiscal burden of reform.

The major problem — large debts and deficits — pose for any government is the burden of servicing the debt. In fact, the central government has an interest liability amounting to more than 4.5% (as a proportion of GDP). This is a large drain on the government's limited revenues and squeezes expenditures on other heads.

Table 21.2: Combined deficits of the Centre and the states

Year	FD	RD
1980/81	7.5	0.4
1981/82	6.3	-0.6
1982/83	5.9	0.2
1983/84	7.3	1.1
1984/85	9.0	2.1
1985/86	8.0	1.9
1986/87	9.9	2.4
1987/88	9.2	2.9
1988/89	8.5	2.9
1989/90	8.9	3.2
1990/91	9.4	4.2
1991/92	7.0	3.4
1992/93	7.0	3.2
1993/94	8.3	4.3
1994/95	7.1	3.7
1995/96	6.5	3.2
1996/97	6.4	3.6
1997/98	7.3	4.1
1998/99	8.9	6.3
1999/2000	9.0	6.4
2000/2001	9.5	6.3
2001/2002	9.6	6.6
2002/2003	9.9	7.0
2003/2004 (P)	9.4	5.8

where FD = Fiscal Deficit, PD = Primary Deficit, RD = Revenue deficit

Source: Economic Survey, Various Years.

21.7 Revenue Issues

The government could however reduce its deficit by increasing revenues – by either increasing taxes or through higher profits of the public sector enterprises. As part of the reform package, in order to reduce its liabilities, the government decided to sell its non-profit making enterprises. Expectedly, there were no takers, because these were companies acquired by the government when the private sector was unable to run them. Since disinvestment was a stated policy of the government, it decided to sell the profit-making companies, thereby closing future sources of revenue. In 1999 the department of disinvestment was formed by the Indian government with a view to establishing a systematic policy approach to disinvestment and privatisation and to give fresh impetus to the govt's disinvestment programme.

Taxes form the major source of revenue for the government. In the initial phase of the structural adjustment programme, a series of reform measures were undertaken both on the direct and indirect tax front. The tax rates were reduced substantially with the hope that reduced tax rates would result in greater tax compliance. Further, attempts were made to increase the tax base by using non-income measures such as possession of mobile phones, luxary

cars etc. to determine tax liability because it is widely acknowledged that there is gross underreporting of incomes.

However, despite all these measures, there was a decline and stagnation of tax revenues (when measured as a proportion of GDP). The tax-GDP ratio has not been able to climb back to the pre-reform period, which has severely affected the fiscal position of the government (see Table 3). A part of the decline can be attributed to the reduced customs collections since the process of liberalisation entailed a reduction of import duties and taxes.

There is, however, one thing to cheer about here – the share of direct taxes has gone up from a lowly 19% at the beginning of the reform period to a respectable 41% in 2003-2004. It is important that the bulk of tax revenue be raised from direct taxes otherwise the tax system will be considered "regressive". Indirect taxes impose the same burden irrespective of the income earned by individuals, which is undesirable under the principles of "Ability to Pay". According to this principle, the tax burden must increase with income.

Table 21.3: Tax Revenues

Tax revenue as a percentage of gross tax revenue GDP			Tax revenue as a percentage of		
	Direct	Indirect	Direct	Indirect	Total
1990-91	19.1	78.4	1.9	7.9	10.1
2003-04 (Prov)	41.4	57.9	3.8	5.3	9.2

Having discussed the revenue options of the government to finance its expenditures, we now turn to issues of borrowing – debt and its sustainability. Herein we will examine the debt liability status of the centre and this would link up with the discussion on rising revenue and fiscal deficit. When the tax and non-tax revenues are insufficient to meet the expenditure requirements of the government, the deficit can then either be financed by increasing the currency in circulation (printing more money) or by borrowing — increasing debt. The first option can be fraught with one kind of danger – it could lead to inflation in the economy. Since one of the targets of reform was to keep inflation under check, monetisation of the deficit, at least not all of it, was not a valid option.

The next option was to increase market borrowing. Though there may not be a direct inflationary impact of this, the flip side is that there is an increase of debt liability, debt servicing obligations and also fiscal vulnerability of the government. Patnaik (1986) has, however, demonstrated that financing of deficit by directly selling in market as opposed to the process of borrowing from the central bank is not necessarily less (or more) inflationary when the credit market does not clear and there is an excess supply of credit that the banks are saddled with.

In India, the debt-GDP ratio has risen over the reform period but this has been mainly on the domestic front (see Table 4). The external debt (as a proportion of GDP) has actually declined to 1.7% in 2003-04 from 5.5% in 1990-91. While increase in debt is not desirable, the fact that most of it is domestic has one advantage – at least the debt servicing is in domestic currency. This means that foreign currency is not required for repayment of loans to international lenders and this reduces the external vulnerability of the Indian economy. However, a secular rise in the debt even if domestic is not desirable as it could leave the economy vulnerable to a fiscal crisis (*Rakshit 2004*, Pinto and Zahir 2004, Singh and Srinivasan 2004).

Table 21.4: Liabilities of the Centre (as a percentage of the GDP)

Year	Internal liabilities	External debt (outstanding)*	Total outstanding liabilities
1990-91	49.8	5.5	55.3
1999-00	49.7	3.0	52.7
2000-01	52.8	3.2	55.9
2001-02	56.7	3.1	59.9
2002-03	60.7	2.4	63.1
2003-04 (P)	60.9	1.7	62.6

Source: Economic Survey 2004-05 page 30

The other area of concern that had emerged during the crisis of 1990-91 was the management of the external account. Trade deficit, which had grown steadily over the 1980s and was financed by short-term borrowing in the international market, created a payment crisis at the time of the Kuwait-Iraq war, forcing India to seek an IMF loan. As part of the loan conditionalities, India was asked to liberalise its external sector (imports and exports) and make the current and capital account fully convertible. After the East Asian crisis, which many felt was exacerbated if not caused by an open capital account, India slowed its move to a fully convertible capital account.

21.8 External Sector

Liberalisation on the external account implies making the flow of goods in and out of the country easier. This can involve a reduction in procedures as well as tariffs or removal of quotas. Quotas on import of various commodities had earlier been introduced because the government wanted to offer domestic industry an assured market in which to establish itself.

The removal of quotas meant that goods could be imported in any amount on payment of appropriate tariff. In the reform period, there has been a substantial increase in exports, but the trade balance continued to be negative as imports grew faster than exports (see Table 5). However, the positive side to this is that an increase in net inflows of invisibles has moved the current account balance to be positive from 2001-02.

Table 21.5: Current Account Balance (as a percentage of the GDP)

Year	Exports (2)	Imports (3)	Trade Balance (4) = (2) - (3)	Net Inflows on "Invisibles" (5)	Current Account Balance (6) = (4) + (5)
1980-81	4.8	9.2	-4.4	3.2	-1.2
1985-86	4.4	8.1	-2.9	1.7	-1.2
1989-90	6.4	9.3	-2.9	0.6	-2.3
1990-91	5.8	8.8	-3.0	-0.1	-3.1
1998-99	8.3	11.5	3.2	2.2	-1.0
1999-00	8.4	12.4	-4.0	2.9	-1.0
2000-01	9.9	12.7	-2.7	2.2	-0.5
2001-02	9.4	11.8	-2.4	3.1	0.7
2002-03	10.6	12.7	-2.1	3.3	1.2
2003-04(P)	10.8	13.3	-2.5	4.3	1.8

Source: Economic Survey 2004-05 page 110

In recent years, the current account and capital account are both positive, which implies that the foreign exchange reserves have been rising rapidly. Table 6 shows that in the net inflow on the capital account of the last few years there has been substantial inflow of funds from Foreign Institutional Investors into the stock markets which has increased the foreign exchange reserves to "unsustainable" levels. There have been suggestions from some economists that the rising foreign exchange in the RBI's coffers should be used for financing imports for infrastructure. This is fraught with danger since it amounts to borrowing in the international market. The increase in reserves is due to short run stock market inflows, which could exit with ease at little notice, and the RBI would have to come up with the necessary hard currency. If India chooses to invest these reserves in infrastructure it would have two flaws: (a) it would be borrowing short to invest long which runs the risk of a liquidity crisis, (b) infrastructure is not a foreign exchange earning area, therefore these projects even in future would not generate the necessary foreign exchange for repayment (Patnaik 2004, Rakshit 2004).

Table 21.6: Capital Account Balance (in $ US million)

Year	Capital Account Balance
1990-91	8402
1997-98	9393
1998-99	7867
1999-00	10840
2000-01	8508
2001-02	8357
2002-03	10640
2003-04 (P)	20860

Source: Economic Survey 2004-05 page 109

Let us discuss the external sector reforms in a little more detail. The liberalisation of the external account involved not only an easier flow of goods but also a large devaluation of the currency and a simultaneous move from a system of fixed exchange rates to a "managed" float.

Devaluation, theoretically, is good news for exporters because their goods become relatively cheaper in the international market and imports become more expensive resulting in a decline in the demand for imports in the country. The trade balance should therefore improve. However, if the domestic industry is undergoing inflation and imports are liberalised, then it could have the opposite effect, especially if exports are elastic and imports are not. A commodity is said to have elastic demand if a small price fall brings about a proportionately larger change in quantity demanded. So if exports are elastic and imports are not, then the import bill will rise further after devaluation since we will import the same volume of goods. In an inflationary situation, even after devaluation, if exports are elastic, we will not see an equivalent rise in the volume of exports. Therefore, the trade balance could worsen even when devaluation occurs in the process of external sector liberalisation.

There have been more serious fears about the domestic consequences of import liberalisation – it could lead to de-industrialisation. Much of the discussion on de-industrialisation here borrows from Patnaik (2003). De-industrialisation here is defined as a situation where there is a decline in the work force of the industrial sector due to a decline in aggregate demand, which pushes people out of the work force (Patnaik 2003: 1).

This could happen on three counts. The first and most straightforward one is where imports exceed exports and the current account balance is negative. This implies that there is a decline in demand for domestic goods, which reduces employment. In the second instance, de-industrialisation could occur even in the presence of a trade balance of export surplus where the agricultural surplus instead of augmenting production or demand in the domestic economy is used to consume imported goods. This is the classic colonial drain situation where the colonial ruler would siphon off a part of the surplus to the metropolis without either generating adequate demand for non-agricultural goods or augmenting the productivity of the land. This killed the market for domestic non-agricultural goods, which led to de-industrialisation. In the third instance, which is representative of modern day globalised economies, assume that we have an open capital account with a flexible exchange rate. If for some reason there is an increase in capital inflow, then the rupee will become more valuable vis-à-vis the foreign currency. This would make the imported commodity less expensive as compared to the domestic good even in the home market. Consumers will switch from domestic goods to imported goods thereby reducing domestic production and employment.

In such circumstances, the state could autonomously act by increasing expenditure to counteract the de-industrialisation. But even that may be curtailed by multilateral agency pressures who believe in "prudent finance" policies to balance budgets even at the cost of rising unemployment in the economy. The exercise of trying to curb fiscal deficits in India therefore must be seen with care since it is now well accepted that the decade of the 1990s was a period of "jobless growth".

There are two possible ways of reducing the fiscal deficit – pruning expenditures or increasing tax and non-tax receipts. It is politically easier to cut expenditures where there are no lobby groups opposing this, unlike increase in taxes which is politically undesirable. For example, social sector and capital expenditure reductions attract the least direct opposition, as the immediate effect of the decline is not felt by the current generation. It is therefore no surprise that these are the two areas, which have seen substantial reductions in expenditures as a proportion of the total national income.

Public expenditure as a proportion of GDP has declined from about 30% at the beginning of the reform period to 27% at the end of the 90s (see Table 7). The share of capital expenditures as well as the share of development expenditures has also declined substantially over the decade of the 1990s. Capital expenditures impact on long term growth since these are in the nature of infrastructure investments. Social sector expenditures enhance human security by ensuring access of the citizen to affordable healthcare and education. Reduced expenditures in both these areas therefore have long-term impacts on accumulation of physical assets as well as the growth of human capital in the economy (Balakrishnan 1996).

Table 21.7: Combined (Centre+States) Public Expenditure as PerCent of GDP and Capital Expenditure as PerCent of Public Expenditure

Year	Public Expenditure	Capital Expenditure Expenditure as a proportion of Total Public Expenditure (Revenue + Capital)	Development Expenditure as a proportion of Total Public Expenditure
1987-88	30.6	22.7	56.8
1988-89	29.3	21.3	55.9
1989-90	30.3	21.1	56.4
1990-91	29.1	19.5	54.3
1991-92	28.8	20.9	53.6

1992-93	28.1	18.6	50.8
1993-94	28.2	17.6	49.5
1994-95	25.6	15.4	50.0
1995-96	24.7	14.7	47.5
1996-97	23.8	11.8	48.4
1997-98	24.5	12.9	47.8
1998-99	25.4	13.3	46.3
1999-00 (R)	27.3	12.2	46.7

Notes: RE= revenue expenditure;

Source: Computed from the data available in Indian Public Finance Statistics, Ministry of Finance, GoI,various issues as reproduced in Dev & Mooij (2002: 854).

Let us now turn attention briefly to the social sector. The social sector includes Education, Health (and Family Welfare) and Rural Development. One of the core arguments of neo-liberal ideology is that intervention by the state should be restricted to social development and defence, which are its fundamental duty, and economic activity should be left with the private sector. Going by this logic, we should expect that irrespective of allocation changes in other sectors, in the social sector there should have been an increase. However, in the 1990s, there was lower social sector spending by the Centre as well as the states combined as a proportion of GDP even though there seems to be an increase in per capita expenditures in the social sector (Dev and Mooij 2002). What this implies is that the increase in social sector spending has not matched the increase in GDP in the reform period.

Table 21.8 : Social Sector (Social Services + Rural Development) Expenditure by Centre and States as a proportion of GDP

Year	Social Sector Exp (Revenue +Capital)	Social Sector Exp (Revenue)	Per capita expenditure at 1993-94 prices
1987-88	7.74	7.23	562
1988-89	7.40	6.95	583
1989-90	7.64	7.23	633
1990-91	6.78	6.43	623
1991-92	6.58	6.21	599
1992-93	6.39	6.06	594
1993-94	6.46	6.16	623
1994-95	6.41	6.06	633
1995-96	6.40	6.10	675
1996-97	6.48	6.15	739
1997-98	6.60	6.29	789
1998-99	6.94	6.60	890
1999-00(R)	7.55	7.11	1027

Note: R: revised estimates

Source: Estimate based on data from Indian Public Finance Statistics, GoI, 1995 and 2000-01 as presented in Dev & Mooij (2002: 856).

21.9 Economic Reforms — An Appraisal

Finally, we need to understand the impact of the reform process with respect to two not unrelated measures – the rate of growth of incomes and its distribution. The first is fairly easy to establish since we have data for per capita incomes as well as aggregate national income published annually by various government sources. It is true that the rate of growth in the Indian

economy during reform period has been much higher on the average than in any other phase in the post-Independence era. So, on that count, economic reforms have something to celebrate about. It remains a moot question whether the economy would have done better (grown faster) if the earlier policies were pursued, and this is more difficult to establish. As Table 9 indicates, the GDP growth rate and the per capita growth rate have been higher in the reform period.

Table 21.9: Rate of growth of the GDP and per capita incomes

Period	1970-71 to 1979-80	1980-81 to 1989-90	1992-93 to 2000-01	1992-93 to 1996-97	1997-98 to 2000-01
GDP	2.95	5.81	6.1	6.68	5.35
Per Capita	0.73	3.67	4.17	4.75	3.42

Sources: RBI, Report on Currency & Finance, 2000-01; RBI Handbook, 2001;Economic Survey, 2001-02 as quoted in Rakhsit (undated)

On the second issue regarding distribution, there is wide divergence between the official estimates (and its adherents) and the dissenters. The official estimates suggest that poverty has declined to 27%, (some even went to the extent of arguing that this was an overestimate) (Sundaram and Tendulkar (2003), Deaton and Dreze (2002)). However, Sen and Himnagshu (2004) debunk these findings and suggest that during the 90s, the claim of poverty decline by earlier studies is not tenable due to miscalculations. They conclude that not only has poverty not declined but inequality in all dimensions has increased sharply during in the 1990s which makes this decade unique – it was the first decade in post-Independence India when inequality increased (see unit 20). However, all these measures of poverty use an indirect way to measure poverty — an income measure of the poverty line which is actually meant to be linked to an energy requirement measure — 2400 and 2100 calories for rural and urban areas per adult person.

U. Patnaik (2004), using calorie-based estimates to measure poverty finds the picture to be even more alarming. In the course of the last five years (1998 to 2003), the level of per capita foodgrains absorption has been lower than seen in the last 50 years. Between the early 1990s and 2003 the annual absorption of foodgrains per head has come down from 177 kg to 155 kg. The decline has accelerated in the second half of this period and 80% of the decline has been in the five-year period 1998-2003 and has been concentrated largely in the rural areas. Using the National Sample Survey data for calorie intake, she finds that in 1999-2000, seven-tenths of the rural population was below the norm of 2400 calories per day (the norm originally adopted in all poverty studies), and about two-fifths of the urban population was below the lower urban norm of 2100 calories.

To conclude, the period of the reforms has been one where numerous changes have occurred structurally. The role of the market is much greater than it ever was in independent India. The rate of growth has been higher in this period. But its distribution has been unequal which raises questions on the justifiability of the reform process especially when actual deprivation seems to be on the rise due to the process of global integration.

21.10 Conclusion

We have discussed in detail two of the important economic aspects of globalisation; liberalisation and structural adjustment programme with special reference to India. Liberalisation, as we have seen, is loosening up of controls, which the government exercises on economic forces that lead to opening up of the economy to external flow of goods and services or the relaxation of domestic controls. And the structural adjustment means a series of policy

shifts by the national government with regard to the economic, political and social affairs.

The unit delineates on the national and international politico-social circumstances, which lead to the adoption of the national policies that drastically increased the pace of globalisation and liberalisation in India. The unit also explores various economic parameters for accessing the economic growth in India especially since the adoption of the economic reform policies. Attempt is also made to analyse the implications of this reform policies in the social and other sectors in the society. When we make an appraisal of the impact of the reform policies in the economic and social fronts it is obvious that though the growth in the economic front is phenomenal, the question of whether it has been transformed into the social sector remains doubtful.

21.12 Further Reading

Ghosh, J. 1998. "Liberalization Debates". In T.J Byres (ed.) *The Indian Economy: Major Debates Since Independence*. Oxford University Press: New Delhi

Nayyar, D. 1996. *Economic Liberalisation in India: Analytics, Experience and Lessons*. Orient Longman: Hyderabad