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Economic Growth in India: Pre and Post Liberalization Era

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Abstract: Economic history of India can be divided into two periods, 1950 to 1980 the era of government intervention and liberalization period after 1990. In the wake of severe balance of payments crisis, India adopted structural adjustment program in 1990. During 1950 to 1980, Indian economy grew at a slow pace. One of the major arguments behind reform program is to improve growth performance of Indian economy. Present paper is an attempt to analyze growth performance of Indian economy during pre and post liberalization periods.
Keywords: Liberalization, economic planning, growth

Introduction

India is fastest growing economy with growing young population and largest democracy in the world. India is moving ahead with a very faster rate on path of growth and development. Many economists argue that improved performance of India is a result of liberalization program adopted by India in early 1990s. After pursuing an inward –looking development strategy with the state assuming an important role for more than four decades, India decided to change its policy stance from restrictive and planned economy towards a more open and liberalized economy. These reforms were necessary because India have evidently failed to generate adequate rates of growth of income and per capita. India's weak performance leaves it behind many countries. There was a major turning shift in economic history of India in 1990-1991 when after facing a severe BOP crisis India adopted structural adjustment program. This paper analyzes the performance of Indian economy since independence in economic growth context. In seeking to establish turning points in the performance of the economy or structural breaks in the pace of economic growth, we focus on period since 1950-1990 and 1990 to present. So the main objective of the paper is to find the impact of liberalization program on economic growth in India. Why do we expect economic liberalization to produce growth? First, import liberalization provides domestic firms access to capital equipment embodied with new technologies, better intermediate inputs and expands their choice set to act. A freedom to invest and enter the market increases the extent of competition and puts pressure on the incumbents to upgrade their technologies often through imported machinery. With the entry of new firms in a more competitive market, the process of creative destruction goes to work. Efficient firms drive out inefficient firms, factors gets reallocated to more productive use increasing the overall productivity of factors in the economy. Due to technology transfer, productivity in industry and service sectors grows rapidly attracting labor from agriculture. The re-allocation of labor from agriculture to more productive sectors contributes further to growth. This process also makes the workers left behind in agriculture better off because the real wage rises as labor markets tighten in agriculture[1]. In the present paper we will analyze the impact of economic liberalization on economic growth in India.

Economic Trends in India

During the period from 1950-51 to 1979-80, growth in GDP was 3.5 per cent per annum while growth of GDP per capita was 1.4 percent per annum. However growth rate is 6 percent during 1990-2012. It is clear from following table that there was sharp acceleration in economic growth since 1980. This growth was impressive not only in comparison with the past in India but also in comparison with the performance of most developing countries in the world. Indeed in terms of growth India performed better than the industrialized countries which experience a slowdown in growth. And it was only East Asia which performed better [2].

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Table 1: Average annual growth rates (%) in pre-liberalization period

Year	1950s	1960s	1970s	1980s
Real GDP Growth	3.6	4.0	2.9	5.6
Agriculture and Allied	2.7	2.5	1.3	4.4
Industry	5.8	6.2	4.4	6.4
Services	4.2	5.2	4.0	6.3
Nominal GDCF/GDP	10.8	14.3	17.3	20.8
GDS/GDP	9.6	12.3	17.2	19.0

Source: Economic Survey

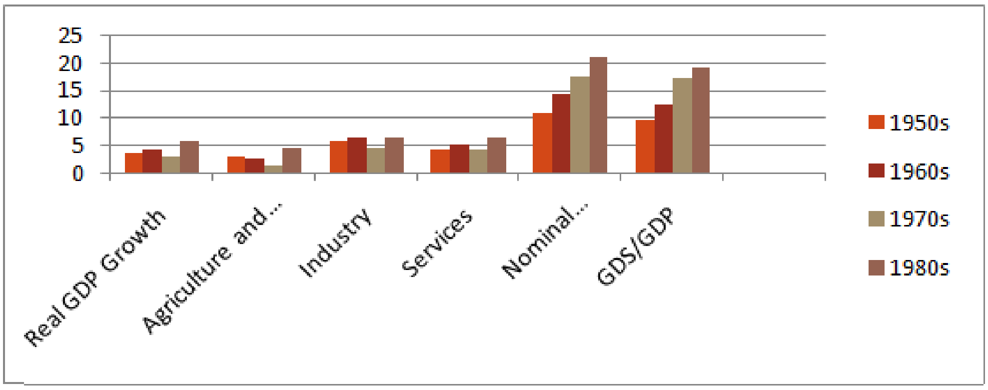

Fig. 1: Average annual growth rates in pre-liberalization period

Table 2: Average annual growth rates (%) in post-liberalization period 1990-2012

Year	1991- 1997	1997- 2003	2003-2007	2007-12
Real GDP Growth	5.7	5.2	8.7	8.0
Agriculture and Allied	3.7	0.9	4.9	3.6
Industry	7.0	4.1	8.3	7.56
Services	7.5	3.9	9.1	NA
Nominal GDCF/GDP	23.9	24.5	33.0	31.8
GDS/GDP	22.7	24.1	32.7	33.4

Source: Economic Survey

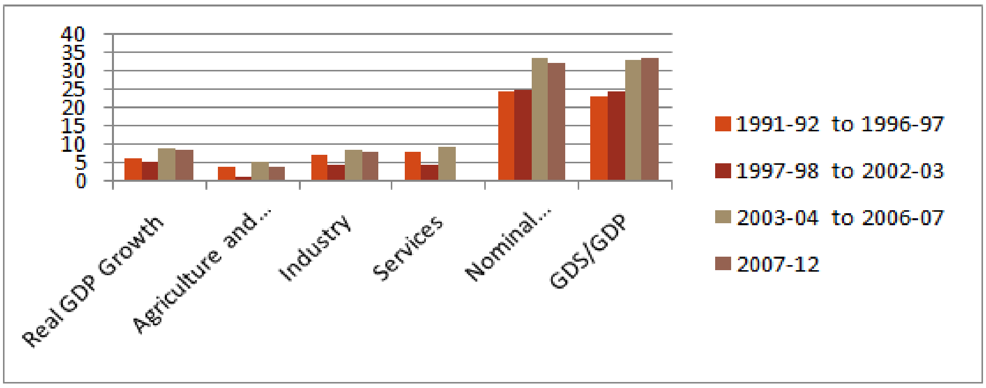

Fig. 2: Average annual growth rates in post-liberalization period

Economic Policies in India Pre-Liberalization period

In the pre liberalization period India adopted an import-substitution policy, more reliance on heavy industry, main role of public sector and greater government intervention in each sector. In second plan India have adopted Mahalanobis strategy under which greater attention was paid to industrialization of India. Due to which agriculture sector was not able to cope up with the food need of rapidly rising population. After that improved techniques were adopted in agriculture sector and agriculture production rise at a fast rate. But other problems poverty, unemployment were become

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worse in this period. Export is not considered as a tool of development rather as a compulsory evil to keep up with the need of capital good and technical products of Indian industry. However during this period India was able to create its own industrial base and self sustainability of food production. But the byproducts of this system were inefficiency, red-tapism, corruption, slow growth, high poverty ratio in India [3].

Post liberalization period

In India the cost of government intervention was increased to a greater extent and in the rapidly globalizing world it became difficult to be remain a closed economy. So India started partial liberalization in 1980s. There was wide spread agitation of liberalization by various groups within the economy. Thus half hearted reforms resulted in balance of payment crisis in 1991. After that India have to adopt structural adjustment program, a fully fledged economic reform program based on World Bank-IMF philosophy. Under structure Adjustment program India adopted following policy [4].

- **Structural Reforms**
  - Privatization
  - Liberalization
  - Globalization
- **Macroeconomic Stabilization**
  - Control Inflation Rate
  - Control of Fiscal deficit
  - Control of Balance of Payment Deficit

Major Economic reforms in India [5]

- Some domestic industrial liberalization during the 1980s.
- More comprehensive and systematic liberalization since 1991.
- Complete removal of QRs on imports of capital goods and intermediates in 1992. Removal of QRs in consumer goods in early 2000s.
- Lowering the custom duties from 100 percent in 1986 to 14.1 by 2009.
- Complete removal of the industrial licensing system (except for a small list of industries on strategic and environmental considerations)
- Elimination of controls on investment and expansion by large industrial houses.
- Opening up of manufacturing industries for FDI.
- Significant disinvestment of government holdings in the equity share capital of PSEs.

Role of Economic Planning in Economic Growth

The launching of the first five year plan in April 1951 initiated a process of development aimed not merely at raising the standards of living of people but also opening out to them new opportunities. Since then 11 five year plans have been completed. Each plan has its own successes and failures. Initial plans are heavy industry based and promoted controlled economy. These plans built basic industrial structure of India but failed on efficiency front. After 1980s planning has become more indicative in nature and to create a supportive environment for private sector. Presently 12^{th} five year plan (2012-17) is targeted towards a faster inclusive and sustained growth. Following table shows the growth rate of gross national income and per capita income.

Table 3: Growth rate of Real GNP and Real per capita income during Plans

	Real GNP Growth Rate	Real per capita income Growth Rate
First Plan	3.7	2.4
Second Plan	4.2	2.2
Third Plan	2.8	0.3
Fourth	3.4	0.9
Fifth	4.9	2.6
Sixth	5.4	3.1
Seventh	5.6	3.3
Eighth	6.6	4.6
Ninth	5.7	3.5
Tenth	7.6	5.9
Eleventh	8.0	6.3

Source: Economic Survey

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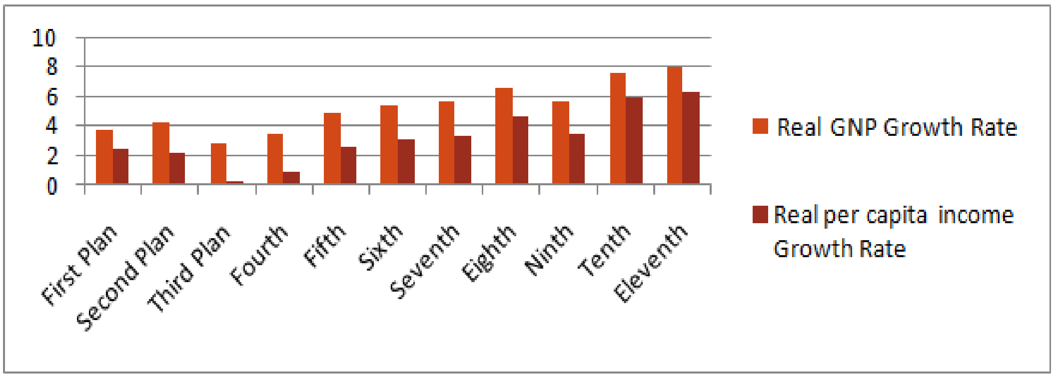

Fig. 3: Growth rate of Real GNP and Real per capita income during Plans

METHODOLOGY

Following regression equation we will use in regression:

$GR=B_0+B_1D+u$

GR= Growth rate of real GNP

D is dummy variable for Economic liberalization

D=0 for pre –liberalization period (1950-1990)

D=1 for post liberalization period (1991-2012)

Hypothesis

Null Hypothesis (H_0) =There is no significant relation between economic liberalization and economic growth.

Alternative Hypothesis ($H_{1)}$ = There is a significant relation between economic liberalization and economic growth.

Table 4: Results of Empirical Analysis

Coefficients	
B_0	3.856 * (7.576)
B_1	2.789* (3.290)
R^2	.155
Adjusted R^2	.141

Significant at 5 percent level of significance

Here T-test value is significant at 5 % level. So here we reject the null hypothesis and accept alternative hypothesis that there is a significant relationship between economic liberalization and economic growth. During the reform period growth quantum increased by 2.7 percent.

Casual Factors

There is an emerging literature on the subject which seeks to analyze this rapid economic growth in India which has been sustained for 25 years. According to Deepak Nayyar a convincing explanation must recognize that the acceleration in economic growth since 1980 was attributable to several factors [2].

- Increase in investment GDP ratio which has continuously increasing at a faster rate since 1970s. Higher level of investment aided by higher efficiency has increased the confidence in increasing growth.
- Trade liberalization beginning in the late 1970s, also probably contributed to productivity increase and economic growth. In particular liberalization of the regime for the import of capital goods and broad –banding which reduced industrial licensing could have played a contributory role.
- FDI helped in fostering economic growth in India due to its strong private sector and entrepreneurial base .India can gain more from FDI if it flows into capital and knowledge intensive sectors and foreign enterprises get vertically integrated with domestic labour intensive enterprises.
- Finally the most important these outcomes are also cumulative impact of economic policies or public actions over the preceding 30 years possibly played an important role in this turnaround. Institutional capacities were created .The social institutions and the legal frameworks for a market economy were put in place. A system of higher education was developed. Entrepreneurial talent and managerial capabilities were fostered. Science and technology was accorded a priority. The capital goods sector was established. Much of this did not exist in colonial India. But it was in place by 1980 and probably provided the essential foundation.

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CONCLUSION

Both pre-liberalization and post liberalization policies played important role in economic development of India. The policy of import-substitution and reliance on heavy industry create strong industrial base for India. However India achieved a very slow rate of growth during this period which Raj Krishna called 'Hindu-Rate of Growth'. The insulation from world economy created problems for Indian economy as backward technology, lower quality, and lack of competition. The less exposure to rest of the world and high imports of capital goods create balance of payments problem in India. The deteriorating problems of Indian economy compel India to adopt liberalization program. It is clear from empirical analysis that the impact of liberalization on economic growth of India is significant. There is a wider difference between economic performance of India during pre-liberalization and post liberalization era. There are various factors responsible for improved economic growth in post liberalization era in India as trade liberalization, foreign direct investment in dynamic factors of the economy and increasing investment GDP ratio in India. But most important can be the cumulative result of government policies in pre liberalization era.

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