Path to Prosperity: Economic Reforms in India

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Abstract: Economic model of India had not changed after the country established its Independence. Even though economic reform that started in 1991 had not changed that model either. The GDP decreased in 2019, the level of poverty is high, and India became semi-agrarian country. Current government of Narendra Modi has been making reforms but the results are less successive for the last months of 2019 and those rates are decelerating. Economic history of China and other “Eastern tigers” shows how these countries achieved industrial growth during short period of time. What it means that the economic policy should be changed in the first place, and only then the GDP per capita will grow. Consequently, India will finally become a post-industrial society.

Keywords: India, politics, economic model, economic reform, state capitalism, economic growth, poverty level, GDP’s indications, FDI.

1. Introduction

Economic policy of India regardless of the ruling political party has not changed in its basic form. This has been decelerating the growth of industry and economy in general. Economic reforms initiated by the government of India since 1991 has not given desirable results. The GDP growth of India during the post-reform years was not very commendable. In ideal situations, if one choose a proper economic policy then the growth of GDP per capita will be expected to be higher. The higher poverty level is one of the major problem for Indian government that could not find a final solution till today. India has to change its economic policy in order to get desirable changes in industry and agrarian sectors. Till 1991 India pursued economic policy of self-sufficiency and wanted to free herself from foreign capital. This was also followed to minimize the size of private property and market economy. However, that economic policy did not free India from dependency because the government did not use objective economic laws for its benefits. When the Soviet Union with socialistic system collapsed in 1991, the soviet model of economic system became a deadlock for many countries in the world which followed this pattern. This economic policy which was declared in 1991 by Indian government did not provide any significant economic growth to the country. The condition has been deteriorated till today, and one could say that India is still under pressure of the previous legacy. The current government has been doing on-going economic reforms which are not impressive, and the last months of 2019 showed decelerated rates of growth. This outcome leads to conclusion that changing political parties are unable to overcome major issues such as poverty. There is a big percentage of Indian population that are below the poverty line even today. That is why an economic policy of Indian government should be reformed in order to develop industry and agrarian sector. For that purpose, a new economic model should be introduced. Economic history of China and other “Eastern tigers” is a clear example how these countries in relatively short period of time could overcome economic difficulties and achieve industrial growth. There are signs of economic model in India but prominent politicians declared that there is confuse in defining economic pattern of growth. We do not need just define current economic model where government is making unsuccessful effort. All we need is to give some recommendation about possibilities to achieve higher level of growth and overcome poverty in India.

2. Economic legacy and development of India

One of the famous politician and economist of India Gopal Krishna Agarwal, a member of Bharatiya Janata Party (BJP), which is the party of prime minister of India Narendra Modi, in his article wrote that “There is considerable confusion in the minds of people and policymakers regarding the economic model that the country needs to follow” [14]. Let’s disagree with this person and try to analyse what is going on in India. Starting from Independence Jawaharlal Nehru’s stands were dominated on economic reforms and he was a follower of soviet economic model. During the initial period of Independence, Indian National Congress ruled the government, and communists had an immense influence on economic policy. There was an inspiration to create a just society and they thought that state property is a key ingredient for economic development of India. Due to these ideas state property should be dominated in the most areas of Indian economy such as industry, banking, railroad, construction, service and trade.

After 1991 when India faced financial difficulties with payments of its foreign debts, India was forced to initiate economic reforms and open its market for international capital. Till 1991 India pursued economic policy of self-sufficiency and wanted to free herself from foreign capital. Policy of self-sufficiency was proposed to minimize the size of private property and market economy but such economic policy did not free India from market economy. After 1991 when economic reform was launched, and Soviet socialist system had collapsed, this system became a deadlock for many countries in the world which followed this pattern. “Nonalignment” left itself with the capitalism. India turned to East Asian states also knowns as “Tigers”, and, encouraged by their achievements, tried to mimic their success. They did not leave any sign of socialism of Soviet model while China converted their policy into capitalism diluting with socialistic features. In short, China and India withdrew from socialism.

There is position when one wants to define socialism; he usually refers to the state property as key element of economic basis. Nevertheless, Lenin has also wrote, that...
If state became the owner of property that will be the state-capitalism. He defined state-capitalism as socialism. There must be private and collective property along with a state property in the state-capitalistic model. Therefore, the economic model of India was capitalistic starting from Independence like in China and Soviet Union, and implementation of market economy and action due to the objective economic law will be a factor of economic growth. The law of economy demands that if any company did not obtain profit, then it will bankrupt. State property is not free from this law as well. It is necessary for state company to be profitable as private companies, but Gopal Agarwal mistakenly writes: "The basic purpose of PSEs cannot be making profits for their owners (government)" [14]. Here we can conclude that even a member of BJP is under the influence of Stalinist's communism. The task of state property as well as private is to make profit. If it did not make any profit it cannot define economic growth and provide country with capital and investments. In India as well as in Soviet Union such approach to economic model had hindered the economic development, especially industry, and, finally, it was overhauled by international companies.

Economic model which was used in India and Soviet Union is named "import substitute" [1]. This economic model has several properties.

First - The important factor is a strong currency rate - local currency superficially is kept overvalued. In India Reserve Bank always tries to follow this policy by justifying that this policy lower the inflation. Strong currency rate is relevant to monetarist's economic doctrine. This economic doctrine worked only once in economic history of Europe in beginning of 70s of XX century, when stagflation hit its economy. After that no developed country followed this doctrine because overvalued local currency will bring to price surge of commodities in local market. Marx had some reasoning about such issues in his letter to Engels from April 22, 1867. He brought an argument that if currency rate increases then outcome will be a fall of profits, and this policy will lead to bankruptcy of local industries. In order to protect local industry from bankruptcy government will protect the local market with constrains against foreign companies. By this way government creates a greenhouse for domestic industry where no foreign companies disturb them. As a result, the growth will be decelerated. After economic reform in 1991 Indian government adopted the policy of disinvestment for those state companies which were less profitable or bankrupt.

Second sign of this economic model is prevalence of import over export. Country mostly exports raw material, products of agrarian sector, and goods of light economy in order to import technology and equipment for domestic industry. India also followed such economic policy due to the policy of self-sufficiency and industrialization. Today India urgently needs industrialization. In order to receive foreign currency for industrialization government imposed its monopoly or established several big companies under its control for export and import of the commodities. Starting from 60s till 80s India succeeded in green revolution and developed export of agrarian goods.

Looking strictly to local market it is noticeable such subtle order where poor relationship between agrarian sector and industry is indicated. Because of the greenhouse condition prices of local industry will increase in compare with agrarian products. The prices of agrarian products will be low, and, these conditions will cause difficulties for Indian government to obtain foreign currency in order to serve its foreign debts. Then India faced a cliff of the default.

Third signs of this model relate to development of service sector in economy. Because of profitability of the service sector it attracts more capital inflows in comparison with other sectors. No profitability of agrarian and industrial sector of economy causes unavailability for overpopulated Indian society to find job in these sectors. The service sector has been growing immensely after economic reform and digested many residents of India. What was a reason that service sector developed very fast in compare with other sectors of economy? The only reasonable explanation for this case will be a profitability of this sector and the turnover of capital is fast. GDP of India in such condition that during 2000-2018 the share of the industry and agrarian sectors were low but the share of the service sector had been growing. For instance, in 2018’s GDP the share of the agrarian, industrial, and service sectors were 18.1%, 28.2% and 52.8%, respectively [2], [4]. Those numbers clearly show that the industry and agrarian sector cannot compete with their counterparts from abroad in domestic and international markets, and became bankrupt. It is not in vain that in Indian market is overwhelmingly saturated with goods produced in China.

Forth sign of the economic model in India, which caused a declemation of the share of industry and agrarian sector is taxation. This economic model implies an increase of percentage of taxes because of the bankruptcy of the most public sector enterprises, and government needs to hang a tax burden on the profitable industries or service sector. The tax rate in India which entrepreneurs should pay for is 52.1% [11], and this condition will bring to the rise of price of goods. Indian specialists offer such calculations: average income tax (20%), entrepreneurship tax (32.44%) and indirect tax in general (16%), and, if conclude, all taxes together will be 68.44% [14]. Because of the high rate of taxation, the only survival companies will be service companies, and Indian scholars indicate that "with this shift, the Indian economy which was considered to be agriculture-based economy by opening up the economy to the post economic reforms of 1991, has become predominantly services-based..." [2].

We can conclude that till today the Indian economy developed the import substitute model which has following features: 1) strong currency; 2) tax rates are extremely high that decelerates the growth of industry and agrarian sector; 3) protectionism of the domestic industry because of their impossibility to compete with foreign companies who will cause them to die, and hence, the imposed customs fee for foreign goods; 4) agrarian and light industry products will be exported while the new
technologies will be imported. Because of non-profitability of local industry there is no demand for new technology, and this brings to lags of the industrial growth.

3. Economic condition of India

Government of India during economic reform has been trying to get away from this economic policy, but, as Gopal Agarwal said, nobody knows how and where to go. The reason of why it is so difficult is unknowability of the way of the economic growth. It is obvious that for economic growth it is necessary to develop industry first. If the share of the industry in GDP structure in 2018 was 28.2% in India, in “Eastern Tigers” countries this share was over 40%. As K. Siddiqui wrote: “India lags behind other developing countries in the industrial sector’s contribution to GDP, for instance 25% in India, 46% in Brazil, 44% in China, 40% in Malaysia in 2010” [8], but in Singapore there is now agrarian sector because this country does not have enough arable lands. The level of industrial sector in India is very low in compare with expected level and the ground for that is tax system and artificially high rate of rupee. Then only those companies could afford such situation are companies for whom Indian government make concession and give some preferences. Using that preferences these companies could manage their activities in domestic market profitably enough. Indian industrial companies mostly family-based and are famous in domestic market: Tatas, Birlas, Bajaj, Reliance; and they have best conditions as government cherishes them by supporting and protecting from foreign companies.

India performed highly developed industries such as IT and pharmacy because of tax preferences, and these industries are mostly export-oriented. The same thing should be done to other sectors of economy. It does not matter should private or public investments be supported, but because of the high rate of rupee and high level of taxation the most DFI and direct domestic investment (DDI) inflows into service sector. That is why most investments which domestic industry needs do not come to India. Indian domestic market is shrunken that indicates a low level of PPP (purchase power parity) of population and because of the high level of poverty of significant number of populations. In addition to low level of domestic market capital flies out of India where the total sum of it composes around $100 billion till 2018 [7]. If the country needs to develop industrial sector, it is necessary to implement new economic model. Due to this economic model the tax rate during several years should be reduced till 30% in total. In that case number of taxpayers will be increased and foreign companies will have equal conditions as locals, and industrial sector will create jobs for overpopulated India.

More than 65% of Indian population lives in rural area and majority of them are not provided by constant job with high salary. Farmers with small land area have a plight living condition. Because of the current economic policy this sector stays inactive, and farmers find less support from government. Government distracts itself from agrarian sector in order to strict financial policy and fight against inflation. Therefore, investments in this sector are very poor. If starting from 60s till 80s the government invested in agrarian sector because of the profit, but today agrarian sector is developing by itself. Small farmers committed suicide because of the overwhelming debt and difficulties. “The National Crime Records Bureau reports that between 1997-2005 156,562 farmers committed suicide. Nearly 60 of them took place in the 4 progressive states, viz., Maharashtra, Andhra Pradesh, Karnataka and Madhya Pradesh. More than 20 per cent of suicides have taken place in Karnataka” [10]. The only way to be more profitable and financially self-sufficient is a collective farming, and then financial assistance of government will bring success. It is not true that collective farming is less profitable because of the practice of Soviet Union. When we look closely to agrarian policy of Soviets then it will be clear that it was policy of government starting from Stalin when collective farmers have been theft by government because of the disparity of industrial goods to agrarian. In Israel, on the contrary, collective farming shows its profitability in market economy. If government of India could apply toward agrarian sector tax discount for 30-35% totally that will stimulate their economic activity and make their job most profitable by developing allied industries for processing agrarian harvests. The growth of agrarian sector by that way will create jobs for rural population of India. The growth of agrarian industry will be a stimulation for development of agrarian companies and creation of condition for using advanced technology. The amount of workers involved in agrarian industry will enlarge the basis of taxation and general amount of tax will increase. India implements a progressive income tax but low-income tax in general will increase all amount of taxes.

In India the number of poor people is very high. World Bank 2005 survey showed $1.25 in PPP while about 456 million people in India lived in the poverty. However, in 2008 Asian Development Bank defined PPP in $1.35 and between 622 and 740 million people lived in the poverty [6]. Jayati Ghosh writes that “this gives India the second highest poverty ratio (at 54.8 per cent) among all Asian countries considered by ADB...” and she also adds “Indian poverty reduction has been relatively slow, and certainly much below what would be expected given the rapidity of income growth in the past fifteen years” [6]. One of the main reasons why war against poverty slows down in India is that many financial aids for poverty reduction had been appearing within the structure of poverty reduction agencies. Rajiv Gandhi described this condition by saying that almost 85% of all of financial aids go to clerks of the system, and poor people who really needs these aids receive only leftovers. Can we blame a cast system of Indian society because of many people to be a poor as their birth right? The system of inequality or cast system exists for a long time but today the only system which failed to handle poverty in India is government’s economic policy. Indian government leads import-substitute economy which did not allow industries to develop and, as a result, only small number of people benefit from such policy. Majority of Indians live in poor condition. There are several measurements of poverty and most useable is Gini, and due to this measure majority of people in India are poor. Anyway when we compare the result of poverty reduction in India and China.
the conclusion will be that the only economic development and industrialization are the factors of poverty reduction and provision for creating jobs for poor people in India.

4. What should be done

For economic development of Indian industry there are other factors which is possible to use. Many economists who support monetaristic macroeconomic theory fear from this factor, meaning the inflation. First, inflation indicates a declension of rupee’s rate and quantity grow of money circle. As a result, we see a rise of prices. In 2010 economic growth in India was at 10.3% and inflation urged on the industrial development and growth of export. Indian Reserve Bank implemented an austerity financial policy that decelerated economic growth, and such policy declined the export of goods and commodities [4].

In 2018 inflation rate was at 5.3% but government did not use this for economic growth. The only way for economic growth to take place it is the devaluation of rupee regarding to inflation that will stimulate export. Government kept the rate of rupee superficially high that from one side the prices for goods were increased and from other side Chinese goods declined significantly in the local market. As the economic policy was depended on monetarism, we see the development of trade and service sectors in the economy.

Monetarist based Indian government policy did not stimulate export that brought to industrial decension. International trade balance is negative, and it depends on economic policy of government. In 2018 trade deficit was $120 billion, export was $216.9 billion and import was $337.4 billion [4]. Remittance of those Indians who works abroad composes around $75 billion and this amount of money cannot cover a deficit of foreign trade. The fear of the inflation among politician and scholars is so great that they cover it with wrong policy. For instance, in November 8th, 2016 Prime Minister of India Narendra Modi initiated withdrawal of ₹1000 and ₹500 rupees denominations from the trade turnover. Modi declared that this policy was leading against corruption and black market. This policy is relevant actually to austerity financial policy which come out of monetaristic theory. Monetarism states that if a number of rupees are decreased in the circle this will stimulate a development of industry and declension of inflation. What it has is the temporary effect, and next year inflation returns to its place, and GDP in 2017 declined to 6.7% [4]. The better way to handle inflation and corruption is to change economic policy from import-substitute economy to export oriented. When the quantity of rupees in the money circulation is high it is demanded to depreciate national currency, and this will stimulate export and accelerate a local industry. Modi mostly focused his attention to outcomes of inflation but missed the reasons. That is why we cannot see development of industry and export in India for the last several years. Finally, in last half year of 2019 the growth economic strategy had failed. The rate of GDP was about 5% in compare with the previous years. The rates of economic reform which was started in 1991 became slow and less productive.

For industry growth, poverty reduction, economic development and GDP growth the Indian Government should shift should from of import-substitute economy to the new one. That new economic model for India is old per se and is named “export-oriented”. To implement this economic model there are several factors which government should use. First, it needs to use benefits of the currency rate. When currency rate is depreciated it allows to stimulate export of goods because the price of domestic products will be lower than international. Domestic market will be totally under control of local producers, but this strategy cannot be used forever. Since at the beginning the price of local goods will decrease but gradually it will equalize to changed currency rate. It is necessary to use inflation which means to increase money quantity in the circulation and combine it with the currency devaluation. If quantity of money is increased in the market, but currency rate will remain stable it will cause a stagflation, which hinders the growth of domestic industry and leads to bankruptcy.

For currency devaluation government need to initiate investments into infrastructure, roads, electro-stations, water supplies, constructing schools and hospitals, etc. This way government will increase budget expenditure and lead to depreciation of rupee. The depreciation of rupee will lead to creation of a such condition when produced goods will be cheaper than foreign ones and this procedure will encourage local producers to enlarge production. As soon as export of goods will increase that will allow local producers to attract foreign currency into Indian market and government should buy all of it in order to keep currency rate low. If government allows to rise the rate of rupee that will decelerate export and growth of domestic industry. Indian Reserve Bank should always input rupee and buy foreign currency in order to control the rate of rupee. That policy will result in rising of foreign reserve funds which today it amounts in about $400 billion. Therefore, industrialization of economy in India demands a cooperation and join action of government and IRB in order to keep currency rate steadily low.

Keeping currency rate low is not the only factor of the export-oriented economy. Next factor relates to reduction of tax rates. The prices of local goods will be lower, and Indian commodities will be competitive in domestic and international markets as well. Some challenges will be appear relating budget. Logically, if tax rate is decreased then it is anticipated that the budget will be under the threat. But low tax rates will increase the number of taxpayers that leads to the increase of budget inflows.

Third factor of the export-oriented economy is related to banking loans where the government issues credits to entrepreneurs under low or no interest rates for several years. Nascent enterprises will have the proper condition to rapidly start growing. This way also leads to the decrease of the prices and development of industries.

These three main factors will lead to the industrial growth in India and the majority of population will be provided with jobs. This economic policy is also crafted toward poverty reduction and increase of basis of taxation. Indian government could use these factors as macroeconomic measures and in near future these factors will be the reasons for technological development which lead to development of education. Because export of goods and commodities demand to invent new devices

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and equipment and for that purpose import of new technology will limit the speeds of technological development. That is why India should rely for its own intellectual potentials. What had happened with Chinese company Huawei is when it developed its own technology and faced with severity of US companies. That had happened with Huawei because China was developing under export-oriented economic model for forty years. India urgently needs to develop its own producers of new technology.

If somebody argues that India depends on oil and gas because of scarcity of these natural resources and an increase of price of oil and gas will lead to increase of the prices of Indian goods, their arguments will be correct partly. However, we know several countries with similar circumstances where such approach did not decelerate their growth as industrial economy. Another argument relates to overpopulation of India, but the example of China is a clear argument for rejecting of such argument.

There is no excuse but this is a logic of economic model of India which leads to hinder the poverty reduction and decelerate the economic development. It needs to change Indian economic model and reform it. Current economic reform in India is doing no good and as a result it is indicated in 2019’s GDP. On the opposite side, another economic model which is named “export-oriented economy” indicates a growth. That economic model was used first in the USA when John M. Keynes was invited by Roosevelt’s administration. Before that Keynes visited USSR and made field studies of Lenin’s economic reform which was continued till 1927. He analysed that real practice and made theoretical conclusion. When it was used in US example that brought significant achievements when the USA became a developed country. After that this economic model implemented in Japan, Singapore, South Korea, Thailand, Malaysia, Hong Kong. After 1978 this economic model was implemented in China, when Deng Xiaoping visited Li Quan Yu in Singapore.

India started economic reform since 1991 under the pressure of financial crisis in 1987-1988 and till today India cannot come out from import-substitute economy. That is why it needs to be changed. Otherwise, the decension of industry and agrarian sector will continue.

5. Conclusion
India is raw material depended country as China and Japan, and regardless of that condition economic development mostly depends on economic model but not from people. Wisely using this economic tool allows the country to become more industrialized and handle one of the biggest problems of Indian society - poverty. Poverty is a result of economic policy of Indian government as everywhere, and in order to overcome it there is mandatory to change economic model of India and implement “new” one which is not new per se. India has all opportunities like Japan and other “Eastern Tigers” to become the most developed country and one more time to show the world that Indian enchanted ancient culture still has some fuel in the tank to wonder the world.

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Reference: