TRANSITION FROM AN INWARD-LOOKING STRATEGY TO AN OUTWARD-LOOKING STRATEGY : THE INDIAN EXPERIENCE

*Vijay Prakash Ojha**

The origin of the debate in India on the transition from an inward-looking to an outward-looking strategy can be traced back to the early seventies. However, the initiation of the transition to the outward-looking strategy comes about only after the eighties. This paper deals with the policy debate as well as the real economic compulsions behind policy reforms which bring about the transition to an outward-looking strategy in India. Accordingly, the paper is divided into five sections. Section I deals with the theoretical issues in the inward-looking vs. outward-looking strategy debate. In Section II, a brief review of policy developments in the sixties and seventies is provided. Section III traces the evolution of policies in the eighties, and section IV deals with the trade and industrial policy reforms in the post 1991-92 period. Section V is the concluding section in which we present a brief assessment of the impact of the trade and industrial policy reforms and some observations on the future of the reforms programme.

I. TRANSITION FROM AN INWARD-LOOKING STRATEGY TO AN OUTWARD-LOOKING STRATEGY : THE MAIN ISSUES

The industrialisation strategies pursued by the developing countries have been classified by Balassa (1989) into two broad types — inward-looking strategies and outward-looking strategies. An inward-looking strategy (also alternatively described as an import substitution strategy although this description does not adequately convey the underlying philosophy of 'export-pessimism') is one in which the production pattern is oriented towards the production of import substitutes rather than exportables even at the cost of static allocative efficency — and this is justified by invoking the principle of dynamic comparative advantage. In an outward-looking strategy, on the other hand, the gains from international trade and efficient resource allocation are considered important and there is, therefore, no discrimination in production against exportables. Note that an outward-looking strategy need not be the same as an export-oriented strategy which is based on the principle of export-led growth. In the outward-looking strategy, as pointed out by Balassa (1989), there is merely a neutrality in the incentive structure for the production of importables and exportables. Note also that it is wrong to view the inward-looking and outward-looking strategies as two

* Senior Lecturer in Economics, Department of Commerce, Shri Ram College of Commerce, University of Delhi, Delhi.

radically different options which must be ranked in the order of superiority. This is because firstly, the choice of a particular strategy in any country is almost invariably made in response to what are called the "initial conditions" of that country — these conditions include resource endowments, physical capital stock, technological and manpower skills, opportunities in international trade and historical factors. Secondly, the act of choosing or rejecting a strategy is essentially an exercise in balancing the costs and benefits that are expected to ensue from the implementation of the strategy under consideration. In other words, if in an economy at a point of time the choice is made in favour of, say, an inward-looking strategy, it is because the short-term costs arising from the disregard of specialisation suggested by static comparative advantage are considered to be outweighed by the long-term benefits from the protective policies based on dynamic comparative advantage. Over time, changes in the initial conditions may bring about the corresponding change in the relationship between the costs and the benefits of the chosen inward-looking strategy. And if, under the changed circumstances the costs outbalance the benefits — which can very well be the case for an economy saddled with the problem of persisting adverse foreign trade balance and thereby relying increasingly on foreign borrowing — the justification for the continuation of the inward-looking strategy would be lost.

Under such circumstances, there will naturally be a compulsion to change over to an outward-looking strategy. In fact, much of the policy debate on inward-looking vs. outward-looking strategies is really concerned with the question of *how* and *when* to execute a transition from an inward-looking strategy to an outward-looking strategy. Policy debate in India (in the eighties) also fits into this general trend.

Policy Instruments of Inward-Looking

India remained firmly committed to an inward-looking strategy throughout the eighties.[1] The major policy instruments of this strategy may be summarized as follows: (i) Channelizing public investment into import-competing and socially desirable sectors; (ii) Regulating the flow of private investment through an elaborate and complex industrial licensing system to reduce conflict between private profitability and social objectives; (iii) Maintaining an 'overvalued' real exchange rate; and (iv) Maintaining a high average rate of tariff compounded by a differentiated tariff structure for imports. (In addition to the tariffs there are quantitative restrictions imposed on many imports).

In the policy debate in India, it is not that each of the four policy instruments mentioned above has been subjected to the same degree of criticism. For instance, in case of (i), what has been considered objectionable is not the underlying objective of promoting investment in sectors in which private investment would not flow readily — because of long gestation lag or low private profitability even though social profitability may be high — but the fact that in practice the composition of public investment includes substantial investment in non-priority areas. Moreover, there has been some criticism of the policy of not allowing the supplementation of public investment by private investment in sectors hitherto reserved for the public sector on the grounds that some control over the so-called "commmanding-heights" would pass into the private hands. What is noteworthy, however, is that there is as yet nobody, among the critics of the inward-looking strategy, who would seriously question the useful role played by public investment and

its 'discretionary' rather than strict profitability based allocation.[2] In other words, the policy of controlling the size and allocation of public sector investment may well be incorporated in an outward-looking strategy. For example, it may be desirable to attempt to promote growth through an expansionary public investment programme provided the latter does not have adverse repercussions for the balance of payments in the economy. On the other hand, the criticism that the policy instrument (ii) — that of regulating private investment flows by means of controls enforced through licences — has been subjected to is much harsher. Also, there has been near unanimity in denouncing the licensing system as obsolete and counterproductive. So much so that even those who believed in the continued relevance of the inward-looking strategy had no sympathy for the overextended licensing controls and did not see the latter as forming an integral part of the inward-looking strategy. In fact, the criticism against the industrial licensing policy of the government did not arise from the felt need, in the eighties, to change over to an outward-looking strategy, but originated much earlier in the late sixties. Criticisms against the policy instruments (iii) and (iv), however, have been made most often from the perspective of an outward-looking strategy. Viewed from this perspective, the combination of a high average tariff rate and a differentiated tariff structure — that of policy instrument (iv) — is seen first to lead to an unduly high cost industrial structure which, in turn, implies an erosion of international competitiveness (i.e. domestic prices are much higher than international prices) of exportables. And this inbuilt bias against exports is manifested, sooner or later, in perpetual balance of payments difficulties. To understand the criticism of the policy instrument (iii) — that is, maintaining an overvalued real exchange rate — it is necessary to first clarify what is meant by an overvalued real exchange rate. The real exchange rate (RER) is defined by Edwards (1988) as the relative price of tradable with respect to non-tradable goods.[3] In this definition, it is obvious that RER measures the cost of domestically producing the tradable goods. It is, therefore, a good proxy for a country's degree of competitiveness in international markets. It follows that an increase in RER implies a decrease in the cost of domestically producing the tradable good — and the latter in turn represents an improvement in the country's international competitiveness. (Note that what is described normally as a depreciation of the real exchange rate implies—as per our definition of RER—an increase in the magnitude of RER). Now overvaluation in RER can be defined, strictly speaking, only with respect to what may be called the correctly valued RER, and, as pointed out by Bruton (1989), in a world of large and rapid capital movements, large-scale aid and foreign investment the definition of even the concept of "correct RER" is exceedingly difficult. Edwards (1988) defines misalignment in RER — which may be either an overvaluation or an undervaluation in RER — as a departure from what he calls the equilibrium real exchange rate (ERER), and, the latter (i.e. the ERER) is one which leads to a simultaneous attainment of equilibrium in the external sector and the domestic (i.e. non-tradable) sector of the economy. Internal equilibrium means that the non-tradable goods markets clear in the current period (and is expected to clear in the future), and, external equilibrium means that the foreign trade current account balances (current and future) are compatible with long-run sustainable capital inflows. Balassa (1989), in his comparative analysis of inward-oriented and outward-oriented countries, explains the better

export performance of the outward-oriented countries by the fact that they maintained realistic exchange rates while inward-oriented countries supported overvalued exchange rates by foreign borrowing. We may then define an overvalued RER as one which leads to current account balances that are not compatible with long-run sustainable capital inflows. In an *ex-post* analysis of the developments, the scenario of persisting large current account deficits resulting in increasing dependence on foreign borrowing and an overvalued RER are merely the two sides of the same coin. In an *ex-ante* sense, however, depreciation in the real exchange rate may well improve foreign trade balance. The problem with an inward-looking strategy is that because of its emphasis on import substitution there is no *ex-ante* concern for a realistic RER. Moreover, the overvaluation in RER does not catch attention of the policy makers because it reinforces the basic objective of an inward-looking strategy — i.e. providing protection to import substitutes.

Policy Instruments of Outward-Looking

From the above discussion on the inward-looking strategy and the real exchange rate, four main policy instruments of the alternative strategy — i.e. the outward-looking strategy can be pointed out.

These are : (a) Opening up the sectors considered to be the exclusive reserve of the public sector for the private sector ; (b) Dismantling the industrial licensing policy regime and allowing the private sector to take investment decisions on the basis of market signals; (c) Depreciation of the (overvalued) real exchange rate; and (d) Reduced tariff rates for imports, preferably, the adoption of a low uniform tariff rate across all imports in place of the high average as well as spread in the tariff structure.

In the inward-looking strategy, the public sector not only bears the exclusive responsibilty of undertaking investment in the infrastructure and many other highly capital intensive industries, but is also expected to refrain from pursuing the goal of profit maximisation. It follows that in an inward-looking strategy, over a period of time, the public sector gets trapped in its own internal contradictions. That is to say, the growth (and even maintenance) of the public sector in the inward-looking strategy, instead of being self-supporting, becomes increasingly dependent on budgetary support by the government. And this brings to the fore the relevance of the above mentioned policy instrument (a).

In an industrial licensing policy regime, the prerequisite of competition and efficiency — i.e. free entry and exit — is denied, and the entrepreneurs take optimising decisions on the basis of constraints imposed by the bureaucratic controls and regulations. This, not surprisingly, leads to enormous wastage of (capital and labour) resources. In other words, the industrial licensing system almost invariably results in a high-cost indutrialisation. For creating a competitive industrial environment and thereby promoting efficiency, policy instrument (b) becomes a must.

Policy instrument (c) of the outward-looking may be seen as a counterpart of the policy instrument (iii) of the inward-looking strategy. That is to say, because overvalued RER (instrument (iii) of the inward-looking strategy) affects the international competitiveness adversely, thereby preparing ground for the emergence of balance of payments difficulties, depreciation of the RER (instrument (c) of the outward-looking strategy) is recommended to restore international competitiveness and encourage exports, thereby easing the pressure on the balance of payments.

Similarly, policy instrument (d) of the outward-looking strategy may be seen as a counterpart of the policy instrument (iv) of the inward-looking strategy. Because high non-uniform tariff rates for imports (instrument (iv) of the inward-looking strategy) were seen to be the primary cause of the high-cost industrial structure, lower tariff rates (instrument (d) of the outward-looking strategy) are recommended to reduce protection and thereby promote international competition — which in turn would lead to lower costs. It may be added here that a trade policy of reducing the tariff rates on imports is ideally accompanied by a policy of reducing the indirect taxes (i.e. the domestic excise duties) on domestically produced intermediate inputs. The latter would not only add to the contribution of the former in cost reduction but also ensure that there is no policy-induced incentive for an increased substitution in favour of imported inputs.

II. INDIAN ECONOMY IN THE SIXTIES AND THE SEVENTIES

India adopted an import-substituting industrialisation strategy in the fifties. The successful implementation of this strategy depended crucially — in the light of the "export-pessimism" prevailing at that time and the low productivity of the then traditional Indian agriculture — upon the ability of the economy to overcome the critical constraints on availibilty of wage-goods and foreign exchange. Under such circumstances, the tempo of the import-substitution drive could be maintained as long as concessional foreign aid was available. In 1965, the American foreign aid was abruptly stopped; the situation was further aggravated by two successive droughts in the years 1965-66 and 1966-67. The crisis created was managed by a cut-back in public investment and undertaking foodgrains imports under PL480. Beyond this immediate response, there were also measures taken to increase productivity in the agricultural sector (these measures initiated the so-called Green Revolution in the Indian agriculture) and to create incentives for export promotion — by devaluing the rupee in 1966. The 1966 devaluation, as shown by Bhagwati and Srinivasan (1975), had some positive incentive effects on exports. But, because there were severe supply side problems created by the droughts exports performed indifferently. Moreover, as emphasised by Bhagwati and Srinivasan (1975), within a few years (after 1966) trade policy reverted to the import control cum export subsidization regime. What is worth noting then about the policy developments of the late sixties is the fact that, despite the realisation in policy making circles of the limits of the inward-looking development strategy, there were only ad-hoc promotional measures undertaken by the government for developing exports — there was nothing in the nature of a comprehensive set of policies (and as we shall see not even in the seventies and eighties) aimed at achieving a breakthrough in exports.

In the seventies, particularly after 1973, some effort was made to change the policy stance towards 'outward-orientation'. The import-substitution drive of the fifties and the sixties resulted in a diversified industrial structure which made possible a widening of the range of exportables. Moreover, sluggish growth in exports could not be explained anymore (i.e. in the seventies) in terms of supply constraints; nor, as argued by Wolf (1982), could exports be seen to be constrained by world demand. It follows, and in fact has been emphasised by Wolf (1982), that it was the overall trade and development policy which weakened the incentive to produce exportables and undermined their competitiveness in international markets. The major shift in the policy

stance in the seventies towards developing exports came when, in response to the floating of the major currencies of the world, the Government of India also changed over to its own version of a floating exchange rate system in which the rupee was pegged initially to pound sterling and later to a basket of currencies and, thus, prepared the ground for depreciation of the rupee against the currencies of India's major export markets — which, in turn, helped to stimulate exports in the late seventies.

Notwithstanding the policy towards export promotion, the major pre-occupation of the policy makers even in the seventies remained with import-substitution and inflation control.[4] In the seventies, the Indian economy experienced two oil shocks in 1973-74 and 1979-80. At the time of both these shocks, the economy was also subjected to a severe drought resulting in a significant decline in agricultural production. As a consequence, inflation rate rose dramatically — first time in 1974 and then in 1980 — but was effectively controlled on both the occasions.

On the first occasion, the policy measures to contain inflation consisted of the following : (i) strong dose of deflationary demand management; (ii) slow-down in the rate of public investment; (iii) tightening import controls; and (iv) raising the domestic price of petroleum products in order to check the growth of demand for imported oil. Inflation-fighting was also aided by acceleration in export earnings and increased current private transfers in the period 1973-74 to 1978-79. During this period another important development was the intensive import-substitution that was carried out in certain intermediate and capital goods industries such as fertilisers, non-ferrous metals, machine tools, castings and forgings and certain groups of machinery.

In the second round of inflation-fighting (1979-80 to 1982-83), attempts were made to resist from undertaking deflationary measures. The policy package for this period consisted of the following ingredients : (i) making effort not only to maintain the rate of real public investment but to raise it; (ii) deregulating imports and thereby exposing domestic producers to international competition to promote efficiency in domestic production; (iii) setting up domestic oil exploration efforts to reduce the dependence on imported crude; and (iv) undertaking measures to switch energy use away from petroleum, oil and lubricants (POL) towards domestically available coal and electricity. And this time also (like in the first bout of inflation control) the effectiveness of these measures was enhanced by a continued increase in private current transfers from abroad and import substitution in selected industries in infrastructure, capital goods and intermediate goods sectors —e.g. crude oil, iron and steel and heavy machinery. Note that deregulating imports, raising the rate of public investment and avoiding deflationary measures were positive features of the policy package during the second round of inflation fighting (1979-80 to 1983-84).

III. INDIAN ECONOMY IN THE EIGHTIES (1983-84 TO 1991-92)

To trace the evolution of policies in the eighties, we divide the period 1983-84 to 1991-92 into the following three sub-periods : (i) the early eighties — 1983-84 to 1984-85, (ii) the Seventh Five-Year Plan period — 1985-86 to 1989-90, and (iii) the post Gulf War years — 1990-91 to 1991-92.

The Early Eighties (1983-84 to 1984-85)

The years 1983-84 and 1984-85 were marked by a return to 'normalcy', after the setback caused to the economy by the

severe drought in the year 1982-83. In 1982-83, the real GNP growth was only 2.6 per cent ; it increased to 7.7 per cent in 1983-84 and then declined again to 3.7 per cent. The growth rate of agricultural production, which had declined by 3.80 per cent in 1982-83, increased dramatically to 13.7 per cent in 1983-84 and fell again to -0.90 per cent in 1984-85. The industrial production growth rate increased from 3.90 per cent in 1982-83 to 5.40 per cent in 1983-84 and to 5.80 per cent in 1984-85. The sustained growth in industrial production in this period, of course, came in the wake of a strong recovery in agricultural production but it was, as mentioned in the *Economic Survey* (1984-85), also supported by a good performance in major infrastructure sectors (e.g. energy and transport). The growth rate of power generation, which had slowed down to 6.60 per cent in 1982-83, recovered to 7.60 per cent in 1983-84 and to 11.90 per cent in 1984-85.[5]

In the years 1983-84 and 1984-85, there was some improvement in the balance of payments situation as well. The balance of payments had been under severe strain since 1980-81, and in 1982-83 the trade deficit and the current account deficit as percentages of GDP respectively were 3.24 per cent and 1.54 per cent. They declined to 2.83 per cent and 1.09 per cent in 1983-84 and rose again slightly to 2.91 per cent and 1.23 per cent in 1984-85.[6] In view of the improvement in the balance of payments position in 1983-84, the Government of India formally terminated the arrangement to borrow under the Extended Fund Facility of the IMF in May 1984.

The *Economic Survey* of 1985-86 attributes the considerable success in achieving improvement in the balance of payments (BOP) position to the policies pursued by the government as well as to favorable 'extraneous' developments such as the increase in the inflows of net invisibles during 1983-84 and 1984-85. The policies which helped to improve the BOP position consisted of : (i) the policy of bringing about effective import substitution in petroleum, steel, cement and non-ferrous metals ; (ii) the trade policy which allowed liberal access for "actual users" to the import of raw materials, intermediates and components needed in production and provided for an even more favourable access for the exporters among the actual users ; for the exporters there were additional facilities provided through schemes for duty free import against import replenishment licenses (REP), and these schemes were made more flexible to enhance enlarged access to required imported inputs (including some of the banned items), and (iii) the policy of offering a premium in the interest rate on the deposits of non-resident Indians in Indian banks to encourage the former to hold their savings in the latter — which would thereby strengthen the capital account side of the balance of payments.

In the *Economic Surveys* of the years from 1983-84 to 1991-92, we also find sufficient evidence of a change (vis-a-vis the seventies) in the policy makers' perception of the constraints on the growth process of the economy. In Chapter 9 — "Future Prospects and Problems" — of the *Economic Survey* (1983-84), we find the following : "To a large extent, acceleration in industry itself depends upon an acceleration in agriculture, which apart from necessary input support would provide substantial expansionary stimulus to industry. Demand constraints are, however, not the only factor depressing industrial growth. Infrastructure consraints, particularly uncertainity and fluctuations in the availibilty of power, have also handicapped industry. There are also structural deficiencies in Indian industry which have created a high cost and low

productivity industrial system lacking the innate dynamism needed for speedy growth. The absence of competitive pressure permits industrial units to survive with little incentive to reduce costs... " (p.75). On another occasion in the same chapter, and on the same page, in a bid to emphasise the need for policy effort to restrict the current account deficit, the following has been said : "An improved export performance will be critical in the years ahead. Higher exports will not only directly reduce the current account deficit; they will also help to improve the debt-service ratio increasing our (the economy's) ability to absorb external financing." *Economic Survey* (1984-85) also takes note of the high cost industrial structure and the need for export promotion. In Chapter 9 — "Problems and Prospects" — of this *Economic Survey*, the possibilty of stretching the limits, set by domestic demand for industrial expansion, through exports is explicitly recognised in the following statement : "As long as production costs are low, it will be possible to export surplus production and so domestic demand should not always be the basis for determining scale." (p.84). In this regard, the following related observation made in the same chapter, on the same page, is also significant : "The relatively high structure of costs and prices in the industrial sector has severely impaired the competitiveness of Indian manufactured products in world markets. Not surprisingly there has been a steady erosion of our (India's) share in the world export trade."

It may be noted that, while in 1983-84 export promotion merited attention because of its implied contribution towards improvement in the current account deficit, in 1984-85 the role of exports in easing the domestic demand constraints on industrial growth was being stressed as well.

It follows that as early as in 1984-85 the compulsions to move towards an outward-looking strategy were felt by the policy makers. In other words, since 1984-85 the scope of policy effort had extended well beyond the policy concerns of the earlier pre-eighties phase — i.e. overcoming constraints imposed by inadequate growth in the agricultural and infrastructural sectors and import-substitution in capital and intermediate goods sectors — to include measures to increase the competitiveness of Indian products in the world markets.

The Seventh Five-Year Plan Period (1985-86 to 1989-90)

Policy developments in the middle and late eighties initiated a process of liberalistion within the framework of an inward-looking policy regime. The policies for liberalisation in the industrial sector were as follows : (i) In March 1985, twenty five broad categories of industries were delicensed; and, later in the eighties, many more industries were added on to the list of delicensed industries; (ii) For many of the industries, which remained within the ambit of industrial licensing, the facility of "broad-banding" was accorded to allow them to make rapid changes in their product mix without losing time in seeking fresh licenses. Broad-banding was also extended in stages to cover new areas; (iii) The scheme of re-endorsement of capacities on the basis of past production, introduced in 1982, was extended to cover newer industries in the later years; and (iv) There were relaxations in regard to MRTPC's scope. The asset size qualifying for MRTP scrutiny was raised five fold, restoring it to what it had been in 1969 (when the Commision was established) in real terms.

In the external sector also there was a move towards import liberalisation with a view to promote exports. The important

policy measures taken in this regard were as follows : (i) For providing easier and quicker access to imported inputs, many capital goods and intermediate goods were shifted to the Open General License (OGL); (ii) The range of export products qualifying for REP as well as the range of items which could be imported through REP was widened. (Note that REP licenses were freely transferable and, on transfer, they commanded a 'premium' in the market which provided some additional subsidy to the exporter); and (iii) The scope of Advance Licensing Scheme — under this scheme imports of specified raw materials required to meet confirmed export orders were allowed without payment of any customs duty — was extended to cover many more imported items.

In addition to these schemes which allowed cheaper (duty free) and liberal access to imports for exporters, there had been traditionally (i.e. since the mid-sixties) in operation two major incentive schemes for the exporters — the Cash Compensatory Scheme (C.C.S.) and the Duty Drawback Scheme (D.D.S.). The C.C.S. was designed to compensate for unrebated indirect taxes paid by exporters on inputs, higher freight rates and market development costs; and, the D.D.S. reimbursed exporters for customs and excise duty paid on inputs entering into export production. Both these schemes were revised in 1986 with a view to enhance the incentive for the exporters. The revisions undertaken were as follows: (i) The C.C.S. was revised so as to work out the incidence of indirect taxes not only on the basis of indirect taxes paid on the inputs directly used in the production of export good at the last stage of production but also at the earlier intermediate stages; and (ii) In the D.D.S. a new simplified procedure for quick drawback reimbursement was introduced, and the drawback rates were enhanced for all industries with high export potential.

Jalan (1991) has shown — on the basis of data compiled for domestic profitability, export profitability without incentives and export profitability with incentives by the Industrial and Investment Corporation of India (ICICI) and the World Bank — that even after taking the numerous incentives (described above) for exports into account, export profitability remains well below domestic profitability. Moreover, as Jalan (1991, p. 114) argues : " the multiplicity and complexity of the incentive structure have had three unintended effects, which have reduced their efficiency :(a) the actual combined benefit from the incentive structure is not transparent and difficult to calculate. Thus, there is no clear relationship between the cost to the government of providing these incentives, and the actual net foreign exchange earned from different products; (b) the collection of these incentives involves important transaction costs for exporters because of delays in disbursement and disputes in interpretation; and (c) the pressure lobbies have developed to protect, preserve and enhance one or the other incentve. 'Incentive bargaining' becomes a more important determinant of export profitability than the expansion of exports and the search for new markets."

In short, policy changes in the middle and late eighties did nothing to correct the bias against exports that is inherent in an inward-looking strategy, and, the higher growth in the real sector of the economy therefore had to be financed — in the presence of large current account deficits — by inflows of capital by way of commercial borrowings. (Note that in the eighties there was a marked reduction in flows of concessional assistance to India, and, the

reliance on commercial loans therefore increased.)

The Post Gulf War Years (1990-91 to 1991-92)

In the year 1990-91, the Indian economy was exposed to the third oil shock which came about as a consequence of the Gulf crisis created by the Iraqi invasion of Kuwait on August 2,1990. The average prices paid by India for crude oil in the world market rose from $ 15 per barrel during April-July 1990 to $ 30 per barrel during August-November 1990 and then declined to an average of $ 19 per barrel during the remainder of 1990-91. The average price of petroleum products rose from $ 182 per tonne to $ 354 per tonne and then declined to $ 313 per tonne over the same period. The spurt in the price of crude oil and petroleum imports brought a massive surge in the POL import bill. The import bill of POL as percentage of imports increased from 17.72 per cent in 1989-90 to 25.04 per cent in 1990-91. The trade deficit as percentage of GDP deteriorated from 1.25 per cent in 1989-90 to 1.59 per cent in 1990-91. The Gulf crisis had a significant adverse impact on the three major sources of financing the trade deficit — net receipts from invisibles, inflows into non-resident deposits (NRD) and external commercial borrowing — as well. And the government, therefore had to take recourse to drawings from the IMF. It drew Rs. 1177 crore from the reserve tranche during July-September 1990; again in January 1991 the government made a drawing of Rs. 1884 crore under the Compensatory and Contingency Financing Facility (CCFF) and a drawing of Rs. 1450 crore under a first credit tranche (FCT) arrangement. However, inspite of the recourse to IMF resources the foreign currency assets holdings of RBI declined for the year 1990-91 by 24.17 per cent. In short, the already vulnerable balance of payments position at the end of 1989-90 became much worse in 1990-91 under pressure from the third oil shock. The fiscal balance, which had been precarious throughout the seventh five-year plan period, was further exacerbated in the year 1990-91. The average revenue deficit (as percentage of GDP) was 2.6 per cent for the Seventh-Plan period; in the year 1990-91 it went up to 3.5 per cent. Similarly, the average fiscal deficit (as percentage of GDP) was 8.2 per cent for the Seventh-Plan period, and in the year 1990-91 it increased to 8.4 per cent.

The real sector of the economy, however, continued to perform well in 1990-91. The real GDP increased by 5.65 per cent, while the annual growth rates of industrial and agricultural production indices were respectively 8.25 per cent and 2.67 per cent. In other words, the trend established in the growth rates of the indicators of performance in the real sector of the economy during the Seventh-Plan period continued in the year 1990-91 as well.

The impact of the Gulf crisis of 1990-91 was felt by the 'real' economy, with a lag, in the subsequent year 1991-92. Policy measures undertaken in the wake of the Gulf crisis had a strong recessionary impact on the industrial sector, and the industrial production index for the year 1991-92 registered a negative growth. Factors responsible for this downturn were import compression, rise in the cost of imports due to high cash margin requirements and the tight money policy on the supply side; and a reduction in public expenditure and other fiscal adjustment measures leading to a slump in demand on the demand side. There was a significant slowdown in export growth during 1991-92 as well. In 1990-91, export growth was modest at 9.10 per cent per annum in dollar terms and during 1991-92 dollar exports

declined by 1.50 per cent. In rupee terms, export growth in 1990-91 was 35.30 per cent but reduced to only 23.10 per cent in 1991-92. This deceleration was caused by a number of factors such as slowdown in the expansion of world trade, recession in the major industrial economies, loss of markets in the Middle East due to the Gulf crisis, virtual collapse of exports to the erstwhile Soviet Union and import curbs affecting export-related imports. Imports were directly hit by the tough policy measures and, hence, there was a stronger deceleration in their case. Imports in dollar terms increased by 13.20 per cent in 1990-91 and declined by 19.40 per cent in 1991-92. In rupee terms imports increased by 22 per cent in 1990-91 but only by 10.8 per cent in 1991-92. The downturn in economic activity in 1991-92 was further compounded by the fall in agricultural production that year. The erratic behaviour of monsoon in 1991-92 caused a setback in agricultural production and the agricultural production index registered a decline of 2.81 per cent. The end result of all this — i.e. fall in agricultural and industrial production and exports — was that growth in real GDP experienced a steep decline from 5.65 per ent in 1990-91 to only 1.31 per cent in 1991-92.[7]

In 1991-92, a series of bold policy reforms were implemented to prepare the ground for a shift from an inward-looking policy regime to an outward-looking one. The more important ones among them were as follows : (i) Industrial licensing was finally removed for new and old projects, whether for creation or expansion of capacity or for product diversification, except in 18 industries where strategic or environmental concerns are paramount or where there is an exceptionally high import content; (ii) Pre-entry clearance requirements imposed on large companies under the MRTP were eliminated to enable Indian firms to become large enough to compete effectively in global markets; (iii) Automatic licensing was allowed for projects involving foreign equity investment upto 51 percent in high-priority industries but only under conditions such as the self-financing of foreign exchange for capital goods imports and profit repatriation; (iv) Actual user requirement for the import of capital goods, raw materials and components under OGL was removed; (v) The rupee was devalued by 18 per cent to provide a stimulus to exports; (vi) A more enlarged and liberalised version of the REP system called the EXIM scrip system was introduced — and this signified a partial shift from administrative controls on imports which conferred benefits on importers at the cost of exporters and increased profitability of import based production for the domestic market to a direct market based link between import and exports which would help increase the relative profitability of exports over production for the home market; and (vii) The maximum import duty was reduced from 150 per cent to 110 per cent.

It may be noted (from the above policy reforms) that while in the industrial sector a decisive step towards liberalisation had been taken in 1991-92, in the external sector the reforms were nowhere near so dramatic — the maximum import duty was lowered but it remained as high as 110 per cent in February 1992, and there was no move towards free convertibility of foreign exchange for exporters and importers. Nevertheless, by introducing the EXIM scrip system the government did take a small step — and showed promise for logical follow-up action — towards correcting the bias against exports of the earlier policy regime.

IV. THE POST-ECONOMIC REFORMS PERIOD (1992-93 ONWARDS)

Since July 1991 the Indian economy has progressed steadily towards an outward-looking strategy of growth. Major reforms in the trade and industrial policy have been brought about in the years 1992-93 to 1995-96 (and the process continues as the task is obviously yet unfinished) to improve the international competitiveness of Indian products and remove the bias against Indian exports.[8]

Trade Policy Reforms

The trade policy reforms of the period 1992-93 to 1995-96 can be summarised as follows : (i) *Full convertibility on current account.* In the year 1992-93, the liberalised exchange rate mechanism system (LERMS) was introduced. Under this system, there prevailed a dual exchange rate system in which 40 per cent of foreign exchange earnings was converted at the official exchange rate and the remaining 60 per cent of the foreign exchange was to be converted at the market determined rate. In the year 1993-94, the dual exchange rate system was abolished, and full convertibilty on the trade account transactions — i.e. 100 per cent conversion for the merchandise trade transactions — was introduced. Finally, in the year 1994, full convertibility on current account was introduced. This implies freedom to buy and sell foreign exchange for all transactions relating to merchandise trade and services, remittances, interest on loans, net income from other investments, and amortisation of loans; (ii) *Abolition of import controls.* For imports, the number of items in the restricted and canalised lists has been continuously reduced in the period 1992-93 to 1995-96 so that more and more goods can be freely imported; (iii) *Reduction in import duties.* The maximum import duty was reduced to 85 per cent in February 1993, 65 per cent in February 1994 and to 50 per cent in March 1995; and (iv) *Other incentives for exports.* The duty exemption scheme for exports permits imports of raw materials and components at concessional rates of 15 per cent and 25 per cent, and the exporters now have a choice to opt for advanced import licenses based on value based norms.

Industrial Policy Reforms

In the year 1991-92, a major move was made to liberalise India's industrial economy with a view to promote competition and efficiency therein. Since then, the industrial policy reforms have been carried forward to create a competitive industrial environment in which entrepreneurs can take decisions based on market signals instead of optimising on the basis of constraints imposed by bureaucratic controls. The major industrial policy reforms since 1991-92 are as follows : (i) *Abolition of industrial licensing.* After 1991-92, four more industries have been exempted from industrial licensing. Now there are only 14 industries which are subject to licensing. Moreover, no prior approval or capacity clearance is required for expansion of existing industries, and the latter are now allowed to expand in accordance with the market needs; (ii) *Public sector reforms.* The number of industries reserved for the public sector was reduced to 8 in 1991-92. Two more industries have been dereserved since then. And now only six *strategic* industries continue to be resrved for the public sector. The Board for Industrial and Financial Reconstruction (BIFR), which was already dealing with sick private sector units, has now been entrusted with the responsibility of sick public sector enterprises as well. Moreover, emphasis has been given to improving performance of public sector enterprises through the instru-

ment of Memorandum of Understanding (MOU) by which managements are granted greater autonomy subject to greater accountability. The Standing Committee on Public Enterprises Disinvestment (set up on the recommendation of the Committee on Disinvestment in the Public Sector Enterprises) has set a target of disinvestment in the public sector enterprises at 49 per cent in industries reserved for public sector and 74 per cent in other cases. However, the actual achievement till date is much too short of the target; and (iii) *Encouragement to Foreign Investment and Technology.* After 1991-92, the list of items for automatic approvals of foreign equity has been expanded. As of now, 48 industries are eligible for automatic approval upto 51 per cent foreign equity, 3 industries relating to mining activity are eligible upto 50 per cent foreign equity and another set of 9 industries are eligible upto 74 per cent foreign equity. Moreover, the procedure for foreign investments in priority areas has been drastically simplified. Likewiswe, the procedure for Indian business for operating abroad has also been simplified.

V. CONCLUSION

The fact that the transition to an outward-looking strategy in India was considerably delayed is now widely acknowledged. From an international comparison standpoint, the delay in the initiation of the outward-looking strategy can be said to be of more than a decade considering the fact that almost all the newly industrialised countries in the Asia-Pacific region initiated the transition to an outward-looking strtegy in the seventies itself. Even from the national viewpoint, the policy makers in India (as argued above in section II) had realised the need for a changeover to an outward-looking strategy as early as in the early eighties. Politically speaking, however, the preference remained for status-quo. The initiation of the transition to the outward-looking strategy finally came in the form of a stabilisation programme in response to the crisis in the Indian economy in the year 1991. The crisis succeded in changing the mind-set of the people in favour of liberalistion and economic reforms. The policy makers, of course, acted wisely in using the crisis as an opportunity to embark on a reforms programme. Since 1991-92, the realisation of the need for reforms has deepened in all quarters, and today there is no fear of backtracking on reforms. In fact, as noted above, after the initiation the economic reforms programme has steadily progressed.

The pace of progress in reforms, however, is far from satisfactory. For example, the import duty rates in the Indian economy are still very high and they are discriminatory among the various goods. The absence of low uniform import tariffs makes India one of the most highly protected countries in the world even today (after 5 years of trade policy reforms). Industrial policy reforms have also not proved to be adequate. They have not succeded in bringing private investment, domestic and foreign, in infrastructure which remains a grossly underinvested area and seriuosly limits the growth potential of the industrial sector. Nor have the public sector reforms resulted in any significant improvement of the profit making capabilty of the public sector enterprises. Privatisation is an urgent need but does not yet figure on the official agenda. Exit policy is another area which has not been given the importance it deserves. There are too many legal impediments in the way of closure for bankrupt firms. This has resulted in a highly inefficient use of productive resources.

The steady progress of reforms is already showing signs of having placed the Indian

economy on a higher growth path, but regarding the future of reforms one can have reservations. This is so because the pace of reforms has been quite slow. Unless and untill the pace of reforms is quickened, Indian economy might well get into a crisis in the coming years. And a crisis driven reforms programme is not likely to realise the full potential of the outward-looking strategy of growth.

Notes

1. In the year 1991-92, in response to the crisis in the Indian economy posed by high rate of domestic inflation, deteriorating current account deficits and falling industrial growth, the Government of India undertook drastic policy reforms geared towards outward-orientation. Attempts at reforms were made even earlier during the eighties but these reforms were too marginal in nature to imply a shift towards an outward-looking strategy.

2. It is true that privatisation is recommended to remedy the inefficiency of selected public sector units. But such a recommendation does not deny the role envisaged for public sector investments in a mixed economy.

3. Many authors (e.g. Dornbusch, 1980; Krueger, 1982; Frenkel and Mussa, 1984) define the RER as the relative price of tradable to non-tradable goods. On the other hand, some authors use an early definition of the RER known as the price-level-deflated or the purchasing-power-parity real exchange rate. The latter is defined (see Dervis, de Melo and Robinson, 1982) as the nominal exchange rate deflated by the domestic prices relative to world prices. A price-level-deflated real exchange rate measure indicates whether nominal exchange rate movements offset the difference between domestic and world inflation rates, and, a constant real exchange rate implies no change in aggregate incentives to export or produce for the domestic market.

4. For a detailed discussion of the inflation-control and the import substitution policies of the seventies (1973-74 to 1983-84), see Mitra, and Tendulkar, 1986 and Datta - Chaudhri, 1990).

5. The statements in this paragraph are based on the figures available in the various issues of the *Economic Survey*, published by the Ministry of Finance, Government of India.

6. The figures on the trade and current account deficit as percentages of GDP have been taken from the *Economic Survey* (various issues), published by the Ministry of Finance, Government of India.

7. The source of the figures in this section are the various issues of the *Economic Survey* published by the Ministry of Finance, Government of India.

8. It may be noted that the full agenda for policy reforms to implement the transition to the outward-looking strategy in the Indian economy includes, apart from trade and industrial policy reforms, also fiscal and financial sector reforms. In the present paper, however, the discussion is restricted to the trade and industrial policy reforms. This has nothing to do with the order of importance of the various constitutent parts of the reforms programme, but is merely a consequence of the writer's specialisation.

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