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Economic Reforms in Asia: India's 1991 LPG Policy vs. China's 1978 Approach

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Abstract: ***The 20th century saw a boost in the number of economic reforms and policies as people came to recognize the role and importance of economic stability in the evolving world. The primary areas of focus in this research paper are two well known countries: India and China. The Indian economy had reached near stagnation by the late 1980's. Many argued that it was the complex system of rules, regulations, and licensing that hampered the growth and development of the country. India's external debt rose and Foreign Exchange Reserves were greatly depleted. The prices of essential goods increased and the country was in deficit. The LPG reforms initiated a major change in India's economy, bringing about a new era. This paper aims to discuss the details of the reform and contrast it with another such policy.***

The economic reforms in China, initiated under the leadership of Deng Xiaoping in 1978, represent one of the most significant transformations in modern economic history. This paper aims to discuss the intricacies of the reforms and to provide an in-depth analysis of the motivations behind these reforms, the specific changes implemented, and their profound impacts on their respective economies and society divided as Part-I (Indian LPG policy 1991) and Part-II (Chinese economic reform 1978).

I. PART - I (INDIAN LPG POLICY 1991)

During this time, revenue of the government was low, but the challenges of unemployment and poverty remained. The government had to continuously spend on development programmes that did not generate additional revenue to oppose these issues. The income from Public Sector Undertakings (PSUs) was similarly low. By the 1980's, India did not have enough Foreign Exchange reserves to pay interest on loans. It's imports had increased drastically in comparison to exports and more borrowing became unsustainable. In 1990-91, Inflation had grown to 16.7%, and the country was in debt. India had a fiscal deficit of almost 10.4% and a current account deficit of 3.14%. This indicated an adverse Balance of Payment (BoP) which leads to increase in foreign loans and interest payments. PSUs became liabilities due to poor performance. The Rupee was inconvertible to other currencies. The International Monetary Fund (IMF) and International Bank for Reconstruction and Development (World Bank) were willing to lend US $ 7 Billion but expected India to open up their economy. India, thus, stopped pursuing an inward-looking trade strategy. It adopted the New Economic Policy (NEP 1991) on July 24, 1991.

II. FEATURES OF LPG POLICY

A. Liberalisation

Liberalisation saw a relaxation of strict rules and regulations set by the government. It encouraged international trade and increased domestic competition.

B. Privatisation

Privatisation heralded the complete transfer of publicly-owned operations to private owners. It reduced the control of the public sector and increased the participation of the private sector.

Privatisation was done through:

1) Strategic Sale/ Denationalisation: Complete transfer of ownership to private individual
2) Partial Sale/ Partial Privatisation: Minimum 50% shares remain with government and the rest are transferred
3) Token/ Deficit Privatisation: Government disinvests share capital up to 5-10% in case of budget shortage

C. Globalisation

As the name suggests, globalisation encourages a worldwide network of trade, service, and technology exchange. An integral component of globalisation is outsourcing. Outsourcing is the phenomenon of hiring professionals from other countries to work remotely. India was a prime spot for it as it provided both cheap labour and skilled workers.

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D. Industrial Policy

License Raj was abolished and entrepreneurs no longer had to procure permission to set up industries or increase production other than for a few select categories. A licence was still necessary for industries that produce goods such as alcohol, hazardous chemicals, industrial explosives, drugs and pharmaceuticals, etc. Many industries were opened to private enterprise except for defence, atomic energy, and railways. The list of goods reserved for small-scale industries was shortened. Controls on price fixation were relaxed and market forces were allowed to determine prices in many industries.

E. Financial Sector Reforms

The role of the Reserve Bank of India (RBI) was greatly reduced. It was no longer required to consult the RBI for all decisions. More banking licences were issued and new banks came up, both Indian and foreign. The financial market was opened to investment and the foreign investment limit in banks was raised to 74%. Indian businesses were allowed to access the global capital market by issuing shares and equity. Export subsidies were abolished and financial assistance to loss-making PSUs ceased.

F. Tax Reforms

High tax rate was assumed to be the major cause of tax evasion. To reduce such activities, taxes were reduced continuously from 1991. Income tax and corporation tax saw great reduction while indirect tax experienced many reforms.

G. Trade Policy

Quantitative trade restrictions on imports and exports were removed and tariff rates were reduced. Licensing procedure for imports was dismantled except for hazardous and environmentally sensitive industries. This was done to increase competitiveness of industrial production in the local market. It brought foreign investment and technology into the country, improving the efficiency of domestic producers.

H. Foreign Exchange Reforms

The Rupee was devalued against other currencies in July 1991, to increase the inflow of Foreign Exchange. In 1993, India switched to a managed floating exchange rate system, allowing market forces to impact price while still keeping it within the desired limits.

III. POSITIVES

The new reforms resulted in a rapid increase of Foreign Direct Investment (FDI), Foreign Institutional Investment (FII), and Foreign Exchange reserves. Inflation dropped from about 17% to around 8.5%. Foreign Exchange reserves rose from US $6 billion in 1990 to nearly $413 billion in 2018, making India one of the largest Foreign Exchange reserve holders in the world. GDP growth rate increased from 1.3% in 1991-92 to 5.1% in 1992-93. The fiscal deficit was also greatly decreased. Foreign investment grew from $100 million in 1990-91 to $30 billion in 2017-18. Between 1990 and 1994, exports nearly doubled.

IV. LIMITATIONS

The reforms did not address the issues of employment, agriculture, industry, infrastructure development and fiscal management. GDP expanded, but this did not generate sufficient employment opportunities. It did not benefit the primary sector, where growth rate had been decelerating. Public investment in agriculture had decreased while the cost of production increased. This was due to the removal of subsidies for farmers along with the elimination of restrictions on import of agricultural products. International competition rose and demand for domestic goods was replaced by cheap imports. Therefore, Globalisation is often seen as adversely affecting the domestic markets and local industries. Income from disinvestment was used to cover any shortage of revenue instead of for developing PSUs. India became highly dependent on indirect taxes since tax evasion did not reduce as expected. Due to removal of trade barriers, custom duties were no longer possible. Opening its market has made India more vulnerable to global market forces, such as fluctuations in prices. The reform also had the unintended consequence of increasing the wealth disparity in the country.

V. CONCLUSION OF PART-I

The LPG reforms brought about enormous change in India's economy and facilitated growth and development. Liberalisation, Privatisation, and Globalisation provided more opportunities for India to develop into the country it is today. Nevertheless, the reforms failed to address unemployment, and is considered to be a period of 'jobless growth'. India has made long strides, but the country still has a long way to go in terms of social welfare.

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VI. PART-II (CHINESE ECONOMIC REFORM IN 1978)

Before 1978, China operated as a socialist planned economy characterised by state ownership and centralised planning. This system resulted in economic stagnation, widespread poverty, and limited industrialization. Recognizing the urgent need for economic modernization, the Chinese leadership embarked on a series of reforms aimed at revitalising the economy and improving the standard of living for its citizens. Historically, this reform is considered to be a revolutionary success and a building block towards the growth and development of China as an economic superpower. Now the most important question arises, what exactly is so revolutionary and significant about this policy? Why must it be analysed and how exactly was it beneficial to the masses?

A. Features

1) Household Responsibility System

The Household Responsibility System (HRS) was one of the first and most crucial reforms implemented in the early 1980s. Prior to the HRS, agricultural production was organised through collective farming, where farmers worked on large communal farms and had limited personal incentives for productivity. Under the HRS, the government allowed rural households to lease land from collective farms on a long-term basis and granted them the right to retain surplus production after meeting state-imposed quotas.

a) *Impact on Productivity:* The HRS significantly boosted agricultural productivity as farmers had direct incentives to increase output. They could now make decisions on crop choices, farming techniques, and investments in their land, which led to more efficient and diverse agricultural practices.

b) *Income Growth:* The system led to a substantial increase in farmers' incomes, reducing poverty in rural areas. By the mid-1980s, nearly all rural households were participating in the HRS, and agricultural output had increased dramatically.

c) *Foundation for Further Reforms:* The success of the HRS provided a strong foundation for subsequent economic reforms by demonstrating the benefits of introducing market mechanisms and individual incentives within the framework of a socialist state.

2) Industrial Reforms

a) Autonomy for State-Owned Enterprises (SOEs)

The reform of SOEs was a gradual process aimed at increasing efficiency and productivity in the industrial sector. Initially, the reforms granted SOEs more autonomy in decision-making related to production, investment, pricing, and employment.

- Profit Retention: Enterprises were allowed to retain a portion of their profits instead of remitting all earnings to the state. This provided incentives for managers to improve efficiency and profitability.
- Contract Responsibility System: Similar to the HRS in agriculture, this system allowed SOEs to enter into contracts with the government, setting production targets and financial obligations. Surplus profits beyond the contracted amount could be reinvested or distributed as bonuses to workers and managers.
- Management Reforms: SOEs began adopting modern management practices, including performance-based incentives, which further enhanced productivity and efficiency.

b) Township and Village Enterprises (TVEs)

TVEs emerged as a dynamic and significant sector in rural industrialization. These enterprises were collectively owned by local governments or cooperatives but operated with considerable autonomy.

- Flexibility and Innovation: TVEs had the flexibility to respond to market demands, innovate, and diversify their production. They became crucial in absorbing surplus rural labour, reducing urban migration pressures.
- Economic Contribution: By the mid-1980s, TVEs were contributing significantly to China's industrial output and exports, providing a competitive edge in various industries, including light manufacturing, textiles, and electronics.

3) Foreign Investment and Trade

a) Special Economic Zones (SEZs)

To attract foreign direct investment (FDI) and integrate with the global economy, China established Special Economic Zones (SEZs) in coastal regions, starting with Shenzhen, Zhuhai, and Xiamen.

- Incentives for Investment: SEZs offered a range of incentives, including tax exemptions, reduced customs duties, and simplified administrative procedures. These zones provided a more liberal economic environment compared to the rest of the country.

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- Catalysts for Development: SEZs became testing grounds for market-oriented reforms and innovations. The success of these zones demonstrated the benefits of opening up to foreign investment, leading to the expansion of similar policies to other parts of the country.
- Technological and Managerial Transfer: FDI brought in not only capital but also advanced technologies and managerial expertise, which were crucial for modernising China's industries.

4) Dual-Track Pricing System

The introduction of the dual-track pricing system was a pragmatic approach to transition from a centrally planned economy to a market-oriented one without causing significant disruptions.

a) State and Market Prices: Essential goods and services were sold at both state-controlled and market prices. Enterprises could produce a certain quota for the state at fixed prices and sell the surplus at market prices.

b) Gradual Transition: This system allowed for a gradual adjustment of prices, helping to manage inflation and avoid social unrest. Over time, the market track expanded, and more goods and services transitioned to market-based pricing.

c) Efficiency Gains: The dual-track system improved resource allocation by introducing market signals, which encouraged producers to respond to consumer demand and optimize production.

5) Modernization of the Banking System

Reforms in the financial sector aimed at establishing a modern banking system capable of supporting a market-oriented economy.

a) People's Bank of China: The People's Bank of China was restructured to function as a central bank, with responsibilities for monetary policy, financial regulation, and currency stability.

b) Commercial Banking: State-owned commercial banks were created, separating commercial banking activities from policy lending. This restructuring aimed to improve financial intermediation and support private sector growth.

c) Capital Markets Development: Steps were taken to develop capital markets, including the establishment of stock exchanges in Shanghai and Shenzhen. These markets provided alternative funding sources for enterprises and facilitated investment diversification.

6) Regulatory Reforms

To ensure the stability and integrity of the financial system, regulatory frameworks were strengthened.

a) Banking Regulation: The China Banking Regulatory Commission (CBRC) was established to oversee the banking sector, ensuring sound banking practices and mitigating financial risks.

b) Securities Regulation: The China Securities Regulatory Commission (CSRC) was created to regulate the securities markets, promote transparency, and protect investors.

B. Part- II Conclusion

The key features of the 1978 economic reforms in China were comprehensive and multifaceted, targeting critical sectors of the economy. These reforms were designed to introduce market mechanisms, incentivize productivity, attract foreign investment, and integrate China into the global economy. Despite the challenges and criticisms, these reforms laid the foundation for China's remarkable economic transformation and sustained growth.

VII. DRAWING CONTRAST

India’s reforms in 1991 were more focused on liberalization and deregulation, which improved access to advanced technology and managerial expertise from abroad. The Foreign exchange reserves increased significantly, providing a buffer against external shocks. Despite high economic growth rates, employment generation did not keep pace, leading to jobless growth. Rapid industrialization and urbanization led to environmental degradation. China’s policy in 1978 stood out in this matter as its reforms reduced poverty and led to rapid industrialization. China’s reforms involved a gradual shift from a planned to a market economy. However, social inequality and regional imbalances became more pronounced. Both the policies introduced by China and India faced significant challenges regarding Environmental sustainability. There was resistance from within the existing political and administrative structures. In both cases, entrenched interests that benefited from the old system resisted the reforms.

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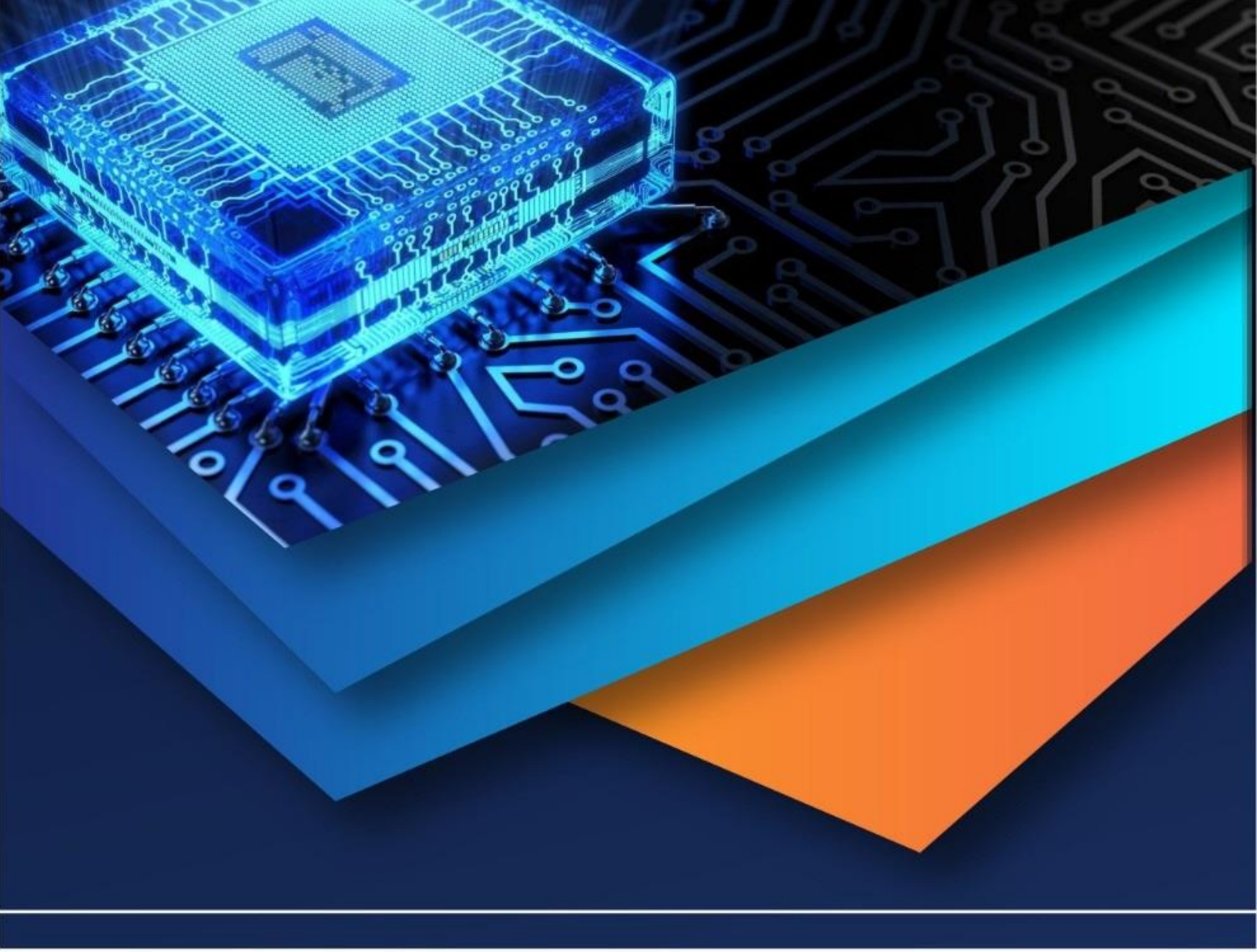
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Both countries had to navigate the complexities of integrating into the global economy, including managing foreign investment, trade policies, and exchange rates. The reforms attracted substantial foreign direct investment. Both countries invested heavily in infrastructure as part of their economic reforms. These shared challenges highlight the complexity and difficulty of transitioning from a controlled economy to a more liberalized and globalized one. Overall, both reforms were pivotal in transforming their respective economies, each with its unique set of advantages and challenges.

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