

A Study on Open Economy and Its Liberalisation

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Authors' contributions

This work was carried out in collaboration between both authors. Author Kadambari designed the study, performed the statistical analysis, wrote the protocol and managed the analyses of the study. The complete work conducted under guidance of author Chanderjeet. Both authors read and approved the final manuscript.

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ABSTRACT

The objective of this study is to shed light on the determinants of Open Economy in India. The paper discusses the move of allowance of Open Economy. The initial step took towards economy reform and liberalization took by the Central Government of India with respect to its reasons and effects on different sectors in India. The effect of policies introduced and applied in economy. Issues concerning economic policy, impact of the reforms on poverty, sectoral issues relating to agriculture, industry and infrastructure are briefly discussed. The paper is based on secondary data collected from different newspapers and online sources, mentioned in references.

Keywords: Liberalisation; open economy; reforms; economic reform in 1991.

1. INTRODUCTION

An economy open to international trade and payments will face different problems than an economy closed to the rest of the world. The typical introductory economics presentation of

macroeconomic equilibrium and policy is a closed-economy view. Discussions of economic adjustments required to combat unemployment or inflation do not consider the rest of the world. Clearly, this is no longer an acceptable approach in an increasingly integrated world.

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An open economy is that in which there are economic activities between the domestic community and outside. People and even businesses can trade in goods and services with other people and businesses in the international community around the world, and funds can flow as investments across the border with no barriers.

In the open economy, can summarized as the desirable economic goals as being the attainment of internal and external balance. Internal balance refers to the steady growth of the domestic economy consistent with a low unemployment rate. External balance is that when the achievement of the desired trade balance or desired international capital flows. In the principles of economics classes, the emphasis is on internal balance. By concentrating solely depends upon internal goals like inflation, unemployment, and economic growth, simpler-model economies may be used for analysis. A consideration of the joint pursuit of internal and external balance calls for a more detailed view of the economy. The slight increase in complexity yields a big payoff in terms of a more realistic view of the problems facing the modern policy maker. It is no longer a question of changing policies to change unemployment or inflation at home. Now the authorities must also consider the impact on the balance of trade, capital flows, and exchange rates.

There are several other changes which were made in 1991 in terms of the open economy. The major change was made in Import and Export. The trade is generally focused on Export and Import. The trade of exchange of goods and services in terms of considerable value with Tax. On import, the rate of tax was generally decreased to upgrade the economy with open global market whereas the export was promoted with rewards of subsidies and exemption from tax. Both sides were generally induced for global market completion. That change increases the market area for India to the international platform and other countries were welcomed in India for business.

2. REVIEW OF LITERATURE

There is a huge empirical literature available on the economic development growth hypothesis. The theoretical arguments regarding development growth hypothesis nexus have been empirically verified by economists & researchers at different times. The economic

growth hypothesis implies that an increase in exports would lead to an increase in economic growth. A feedback relationship between liberalization and economic growth is possible. Most recent studies using time series data to investigate the causality between a country's policy growth and its economic growth have failed to provide uniform support for the growth hypothesis. The studies have provided mixed conclusions. The literature related to India has been reviewed in this section.

For Bhagwati and Srinivasan [1] the industrialization policies pursued by India in the pre-reform period protected domestic industries from foreign competition but led to excessive or inappropriate state intervention in the market resulting in high cost and low growth in the Indian economy.

According to Jalan [2], the year 1990-1991 was the cruelest year in Indian history and the export performance of the Indian economy since independence was despondent when compared with other developing countries.

Ahluwalia [3] while rejecting the arguments of the critics of economic reforms considered India's efforts of liberalising its economy since 1991 as an 'economic revolution'. He, however, suggested a cautious approach towards opening up of route to a foreign capital since it brings in the elements of volatility.

Bhagwati and Srinivasan [4] argued that the crisis of 1991 was not governed by external factors rather was only an outcome of internal causes of weak policy regimes of the 1980s.

Mukesh Kumar [5] in their paper entitled "Impact of Economic Reforms on India" made study with an objective to find out the impact of Globalization on India and also study the Performance of the corporate sector after 1991. The finding shows that during the 11-year period 1995-2006 India's merchandise exports increased at the rate of 13.3 percent per annum and corporate sectors growth rate in sales and net profits are increased.

Dr. Thakur B., Sharma V K., Som Raj [6] in their paper entitled "Had Economic Reforms had an Impact on India's Industrial Sector?" threw the light on the impact of Economic Reforms on Industrial sector. Findings show that Economic reforms had started showing a positive impact on current Indian industrial performance in the

last few years in terms of an increase in the level of productivity and a reasonable rate of growth of the industrial sector because of Liberalisation.

3. OPEN ECONOMY CONCEPT IN INDIA

In 1991, economic liberalization in India refers to the changes and reforms, of the country's economic policies, with the goal of making the economy more market- and service-oriented, and expanding the role of private and foreign investment. That reform was an introduction to Open Economy for the Indian Economy. It was a mixture of macroeconomic stabilization and structural adjustment. It was guided by short-term and long-term objectives. Stabilization was necessary for the short run to restore the balance of payments equilibrium and to control inflation. At the same time changing the structure of institutions themselves through reforms was equally important from a long term point of view.

The new government moved urgently to implement a program of macroeconomic stabilization through fiscal correction. Besides this, structural reforms were initiated in the field of trade, industry and the public sector.

Problem: The low growth rate of the economy of India before 1980, which stagnated around 3.5% from the 1950s to the 1980s, while per capita income averaged 1.3%. At the same time, Pakistan grew by 5%, Indonesia by 9%, Thailand by 9%, South Korea by 10% and in Taiwan by 12%.

The crisis was caused by currency devaluation the current account deficit, and investor confidence played a significant role in the sharp exchange rate depreciation.

Infrastructure investment was poor because of the public sector monopoly. The facility of infrastructure was very low. No global trade, complete dependence on agriculture as National Income, other sectors did not emerge.

3.1 Objective of Study

- 1) To understand the impact of Liberal policy on Indian Economy.
- 2) To know the effectiveness and effect of policy on Indian Economy after 1991.
- 3) To measure the changes and growth of economy of India.

4. RESEARCH METHODOLOGY

For the completion of research paper has used Descriptive research method. In this study the data has been collected from secondary sources. The research is completed bases on secondary data, collect from reports, books, magazines,

There are many methods of data collection which can be used according to nature and type of research. I will use following data for the research purpose.

My research only the basis of secondary data.

- Articles
- Factsheet
- Economic Journals
- Annual report
- Research papers
- Internet
- News papers

5. RESULTS AND DISCUSSION

After evaluating the result there are lots of reforms that came forward.

In 1991, the government of India was headed by Narasimha Rao. As India faced a severe economic crisis, newly elected Prime Minister P. V. Narasimha Rao surprisingly inducted the apolitical Singh, Sardar Manmohan Singh into his cabinet as Finance Minister. Despite strong opposition, he as a Finance Minister carried out several structural reforms that liberalized India's economy. Although these measures proved successful in averting the crisis and enhanced Singh's reputation globally as a leading reform-minded economist, an acclaimed economist, played a central role in the implementation of reforms.

Major Steps in the 1991 Reforms: The major policy initiatives taken by the Government to fundamentally address the balance of payments problem and the structural rigidities were as follows:

- **Fiscal Reforms:** A key element in the stabilization effort was to restore fiscal discipline. The budget aimed at containing government expenditure and augmenting revenues; reversing the downtrend in the share of direct taxes to total tax revenues and curbing conspicuous consumption. Some of the important policy initiatives

introduced in the budget for the year 1991-92 for correcting the fiscal imbalance were: reduction in fertilizer subsidy, abolition of subsidy on sugar, disinvestment of a part of the government's equity holdings in select public sector undertakings, and acceptance of major recommendations of the Tax Reforms Committee headed by Raja Chelliah. These recommendations aimed to raise revenue through better compliance in case of income tax and excise and custom duties, and make the tax structure stable and transparent.

- **Monetary and Financial Sector Reforms:** Monetary reforms aimed at doing away with interest rate distortions and rationalizing the structure of lending rates. The new policy tried in many ways to make the banking system more efficient. Some of the measures undertaken were:
 - Reserve Requirements
 - Interest Rate Liberalisation
 - Greater competition among public sector, private sector and foreign banks and elimination of administrative constraints
 - Liberalisation of bank branch licensing policy
 - Banks were given freedom to relocate branches and open specialized branches
 - Guidelines for opening new private sector banks
 - New accounting norms
- **Industrial Policy Reforms**
- **Trade Policy Reforms**
- **Promoting Foreign Investment**
- **Rationalization of Exchange Rate Policy**

The 1991 economic reforms were focused primarily on the formal sector, and as a result, we have seen a significant boom in those areas that were liberalized. Sectors such as telecom and civil aviation have benefited greatly from deregulation and subsequent reforms. However, liberalisation and economic reforms still have a long way to go, especially for the informal sector—including the urban poor who hold jobs as street vendors or rickshaw pullers, the agricultural sector, Micro, Small and Medium Enterprises (MSMEs) and tribal. The slow growth and stagnation in these sectors which have not seen any reform further highlight the significant

role of the 1991 reforms in helping India's economy become what it is today.

6. FINDING AND INTERPRETATION

The new policies included startup for international trade and opening of investment, deregulation, initiation of privatization, tax reforms, and inflation-controlling measures. The overall direction of liberalisation has since remained the same, irrespective of the ruling party, although no party has yet tried to take on powerful lobbies such as the trade unions and farmers, or contentious issues such as reforming labor laws and reducing agricultural subsidies.

Pre-liberalisation Policies: Policy tended towards protectionism, with a strong emphasis on import substitution, industrialization, state intervention in labor and financial markets, a large public sector, business regulation, and central planning.

As of 1991, India still had a fixed exchange rate system, where the rupee was pegged to the value of a basket of currencies of major trading partners. India started having the balance of payment problems since 1985, and by the end of 1990, it was in a serious economic crisis.

The reforms progressed furthest in the areas of opening up foreign investment, reforming capital markets, deregulating domestic business, and reforming trade regime. Liberalization has done away with license raj that is for investment, industrial and import licensing. And many public monopolies, allowing automatic approval of foreign direct investment in many sectors.

Impact of reforms: After the implementation of reform policies, there were various changes and progress has been found. The unemployment rate declines along with the increase in Literacy rate. On the other side, there was an increasing trend with the promotion of FDI (Foreign Direct Investment). With the effect of the open economy the Import and Export both activities also inclined with effect from liberalization. The following are some graphs showing the post and pre liberalisation effect.

The total annual GDP was increasing and has been averagely increased. The following are the Tables and information in respect of the growth of the economy.

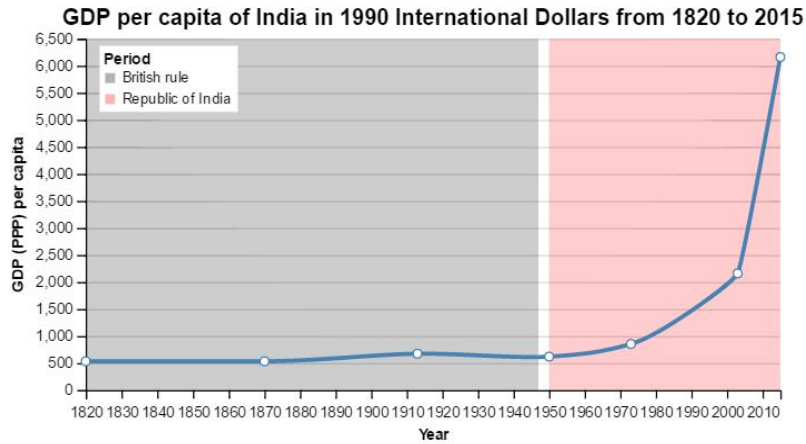


Fig. 1. Figure showing GDP per capita of Income post and pre independence

Discuss: The GDP from period of British Rule was approximately constant. Afterwards it starts inclining. Whereas the difference of GDP rate can be easily classified after 1991 as it remains in inclining trend with the effect of reform and liberalization effect. From post British rule the GDP always remain in increasing trend.

Table 1. Table showing annual growth of GDP on an average

1950-80	3.5%
1980-92	5.5%
1992-2003	6.0%
2003-15	8.0%

Source: Calculated from tables of the Government of India's Economy Survey, various years

Discuss: The GDP annual growth rate remains in increasing trend since liberalisation and its effects.

Table 2. Table showing the Literacy growth level of India over the period of time

Literacy	1950-51	1960-61	1970-71	1980-81	1990-91	2000-01	2010-11
	18.3	28.3	34.4	43.6	52.2	64.8	74.0

Source: Government of India, Census of India, 2011

Discuss: The literacy level which was earlier very low raises to maximum in 2010-11 and thereafter incline. This leads to educated society and develop individually.



Fig. 2. Figure showing the unemployment rate over a period of 2 decades

Source: World development indicators, World Bank

Discuss: The rate of unemployment became low with time. Overall the employment rate during past decades keep fluctuating.

Post Reform FDI inflow in India

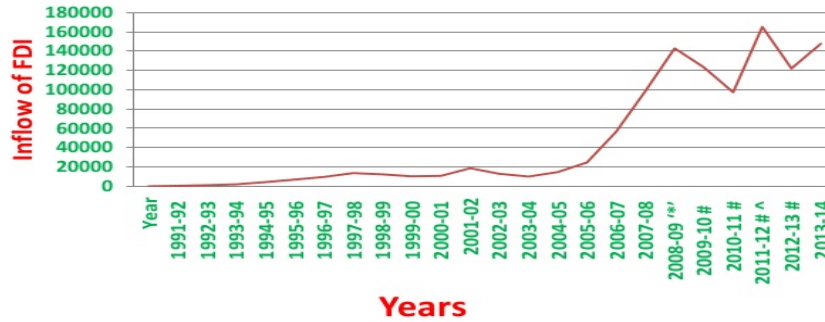


Fig. 3. Figure showing post reform investment of FDI (Foreign Direct Investment)
 Source-http://dipp.nic.in/English/Publications/FDI_Statistics/FDI_Statistics.aspx

Discuss: With effect from liberal policies in India the foreign direct investment were promoted and FDI got new ways to business in India and in initial period they had less growth rate but after a decade the rate of increase of FDI was very high.

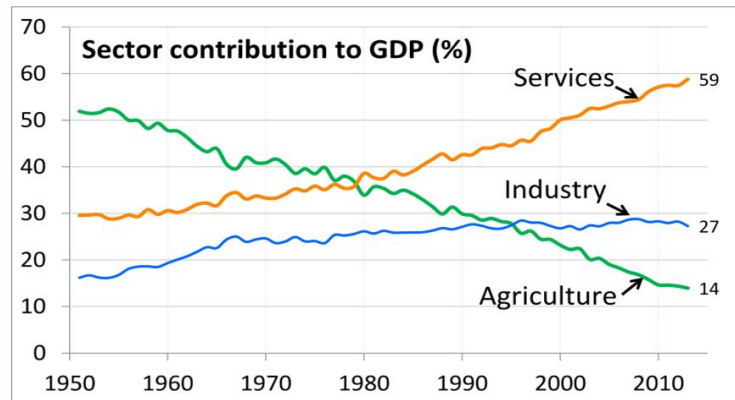


Fig. 4. Figure showing the Sector wise contribution made in GDP
 Source: <http://statisticstimes.com/economy/sectorwise-gdp-contribution-of-india.php> [7]

Discuss: The GDP in different sector has been explain in above chart. The agriculture contribution was very high in 1950, where as other sectors like Service and Industry contribution to GDP was very less comparatively. In 1980 to 1990 in this period the agriculture contribution inclined with increment in service sector and industrial income contribution.

7. CONCLUSION

Economic reforms have an important impact on the Indian economy. There are many changes in the Indian economy, after the adaptation of the policy of Liberalisation, Privatisation, and Globalisation in 1991. Because of these reforms, many good things happen like an increase in

India's GDP growth rate, Foreign Direct Investment, and Per Capita Income. The policy has facilitated the flow of foreign capital, technology, and managerial expertise thereby improving the efficiency of the industry. Also, the unemployment rate is reduced. Though certain negative impacts are also there like low growth of the agriculture sector, adverse impact on the

environment, etc. Lastly, we can say that development in India is taking place because of the implementation of this policy.

COMPETING INTERESTS

Authors have declared that no competing interests exist.

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