The transition of the Indian Economy from a Mixed Economy to a Neo-Liberal Economy

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Abstract:
Right after the independence Indian political leaders adopted a Mixed economic policy and the first prime minister Mr. Pandit Nehru inclined towards the socialist and capital approach to the economy. India started its journey with a closed trade policy and product substitute strategy. With the five-year planned system, India concentrates on the nascent industries and agriculture sector for the development of India. The economic growth rate of India was slow and stagnant post-independence. Later on, in the 1960s, and 1980s due to external and internal shocks Indian economy was trapped in the balance payment crisis, and India tried to shift its economy towards liberalization in 1966 this attempt failed but in the 1980s we can see some progress in India’s liberalization and could be the foundation for radical change from closed economic policy to neo-liberal economic policy. The importance of the study lies in the transition from a mixed economy to a neo-liberal economy, and the necessity of the economic shift from one economic thought to another. This study intended to understand reforms that took place in the reform period and in the three different phases after the independence. This study will reveal the political economy of India at different times and the political-economic reluctance and willingness toward liberalization.

Keywords: Economic reforms, Economic Crisis, Balance Payment, Liberalization, Political Economy.

Background:
The political economy is a thread that ties the citizens, government, and Public Policy. The Political economy studies how the government uses economic theories for the welfare of their country and countrymen. Every country runs its economy on a basic theory i.e., capitalism, socialism, or mixed economy. Post-independence India adopted a Mixed Economy under the leadership of the first Prime minister, Mr. Pandit Jawaharlal Nehru. This article intends to critically review the transition of economic policy of India from a Mixed and closed economy to a Neo-liberal Economy. India has transformed from a slower economy to fasted economy in the world, but this change has not come in a single day, for this, India has gone from simple and dripping changes to drastic economic changes in 1991 in Economic policy. Before 1991, India had abortive attempts at liberalization first in 1966, and second in the year 1980 under the leadership of Mrs. Indira Gandhi due to a balance of payment crisis. Moreover, these two unsuccessful attempts were due to the legacy of the Nehruvian economic impact on Mrs. India Gandhi.

The concept behind the acceptance of India’s Mixed-Economy:
In 1947, India got independence from 200 years of British rule, so the political leaders and freedom fighters discussed suitable economic policies for the welfare of the country and the development of the countrymen (Mukerji, 2002). Mr. Pandit Jawaharlal Nehru was greatly influenced by Soviet Russian development and the socialist economy and he was under the impression the development was made by the five-year planning in Soviet Russia. But at that time, in Soviet Russia all the properties were in the control of the government only, no place was in the private hand (Anand, 2005). This was not affordable for India because many people were landlords and they had their private properties and also many farmers were cultivating their land for bread and butter. Furthermore, the purchasing power of Indian people was very less at the time of independence due to poverty, so, Capitalist economic theory was not acceptable to India. Hence, Mr. Nehru, and other political leaders draw a middle way from this and accepted Mixed-Economy i.e., equal existence of public and private sectors (Budhwar, 2001). Thus, India started its
economic operation through the coexistence of the public sector and private sector as a mixed economy and this coexistence can be reflected in the provisions made by the Indian government in the early independence period. The fundamental heavy industries were under the control of the government. Whereas agriculture, small industries, housing and construction, and goods and service industries were privately owned under Restrictive Trade Policy and regulation (Jalal, 1995).

**Embarkment of Indian Five-year Planning System:**

India was known as an agriculture-based country and nearly more than three fourth the population is dependent on agriculture or agriculture-allied business for its livelihood. The industrial situation was very poor after independence as in British Raj the economy of India was ruined in great percentage. Now, India was in needs to overcome its poor economic situation with a planned strategy to recover the economy with the development of the industrial sector (Roy, 2019). Hence, the India board in the five-year planning system will be a self-sufficient county in the future from an agricultural and industrial perspective.

The five-year plan system is a quota system, to concentrate on specific economic sectors for a short period. This five-year plan system was first adopted in Soviet Russia by Joseph Stalin in 1928 for rapid growth in the industrial and agricultural sectors. The first five-year plan of Russia is known for its rapid industrialization (Davies et al., 1994). First Prime Minister Mr. Pandit Jawaharlal Nehru had a dream of socialist and modern India, Nehru was under the Impression of the Soviet Union’s industrialization by implementing a Five-year plan system (Anand, 2005). Indian economic planning started in the year 1950 with the motto of social and economic development of the country. The Planning Commission of India was established on 15 March 1950 and it is India’s Prime minister is a chairperson of the planning commission including the full-time experts of all sectors (Paranjape, 1964). The purpose of the formation of the planning commission is to raise the living standard of Indian citizens by exploiting natural and human resources in a directive way, boosting the industrial and agricultural sectors to generate employment (Gaynor & Mahalanobis, 1965).

**First Liberalization Move of India in 1966:**

After the sudden death of the First Prime Minister Pandit Nehru, Mr. Lal Bahadur Shastri became the second Prime Minister of India. The appointment of Mr. Shastri as a Prime Minister was a soothing effect on class business class because Mr. Shastri had very good relations with business tycoons of that time (Kudaisya, 2002). In the 1965 budget, we can see a space for export and private sectors, this is the result of the World Bank and IMF’s impact on Indian policymakers for the sake of international aid (Denoon, 1998). After Prime Minister Shastri, Mrs. Indira Gandhi became Indian Prime Minister and as a Prime Minister, she visited the US for food and financial aid with businessman Birla. On this visit, Mrs. Indira Gandhi expressed her positive approach towards liberalization against the US government and agreed to provide food and financial assistance to India (Kudaisya, 2002). In the 60s India faced two wars, in 1962 against China and 1965 against Pakistan trapped India in an economic catastrophe (Ganguly, 1990), later on, in the consecutive years 1965 and 1966, there was fewer seasonal Monsoon due to this the Indian agricultural economy collapsed (Ray et al., 2015). As a result, due to these exogenous shocks, the inflation rate increased by 12 % and annual food prices increased by 20% from the year 1965 to 1968. Also, the fiscal deficit rate in 1966-67 was 7.3 % of India's GDP (Chandra et al., 2008), leading India to a major economic crisis. The drought and famine situation nailed down the Indian government under the leadership of Prime Minister Indira Gandhi and the political conditions also got worsened in this period (Lockwood, 2016).
During this period, the balanced payment issue, shortage in foreign exchange, rising inflation, drought, two successive wars, etc. conditions reluctantly India forced to seek assistance from the International Monetary Funds (IMF) a trade liberal organization and unwillingly India devaluated the rupees in June 1966 to minimize of the inflation rate and to stimulate export as per IMF direction against the loan (Mukherji, 2000). Furthermore, the tariffs and subsidies on the export were removed under, simply this transition from import substitution policy to export promotion policy. This transition happened under the pressure of the IMF and the US government, but soon after that time Prime Minister Indira Gandhi returned to its protectionist socialist policy of Import substitution later in 1969 to get political support from the Communist Party of India and abandoned the policy of liberalization (Lockwood, 2016). Overall, due to the critical economic crisis India deviated from its mixed economic policy and leaned towards liberalization under international pressure. This was the first knock at the direction of the neo-liberalization of India.

Second Phase of Indian Liberalization in the 1980s: -

In the year 1979-80, India faced a 10% decline in agricultural production as well as a severe hike in the price of petroleum oil (Costa, 1986). In this period India confronted the severe Balanced Payment issue and in 1985 the balanced payment deficit increased up to Rs.11,384 crores (Sangvilkar et al., 2019). There are two main reasons behind the oil prices increase, the first reason is the production of crude oil became less as Iran was undergone through rebel in the year 1979, and the second reason behind the oil price is the war between Iran and Iraq oil production stopped. This disturbed India the most from 1978 to 1982 because the import price of oil products nearly doubled in this period (Kubursi, 1988). This is the prime reason India couldn’t absorb the economic shock which led to the Balance Payment crisis. Also, there was a global recession period from 1980 to 1983 (Hamilton, 1983), and due to this India’s export collapsed the most in this consecutive period.

In the 1980s, in 1980 there was a year of the 7th general election of India and Mrs. Indira Gandhi returned after defeating the Janata Party government. This new majority-owned government came back after the economic setback in the country (Gould, 1980). In this government, Mr. Venkataraman became the finance minister and he opined that this economic crisis arose due to a decline in agricultural and industrial production. Agricultural production decreased because of drought conditions in the majority areas of the country, and on the other hand, the lack of proper infrastructure industrial production got declined. To overcome this balance payment issue, many actions took place in India. India borrowed loans from international organizations like World Bank and International Monetary Fund and also tried some financial aid to recover from this economic trap (Danaher, 1994). Also. In this year India withdrew SDR-Special Drawing Rights from International Monetary Fund.

As a result, India has changed its economic policy and major liberal reform can be appeared in the Indian economy. The import tariff minimized on the import product and item, there was only around 80 products Open General License list (OGL) for import in the year 1976-77. in the year 1988-89, the import list increased considerably up to almost 1200 items (Chandra et al., 2008). This means that India relaxed its import policy through the product substitution policy. Moreover, the Indian government also released the canalized import right over some products, and from 1980 to 87 this rate of government import products declined from 67 % to 27 %. There could be due to an increase in the domestic production of imported products like oil and petroleum products (Panagariya, 2004). Before the green revolution, India depended on food grains for the international market, but after the green revolution, India decreased the import of food grains. In addition, India started allowing the import of products for new businesses like machinery, technology, and raw materials necessary for the businesses (Mr. Arvind Panagariya, 2004). Overall, the Indian government steps up towards liberalization to release the restrictions for import.
Certainly, not only the Indian government minimized the import restriction in the 1980s but also stimulated the export government anchored the policy of incentives in 1985. The government also motivated those businesses which could minimize the burden of import by the production of replacement products by providing incentives and also offered REP-Replenishment Licenses to countries’ export businesses. Along with this, the government has released tight control of regulations on industries and allowed them to import business-related goods and technology. Also, control the exchange rate on trade goods and non-trade goods and tried to work on the exchange rate with proper execution. But in the 1980s the external loans and debts were increasing aftermath of the major economic consequences India faced. To put it in a nutshell, the reforms in the 1980s are important in the transition of the Indian economy from a mixed economy to a liberal economy and the foundation for the drastic liberalization in the year 1991 (Dean, JM. et al., 1994).

**Story Behind the Drastic Liberalization and the Reforms in India in 1991:**

In 1991 under the leadership of prime minister Mr. P. V. Narsimha-Rao government’s neo-liberal economic policy was implemented on the verge of a severe economic crisis due to international loans (Jenkins, 1995). Many thinkers and economists argue that this economic crisis was faced by India due to the missed economic management in the 1980s. In the 1980s the expenses and revenue couldn’t be managed properly and economic utilization occurred. So; to repay the loans the new loans were borrowed by the government to bare the expenses and this consecutive borrowing trapped India in a severe economic situation (Denoon, 1998).

![Crusader of Economic Reforms in India Mr. P. V. Narsimha Rao & Dr. Manmohan Singh in a frame, Source: Hindustan Times 21 July 2021](image)

Generally, we focused on the external debt behind the balance payment issue that happened in the early 1990s and subsequent reforms in India, but there are other reasons also which impacted India and lead India to a severe economic crisis. The broken of the Soviet Union, the Iraq-Kuwait war, and the slow-
down of US growth as the single largest trading partner in the year 1988 to 1991 respectively (in the year 1991 the growth rate of the US was negative), from 1989-91 there are three coalition government changed and this political instability couldn’t address the balance payment issue, losing the confidence of investors, increased import of non-oil products (before India’s was mainly importing the petroleum oil). Along with external debts, these reasons squeezed the Indian economy and left the deterioration effects (Disha Experts, 2020).

The Indian government was trapped in external debt to manage the deficit, and the external loan burden was increasing since the 1980s. Due to this rising external debt, the balance payment issue deteriorates and pushed the Indian economy into a political-economic crisis. At the start of 1991, the month of January India’s foreign exchange reserve reached only $1.2 bn (Chandra, 2008), and washed-out almost 50 % by the month of June. Now just three weeks of foreign exchange reserved remained to import the necessary goods. In this economic catastrophe situation, India Prime Minister Mr. P.V. Narasimha Rao, and Finance Minister Dr. Manmohan Singh sought emergency assistance from IMF and on the word of collateral of 67 tons of Reserve Gold convinced to pay a $2.2 bn emergency loan to India. As per the pledge, India airlifted 47 tons of Gold to the Bank of England, and 20 tons to the Union Bank of Switzerland to raise $ 600 million to resolve the balance payment issue (Bhattacharjee & Bhattacharya, 2018). This was just temporary first aid to the economy, this incident awakened Prime Minister P. V. Narasimha Rao and Finance Minister Manmohan Singh and they started acting towards the drastic economic reforms in India after this lesson.

In the period of 1991, the worsening economic situation need a wiser economic vision, unfortunately, Politicians in ruling parties and opposition parties are far away to recognize the economic condition of that time. In the newly elected government Prime Minister, Mr. P. V. Narasimha Rao understand the economic mess of the country and he appointed Mr. Manmohan Singh as a finance minister a well-known economist and former governor of the Reserve Bank of India and deputy chairperson of the Indian Planning commission. In this economic crisis, Mr. Narasimha Rao and Dr. Manmohan Singh had an opportunity to introduce economic reforms for the welfare of the country. The Congress party kept silent and offered time to Dr. Manmohan Singh to establish the economic policy strategy for India (Bhushan & Katyal, 2004).

India needs economic reforms that will minimize the balance payment issue in the short run with well-structured economic reforms for the long term. The target of reforms was hasty growth in income and productive employment. This could be achieved by investment in land, infrastructure, irrigation, industrialization, and power. Sustainable development could be achieved by the productivity of our capital, land, and labor. Dr. Manmohan Singh implemented a strategy of structural adjustment and macroeconomic stabilization. The reason behind this is to overcome the balance payment crisis and inflation rate issue. Under the leadership of the Narasimha Rao government, they started structural and institutional changes in the area of trade, the public sector, and the industrial sector (Singh, 1995).

In the reforms of the 1991 governments, the prime moto was to stabilize the fiscal deficit. Due to the failure in the management of revenue and expenditure, the economic crises have been faced by India and we paid a huge cost for this. Hence, In the yearly budget of 1991-92 aimed to minimize the expenditure and increase revenues. In this budget, the government reduced the fertilizer subsidy, removed the subsidy on sugar, disinvestment in the public sector, and tax reforms, generating revenue with better execution in income-tax, excise, and customs duty collection. In addition, to resolve the balance payment issue one more measure was taken by the government the nearly 20 % devaluation of the rupees has done in 1991(Singh, 1995). This measure of devaluation of rupees took place to promote competitive export and stabilize the exchange rate.
In the monetary and financial sector reforms, the government removed the regulation on the interest rate given on deposits and loans. This means, a liberal interest rate policy was adopted by the government and released the control of RBI on interest rates of loans and long-term & short-term deposits. Also, for reserve, some reforms have been included the Cash reserve ratio was minimized from 25% to 10% for 4 years, and the statutory liquid ratio decreased from 38.5% to 25% for 3 years (Das & Ghosh, 2006). The government removed the administrative regulation for international banks and the competition in private and public sectors. Furthermore, the government relaxed the license policy for the banks’ branches to develop the banking sector and constructed a private bank policy. In 1991 the government also implemented drastic reforms in the capital market and offered legal recognition to the Security Exchange Board of India (SEBI) in 1992 (Joshi & Little, 1996). This means the government control on the capital market has been removed and introduced a supervisory body for better transparency. SEBI has assigned a role to mobilize the resources through securities and their distribution.

In the industrial reforms, the government implemented New Industrial Policy on 24 July 1991 for extensive deregulation of industries to increase the competitiveness among the industries for their sustainable growth. In this deregulation and reforms government eliminated License Raj and near about more than 80% of businesses were removed from licensing system, and only 18 sectors were kept in the loop for licensing. Monopolies and Trade Policy Act was revoked which was a barrier for industries to expand and diversify (Singh, 1995). The 17 important reserve public sectors were minimized and private sectors were introduced in these sectors, only 8 strategic and securities concern sectors were kept reserved for public control. The public sector has given autonomous status and professional management to compete in the market as a profitable entity and encourage the public sector units for disinvestment (Singh, 2008).

In these reforms we can find radical changes in the trade policy, a major shift can be seen from a closed trade economic policy to an open trade economic policy adopted in these reforms year. To enhance the export a nourishing environment has been created for this considerable deregulation policy adopted and also licensing policy relaxed to a greater extent for international trade. Indeed, the import and export restrictions have tried kept comfortable for encouraging foreign trade. In the reform, the government showed its willingness to endorse foreign investment in the country and some sweeping measures have been taken to attract foreign investment. First and foremost, the government announced the prioritized list of industries where foreign investment is essential. Secondly, the government implemented a foreign direct investment policy (FDI) for those prioritized industries, and the foreign equity limit increased step by step to 100% for most industries (Chakravarthy, 2005).

Conclusion:

Overall, the Indian economy has undergone an overwhelming transformation in a democratic way. After the implementation of the mixed economy, the growth of the Indian economy was slow and stagnant. At a later stage, India faced wars against the neighboring country and also natural disasters, and some oil importer countries’ wars shattered the Indian economy and India faced a balance payment crisis before 1991. The economic miss management and unstable political conditions obstruct India’s economic reforms. The willingness and strong leadership of Mr. P.V. Narsimha Rao stand behind Dr. Manmohan Singh for the liberal economic shift with the ruling party and opposition parties clashing with the reforms made by the government. Now, the Indian economy stands tall in the world, and consistently increasing GDP because of the radical changes made in the New Economic Policy of 1991.

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