India’s transformation

Summary

India adopted a democratic system of government and a mixed economy after gaining independence in 1947. However, a large part of their economy was still comprised of state-owned entities. Because of this, the private sector was stifled and any growth came only with hard-won government permission. This was especially true in the auto, chemical, and steel industries. Compounding the issue of strict government control was the fact that various laws made it difficult for businesses in the private sector to flourish. If a business grew to over 100 employees, then it was very difficult to fire a worker.

In turn, business owners kept the size of their firm under the threshold. Unfortunately, those businesses did not grow to their full potential and could not reach the size necessary to be competitive in the international market. At this time, due to the rules and regulations, India was not taking advantage of foreign direct investments. Thankfully, the lack of progress and growth led the government to reform the economic system. In 1991, many industries once closed to the private sector, including electricity generation, oil industry, steel production, air transport and telecommunications, were opened.

Foreign investments were given automatic approval up to a 51 percent stake in an Indian enterprise and, in some cases, 100 percent investment was granted. Tariffs on imports were dramatically reduced as were income tax rates and corporate tax rates. Each of these measures led to an increased rate of economic progress and tremendous growth within India’s private sector. India’s economy is still in a transition phase. While they have seen

growth in private sector enterprise and increased foreign investment, they still have to navigate political barriers and help mitigate risks.

Some import tariffs are still in place because the government fears a flood of inexpensive Chinese products. In addition, even though the private sector has proven more efficient than state-owned enterprises, there are still barriers to privatization. For instance, the Indian Supreme Court ruled that the government could not privatize two state-owned oil companies without the consent of parliament. India also continues to work towards a market economy to keep the country attractive to potential investors.

There are many benefits to investing early in India: the country has a large market population with the potential for continued high growth that can offer first-mover advantages. However, investors do need to take the risks into consideration: adhering to the local laws could be an unwanted cost as well as working within a legal system that may not provide the necessary protection for contract and property rights violations. As India continues to move toward a free market economy, they will continue to see growth in their private sector enterprises and foreign investment.

The government will need to support this growth and continue to reform regulations so businesses can grow and become competitive on a greater scale. This will also make the country more attractive to foreign direct investment where investors can take advantage of India’s growing economy. Questions 1. From 1947 to 1990, India operated under a mixed economy system. This economic system is a blend of private ownership and free market enterprise with state ownership and government planning. During

this time, the mixed economy in India was dominated by state-owned enterprises, centralized planning and subsidies.

This prevented the private sector in India from growing, especially in the auto, chemical and steel production industries which were specifically state-owned enterprises. Today, India is moving toward a market economy where productive activities are primarily privately owned. However, state-owned firms still account for 38 percent of national output in the nonfarm sector. There are several impediments to completing a full transformation to a market economy in India. For example, a reduction in import tariffs has stalled due to political pressure.

Politicians fear a flood of inexpensive products from China if the barriers are taken away. Also, it is still very difficult for privatization within the oil industry. The Indian Supreme Court ruled that the government could not privatize two state-owned oil companies without explicit approval from parliament. In addition, there is a disincentive for business owners to grow their firms more than 100 employees. Labor laws make it almost impossible for firms to fire an employee if the business is greater than 100 employees.

This does not allow the firm to attain the scale necessary to compete internationally. The economic system constrained the growth of the private sector. Private companies needed permission from the government to expand. It could take years to receive permission and several heavy industry products were reserved for state-owned enterprises. Even though private firms are 30 - 40 percent more efficient than state-owned firms, the extensive government regulations prevent the growth of private businesses and creation of new businesses.

These factors negatively affected the rate of economic growth in India. While other Southeast Asian nations were enjoying economic growth and progress, India was still struggling with a small economy despite having a population of 950 million. The GDP was $310 and only 2. 3 percent of the population had a household income greater than $2, 484. At the time, the World Bank estimated that 40 percent of the world's desperately poor lived in India. Compounding these issues was the fact that less than half the population could read and very few had access to clean sanitation.

Without basic necessities, a population will find it difficult to survive much less grow and flourish. 3. Privatization, deregulation and increased foreign direct investment have positively impacted India's economy during the post-1990 time period. For example, the economy has expanded at an annual rate of 6. 3 percent from 1994 to 2004 and increased to 9 percent from 2005 to 2008. Proving that the Indian market is attractive, foreign investment increased from $150 million in 1991 to $36. 7 billion in 2008.

India is strengthening in the areas oftechnologyand pharmaceutical products in part of their attractiveness to foreign investments and the fact that the government was now welcoming foreign investment. Foreign equity stakes in an Indian enterprise up to 51 percent are automatic; 100 percent ownership is allowable under certain circumstances. Industry goods are seeing a freedom of importation and the maximum tariffs have fallen to 35 percent as of 1997. India's success in these industries will continue to prove the efficiency and growth potential of privatizing business.

I believethat India represents an attractive market for foreign multinationals selling consumer products. International firms have the opportunity to

engage early in India’s economy. In turn, this will lead to building brandloyaltyand gaining experience navigating the country’s business practices. Of course, the international firms must be aware of the risks surrounding unprotected property rights and other political and legal matters. With due diligence, investment into India’s economy could provide high dividends to foreign multinationals as the economy continues to grow.