International Journal of Development in Social Sciences and Humanities http://www.ijdssh.com

(IJDSSH) 2016, Vol. No. 1, Jan-Jun e-ISSN: 2455-5142; p-ISSN: 2455-7730

POVERTY AND INEQUALITY IN INDIA POST 1990: HAS OPENING UP OF THE ECONOMY HELPED?

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INTRODUCTION

There has been a dramatic change in the Indian economy during the past three decades which moved from being a closed economy heavily dependent on the state to one which is exposed to the international markets and with substantially reduced dependence on the economic activity of the state. This dramatic change has been confined, with the basic structures determining employment, livelihood and poverty for majority of the population not changing sufficiently. Some of the structural characteristics that persisted include the presence of high degree of under employment ,a strong dualism between the organized and unorganized sectors especially in manufacturing which sometimes translates into the dualism between large scale and small scale, the continuing significance of agriculture as the major employer, the emergence of services as the newer employer often as the refuge sector and the involvement of the larger share of the workforce in low productive employment.

Following Independence India adopted a strategy of import substitution which did have some degree of success but as early as the mid-1960s the strategy faced set backs. The once for all stimulus offered by import substitution was exhausted. The state was also unable to provide stimulus to growth because of its inability to raise adequate resources. This was due to the contradictory roles which the state was required to fulfill. The increasing government expenditure was necessary to keep the domestic market expanding.

ECONOMIC REFORMS IN THE 1990S

The process of economic reforms undertaken circa 1991 were done so with certain precise objectives: First it aimed to eliminate or significantly reduce controls on capacity creation, production and prices, permitting market forces to influence the investment and operational decisions of economic units within the country. Further international competition was allowed which in turn facilitated international relative prices to influence the decisions of these agents. The presence of state agencies in production and trade was significantly reduced, except in areas where market failure necessitates state entry. And finally the liberalization of the financial sector was achieved by reducing controls on the banking system, allowing for the rise of financial institutions and instruments and permitting foreign entry into the financial sector. All the reforms were thus based on the perception that greater freedom given to private agents and market functioning would ensure more efficient and more dynamic outcomes. The government also aimed to restructure production towards areas of international comparative advantage. These areas were seen as intrinsically labor-intensive, which led to the further calculation that, after an initial brief period of net job loss, such a strategy of trade liberalization would create more employment over time.

Towards the attainment of these objectives a number of policy decisions were undertaken. These ranged from substantial reductions in direct State control in terms of administered prices and regulation of economic activity to privatization of state owned assets. Rationalization and reduction of direct and indirect tax rates was carried out which over time caused declining tax-GDP ratios. In addition attempts were made to reduce fiscal deficits which usually involved cutting back on public productive investment as well as certain types of social expenditure, reducing subsidies to farmers and increasing user charges for public services and utilities. Trade liberalization via shifts from quantitative restrictions to tariffs and sharp reductions in the average rate of tariff protection as well as withdrawal of export subsidies were commenced. Liberalization of the financial sector was achieved through reductions in directed credit, freeing of interest rate ceilings and other measures which raised the cost of borrowing, for the government as well. There was a shift to market determined exchange rates and liberalization of current account transactions. And finally considerable liberalization of the capital account was realized including easing of rules for Foreign Direct Investment, permissions for non-residents to hold domestic financial assets, easier access to foreign commercial borrowing by domestic firms, and even freedoms for domestic residents to hold foreign assets.

Before taking into consideration the impact of the reforms on poverty and inequality it is imperative to concentrate on the reforms undertaken in the major sectors of the economy.

INDUSTRIAL REFORMS

Industrial policy prior to the reforms was characterized by multiple controls over private investment that limited the area in which private investors were allowed to operate and also determined their scale of operations, the location of new investment and even the technology to be used. This industrial structure was highly inefficient.

Reforms in the industrial sector had the following key features:

Industries reserved solely for public sector was reduced from 18 to 3, which now were defense aircrafts and warships, atomic energy for generation and railways transport. Industrial licensing was abolished for almost all sectors except for a few hazardous and environmentally sensitive industries. Investment in large investment houses needed a separate clearance under the Monopolies and Restrictive Trade Practices act during the pre reform period which was relaxed during the 1990s.

FINANCIAL SECTOR LIBERALIZATION

Financial sector reforms included reforms in banking sector, capital markets and insurance in the later stages.

Banking sector reforms included

a) Measures for liberalization- changing complex system of interest rate controls, no approval of RBI for the statutory requirements to invest in government securities

b) Measures to increase financial soundness were taken like introducing capital adequacy requirements, prudential norms for banks and strengthening banking supervision

c) Reforms like liberal licensing of private banks and freer expansion by foreign banks were taken to increase competition.

These reforms led to positive outcomes- like reduction in share of non performing assets in the portfolio and more than 90% of banks met the capital adequacy standards. These figures may overstate the improvements because the domestic standards are much lower than the international standards. The government has recently introduced legislation to establish a bankruptcy law which will be closer to accepted international standards. Moreover the efficiency of banking system will depend on the ability of government to increase the efficiency of public sector banks. Serious steps (reforms) in the capital market were taken after the stock market scam in 1992. The reforms included establishment of a statutory regulator, promulgation of rules and regulations governing various types of participants in the capital market and also activities like insider trading and takeover bids, introduction of electronic trading to improve transparency in establishing prices, and dematerialization of shares to eliminate the need for physical movement and storage of paper securities.

AGRICULTURE REFORMS

The economic reforms were concentrated on the industrial and trade sector without giving due attention to the agricultural sector which provides the livelihood of 60% of the population. There was a decline in public investment in areas critical for agricultural growth, such as irrigation and drainage, soil conservation and water management systems and rural roads. Though there was a rise in private investment in agriculture in the post reform period, investment in agricultural- related infrastructure which is critical in achieving high productivity is only likely to come from the public sector. Indeed the rising trend in private investment in agriculture was dampened to an extent because of the lack of public investment in these critical areas. Some of the policies which were crucial in promoting food grain production in earlier years are now hindering agricultural diversification. Government price support level for food grains such as wheat have been fixed at much higher levels than based on the recommendations of the Commission on Agricultural Costs and Prices. This has encouraged over production: the public food grain stocks reached 58 million tons on Jan 1st 2002 against a norm of around 17 million tons.

TRADE POLICY

Pre reform period trade policy was characterized by high tariffs and pervasive import restrictions. Imports were possible only with import licenses and imports of manufactured consumer goods were completely banned, in addition the criteria for issuing the licenses were nontransparent. Post libralisation, import licensing was abolished along with a switch to a flexible exchange rate system. Import licensing had been traditionally defended on the grounds that it was necessary to manage the BOP, but the shift to a flexible exchange rate enabled the government to argue that any BOP impact could be effectively dealt with exchange rate flexibility. The weighted import duty declined from a very high rate of 72.5percent in 1991-92 to 24.6percent in 1996-97.

IMPACT OF REFORMS

On Employment:

One important consequence of the growth pattern during the 1990s was the very low rates of employment generation. Rural employment in the period 1993-94 to 1999-2000 grew at the very low annual rate of less than 0.6 per cent per annum, well below the rate of growth of rural population. Urban employment growth, at 2.3 per cent per annum, was also well below that of earlier periods, and employment in the formal sector stagnated. Further, the quality of employment deteriorated, with increases in casual and part-time work rather than regular, as well as greater fragility of contracts.

Table 1: Growth rates of employment (per cent change per annum)

Time period	Rural	Urban
1983 to 1987-88	1.36	2.77
1987-88 to 1993-94	2.03	3.39
1993-94 to 1999-2000	0.58	2.27

Source: Based on NSS employment rates and Census population figures

Agricultural employment showed the sharpest decline, with absolute declines in the number of people usually employed in agriculture over the 1990s. Part of this was due to technological changes that reduced labour demand in agriculture. There was also a steady rise in landlessness which emerged as a consequence of cultivation becoming less viable given the squeeze on the peasantry as a result of rising input costs and falling or stagnant crop prices. Since peasants using family labour tend to use labour more intensively than farmers using hired labour, this constituted an additional impact on rural employment.

In the urban sector there was a deceleration and even a decline in organized sector employment post 1990. This was a worrying feature of the post reform period given that industrial output increased manifold and the service sector, in which much of the organized employment was absorbed, was the most forceful element in national income growth. This was due to the decline in public sector employment, which was not made up for by the increase in private organized sector employment. The formal feminisation of work was less prominent in India when compared to other Asian countries. There has been some increase in Women's employment during the peak period of 1990s. Women's urban employment was mostly in services and to some extent in home based work which extends from large companied through various sub contract units to women working for low wages.

On Agriculture:

The farming community was affected the most by the economic policies. A package designed specifically for agriculture was lacking. It was assumed that liberalized external trade and a freed agricultural market would create price incentives that would enhance investment and output in the sector as well as shift the intersect oral terms of trade in favour of agriculture. Changes in government expenditure as well as financial measures affected the conditions of cultivation. Fiscal policies reducing expenditure in certain areas particularly rural spending, trade liberalisation, financial liberalisation and privatisation of important areas of economic activity and service provision had an adverse impact on cultivation and rural living conditions.

India's financial liberalisation strategy aimed to make the Central bank more independent, relieve financial repression by freeing interest rates and allowing financial innovation, to reduce directed and subsidized credit as well as greater freedom in terms of external flows of capital in various forms. The reduced emphasis on priority sector lending reduced the availability of rural credit and made farm investment more expensive and more difficult especially for small farmers. Declining credit-deposit ratios in rural areas, the shift of banks away from crop lending and term lending for agriculture, the reduction in the number of rural bank branches and less manpower for rural service provision all lead to an inadequacy on the part of the formal sector to meet the requirements of cultivators. Farmers were hence forced to rely on the private money lenders. This also created the problem of interlinked markets in which control in one market resulted in controls in other related rural markets such as those for agricultural inputs and crop prices as well as the labour market.

The progressive reduction or removal of trade restrictions had significant impacts on Indian agriculture. The devaluation of the rupee in mid-1991 which preceded the neo-liberal economic reforms was followed

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by the removal of export subsidies on agricultural commodities such as tea and coffee. The process of liberalisation accelerated towards the late 1990s in tune with WTO agreements and resulted in the liberalisation of export controls, quantitative controls on imports and decontrol of domestic trade. In the early 1990s tariff rates for most agricultural commodities were low or zero largely because quantitative restrictions made tariffs irrelevant and because the world prices were higher than Indian prices over that period. Subsequently, and especially after 2000, tariff rates have generally been falling and have been significantly below the bound tariffs. What is possibly even more significant, however, is that tariff rates have been relatively stable despite tremendous volatility in world trade prices, so that Indian agriculturalists effectively had to deal with all the volatility of world prices. This meant that even as the uncertainties related to international price movements became more directly significant for farmers, progressive trade liberalization and tariff reduction in these commodities made their market relations more problematic. Government policy did not adjust in ways that would make the transition easier or less volatile even in price terms. Thus, there was no evidence of any co-ordination between domestic price policy and the policies regarding external trade and tariffs.

TRENDS IN INEQUALITY

The period from 1964 to 1990 was characterized by a controlled and stable policy regime. GDP growth was higher essentially because of the adoption of Green-Revolution-type technologies and a more mature industrial base. Inequality remained stable, so that there was a more rapid drop in the incidence of poverty. However, because of rapid population growth, the absolute number of the poor increased. On the other hand, in response to controlled liberalization in the 1990s there was a modest rise in rural inequality and a more significant rise in urban inequality, and, because growth in this period was characterized by a shift of the population to urban areas, there was an increase in aggregate inequality. There was also an increase in regional inequality, of which the most striking aspect was the increase in inequality in the incidence of rural poverty. Despite healthy growth, poverty stagnated because of the increase in inequality and the sluggish increase in agricultural wages, as well as the rise in prices in the public distribution system consequent upon the reduction of food and fertilizer subsidies.

INEQUALITY IN THE RURAL SECTOR

The period until 1963 witnessed a fall in the rural Gini in response to the dismantling of the zamindari and other feudal structures. However, growth rates were so low that real mean consumption declined between 1957-58 and 1963-64. Thus, the distributional improvement was unable to generate a drop in poverty. From 1963-64 to 1990, inequality remained stable, with the rural Gini falling by only 0.78 points. Inequality (and poverty) increased in response to the brief, but costly war with Pakistan in 1965-

66, which was followed by two years of poor monsoons and consequent near-famine-like conditions in many parts of the country. Inequality also began to decline after the initiation of land reforms in 1969.

The post 1991 period provided a major break with the past in rural inequality. The period began with a crisis. Food grain production declined between 1991 and 1992 largely as a result of an increase in the price of fertilizers after a cut in the fertilizer subsidy. Macroeconomic performance started to improve in 1993-94. GDP, NNP per capita, agricultural output and food availability registered good gains, and the inflation rate fell.

This growth, however, exacerbated rural inequality. The Gini was higher in 1997 than it had been at the onset of the economic crisis in 1990-91 (30.11 as compared to 27.71).

Changes in the real wage in agriculture have been a reasonable proxy for the movements in inequality and, particularly, for those in poverty in rural India. Real mean consumption has shown a weak upward trend, and, along with fluctuating real agricultural wages, this indicates the slowly rising importance of (non-agricultural) labour income. Growth in urban real wages seems to have had little impact on rural poverty.

INEQUALITY IN THE URBAN SECTOR

The urban Gini has always been higher than the rural Gini. In the 26-year period 1963-64 to 1989-90, the urban Gini was almost constant (falling by only 0.95 points). In contrast, in the seven-year period between 1990-91 and 1997, the urban Gini went up by 2.17 points. In 1997 it stood at one of the highest values ever in the Indian context: 36.12. Thus, the reforms have led to a sharp rise in urban inequality.

The rise in inequality has been the result of three factors: (i) a shift in earnings from labour to capital income, (ii) the rapid growth of the services sector – particularly banking, financial institutions, insurance, and real estate sectors – with a consequent explosion in demand for skilled workers and (iii) a drop in the rate of labour absorption during the reform period.

The economic reforms have been associated with a drop in the rate of labour absorption since the growth of the banking, financial institutions, insurance, and real estate sectors has outstripped the growth of agriculture during almost every year of the reform period. Since 1996-97 the growth of the banking, financial institutions, insurance, and real estate sectors has consistently also outpaced the growth in manufacturing. It is well known that growth in these sectors creates demand for highly skilled and specialized factors of production and has a substantial speculative component. Facilitating the development of enterprise and investment may have led to a considerable improvement in profit opportunities, but not so in the case of labour earnings.

The gradual pace of the reforms and the practice of staggering major policy changes have limited the negative effects in terms of a worsening of inequality. But the lack of flexibility in labour markets, particularly the difficulties associated with the retrenchment of workers, has tended to cushion workers from the unemployment implications of the reforms. Therefore, it is widely accepted that this has also acted as a brake on more rapid economic growth. Thus, since the reforms have been gradual and partial and labour still enjoys considerable security of tenure, this deterioration in inequality has been mild

TRENDS IN POVERTY: STATE WISE PERFORMANCE

As far as state wise performance regarding trends of poverty is concerned, two studies can be cited in this context, one by K. Sundaram and S .D.Tendulkar and the other by Montek Singh Ahluwalia.

M.S Ahluwalia in his article Economic Performance of states in post reforms period studies the growth rates and poverty trends in 14 major states in India. This study was based on the Gross State Domestic product (SDP) estimates which are further based on Central statistical organization estimates. North Eastern states have been excluded for gaps in data. Small states like Delhi and Goa have also been excluded leaving 14 states for the analysis. There are two periods comparison namely the Pre-Reform period from 1880-81 to 1990-91 and the Post-Reform period from 1991-92 to 1997-98. The combined SDP of 14 states has experienced an increase in the growth rates from 5.2%p.a to 5.9%p.a over the corresponding periods. This acceleration corresponds to the acceleration in GDP over the same time periods.

However there is a considerable variation in the performance of states with some states growing faster than the average while the others growing slower. The degree of dispersion in the growth rates across states has increased significantly in the 1990s and ranged from 3.65% in Kerala to 6.6% in Rajasthan. Thus differences in performance are even more marked when we allow for differences in population growth rates and evaluate growth rates of SDP per capita. While the 1980s variation ranged from 2.1% to 4%, the 1990s variation ranged from 1.1% to 7.6%.
Thus the increased variations in the 1990s reflects that though growth accelerated in the 1990s at the economy wide level it decelerated sharply in Bihar, Uttar Pradesh and Orissa and to a lesser extent in Punjab and Haryana. Six states experienced acceleration in SDP in the 1990s. Therefore the high growth performance in the 1990s is not concentrated in any one part of the country but well distributed regionally.

Differences in growth performance of individual states have an important implication for poverty reduction which is a national policy objective. The expectations were that poverty declined faster in states growing faster while the decline is less in other states. In states such as Bihar, UP and Orissa where the growth of per capita income is low, poverty rates need not have declined at all. However what happened to poverty in individual states is difficult to ascertain due to data limitations. Data consists of large sample survey of 1, 20,000 households which are conducted by the NSS every five years. In addition, annual surveys are conducted based on the sample of 25,000 house holds. These samples are too small to provide reliable estimates of poverty for individual states. In addition state specific poverty estimates are available from the Planning Commission on the basis of three sample surveys in 1983, 1987-88 and 1993-94.

Table 2: Percentage of Population in Poverty

	1983-84	1987-88	1993-94
Bihar	52.22	52.13	54.96
Rajasthan	34.46	35.15	27.41
Uttar Pradesh	47.07	41.46	40.85
Orissa	65.29	55.58	48.56
Madhya Pradesh	49.78	43.07	40.85
Andhra Pradesh	28.91	25.86	22.19
Tamil Nadu	51.66	43.39	35.03
Kerala	40.42	31.79	25.43
Karnataka	38.24	37.53	33.16
West Bengal	54.85	44.72	35.66
Gujarat	32.79	31.54	24.21
Haryana	21.37	16.64	25.05
Maharashtra	43.44	40.41	36.86
Punjab	16.18	13.20	11.77
All 14 states	43.80	39.92	36.25
All India	44.48	38.86	35.97

Source: Planning Commission.

Table 3: Annual Rate of Growth of Per Capita SDP between 1983-84 and 1997-98

	1983-84 to 1993-9 (% pa)	1993-94 to1997-98 (% pa)
Bihar	0.78	2.14
Rajasthan	1.79	5.94
Uttar Pradesh	1.76	1.69
Orissa	1.37	2.61
Madhya Pradesh	2.38	2.71
Andhra Pradesh	3.49	2.40

Tamil Nadu	4.69	4.47
Kerala	4.11	3.79
Karnataka	3.76	3.42
West Bengal	2.69	5.45
Gujarat	2.50	7.62
Haryana	3.39	3.16
Maharashtra	4.96	3.90
Punjab	3.30	2.60
All 14 States	3.16	3.87

Source: Planning Commission.

For the 14 states as a whole the percentage of the population below the poverty line declined from 43.85% in 1983 to 36.3% in 1993-94, i.e. a slow decline of 7.5% in 10 years. Except for Bihar and Haryana 12 states experienced a decline in poverty over the decade. Of the 2 states that showed an increase in poverty, for Bihar the explanation is a very slow growth in SDP of 0.8%p.a in this decade. Haryana is more difficult to explain as it grew at 3.4%p.a in this time period but probably the distribution of income worsened sufficiently leading to rise in poverty rates.

After 1993-94 data only from 60th NSS round surveys of 1999-2000 is available. Till that time it was only speculated on the basis of economic growth in these states. Based on past all India experiences one would expect some poverty reductions in states where per capita SDP growth exceeds 3%p.a .In UP and Bihar these rates continue to be low at below 3%p.a. Growth rates in Orissa, Madhya Pradesh, Andhra Pradesh and Punjab are not fast enough to expect significant poverty declines. However in the other 8 states where per capita SDP has grown in excess of 3%p.a a continued decline in poverty is expected.

At this point Montek Singh Ahluwalia questions would this state performance imply a modest decline in poverty for the country as a whole? The lack of progress in the reduction in poverty for the country as a whole is not borne out by the 1990s, then sample studies. Thus Ahluwalia concluded by saying that ***poverty has not declined in the 1990s, despite robust growth*** and this has naturally raised questions about the nature of the growth process witnessed in this period.

K.Sundaram & S.D.Tendulkar, on the other hand have based their study on 15 major states based on NSS unemployment surveys.

Table 4: The poverty lines in Rs per capita per month

	Urban	Rural
1993-94	274.88	211.30
1999-2000	451.19	335.46

The key results are as follows:

- In the rural areas of 6 states namely Assam. Karnataka, Madhya Pradesh, Orissa, Tamil Nadu and West Bengal the poverty prevalence rate are higher in 1999-2000 than in 1993-94 , while the ratios rose for Maharashtra are unchanged.
- At the all India level and in 8 out of 15 states poverty prevalence ratios have declined in 1990s with most states experiencing sizable decline from 19 to 51%* except for 3 states where it is less than 10% .
- In urban areas there has been a decline in the poverty ratios in 8 out of 15 states and at the All India level. In 5 of these sates this decline has been between 20-25% compared to 1993-94 levels.

Sundaram and Tendulkar conclude that overall there is a confirmation from the Employment unemployment surveys at the all India level that poverty prevalence in India that has unambiguously declined in the 1990s. He also says that the rate of poverty reduction is seen to be faster during the 1990s relative to 1980s.

CONCLUSION

We go back now to the underlying question our project deals with. Have the economic reforms in particular the trade liberalization, reduced inequality and poverty in the Indian economy? An answer to this vexed question is not easy, since India has been a late and slow reformer. Nonetheless certain generalizations can be made on the basis of the assemblage of the articles referred by us.

In both the rural and the urban sectors, at the all-India level inequality was higher
post-reform than it was at the time of the crisis. Since the Gini coefficient for the urban sector is always higher than that for the rural sector, and since rapid economic growth implies a shift in the population from the rural to the urban sectors, the reform process has been accompanied by an increase in overall inequality. This rise in inequality is the result of a shift in the distribution of income from wages to profits and a drop in the rate of labour absorption. This has increased the demand and, therefore, the remuneration of skilled labour and specialized factors of production. However, since the reforms have

been gradual and partial and labour still enjoys considerable security of tenure, this deterioration in inequality has been mild.

Poverty rose in the immediate aftermath of the reforms. Growth picked up, but the
level of poverty remained the same partially because of higher inequality and stagnation in the agricultural real wage, although there was some reduction in urban poverty. The decline in the crucial area of rural poverty was lower than that during the 1980s and quite unsteady. Rural poverty actually rose in 1995-96, and urban poverty in 1997.

Movements in aggregate inequality and poverty measures are actually the outcome of the movements in the measures in opposite directions in some states. This dispersion has increased with the reforms. Thus, there is reason to be concerned about widening regional inequalities. Overall, growth seems to have increased inequality. In some cases, inequality is constraining growth because states with high Gini coefficients also have poor growth performance.

This reinforces the view that rapid economic growth remains the best bet for reducing
However economic growth needs to be accompanied by relevant policy measures as has already been discussed previously.

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