Macromanagement and Business Environment: Analysis of the 1991 Indian Economic Crisis

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Abstract –

In this paper, we discuss the importance that macroeconomic management, policies and stability have on promoting the business environment of a country. For this purpose, the analysis of the 1991 Balance of Payments (BoP) crisis in India has been done to show how poor macroeconomic management of the Indian economy during the 1980s precipitated the BoP crisis in 1991 and led to the disruption of business environment during the crisis phase. We then look at how the subsequent corrective macroeconomic management and policies led to the restoration and improvement of the business climate in the economy.

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Contents

1. Introduction

In this paper, we will attempt to underline the importance of macroeconomic policies and stability on the business environment of a country by analyzing the balance of payments crisis which India faced during 1991-92.

The 1991-92 Balance of Payments (BoP) crisis had far reaching implications for the business environment in India, both during the crisis and after it. We show how the crisis was precipitated by poor macro management of the economy and then analyze the repercussions of the crisis on the business climate of the economy. We then show how the subsequent macroeconomic stabilization policies led to the rebuilding of the business climate which stood temporarily hampered during the crisis years, thereby underlining the importance of macroeconomic stability and management for the business environment of a country.

The paper has been organized into different sections. In section 2, we introduce what is meant by the 1991-92 Indian BoP crisis and analyze the reasons which led to the crisis, central among which is poor macro management and policies of the economy. In section 3, we show how the 1991-92 crisis caused by poor macro management resulted in substantial damage to the country's business environment. Finally, in section 4, we show how subsequent corrective macroeconomic policies improved India's business environment and put it on a high and sustainable growth trajectory, thereby showing how good macroeconomic policies and management can have a positive influence on the business environment of an economy.

1.1 Business Environment

The term 'Business Environment' is used to describe the general conditions for doing business that are present in an economy. It is not possible to exhaustively define business environment as the factors affecting it are numerous.

In this paper, we will be using the word 'business environment' to refer to those factors which influence business decisions such as investment decisions, private investment, etc. in an economy. The term ‘business environment’ or ‘business climate’ will encapsulate the conditions present in an economy which have a bearing, either direct or indirect, on the prospects for profits and returns on investment, and output growth.

Keeping in view the limited scope of this paper, certain indicators (macroeconomic or otherwise) have been used to understand the business environment that prevails in an economy. In the next few paragraph, we briefly talk about these indicators.

An important macroeconomic determinant of business climate is fiscal deficit. Fiscal deficit influences the business environment through its direct effects on interest rates and inflation. Interest rates and inflation, in turn, influence business environment through their influence on savings and investments. Fiscal deficits also influence the business environment of an economy through its effects on infrastructure development and availability of credit.

The business climate in an economy is also substantially influenced by factors such as the prevailing interest rates and inflation. High interest rates makes credit expensive and stifles investments, while high inflation rates is looked upon as a sign of macroeconomic instability.

The foreign trade, exchange rate and industrial policy also have a direct bearing on the domestic business environment. Such policies can either serve to improve or deteriorate the business climate in an economy. The foreign trade and exchange rate policies show a direct bearing on external debt and the current account deficit of an economy which in themselves are important determinant of the macroeconomic stability and business environment prevailing in a country.

Another factor that can play an important part in a country’s business environment is Foreign Direct Investment (FDI). The inflow of FDI into an economy can serve as an important indicator to gauge the business and investment climate prevailing in an economy.

2. The 1991 Indian Balance of Payments (BoP) Crisis

"By June 1991, the balance of payments crisis had become overwhelmingly a crisis of confidence – of confidence in the government's ability to manage the balance of payments…A default on payments, for the first time in our history had become a serious possibility in June 1991."

- The Economic Survey (1991-92)

The 1991 crisis had manifold roots central among which is the growing recourse to various forms of external borrowing to finance a series of large trade and current account deficits in the latter half of the eighties. The foreign exchange reserves were also run down to finance the unsustainable external deficit and in mid-1991 foreign exchange reserves were barely sufficient to meet two weeks import bill.

Although an active policy of real exchange rate depreciation in the second half of the 1980s induced good export growth in late eighties, it was a case of too little too late. The value of imports increased at a faster pace (than what could be financed by the exports) because of the gradual easing of import and industrial licensing requirements after the 1980s.

The growing recourse to external borrowing in the second half of the 1980s had led to a substantial deterioration in India's external debt indicators. As a ratio to foreign currency reserves, short-term debt soared to a dangerous 382 per cent, signaling the heightened fragility of India's external finances.

The crisis was waiting to happen and the trigger came in the form of the Gulf War of 1991 and the associated oil price hike tipped India's fragile external finances into a full-blown balance of payments crisis.

2.1 Reasons for the Crisis

Jalan (2004)[1] lays the blame for the crisis squarely on poor macroeconomic

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[1] Jalan, Bimal (2004): '*Balance of Payments-1956 to 1991'*, in 'The Indian Economy- Problems and Prospects-Edited by Bimal Jalan', Penguin

policies –

> In the eighties, India had imported more than what could be supported by its own exports, other receipts and nominal aid flows. The growth in imports was financed by commercial borrowings or other borrowings on hard terms. This could be sustained only as long as such loans were available. The economy was plunged into a crisis as soon as these sources of financing dried up. The roots of the crisis, therefore, do not lie in import liberalization per se but in overall framework of macroeconomic policies, including fiscal policy, which permitted an expansion of internal demand for the home market without generating adequate exports during a period when the external environment for aid to India was deteriorating.

Acharya (2002)[2] identifies the followings reasons for the 1991 crisis –

i. A series of high fiscal deficits throughout the 1980s,
ii. An overvalued exchange rate (aggravated by real appreciation of the rupee in the first half of the 1980s)
iii. Foreign trade and payments policies biased against exports
iv. Growing recourse to various forms of external borrowing to finance a series of large trade and current account deficits in the latter half of the eighties.

Below we list the reasons for the crisis-

2.1.1 Worsening External Trade Balance and Large External Borrowings-

In official descriptions, India's exchange rate crisis has been attributed to continued current account deficits leading up to the crisis. For the five-year period 1985-90, the trade deficit averaged 3 per cent of GDP, while the current account deficit averaged 2.2 per cent of GDP. By 1990-91, the trade deficit of 3.0 per cent of GDP was fully reflected in a peak current account deficit of 3.1 per cent of GDP (see figure 1), since invisibles had turned marginally negative.

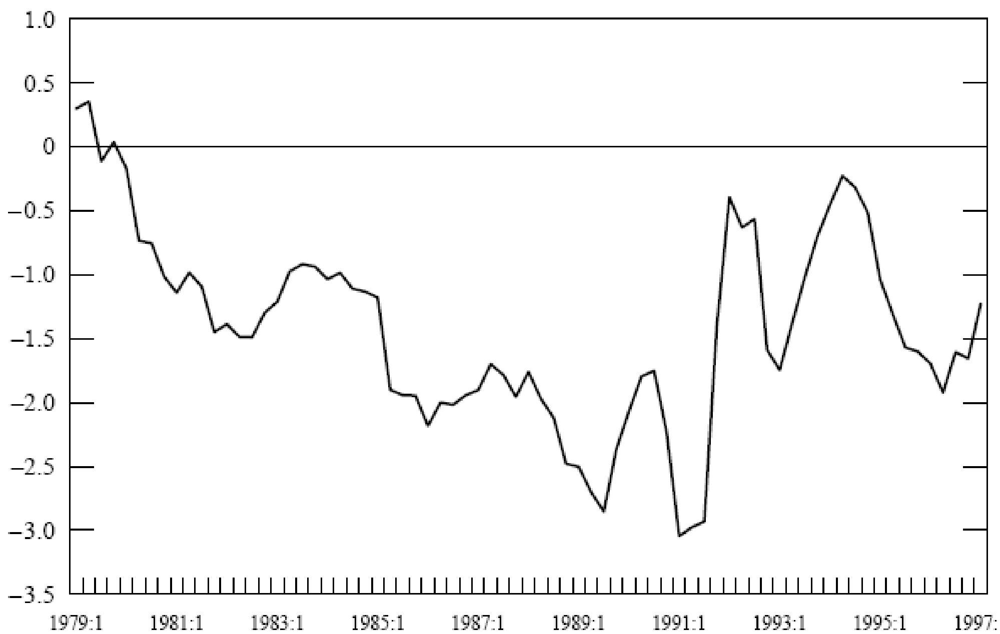
These deficits were financed by growing recourse to various sources of external

[2] Acharya, Shankar (2002): '*Macroeconomic Management in the Nineties*', in Economic and Political Weekly, April 20

borrowing including external assistance, commercial borrowing and increasingly expensive NRI deposits. Foreign exchange reserves were also run down. Foreign investment was a negligible 0.1 per cent of GDP. The growing recourse to external borrowing in the second half of the 1980s had led to a substantial deterioration in India's external debt indicators (see figure 2). The external debt stock to GDP ratio peaked at 39 per cent at the end of 1991-92, as did the debt to exports ratio at 563 per cent. As a ratio to foreign currency reserves, short-term debt soared to a dangerous 382 per cent.

Figure 1

Current Account Deficit (Four-quarter sum as per cent of GDP)

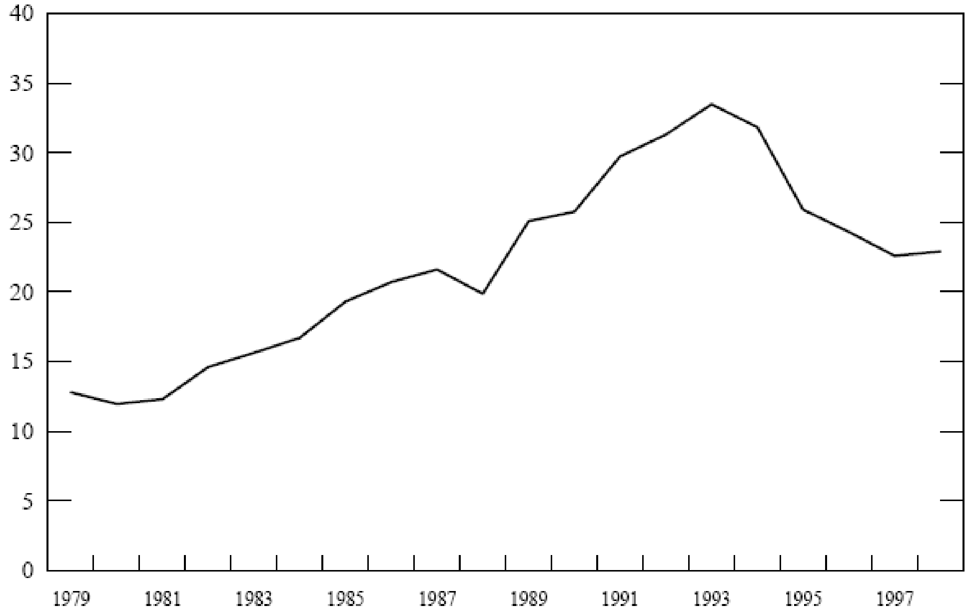


Source: IMF, International Financial Statistics

By September 1990 net inflows of NRI deposits had turned negative and access to external commercial borrowings was becoming costly and difficult. By December 1990 even short-term credit was becoming expensive and elusive. Foreign currency reserves fell sharply and dipped below $ 1 billion in January 1991 (see figure 3).

Figure 2

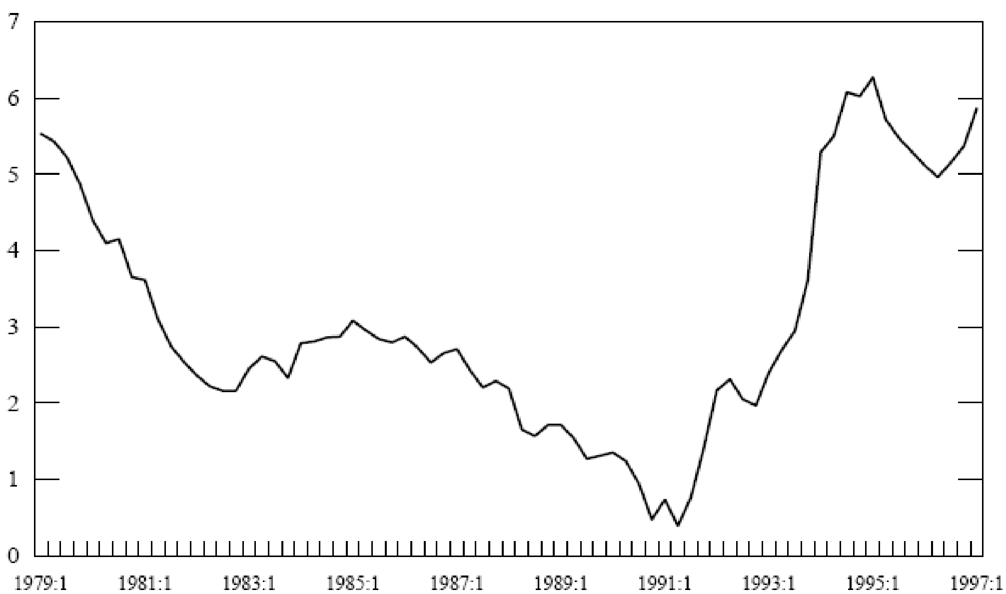
External Debt (Percent of GDP)



Source: World Bank, World Development Indicators

Figure 3

Foreign Exchange Reserves (Percent of GDP)



Source: IMF, International Financial Statistics

2.1.2 High Fiscal deficit –

The series of high fiscal deficits in the late 1980s were clearly a major cause of the 1991 economic crisis in India. The gross fiscal deficit increased significantly from an average of 7.2 per cent in the 5 years 1980-85 to 8.9 per cent in the next period, 1985-90, and even further to 9.4 per cent in 1990-91 (see table 1).

Table 1

Consolidated Deficits of Central and State Governments

(As per cent of GDP at current market prices)

	Fiscal Deficit	Primary Deficit	Revenue Deficit
1980-81	7.5	5.4	0.4
1981-82	6.3	4.1	-0.6
1982-83	5.9	3.4	0.2
1983-84	7.3	4.8	1.1
1984-85	9.0	6.2	2.1
1985-86	8.0	4.9	1.9
1986-87	9.9	6.5	2.4
1987-88	9.2	5.5	2.9
1988-89	8.5	4.6	2.9
1989-90	8.9	4.6	3.3
1990-91	9.4	5.0	4.2
1991-92	7.0	2.3	3.4
1992-93	7.0	2.1	3.2
1993-94	8.3	3.3	4.3
1994-95	7.1	1.9	3.7
1995-96	6.5	1.6	3.2
1996-97	6.4	1.3	3.6
1997-98	7.3	2.2	4.1
1998-99	9.0	3.7	6.3
1999-2000	9.5	3.9	6.3
2000-2001	9.7	3.6	6.3
	Averages		
1980-81/1983-84	6.8	4.4	0.3
1984-85/1990-91	9.0	5.3	2.8
1991-92/1996-97	7.1	2.1	3.6
1997-98/2000-01	8.9	3.4	5.8

Note: For 1998/99 onwards the RBI data have been adjusted for revision of GDP estimates published by CSO in January 2002. For 2000-01 the central government fiscal accounts have been used.

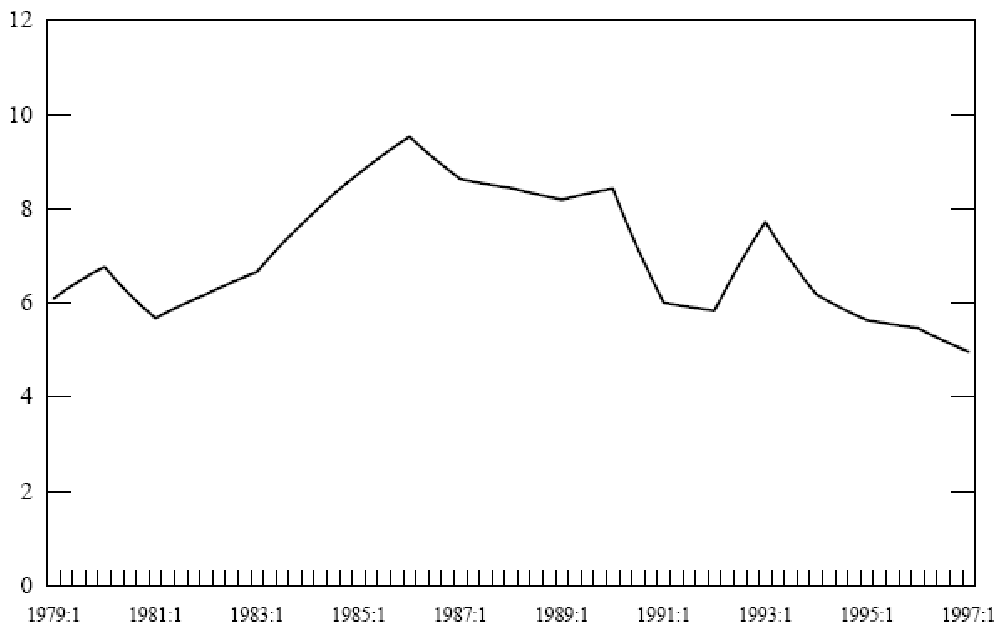
Source: Reserve Bank of India, Annual Reports.

Figure 4 shows us the ballooning of fiscal deficit in the 1980s, reaching a peak of 9.9 per cent in 1986-87. They inevitably fed into the current account deficits, which kept rising steadily until they reached 3.5 per cent of the GDP and 43.8 per cent of exports in 1990-91. The eventual outcome of these developments was the June 1991 crisis.

Figure 4

Government Fiscal Deficit

(As a percentage of GDP)



Source: IMF, International Financial Statistics

Below we try to explain how, in theory, high fiscal deficits can aggravate the external deficit.

We know,

Y = C+I+G+(X-M) --------------------------- (1)

Also,

Y-T = C+S ------------------------------------- (2)

where,

Y= Income

C= Consumption Expenditure

I = Investments

G= Government Expenditure

(X-M) = Net Exports (X=Exports, M=Imports)

T= Taxes

S= Savings

Combining and arranging (1) and (2), we get

I + (X-M) = S + (T-G)

i.e. Government deficit (T-G) gives a corresponding deficit in the current account (X-M), given some S and I.

Mundle and Rao (2004)[3] explain how high fiscal deficit aggravated the current account deficit in the 1980s in the Indian case –

> Growing revenue deficits, combined with losses of public enterprises, have constrained the acceleration of public investment. At the same time, the large public draft on private savings has tended to push up even administered interest rates and crowd out private investments. This has limited the growth of productive capacity on the supply side, while the large deficits have continued to drive the high growth of aggregate demand. The widening gap between domestic absorption and domestic output has led to a growing trade deficit and aggravated the balance of payments problem arising from indiscriminate external commercial borrowing.

The view that large fiscal deficits contributed to a widening of the current account deficit in India in the 1980s is also reiterated by the IMF (2002)[4].

The high fiscal deficits led to a disruption of the business environment by precipitating the 1991 crisis of macroeconomic instability, thereby showing how

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[3] Mundle, Sudipto and Rao, M. Govinda (2004): '*Issues in Fiscal policy*', in The Indian Economy-Problems and Prospects: Edited by Bimal Jalan, Penguin

[4] Cerra Valerie, Saxena Chaman Sweta (2002): *'IMF Staff papers: What caused the 1991 Currency Crisis in India?'*, IMF

important fiscal discipline (which is one of the most important tools of macroeconomic management of an economy) is for an enabling business environment. Below we try and explain how high fiscal deficits can directly affect the business environment through its interplay in savings/investments, interest rates and infrastructure development.

Acharya (2003)[5] explains how high fiscal deficits can hurt private investment:

> I believe they (high fiscal deficits) constitute the single biggest threat to India's economic prosperity and security. In addition to directly reducing savings, these high borrowings eat up resources which could otherwise have been productively invested. Such "crowding out" of productive investments occurs in at least two ways. High real interest rates and pre-emption of credit are well known processes. In addition, with stressed finances and high interest payments burdens, Central and State governments cut back on crucial infrastructure spending on power, roads, ports, etc. This, in turn discourages private investments further by reducing prospects for profits and returns.

Pre-emption of Domestic Savings - Empirically, we see that from the Eighth Plan (1992-93 to 1996-97) to Ninth Plan (1997-98 to 2001-02), while private savings as a percentage of GDP (period avg) increased from 23 per cent to 26.2 per cent, private investments increased only from 15.3 per cent to 15.9 per cent. The fact that private investment grew by much less than private saving during the Ninth Plan relative to the Eighth has been used to argue that the rising fiscal deficit absorbed part of the increase in private savings and to this extent crowded out private investment, thereby helping to keep the current account deficit in check.

Higher Interest Rates – Goyal (2004)[6] concludes that rise in fiscal deficit tends to put upward pressure on interest rates. This seems reasonable as government borrowings are at market-related rates and government competes with other borrowers

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[5] Acharya, Shankar (2003): '*India's Economy: Some Issues and Answers*', Academic Foundation, New Delhi

[6] Goyal, Rajan (2004): '*Does Higher Fiscal Deficit Lead to Rise in Interest Rates*', in Economic and Political Weekly, May 22

in the market to finance its resource gap. Similarly, evidence also substantiate the general contention that with government borrowing being at market related rates, rise in market interest leads to higher interest payments and also higher fiscal deficit.

Effect on Savings and Investments - Fiscal deficit can influence the business environment in an economy through its effects on savings and investment. Acharya, (2003)[7] argues that between 1990-91 and 1995-96 the consolidated fiscal deficit declined by 3 per cent of GDP and this fiscal contraction made room for the investment boom of 1993-96, which took aggregate domestic investment from 22.5 per cent of GDP in 1991-92 (to which it had dropped during the crisis) to a peak of 26.8 per cent of GDP in 1995/96.[8]

2.1.3 Bias against Exports and Overvalued Exchange Rate –

India's post-Independence development strategy was highly inward-looking. India had a heavy anti-export bias and pro import substitution bias. The extent of anti-export bias in the trade and payments regime can be gauged by the fact that in 1985-86 merchandise exports accounted for only 4.1 per cent of GDP, while imports were running more than 80 per cent higher at 7.6 per cent of GDP, entailing a trade deficit of 3.5 per cent of GDP. Although an active policy of real exchange rate depreciation (see figure 2) in the second half of the eighties induced good export growth in the later years of the decade, it was an action too late and did not help much in offsetting the high imports.

Even after continuous depreciation of the exchange rate, both in nominal and real terms, an IMF (2002) study[9] concluded that the Indian rupee was still overvalued at

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[7]Acharya, Shankar (2003): '*India's Economy: Some Issues and Answers*', Academic Foundation, New Delhi

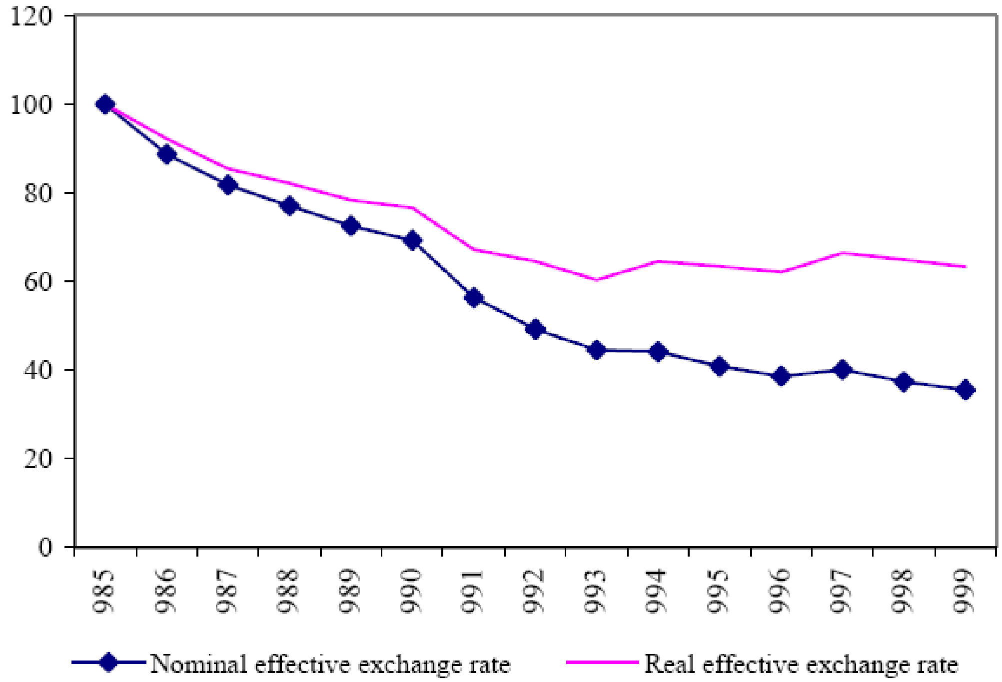
[8]Note that Acharya, Shankar does not claim that fiscal rectitude was the only (or even the main) cause of the investment boom. Other factors, such as the deregulation of industry and foreign trade, strong export performance and the overall reform momentum were also at work.

[9]Cerra Valerie, Saxena Chaman Sweta (2002): *'IMF Staff papers: What caused the 1991 Currency Crisis in India?'* IMF

the time of crisis in 1991.

Figure 5

Nominal and Real Effective Exchange Rates (1985=100)



Source: Kohli, Renu (2001): *'Capital Account Liberalisation: Empirical Evidence and Policy Issues – I'*, in Economic and Political Weekly, April 14

The overvalued exchange rate seriously damaged the export competitiveness of our exports and undermined the potential of our exports to finance our galloping imports. This played an important part in worsening our external position.

3. How the Crisis disrupted the Business Environment

The crisis severely undermined the business environment of the economy and crippled its growth. The Eighth Five Year Plan (1992-97) estimated the growth during 1991-92 to be negligible. In 1991-92, the base year of the Eighth Plan, GDP grew by less than 1 per cent as compared to an annual average growth of about 6 per cent during the Seventh Plan period (1985-90).

3.1 Poor Industrial Performance

On the industrial front, all the major segments witnessed severe recession during 1991-92. The index of industrial production grew by less than 1 per cent during 1991-92. The index of manufacturing production declined by about 1 per cent. GDP from industry, which had grown at about 7.5 per cent during the Seventh Plan period (1985-90), registered a decline of 1.9 per cent in 1991-92.

Table 2

Growth of Industry and Manufacturing

(Per cent per annum)

	1990-91	1991-92	1992-93	1993-94	1994-95
Gross value added					
Industry	7.7	-0.6	4.0	5.2	10.2
Manufacturing	6.1	-3.6	4.1	8.5	12.0
Index of production					
Industry	8.2	0.6	2.3	6.0	9.1
Manufacturing	9.0	-0.8	2.2	6.1	9.1

Note: The sub-sector of Construction is included in 'Industry' in the value added data above but excluded in the data from the 'Index of Industrial Production'.

Source: Central Statistical Organisation

The major reason for the poor industrial growth was the severe restrictions on imports during the crisis. To quote Acharya (2003)[10], "Import compression had reached a stage when it threatened widespread loss of production and employment, and verged on economic chaos".

The negative industrial growth severely damaged the perception about the prevailing business environment in the economy. Serious doubts were leveled against the macroeconomic policies and it seemed India was going through a phase of economic chaos.

[10] Acharya, Shankar (2003): '*India's Economy: Some Issues and Answers*', Academic Foundation, New Delhi

Growth in the agricultural sector was also hampered. Agriculture and allied sectors, after recording an annual average growth rate of 3.2 per cent during the Seventh Plan (1985-1990) declined to 1.3 per cent for the Annual Plan period from 1990 to 1992 (Agricultural growth fell from 4.4 per cent in 1990-91 to -1.9 percent in 1991-92).

3.2 High Inflation

Inflation (or rather its absence) is the generally preferred indicator of macroeconomic stability and thus a good business environment. The first half of the 1990s saw a sharp increase in inflation. The decade began with double digit inflation attributable to the high fiscal deficit and disruption of industrial production because of the crisis. Four out of the first five years of the 1990s registered double digit inflation (WPI), with a 13.7 per cent peak reached in 1992-93. Inflation moderated in the next two years as the stabilisation programme took hold and confidence in macro management was restored.

The effect of inflation on business environment is easy to see. High inflation puts pressure on interest rates leading to a rise in project costs and investment [Kapila 2006][11].

Also, most contracts are written in nominal terms. If you've agreed to make a set rupees payment at some future date and inflation is unexpectedly high, you pay in cheaper rupees and come out ahead of the deal. Of course, if inflation is lower than expected you take a loss. Either way, someone wins or someone loses. This means that the possibility of unanticipated inflation introduces an extra element of risk. Such extra risk eliminates some of what would otherwise be attractive exchanges among both businesses and consumers [Dornbusch, Fischer, Startz 2004][12].

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[11] Kapila, Uma (2006): '*Inflation*', in Indian Economy Since Independence, (18th Edition), Academic Foundation, New Delhi

[12] Dornbusch Rudiger, Fischer Stanley, Startz Richard (2004): '*Macroeconomics*', (9th Edition), McGraw-Hill / Irwin

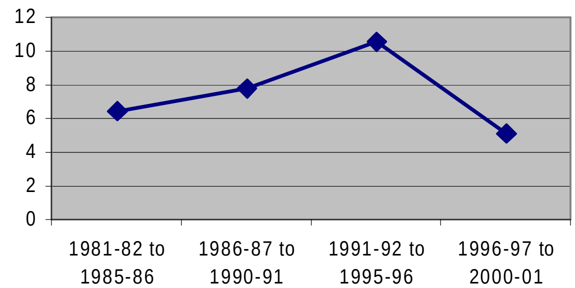
Table 3

5 year Avg Annual Inflation Rate (WPI)

Period	52-week Annual Average
1981-82 to 1985-86	6.5
1986-87 to 1990-91	7.8
1991-92 to 1995-96	10.6
1996-97 to 2000-01	5.1

Figure 6

5 year Avg Annual Inflation Rate (WPI)



Source: Kapila, Uma (2006): *'Indian Economy Since Independence'* (18th Edition), Academic Foundation, New Delhi, p.976

The World Banks' Investment Climate Survey[13] [Batra, Kaufmann and Stone 2003], shows that in the Indian sample, more than 60 per cent of the firms interviewed emphasize inflation along with three other factors (corruption, infrastructure, policy stability) as the most important constraint on their business and investment decisions.

3.3 Interest rates

The 1991 crisis led to a severe disruption and volatility in the money market interest rates (see figure 7). The money market interest rates particularly shooted up during the crisis period.

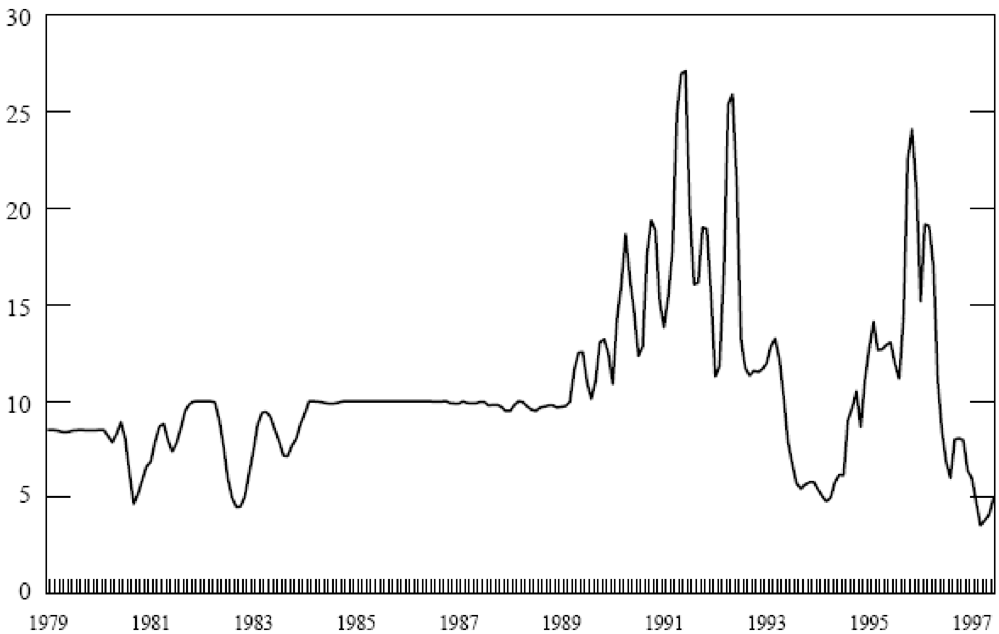
Such high real interest rates on medium to long term borrowings for the industrial sector work as a constraint in undertaking investment decisions. Persistence of high interest costs adversely impacts on the capacity buildup and up gradation. Over a

[13] Batra Geeta, Kaufmann Daniel and Stone Andrew H. W. (2003): '*Investment Climate Around the World: Voices of the Firms from the World Business Environment Survey*', The World Bank.

medium-term, the high interest rate effect is ultimately reflected in lower output growth and deteriorates the business and investment climate of an economy.

Figure 7

Money Market Rate (Three-month centered average)



Source: IMF, International Financial Statistics

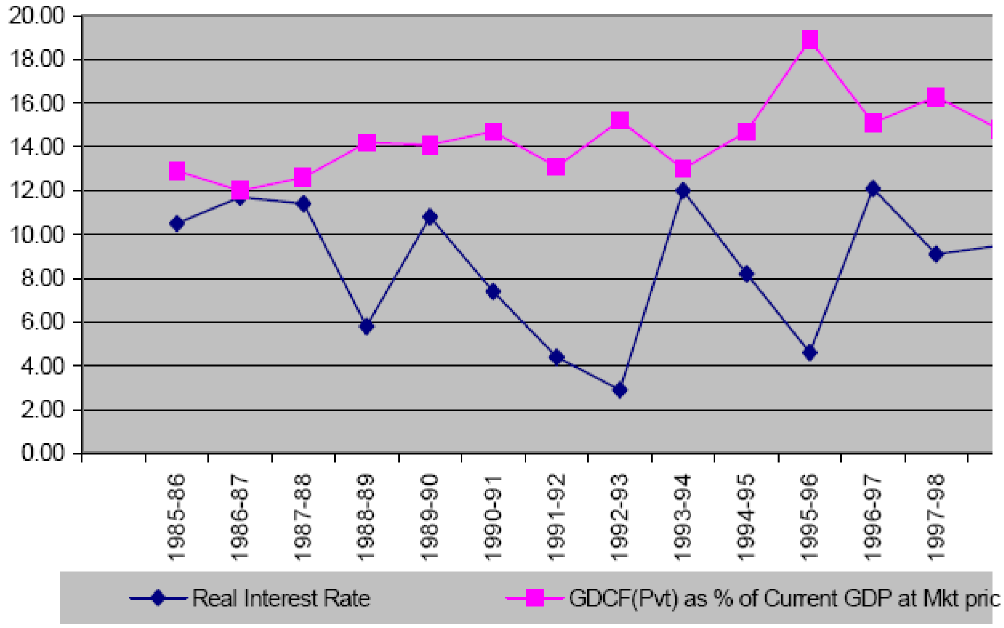
Figure 8 shows some presumption of expected links between real interest rates and private investment in India over the period 1985-86 to 1999-2000. In the figure, the inverse relationship between real interest rate and gross private investment can clearly be seen.

There was also a severe contraction in availability of credit to check inflation (which further dampened the business environment) through a restriction on Reserve Bank's (India's central bank) own credit to the domestic sector, the imposition of a 10 per cent incremental cash reserve ratio, a directive to banks not to raise credit limits of individual borrowers, a 45 per cent ceiling on the ratio of incremental credit to deposit and stricter quantitative controls on bank loans against trader's stocks.

Figure 8

Real Interest Rate and Gross Private Investment

(as per cent of GDP), 1985-86 to 1999-2000



Note: Real Interest Rate refers to the rate prevailing in the beginning of the corresponding fiscal year. It is estimated by the State Bank's prime lending rate minus the WPI inflation over the preceding year.

Source: Acharya, Shankar (2002): '*Macroeconomic Management in the Nineties*', in Economic and Political Weekly, April 20

3.4 Hampered Competitiveness to Attract FDI Inflows

Foreign Direct Investment (FDI) can play an important part in improving the business environment of a country. The following are the ways in which FDI can improve the business environment prevailing in a country –

i. Technology transfers
ii. Human capital enhancement
iii. Competition

With regard to the Indian case, Siddharthan and Lal (2004)[14], have shown the presence of significant spillover effects from FDI. The Organisation for Economic Cooperation and Development[15] lists general macroeconomic frameworks as an important factor for attracting FDI. The 1991 crisis damaged the attractiveness of India for FDI inflow. The increase in doubts about India's ability to manage the current account pressures triggered adverse effects in its capacity to attract FDI.

It was only after the macroeconomic stabilization policies and reforms taken after the 1991-92 crisis that FDI started pouring into India in a significant way compared to the past. FDI averaged only around $200mn annually between 1985 and 1991. However, the calendar year 2005 ended with an actual FDI inflows of about $6.5 billion (about Rs 29,000 crore).

4. Corrective Policies after the Crisis

The instability of the 1991 crisis forced the government to undertake major macroeconomic reforms to rebuild and restore the investment climate in the economy. A conscious policy of industrial de-regulation was followed. The exchange rate was devalued and the system transformed in less than two years from a discretionary, basket-pegged system, to a market-determined, unified exchange rate, following a short intermediate period of dual rates.

The anti-export bias in the trade and payments regime was also reduced substantially by a phased reduction in the exceptionally high customs tariffs and a phased elimination of quantitative restrictions on imports. Policies were initiated to encourage both direct and portfolio foreign investment.

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[14] Siddharthan, N.S. and Lal, K. (2004): *'Liberalisation, MNE and Productivity of Indian Enterprises'*, in Economic and Political Weekly, Jan 31

[15] Organisation For Economic Co-Operation And Development (2002): *'Foreign Direct Investment for Development: Maximising Benefits, Minimising Costs - Overview'*, OECD Publication Service

Short-term debt was reduced and strict controls put in place to prevent future expansion. Medium-term borrowing from private commercial sources was made subject to annual caps and minimum maturity requirements. Growth of NRI deposits was moderated through reduction of incentives.

Foreign exchange reserves were consciously accumulated to provide greater insurance against external sector stresses and uncertainties.

4.1 Recovery of the 1990s

Following a crisis in 1991, India has witnessed a turnaround on many indicators of macroeconomic performance. It has transited from an onerous trade regime to a market-friendly system encompassing both trade and current payments. The acceleration of GDP growth to 6.7 per cent in the period 1992-97 was the highest India had ever achieved over a five year period. Clearly, macro policy was getting some things right.

The sum of external current payments and receipts as a ratio to gross domestic product (GDP) has doubled from about 19 percent in 1990–91 to around 40 percent currently. GDP growth had collapsed to 1.3 per cent in 1991-92 as the balance of payments crisis of 1991 took its toll. The stabilization measures of 1991-93 restored macroeconomic stability and fuelled one of the swiftest recoveries of economic dynamism and business environment seen anywhere in the world in recent decades.

GDP growth recovered to nearly 6 per cent in 1993-94 and exceeded 7 per cent in each of the next three years. Manufacturing recorded average real growth of 11.3 per cent in the four years 1993-94 to 1996-97. Export growth in dollar terms averaged 20 per cent in the three years 1993-94 – 1995-96 and the rates of aggregate savings and investment in the economy peaked in 1995-96. Real fixed investment rose by nearly 40 per cent between 1993-94 and 1995-96, led by a more than 50 per cent increase in industrial investment and private investment showed an astounding average growth of 16.3 per cent per annum during 1992-96. It was, manifestly, boom time for the Indian economy.

Between 1990-2001, there was a decline in short-term debt as a percentage of foreign exchange reserves from an unsustainable 146.5 to a healthy 8.2 per cent and a fall in debt service payments as a proportion of current receipts from 35.3 to 17.1 per cent (Reserve Bank of India 2002)

Donde and Saggar (1999)[16] suggest that macroeconomic policy has had greater success in attaining the economy's output potential in the last decade than in any previous period. By the second half of 1993-94 the restoration of confidence and liberalisation of foreign investment policies had triggered a temporary surge in foreign capital inflow, which added over US$ 12 billion to foreign exchange reserves between September 1993 and October 1994

Today, India continues to be one of the fastest-growing economies in the world. India's balance of payments has been strong and inflation has been moderate.

5. Conclusion

Thus we see how poor macro policies of the government plunged the Indian economy into a major crisis and disrupted the business environment, and how subsequent corrective macro policies helped in the rebuilding of the business environment and put greater resilience in the Indian economy. The growth spurt prior to 1991 was fragile and volatile. There was a jump in the growth rate during 1977-79, massive decline in 1979-80, a jump again in 1980-82, return to the 'hindu rate'[17] during 1982-88 except 1983-84, climb up again in 1988-91 and crisis in 1991-92. However, after 1991, the macroeconomic stabilization policies helped the Indian economy to deliver sustained

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[16] Donde, K and Saggar, M (1999): '*Potential Output and Output Gap: A Review*', in Reserve Bank of India Occasional Papers

[17] In the immortal phrase of the late Professor Raj Krishna ('hindu rate of growth' refers to the dismal growth performance of the Indian economy from 1950-1970s).

growth and show less susceptibility to factors that might contribute to disruption of the business and investment climate in the economy.

Thus, for a conducive business environment it is imperative that the right macroeconomic policy-mix be chosen. Good macroeconomic policies can reinforce strong economic fundamentals of an economy which can act as a buffer to the disruption of business environment, either due to an external or internal shock.

The most important and most encouraging lesson is that when we pursue good macroeconomic policies we quickly get good rewards in the form of a stable business climate and strong economic performance.

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