Chapter

Economic reforms since 1991

BACKGROUND -1991 policy

- ✓ The origin of the financial crisis can be traced from the inefficient management of the Indian economy in the 1980s.
- ✓ Expenditure is more than income; the government borrows to finance the deficit from banks and also from people within the country and international financial institutions.
- ✓ The government was spending a large share of its income on areas that do not provide immediate returns such as the social sector and defense.
- ✓ The income from public sector undertakings was also not very high to meet the growing expenditure.
- ✓ Foreign exchange, borrowed from other countries and international financial institutions, was spent on meeting consumption needs.
- ✓ In the late 1980s, government expenditure began to exceed its margins.
- ✓ No country or international funder was willing to lend to India.
- ✓ India approached the International **Bank for Reconstruction and Development** (IBRD), popularly known as World Bank and the **International Monetary Fund** (IMF), and received $7 billion as a loan to manage the crisis. (The International Bank for Reconstruction and Development (**IBRD**) and **International Monetary Fund** (**IMF**) were **established** by delegates at the Bretton Woods Conference in 1944 and became operational in 1946.)
- ✓ **New Economic Policy (NEP)** consisted of two groups: the **stabilization** measures and the **structural reform** measures.

ODM EDUCATIONAL GROUP Changing your Tomorrow

- ✓ **Stabilization measures** are short-term measures, intended to correct some of the weaknesses in the balance of payments and to bring inflation under control.
- ✓ **Structural reform** policies are long-term measures, aimed at improving the efficiency of the economy and increasing its international competitiveness by removing the rigidities in various

Liberalisation, Privatisations and Globalisation(LPG)

LIBERALISATION

- ✓ Liberalization was introduced to put an end to the restrictions and open various sectors of the economy.
- ✓ Sectors that received greater attention in and after 1991 are in the industrial sector, financial sector, tax reforms, foreign exchange markets, and trade and investment.

(I) Deregulation of the Industrial Sector

- ✓ In India, regulatory mechanisms were enforced in various ways:
- ✓ Industrial licensing.
- ✓ The private sector was not allowed in many industries
- ✓ some goods could be produced only in small-scale industries, and
- ✓ controls on price fixation and distribution of selected industrial products.
- ✓ The reform policies introduced in and after 1991 removed so many restrictions. Industrial licensing was abolished for almost all products. (except alcohol, cigarettes, hazardous chemicals, etc.), The only industries which are now reserved for the public sector are a part of defense equipment, atomic energy generation, and railway transport. Many goods produced by small-scale industries have now been deserved. In many industries, the market has been allowed to determine prices.

(II) Financial Sector Reforms

- ✓ The financial sector includes financial institutions, such as commercial banks, investment banks, stock exchange operations, and foreign exchange markets.
- ✓ The financial sector in India is regulated by the Reserve Bank of India (RBI).

ODM EDUCATIONAL GROUP Changing your Tomorrow

- ✓ One of the major aims of financial sector reforms is to reduce the role of RBI from the regulator to facilitators of the financial sector.
- ✓ The reform policies led to the establishment of private sector banks, Indian as well as foreign.
- ✓ Foreign Institutional Investors (FII), such as merchant bankers, mutual funds, and pension funds, are now allowed to invest in Indian financial markets.
- ✓ The foreign investment limit in banks was raised to around 50 percent. Those banks which fulfill certain conditions have been given the freedom to set up new branches without the approval of the RBI.

(III)Tax Reforms

- ✓ Tax reforms are concerned with the reforms in the government's taxation and public expenditure policies, which are collectively known as fiscal policy.
- ✓ There are two types of taxes: direct and indirect. Direct taxes consist of taxes on incomes of individuals, as well as, profits of business enterprises. Indirect taxes are taxes levied on commodities.
- ✓ The rate of corporation tax, which was very high earlier, has been gradually reduced.
- ✓ Recently, the Parliament passed a law, Goods, and Services Tax Act 2016, to simplify and introduce a unified indirect tax system in India. This law came into effect from July 2017.
- ✓ GST expected to generate additional revenue for the government, reduce tax evasion, and create 'one nation, one tax, and one market'.

(IV) Foreign Exchange Reforms

- ✓ The first important reform in the external sector was made in the foreign exchange market. In 1991, as an immediate measure to resolve the balance of payments crisis, the rupee was *devalued* (decrease in the value of the home currency in the international market due to the deliberate action taken by the government) against foreign currencies.

ODM EDUCATIONAL GROUP Changing your Tomorrow

- ✓ It also set the tone to free the determination of rupee value in the foreign exchange market from government control.
- ✓ It led to an increase in the inflow of foreign exchange.
- ✓ Now, more often markets determine exchange rates based on the demand and supply of foreign exchange.

(V) Trade and Investment Policy Reforms:

- ✓ The liberalization of trade and investment policy was initiated to increase the international competitiveness of industrial production and also foreign investments and technology into the economy.
- ✓ The aim was also to promote the efficiency of local industries and the adoption of modern technologies.
- ✓ To protect domestic industries, India was following a regime of quantitative restrictions on imports.
- ✓ **The trade policy reforms aimed at**

  (i) dismantling of quantitative restrictions on imports and exports

  (ii) reduction of tariff rates and

  (iii) removal of licensing procedures for imports.
- ✓ Import licensing was abolished except in the case of hazardous and environmentally sensitive industries.
- ✓ Quantitative restrictions on imports of manufactured consumer goods and agricultural products were also fully removed from April 2001.
- ✓ Export duties have been removed to increase the competitive position of Indian goods in the international markets.

PRIVATISATION

- ✓ It implies shedding of the ownership or management of a government-owned enterprise.

- ✓ Government companies are converted into private companies in two ways (i) by the withdrawal of the government from ownership and management of public sector companies and or (ii) by the outright sale of public sector companies.
- ✓ Privatization of the public sector enterprises by selling off part of the equity of PSEs to the public is known as **disinvestment**.
- ✓ Some examples of public enterprises with Maharatnas, Navratnas, and Miniratnas status are:
- ✓ Maharatnas – (a) Indian Oil Corporation Limited and (b) Steel Authority of India Limited,
- ✓ Navratnas – (a) Hindustan Aeronautics Limited, (b) Mahanagar Telephone Nigam Limited
- ✓ Miniratnas – (a) Bharat Sanchar Nigam Limited; (b) Airport Authority of India and (c) Indian Railway Catering and Tourism Corporation Limited.

GLOBALISATION

- ✓ Globalization generally refers to the integration of the economy of the country with the world economy.
- ✓ It involves the creation of networks and activities which eliminate economic, social, and geographical boundaries.
- ✓ **Outsourcing** is one of the important outcomes of the globalization process. In outsourcing, a company hires regular service from external sources.
- ✓ As a form of economic activity, outsourcing has been widely enlarged.
- ✓ Many of the services such as voice-based business processes (popularly known as BPO or call centers), record keeping, accountancy, banking services, music recording, film editing, book transcription, clinical advice, etc. outsourced by companies in developed countries to India.
- ✓ The low wage rates and availability of skilled manpower in India have made it a destination for global outsourcing in the post-reform period.

ODM EDUCATIONAL GROUP Changing your Tomorrow

- **World Trade Organisation (WTO)**: The WTO was founded in 1995 as the successor organization to the General Agreement on Trade and Tariff (GATT).
- GATT was established in 1948.
- WTO is expected to establish a rule-based trading regime in which nations cannot place arbitrary restrictions on trade.
- The purpose of WTO is to enlarge production and trade of services, to ensure optimum utilization of world resources, and to protect the environment.
- The WTO agreements cover trade in goods as well as services to facilitate international trade (bilateral and multilateral) through the removal of the tariff as well as non-tariff barriers between member countries.
- As an important member of WTO, India has been at the forefront of framing fair global rules, regulations and advocating the interests of the developing world.

INDIAN ECONOMY DURING REFORMS: AN ASSESSMENT

- In economics, the growth of an economy is measured by the Gross Domestic Product(GDP)
- The post–1991 India witnessed a rapid growth in GDP continually for two decades.
- During the reform period, the growth of agriculture has declined. While the industrial sector was in fluctuation, the growth of the service sector has improved.
- The opening of the economy has led to a rapid increase in foreign direct investment and foreign exchange reserves.
- The foreign investment includes foreign direct investment (FDI) and foreign institutional investment (FII)
- India becomes successful in exporting auto parts, engineering goods, IT software, and textiles in the reform period. Rising prices have also been kept under control.
- **The reform process has been widely criticized** because it does not fully address the areas of employment, agriculture, industry, infrastructure development, and fiscal management.

ODM EDUCATIONAL GROUP Changing your Tomorrow

- ✓ **Growth and Employment**: Though the GDP growth rate has increased in the reform period, scholars point out that reform-led growth has not generated sufficient employment opportunities in the country.
- ✓ **Reforms in Agriculture:** Reforms have not been able to benefit agriculture. Public investment in the agriculture sector especially in infrastructure has fallen in the reform period. The removal of fertilizer subsidy has led to an increase in the cost of production, which has severely affected the small and marginal farmers. Export-oriented policy strategies in agriculture lead to focusing on cash crops. This leads to an increase in the prices of food grains.
- ✓ **Reforms in Industry:** Industrial growth has also recorded a slowdown. This is because of the decreasing demand for industrial products due to cheaper imports, inadequate investment in infrastructure, etc. The infrastructure facilities, including power supply, have remained inadequate due to lack of investment. A developing country like India still does not have access to developed countries' markets because of high non-tariff barriers.
- ✓ **Disinvestment:** Every year, the government fixes a target for disinvestment of public sector enterprises. Critics point out that the assets of public sector enterprises have been undervalued and sold to the private sector. Disinvestment is used to offset the shortage of government revenues rather than the development of social infrastructure.
- ✓ **Reforms and Fiscal Policies:** The tax reductions in the reform period, aimed at yielding larger revenue and curb tax evasion, but it does not achieve the fruitful result. Reform policies, involving tariff reduction, have curtailed the scope for raising revenue through customs duties.

ODM EDUCATIONAL GROUP Changing your Tomorrow