UNIT II: ECONOMIC REFORMS SINCE 1991
Chapter-3 Liberalisation, Privatisation and Globalisation: An Appraisal
(Indian Economic Development)

Since independence, India followed the **mixed economy framework** by combining the advantages of both capitalist and socialist (planned) economic system. This policy resulted in the establishment of various rules and laws, which were aimed at controlling and regulating the economy; became major hindrances in growth and development of the economy. However, some scholars state that increasing role of public sector in economic activities has helped Indian economy to:

- achieve growth in savings,
- develop a diversified industrial sector which produces a variety of goods and
- achieve food security through sustained expansion of agricultural output.

In 1991, the government of India initiated a series of economic reforms due to a financial crisis and pressure from international organisations like World Bank and IMF. **These reforms came to be known as the New Economic Policy (NEP).**

Need for Economic Reforms

1. **Fall in foreign exchange reserves:** In 1991, India met with a foreign exchange or **external debt crisis.**
   a. The government was not able to make repayments on its borrowings from abroad.
   b. The **foreign exchange reserves declined** to a level that was not adequate-
      - to finance imports for more than two weeks and
      - to pay the interest that needs to be paid to international lenders.

2. **Financial crisis**: The origin of the financial crisis can be traced from the **inefficient management of the Indian economy in the 1980s.**
   a. Development policies required that even though the revenues were very low, the government had to overshoot its revenue to meet challenges like unemployment, poverty and population explosion. The continued spending on development programmes of the government did not generate additional revenue.
   b. Moreover, the government was not able to generate sufficient revenue from internal sources such as taxation.
   c. The government was spending a large share of its income on areas which do not provide immediate returns such as the social sector and defence.
   d. The income from public sectors undertakings (PSUs) was also not very high to meet the growing expenditure.

   Hence our foreign exchange, borrowed **f**rom other countries and international financial institutions, was spent on meeting consumption needs.

3. **Mounting government debts**: In the late 1980s, government expenditure began to exceed its revenue by such large margins that meeting the expenditure through borrowings became unsustainable. Moreover, no attempt was made to reduce such profligate government spending.

4. **Adverse Balance of Payments**: Imports grew at a very high rate without matching growth of exports. Slow growth of exports was due to low quality and high prices of Indian goods in the international market. Also, no sufficient attention was given to boost exports to pay for the growing imports.

5. **Rising prices of essential goods:** The economic crisis in 1991 was further compounded by rising prices. Prices of many essential goods rose sharply due to inefficiencies in private as well as public sector production and high tariffs even on essential imports.

To manage the economic crisis in 1991, 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 loan. For availing the loan, India was required to liberalise and open up the economy by

- reducing the role of the government in many areas (or Liberalisation),
- removing restrictions on the private sector (or Privatisation) and
- removing trade restrictions between India and other countries (Globalisation).

India agreed to the conditions of World Bank and IMF and announced the **New Economic Policy (NEP) in July 1991.**

The **New Economic Policy consisted of wide-ranging economic reforms. The three broad components of NEP are – Liberalisation, Privatisation and Globalisation. The main aim of the policy was to create a more competitive environment in the economy and remove the barriers to entry and growth of firms. This set of policies can broadly be classified into two groups: the stabilisation measures and the structural reform measures.**

Classification of New Economic Policy

1. **Stabilisation measures** are short term measures, intended to correct some of the weaknesses that have developed in the balance of payments and to bring inflation under control. (E.g. Devaluation of rupee which means reduction in the value of rupee i.e. domestic currency in terms of foreign currency.)
2. **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 segments of the Indian economy through a range of policies which fall under three heads viz. Liberalisation, Privatisation and Globalisation.

Liberalisation: It refers to the removal or reduction of government controls and restrictions from various sectors of the economy like industrial sector, financial sector, fiscal (tax) reforms, foreign exchange markets and trade and investment sectors for making the economy more competitive.

Need for Liberalisation: Prior to 1991, there were large number of government restrictions on the entry and growth of private enterprises. Liberalisation was introduced to put an end to these restrictions and open various sectors of the economy.

Industrial Sector Reforms:

Before 1991, the industries were regulated in various ways:

- Industrial licensing was compulsory to start a firm, close a firm or to expand or diversify production.
- Private sector was not allowed in many industries.
- Some goods were reserved only for small-scale industries.
- There was control on price fixation and distribution of certain selected industrial products.

The various measures under industrial policy reforms include:

a. **Reduction in Industrial Licensing**: **Industrial licensing was abolished** for almost all products except alcohol, cigarettes, hazardous chemicals, industrial explosives, electronics, aerospace, drugs

and pharmaceuticals.

b. **De-reservation of public sector**: The only industries which are now reserved for the public sector are a part of defence equipment, atomic energy generation and railway transport.
c. **De-reservation of small-scale industries:** Many goods produced by small-scale industries have now been de-reserved.
d. **Removal of price control**: In many industries, the market has been allowed to determine the prices.

Financial Sector Reforms (Banking Sector Reforms):
(Before 1991 the RBI was regulator and it decides the amount of money that the banks can keep with themselves, fixes interest rates, nature of lending to various sectors, etc.)

The reforms included under financial sector are:

a. The **role of RBI was reduced from regulator to facilitator** of financial sector. This means that the financial sector was allowed to take decisions on many matters without consulting the RBI.
b. The reform policies led to the **establishment of private sector banks,** Indian as well as private.
c. **Foreign investment limit in banks** was raised to around 50 percent.
d. Those banks which fulfil certain conditions have been given **freedom to set up new branches without the approval of the RBI** and rationalise their existing branch networks.
e. **Foreign Institutional Investors (FII),** such as merchant bankers, mutual funds and pension funds **are now allowed to invest** in Indian financial markets.

Financial Sector: Financial sector includes financial institutions such as commercial banks, investment banks, stock exchange operations and foreign exchange market. The financial sector in India is regulated through various norms and regulations by the Reserve Bank of India (RBI). The RBI decides the amount of money that the banks can keep with themselves, fixes interest rates, nature of lending to various sectors, etc.

Tax Reforms (or Fiscal Policy Reforms): Tax reforms are concerned with the reforms in government's taxation and public expenditure policies. (Government's taxation and public expenditure policies are collectively known as its **fiscal policy**.)

Types of taxes:
There are two types of taxes:

(i) Direct taxes consist of taxes on incomes of individuals, as well as, profits of business enterprises. The burden of such taxes cannot be shifted. E.g. Income tax, wealth tax, corporate tax etc.
(ii) Indirect taxes are the taxes levied on commodities and services. The burden of these taxes can be shifted to the consumers. E.g. GST, Value Added Tax (VAT) etc.

(Before 1990, tax rates were very high for both direct and indirect taxes)
The major tax reforms made are:

a. Since 1991, there has been a **continuous reduction in the taxes on individual incomes** as it was felt that high rates of income tax were an important reason for tax evasion.
b. The **rate of corporation tax**, which was very high earlier, **has been gradually reduced**.
c. Efforts have also been made to **reform the indirect taxes,** in order to facilitate the **establishment of a common national market** for goods and commodities.
d. In order to encourage better compliance on the part of taxpayers, many **tax procedures** have been **simplified** and the **rates also substantially lowered**.
e. Recently, the Indian Parliament passed a law, Goods and Services Act 2016, to simplify and introduce a unified indirect tax system in India. This law came into effect from July 2017. This is expected to

generate additional tax revenue for the government, reduce tax evasion and create 'one nation, one tax and one market.'

Note: '**Goods and Services Tax'** is a comprehensive **Indirect Tax** which has replaced many indirect taxes in India. The Goods and Services Tax Act was passed in the parliament on 29th March, 2017 to simplify and introduce a unified indirect tax system in India. The Act came into effect in 1st July, 2017. It is a comprehensive, multi-stage, destination-based tax that is levied on every value addition. GST has been identified as one of the most important tax reforms post-independence. The government of India implemented GST following the credo of '**One Nation and One Tax'** and wanting a unified market in order to ensure the smooth flow of goods and services across the country. GST has replaced 17 indirect taxes (like Value Added Tax, Service Tax, Excise duty, Sales Tax etc) 23 cesses of the Centre and States, thereby eliminating the need for filing multiple returns and investments. It has rationalised the tax treatment of goods and services along the supply chain from producers to consumers.

Foreign Exchange Reforms: (Before 1991, Fixed exchange rate system was followed by the RBI.)

The major reforms made in the foreign exchange market are:

a) In 1991, as an immediate measure to resolve the balance of payment crisis, **the rupee was devalued** against foreign currencies. (Devaluation refers to reduction in the value of domestic currency with respect to foreign currency.) This led to increase in the inflow of foreign exchange by making **exports cheaper** and more competitive.
b) It also led to freeing the determination of rupee value in the foreign exchange market from government control. Now markets determine exchange rates based on the demand and supply of foreign exchange.

Trade and investment Policy Reforms: (Before 1991, **India was following Import substitution policy with high tariffs and quotas**-a regime of quantitative restrictions on imports. These policies reduced efficiency and competitiveness which led to the slow growth of the manufacturing sector.)

Objective: To increase international competitiveness of industrial production and also **foreign investments and technology** into the economy. The aim was to **promote the efficiency of local industries** and **adoption of modern technologies.**

The important trade and investment policy reforms include:

a) **Dismantling of quantitative restrictions (Quotas) on imports and exports**- Quantitative restrictions on imports of manufactured consumer goods and agricultural products were also fully removed from April 2001.
b) **Reduction tariff rates**– Export duties have been removed to increase the competitive position of Indian goods in the international markets and import duties have also been reduced.
c) **Removal of licensing procedures for imports** – Import licensing was abolished except in case of hazardous and environmentally sensitive industries.

Privatisation: It implies shedding of the ownership or management of a government owned enterprise and its transfer to the private sector.

Privatisation can be done in two ways:

(i) by withdrawal of the government from ownership and management of public sector companies (Disinvestment)

(ii) by outright sale of public sector companies (Complete privatisation)

Disinvestment: Privatisation of the public sector undertaking by selling off part of the equity of PSEs to the private sector/ public is known as disinvestment.

Types of disinvestment:

1. **Minority disinvestment**: A minority disinvestment is one such that, at the end of it, the government retains a majority stake in the company, typically greater than 51%, thus ensuring management control. E.g. NTPC (National Thermal Power Corporation)
2. **Majority Disinvestment**: A majority disinvestment is one in which the government, post disinvestment, retains a minority stake in the company i.e. it sells off a majority stake E.g. BALCO sale to Sterlite.
3. **Complete privatisation**: It is a form of majority disinvestment wherein 100% control of the company is passed on to a buyer. Example: Modern Bread, ITDC Hotels.

Note: * Strategic Disinvestment Sale: It refers to the sale of 51% or more stake of a PSU to the private sector who bids the highest with the objective of improving efficiency so the management control is with strategic partner.

Purpose of privatisation/ disinvestment: According to the government the purpose of sale was mainly to-

a. improve financial discipline and facilitate modernisation.
b. It was also felt that private capital and managerial capabilities would be effectively utilized to improve the performance of the PSU's.
c. It was felt that privatisation could provide strong impetus (encouragement) to the inflow of FDI.

Navraratnas (profit making PSU's)

- In order to improve efficiency of PSUs, infuse professionalism and enable them to compete more effectively in the liberalised global environment, the government choose nine PSUs and declared them as ***maharatnas, navratnas*** and ***miniratnas***
- They were given greater managerial and operational autonomy in taking various decisions to run the company efficiently and thus increase their profits.
- Greater operational, financial and managerial autonomy has also been granted to profit making enterprises referred to as ***miniratnas***
- Few examples of public enterprises with their status are as follows

(i) **Maharatnas** - Indian Oil Corporation (IOCL), Steel Authority of India Limited (SAIL)
(ii) ***Navratnas*** - Hindustan Aeronautics Limited (HAL), Mahanagar Telephone Nigam Limited (MTNL)
(iii) M***iniratnas*** - Bharat Sanchar Nigam Limited (BSNL), Airport Authority of India (AAI) and Indian Railway Catering and Tourism Corporation Limited (IRCTC).

Effect: The granting of ***Navratnas*** status **resulted in better performances of these companies.** Of late the government has decided to retain them in the public sector and enables them to expand themselves in the global market and raise resources by themselves from financial markets.

Globalisation: Globalisation means integrating the economy of the country with the world economy through removal of barriers on international trade and capital movements.

- It is a complex phenomenon.
- It is an outcome of the set of various policies that are aimed at transforming the world towards greater interdependence and integration.

- It involves creation of network and activities transcending economic, social and geographical boundaries.
- In short, Globalisation implies turning the world into one whole or creating a borderless world.

Outsourcing: Outsourcing refers to the hiring of regular services by a company from external sources, mostly from other countries, which was previously provided internally or from within the country. E.g. legal advice, computer service, advertisement, security- each provided by respective departments of the company.

- Outsourcing is one of the important outcomes of the globalisation process.

- **Outsourcing has intensified in recent times** because of:
  a. The **growth of fast modes of communication**, particularly the growth of Information Technology (IT).
  b. With the help of modern telecommunication links including the internet, the text, voice and visual data in respect of these **services is digitalised and transmitted** in real time over continents and national boundaries.

- **Factors that have made India one of the favourite outsourcing destination in the post reform period are:**
  a. Availability of skilled manpower in India and
  b. the low wage rates.

- **Some of the services outsourced to India include:**
  a. Voice-based business processes (popularly known as BPO or call centres)
  b. Record keeping
  c. Accountancy
  d. Banking services
  e. Music recordings
  f. Film editing
  g. Book transcription
  h. Clinical advice etc

With increasing population and government's inability to provide employment, **outsourcing services** have proved to be a **boon for countries like India which has skilled manpower available at cheaper rates.** Thus, India has been benefited from outsourcing in terms of **generating employment opportunities** as well as it **contributes to the GDP and foreign exchange reserves** of our country.

The developed countries are opposing it because the domestic workers have been replaced by the workers in developing countries. It has resulted in the loss of jobs in favour of developing countries. The domestic workers are struggling to find jobs especially with low skills. This is leading to inequalities between the highly skilled persons and the lower ones (as highly skilled persons are willing to work at lower wages).

Effects of Globalisation: The process of globalisation through liberalisation and privatisation policies has produced positive as well as negative results both for India and other countries.

Positive effects: Globalisation resulted in -

a. greater access to global markets;
b. high (advanced) technology and

c. increased possibility of large industries of developing countries to become important players in the international arena.

Negative effects: Globalisation has been criticised by some scholars because according to them:
a. Globalisation is a strategy of the developed countries to expand their markets in other countries.
b. It has compromised the welfare and identity of people belonging to poor countries.
c. Market-driven globalisation has widened the disparities among nations and people.

World Trade Organisation (WTO): WTO was founded in 1995 as the successor organisation to the General Agreement on Trade and Tariff (GATT). GATT was established in 1948 with 23 countries as the global trade organisation to administer all multilateral trade agreements by providing equal opportunities to all countries in the international market for trading purposes.

Aim (Functions) of WTO:
a. To establish a rule-based trading regime in which nations cannot place arbitrary restrictions on trade.
b. To enlarge production and trade of services.
c. To ensure optimum utilisation of world resources.
d. To protect the environment.
e. To facilitate international trade (bilateral and multilateral) through removal of tariff as well as non-tariff barriers and providing greater market access to all member countries.

Relation between WTO and India: As an important member of WTO, India has been in the forefront of framing fair global rules, regulations and safeguards and advocating the interests of the developing world. India has kept its commitments towards liberalisation of trade, made in the WTO, by removing quantitative restrictions on imports and reducing tariff rates.
Some scholars question the usefulness of India being a member of WTO. According to them:
a. A major volume of international trade occurs among the developed nations.
b. Developing countries feel cheated as they are forced to open their markets for developed countries but are not allowed to access to the markets of developed countries.

Indian Economy During Reforms: An Assessment:

Positive effects of reforms:
1. The **growth of GDP increased from 5.6% during 1980-91 to 8.2 % during 2007-12.** During the reform period, the growth of agriculture has declined, while the industrial sector reported fluctuations, the growth of the service sector has gone up. This indicates that **this growth is mainly driven by growth in the service sector.**
2. The **foreign investment**, which includes foreign direct investment (FDI) and foreign institutional investment (FII) **has increased** from about US $100 million in 1990-91 to US $ 36 billion in 2016-17.
3. There has been **an increase in the foreign exchange reserves** from about US $ 6 billion in 1990-91 to about US $ 321 billion in 2014-15. India is one of the largest foreign exchange reserve holders in the world.
4. India is seen as a **successful exporter of auto parts, engineering goods, IT software and textiles** in the reform period.
5. **Rising prices** have also been **kept under control**.

Negative effects of reforms: The NEP has been widely criticised for not being able to address some of the basic problems facing our economy especially in the areas of employment, agriculture, industry, infrastructure development and fiscal management.

1. **Growth and Employment** - Though the GDP growth rate has increased in the reform period, scholars point out that the reform led growth has not generated sufficient employment opportunities in the country other than the service sector. This is known as '**Jobless growth'.**
2. **Reforms in Agriculture** - Reforms have not been able to benefit agriculture**. The growth rate in the agriculture sector has been decelerating in the reform period** because:
   a. Public investment in agriculture sector especially in infrastructure, which includes irrigation, power, roads, market linkages and research and extension has fallen in the reform period.
   b. The removal of fertiliser subsidy has led to increase in the cost of production, which has severely affected small and marginal farmers.
   c. A number of policy changes such as reduction in import duties on agricultural products, removal of minimum support price and lifting of quantitative restrictions on agricultural products have adversely affected Indian farmers as they have to face increased international competition.
   d. The export-oriented policy strategies in agriculture have resulted in a shift from production of food grains for the domestic market towards production of cash crops for exports thereby putting immense pressure on prices of food grains.
3. **Reforms in Industry: Industrial growth has also recorded a slowdown during the reform period** because of decreasing demand of industrial products due to various reasons such as:
   a. Domestic manufacturers are facing competition from cheaper imports, which have replaced the demand for domestic goods.
   b. The infrastructure facilities, including power supply, have remained inadequate due to lack of investment.
   c. A developing country like India still does not have access to developed countries' markets because of non- tariff barriers. (For e.g. Although all quota restrictions on exports of textiles and clothing have been removed in India, USA has not removed their quota restrictions on import of textiles from India and China.)
4. **Effect of disinvestment:** The assets of PSEs have been undervalued and sold to the public sector. This means that there has been **a substantial loss to the government**. Moreover, the proceeds from disinvestment were used to offset the shortage of government revenues rather than using it for the development of PSEs and building social infrastructure in the country.
5. **Fiscal Policy and Reforms**: Economic reforms have placed limits on the growth of public expenditure, especially in social sectors.
   a. The tax reductions in the reform period, aimed at yielding larger revenue and to curb tax evasion, have **not resulted in increase in tax revenue** for the government.
   b. The reform policies involving tariff reduction have **reduced the scope for raising revenue through custom duties.**
   c. Tax incentives provided to foreign investors to attract foreign investment, **has further reduced the scope for raising tax revenues.**

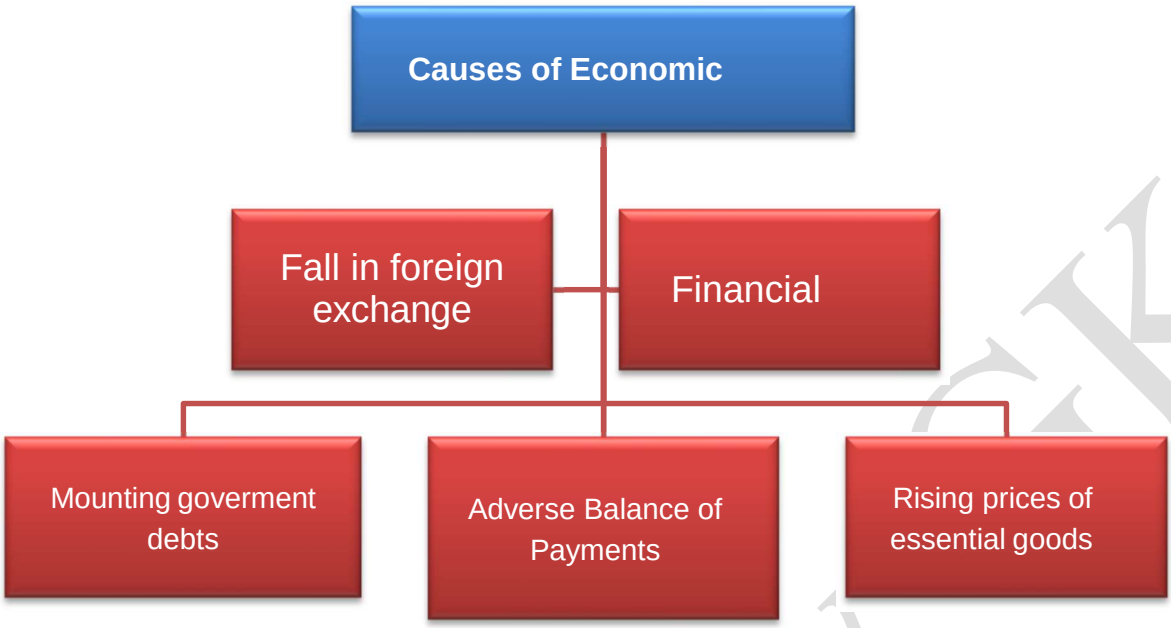
   This has a negative impact on developmental and welfare expenditure

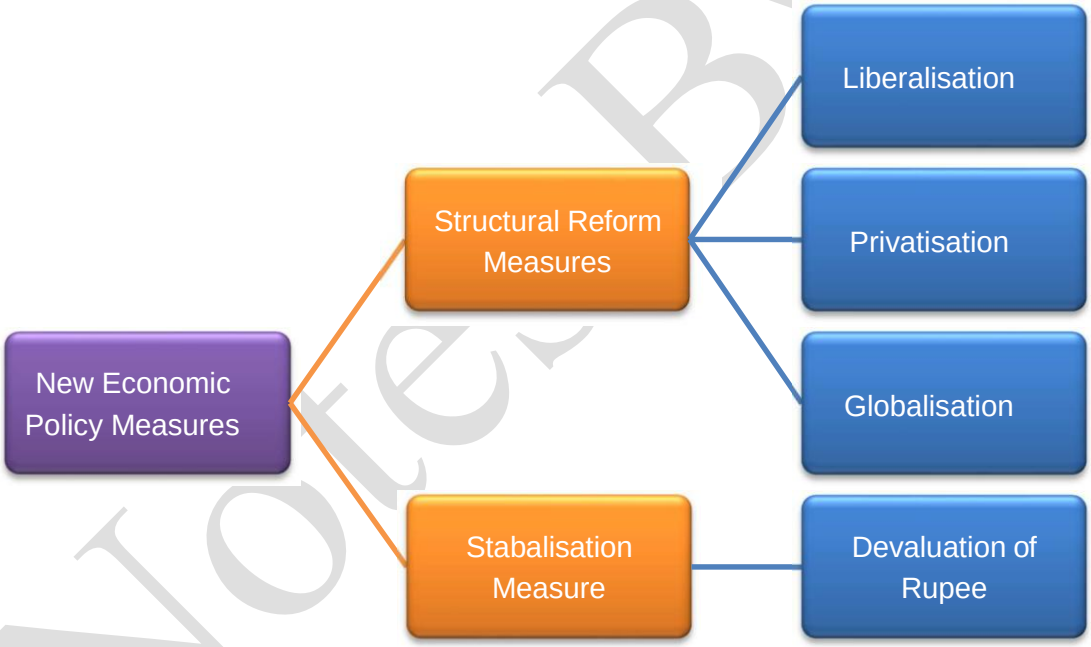
Effect of reforms on welfare and social justice:

a. It has increased the income and quality of consumption of only high- income groups and the **growth and employment has been concentrated only in some select areas** in the services sector such as telecommunication, information technology, finance, entertainment rather than vital sectors such as agriculture and industry, which provide livelihoods to millions of people in the country.

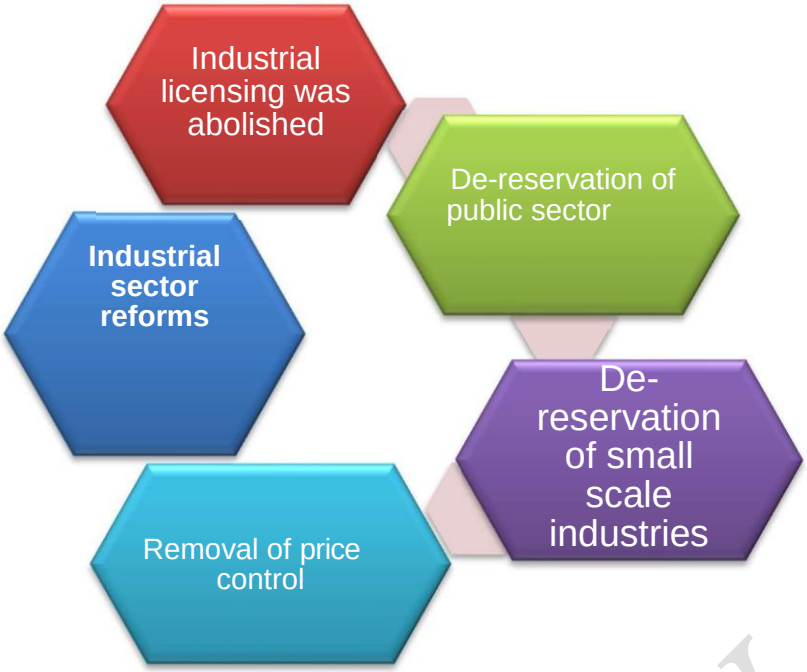
b. It has **adversely affected the agricultural sector incomes** due to removal of subsidies and import duties.
c. Due to export oriented agricultural strategies and shift towards cash crops, there has been **a rise in price of food grains** affecting the lower income groups adversely.
d. It has resulted in the **wiping out of small manufacturing and retail outlets** because of cheap imports.
e. Globalisation has **increased the inequalities of income and wealth between the rich skilled and the poor unskilled population.**

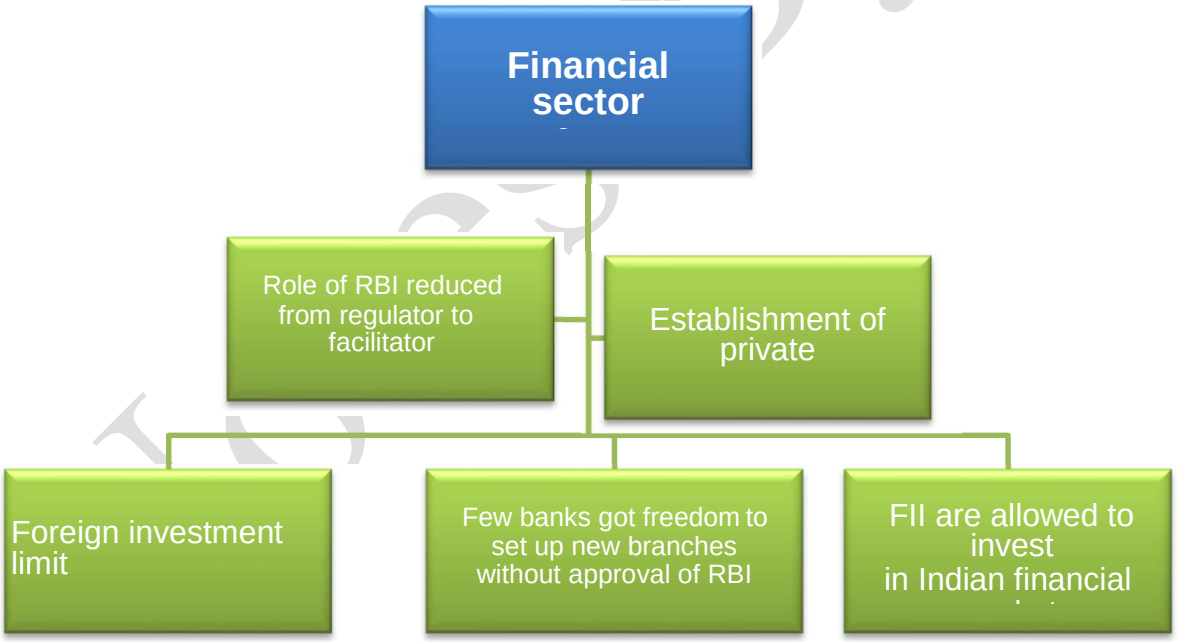
MIND MAP: Chapter-3 Liberalisation, Privatisation and Globalisation: An Appraisal



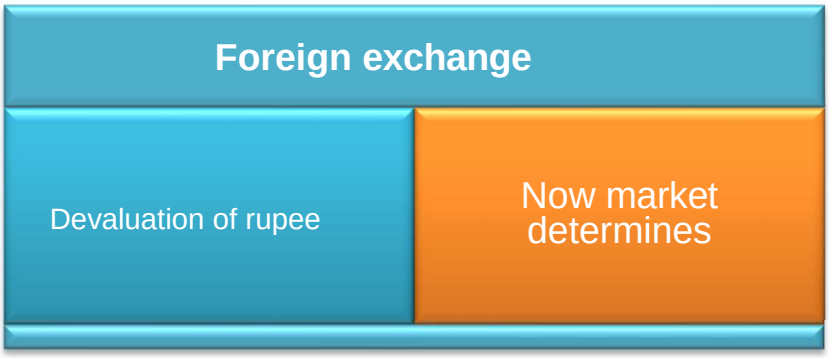


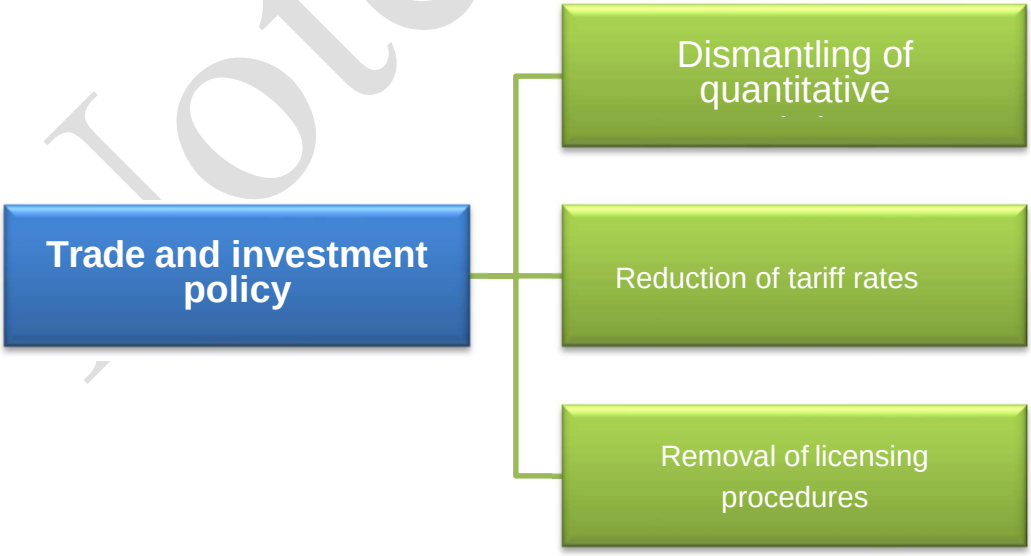
Liberalisation	Privatisation	Globalisation
• Involves deregulation and reduction of govt. controls from various sectors of the economy.	• Transfer of ownership, management and control of PSEs to private sector.	• Integrating the domestic economy with the world economy.


Industrial licensing was abolished
De-reservation of public sector
Industrial sector reforms
De-reservation of small scale industries
Removal of price control


Financial sector
Role of RBI reduced from regulator to facilitator
Establishment of private
Foreign investment limit
Few banks got freedom to set up new branches without approval of RBI
FII are allowed to invest in Indian financial


Continuous reduction in income
Introduction of GST in 2017
Fiscal policy
Efforts made to reform indirect taxes
Tax procedures simplified


Foreign exchange
Devaluation of rupee
Now market determines


Trade and investment policy
Dismantling of quantitative
Reduction of tariff rates
Removal of licensing procedures

CRITICAL APPRAISAL OF ECONOMIC REFORMS

Positive

Arguments in favour of NEP

- Increase in GDP growth rate
- Increase in foreign investment (FDI & FII)
- Increase in foreign exchange reserves
- Became a successful exporter of auto parts, IT software etc
- Rising prices kept under control

Negative

Arguments against NEP

- Increase in GDP without sufficient increase in employment opportunities
- Agricultural growth rate has been decelerating
- Industrial growth has recorded a slowdown
- Disinvestment led to substantial loss to the government
- Fiscal reforms adversely affected govt. tax revenue
- The NEP has increased inequalities; growth has been concentrated in some selected areas