INDIAN ECONOMIC DEVELOPMENT

REVISION NOTES

CHAPTER-3

LIBERALISATION, PRIVATISATION AND GLOBALISATION: AN APPRAISAL

- **Economic Crisis in 1991 and Indian Economy Reforms**

  Crisis in India is figured out because of the inefficient management in the Indian economy in 1980s. The revenues generated by the government were not adequate to meet the growing expenses, So, the government resorted to borrowing to pay for its debts and was caught in a debt-trap.

- **<u>Causes of Economic Crisis</u>**

1) The continued spending on development programmes of the government did not generate additional revenue.
2) The government was not able to generate sufficient funds from internal sources such as taxation.
3) Expenditure on areas like social sector and defence do not provide immediate returns, so there was a need to utilize the rest of the revenue in a highly effective manner, which government failed to do so.
4) The income from public sector undertakings was also not very high to meet the growing expenditures.
5) Foreign exchange borrowed from other countries and international financial institutions was spent on meeting consumption needs and to make repayment on other loans.

- **<u>Need for Economic Reforms</u>**

  The economic policy followed by the government upto 1990 failed in many aspects and landed the country in an unprecedented economic crisis. The situation was so alarming that India's foreign reserves were barely enough to pay for two weeks of imports. New loans were not available and NRIs were withdrawing large amounts. There was an erosion of confidence of International investors in the Indian economy.

- **The Following Points Highlight the Need for Economic Reforms in the Country**

1) Increasing fiscal deficit.
2) Adverse balance of payments.
3) Gulf crisis.
4) Rise in prices.
5) High rate of deficit financing.

➢ **Emergence of New Economic Policy (NEP)**

Finally, India approached International Bank for Reconstitution and Development, popularly known as World Bank and International Monetary Fund (IMF) and received $7 million as a loan to manage the crisis. International agencies expected India to liberalize and open up economy by removing restrictions on private sector and remove trade restrictions between India and Foreign countries.

India agreed to the Conditions of world bank and IMF and had announced new economic policy which consist of wide range of economic reforms.

➢ **LIBERALISATION**

Liberalisation was introduced to put an end to these restrictions and open various sectors of the economy. It is generally defined as loosening of government regulations in a country to allow for private sector companies to operate business transactions with fewer restrictions. In relation to Developing countries this refers to opening of economic borders for multinational and foreign investment.

- **Objectives of Liberalisation**

1) To increase competition among domestic industries.
2) To increase foreign capital formation and technology.
3) To decrease the debt burden of the country.

4) To encourage export and import of goods and services
5) To expand the size of the market.

- **Economic reforms under Liberalisation**

1) **Deregulation of Industrial sector:** In India, the following steps were taken to deregulate the industrial sector.
    i. <u>Abolition of Industrial Licensing government</u> abolished the licensing requirement of all Industries, except for the five Industries which are: Liquor, Cigarettes, Defence equipment, Industrial explosives, Dangerous chemicals and pharmaceuticals.
    ii. <u>Contraction of Public Sector</u>: The number of industries reserved for the public sector was reduced from 17 to 8. Presently only three Industries are 'reserved for public sector'. They are Raliways, Atomic Energy and Defence.
    iii. <u>De-reservation of Production Areas:</u> The production which were early reserved for SSIs were de-reserved.
    iv. <u>Expansion of Production Capacity:</u> The producers were allowed to expand their production capacity according to market demand. The need for licensing was abolished.
    v. <u>Freedom to Import Capital Goods:</u> The business and Production units were given freedom to import capital goods to upgrade their technology.

2) **Financial Sector Reforms:** It includes Financial Institutions such as Commercial banks, Investment Banks, Stock exchange operations and Foreign exchange Market.

3) **Tax Reforms:** Tax reforms are concerned with the reforms in the government's taxation and public expenditure policies, which are collectively known as its fiscal policy. 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.

4) **Foreign Exchange Reforms:** It includes reforms relating to foreign exchange and foreign trade

5) **Trade and Investment Policy Reforms:** Liberalisation of trade and investment regime was initiated to increase international competitiveness of industrial production and also foreign investments and technology into the economy.

➢ **PRIVATISATION**

It implies shedding of the ownership or management of a government owned enterprise. Government companies are converted into private companies.
Privatisation of the public sector enterprises by selling off part of the equity of PSEs to the public is known as disinvestment.

➢ **GLOBALISATION**

It means integration of the economy of the country with the world economy.
Globalisation encourages foreign trade and private and institutional foreign investment.
Globalisation is a complex phenomenon as it is an outcome of the set of various policies that are aimed at transforming the world towards greater interdependence and integration.

- **Outsourcing**

This is one of the important outcomes of the globalisation process. In outsourcing, a company hires regular service from external sources, mostly from other countries, which was previously provided internally or from within the country (like legal advice, computer service, advertisement, security — each provided by respective departments of the company).

- **World Trade Organisation (WTO)**

The 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 organization to administer all multilateral trade agreements by providing equal opportunities to all countries in the international market for trading purposes. WTO is expected to establish a rule-based trading regime in which nations cannot place arbitrary restrictions on trade.

- **Economic Growth During Reforms.**

Growth of an economy is measured by gross domestic product (GDP). The growth of GDP increased from 5.6% during 1980-1991 to 8.2% during 2007-2012.

- **<u>Main highlights of economic growth during reforms are given below:</u>**

1) During the reform period, the growth of Agriculture was declined. While the industrial sector reported fluctuation, the growth of service sector has gone up. This indicates that the growth is mainly driven by the growth in service sector.
2) The opening up of the economy has led to the foreign direct investment and foreign exchange reserves.

   The foreign investment which includes Foreign Direct Investment (FDI) and Foreign Institutional Investment (FII), has increased from about US $100m million in 1990-1991 to US $400 billion in 2010-2011.
3) There has been increase in Foreign exchange reserves from about US $6 billion in 1990-1991 to US $300 billion in 2011-2012. In 2011 India was the 7th largest foreign exchange holder in the world.
4) India is seen as a successful exporter of auto parts, engineering goods, IT software and textiles in the reform period. Rising prices also have been kept under control.

- **<u>Failures of Economic Reforms</u>**

1) Neglect of Agriculture

There has been deterioration in agricultural growth rate. This deterioration is the root cause of the problem of rural distress that reached crisis in some parts of the country. Economic reforms have not been able to benefit the agricultural sector because

a. Public investment in agriculture sector especially in infrastructure which includes irrigation, power, roads, market linkages and research and extension has been reduced in the reform period.

b. The removal of fertilizer subsidy has led to increase in the cost of products, removal of minimum support price and lifting of quantitative restrictions have increased the threat of international competition to the Indian formers.

c. Export-oriented policy strategies in agriculture has been a shift from production for the domestic market towards production for the export market focusing on cash crops in lieu of production of food grains.

2) Uneven Growth in Industrial Sector

Industrial sector registered uneven growth during this period. This is because of decreasing demand of industrial products due to various reasons.

a. Cheaper imports have decreased the demand of domestic industrial goods.

b. There was inadequate investment in infrastructure facilities such as power supply.

c. A developing country like India still does not have the access to developed countries markets because of high non-tariff barriers.

3) Other Failures

In addition to the above mentioned failures, the other drawbacks of LPG policy were:

a. It led to urban concentration of growth process.

b. It encouraged economic colonialism.

c. It resulted in the spread of consumerism.

d. It led to cultural erosion.

CHASE ACADEMY