New economic policy of India

VAM group

Economic policy:

Economic policy refers to the actions that governments take in the economic field. It covers the systems for setting levels of taxation, government budgets, the money supply and interest rates as well as the labor market, national ownership, and many other areas of government interventions into the economy.

Pre-1991 economic scenario in India:

- Indian economic policy after independence was influenced by the colonial experience (which was seen by Indian leaders as exploitative in nature) and by those leaders' exposure to Fabian socialism.
- Nehru, and other leaders of the independent India, sought an alternative to the extreme variations of capitalism and socialism.
- In this system, India would be a socialist society with a strong public sector but also with private property and democracy.
- As part of it, India adopted a centralised planning approach.
- Policy tended towards protectionism, with a strong emphasis on import substitution, industrialisation under state monitoring, state intervention at the micro level in all businesses especially in labour and financial markets, a large public sector, business regulation.

Drawbacks of Pre-1991 economic policy:

1.Licence raj:

The “Licence Raj” or “Permit Raj” was the elaborate system of licences, regulations and accompanying red tape that were required to set up and run businesses in India between 1947 and 1990.

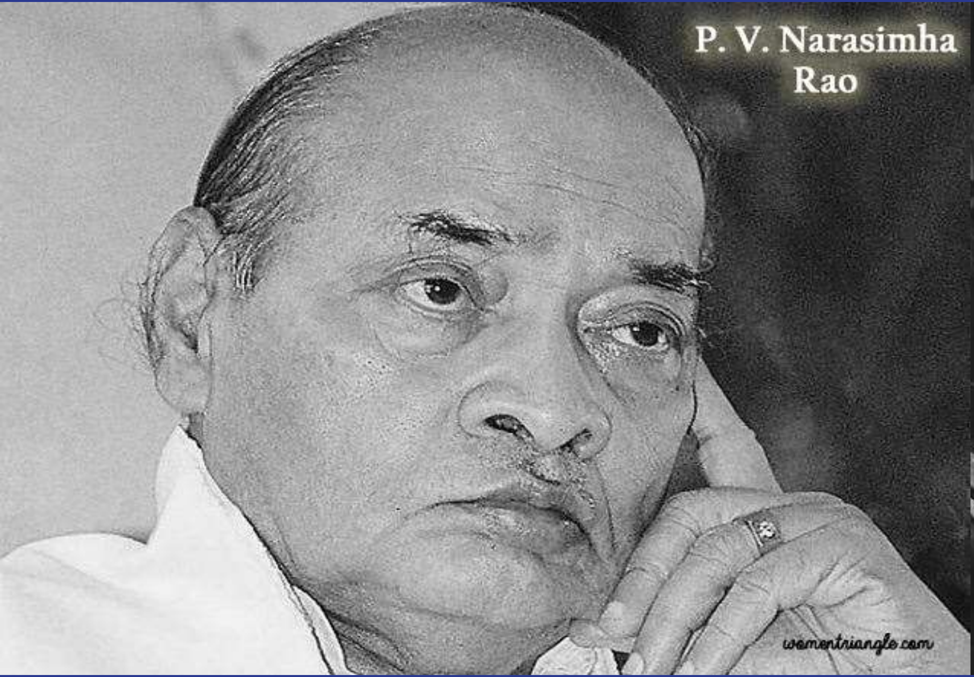
2.Import substitution:

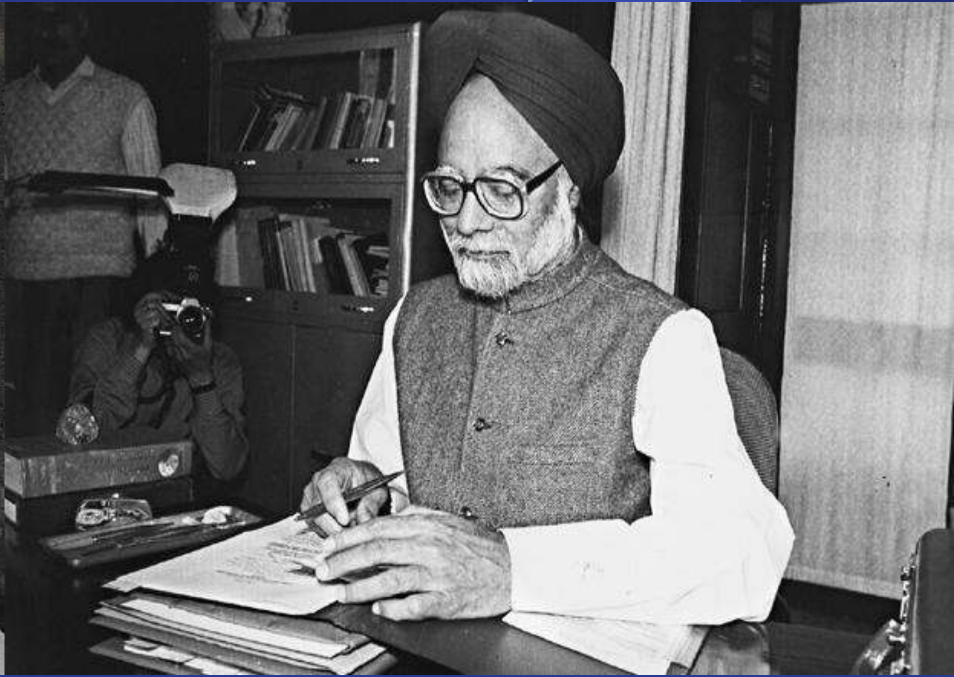
Import substitution industrialization (ISI) is a trade and economic policy which advocates replacing foreign imports with domestic production. ISI is based on the premise that a country should attempt to reduce its foreign dependency through the local production of industrialized products and was intended to promote self reliance. But this meant the monopoly of indian industries and lack of incentive for them to improve the quality of products which hampered consumer interests.

“Before the process of reform began in 1991, the government attempted to close the Indian economy to the outside world. The Indian currency, the rupee, was inconvertible and high tariffs and import licensing prevented foreign goods reaching the market.The labyrinthine bureaucracy often led to absurd restrictions—up to 80 agencies had to be satisfied before a firm could be granted a licence to produce and the state would decide what was produced, how much, at what price and what sources of capital were used.”

- BBC on the Pre-1991 economic policy

New economic Policy of 1991 - Architects





P.V.Narasimha Rao

Dr.Manmohan Singh

Prime Minister

1991 economic crisis:

- By 1985, India had started having balance of payments problems. This is due to more expenditure by the government whereas the income generated was less. In addition there was huge disparities between income and expenditure.
- By the end of 1990, it was in a serious economic crisis. The government was close to default, its central bank had refused new credit
- In 1991, India met with an economic crisis - relating to external debt. The government was not able to make repayments on its borrowings from abroad.
- The foreign exchange reserves, which we maintain to import petroleum and other important items, dropped to levels that were not sufficient to last even a fortnight.
- The crisis was further compounded by rising prices of essential goods.

Advent of IMF and World Bank:

- India approached the International Bank for Reconstruction and Development(IBRD), commonly known as World Bank and the International Monetary Fund(IMF) for help.
- India received 7 billion dollars as loan from these agencies to solve the crisis.
- It had to pledge 20 tonnes of gold to Union Bank of Switzerland and 47 tonnes to Bank of England as part of the deal with the International Monetary Fund (IMF)
- In addition, as part of the bailout, IMF expected India to liberalise and open up the economy and remove trade restrictions between India and other countries.

Cartoon criticising that IMF pressurized India to adopt New Economic Policy

“There is no time to lose. Neither the Government nor the economy can live beyond its means year after year. The room for manoeuvre, to live on borrowed money or time, does not exist any more.... We need to expand the scope and the area for the operation of market forces.”

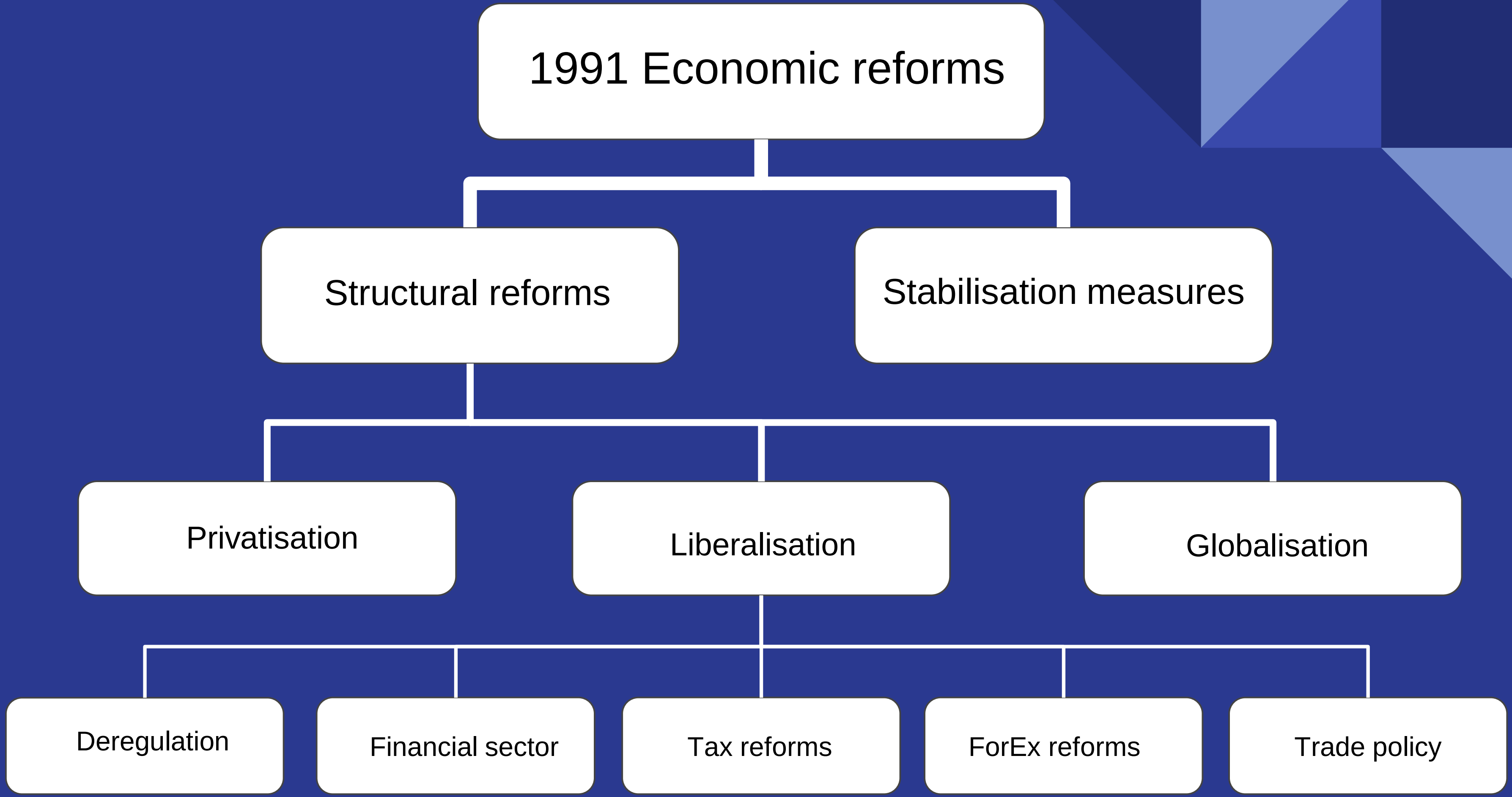
—

Dr.Manmohan Singh.

Budget Speech,

July 24, 1991.

(Before proposing the reforms)


1991 Economic reforms
Structural reforms
Stabilisation measures
Privatisation
Liberalisation
Globalisation
Deregulation
Financial sector
Tax reforms
ForEx reforms
Trade policy

Stabilisation measures:

- These are short term measures aimed at solving the immediate cause - the 1991 economic crisis.
- These included correcting the weakness which resulted in the balance of payments crisis and steps to bring the inflation under control.

Structural measures:

- These 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.
- These reforms fall under three leads:
  1. Liberalisation
  2. Privatisation
  3. Globalisation

Liberalisation:

Liberalisation was done in various sectors in the following ways:

1. Deregulation of industrial sectors :
   - Industrial licensing was abolished for all but product categories - alcohol, cigarettes, hazardous chemicals, drugs, explosives etc.,
   - Many industries which are reserved for public sector in have now been “dereserved”. Only railways, defence equipment, atomic power generation have been reserved with the public sector.
   - Market has been allowed to determine the prices.

2. Financial sector reforms :
   - Reduce the role of RBI from regulator to facilitator of financial sector.
   - These reforms led to the establishment of private banks.
   - FDI in banks was raised to 50%.
   - But certain managerial aspects have been retained with the RBI, to safeguard the interests of the account holders.

3. Tax reforms :

- Corporate tax, which was very high earlier has been gradually reduced.
- The tax procedures have been simplified and the rates also have been lowered.
  1973-74 - Eleven tax slabs, with rates from 10 to 85 per cent.
  1990-91 - In five Budgets between 1991-96, FM Manmohan Singh reduces IT slabs to three (20, 30 and 40 per cent).

4. Foreign exchange reforms:

- The rupee was “devalued” against foreign currencies which led to an increase in inflow of foreign exchange.
- Market has been allowed to determine the foreign exchange rates.

5. Trade and investment policy reforms :

- Dismantling of quantitative restrictions on imports.
- Reduction of tariff rates(taxes on imports)
- Removal of licensing procedures for imports except in case of hazardous and environmentally sensitive products
- Quantitative restriction on imports was also fully decreased later.
- Export duties have been removed to promote exports.

Privatisation:

- Privatisation means the transfer of assets from public sector to private sector.
- Privatisation helps in improving financial discipline and to facilitate modernisation.
- Privatisation helps in strong inflow of FDIs
- <u>Disinvestment :</u> Privatisation of public sector enterprises by selling off part of the equity of PSEs to the public is called Disinvestment.
- Criticism:
  1.Assets of PSUs has been undervalued.
  2.The money from disinvestments were diverted to meet the shortage in the government revenue rather than in creating new assets.

Globalisation:

- Globalisation:
  Globalisation is the process of international integration arising from the interchange of world views, products, ideas and mutual sharing, and other aspects of culture.
- Outsourcing:
  In Outsourcing, a company hires regular service from external sources, which was hitherto provided internally. It is an outcome of globalisation. Thanks to new economic policy, India became a major source for outsourcing jobs.   Eg: BPO, banking services etc.,
- World Trade Organisation(WTO):
  WTO was established to administer all multilateral trade agreements by providing equal opportunities to all countries in the international market for trading purposes. India has been an active member of WTO, which aims to enlarge trade between countries.

“ I do not minimise the difficulties that lie ahead on the long and arduous journey on which we have embarked. But as Victor Hugo once said, "No power on earth can stop an idea whose time has come". I suggest to this august House that the emergence of India as a major economic power in the world happens to be one such idea. Let the whole world hear it loud and clear. India is now wide awake. We shall prevail. We shall overcome.”

—

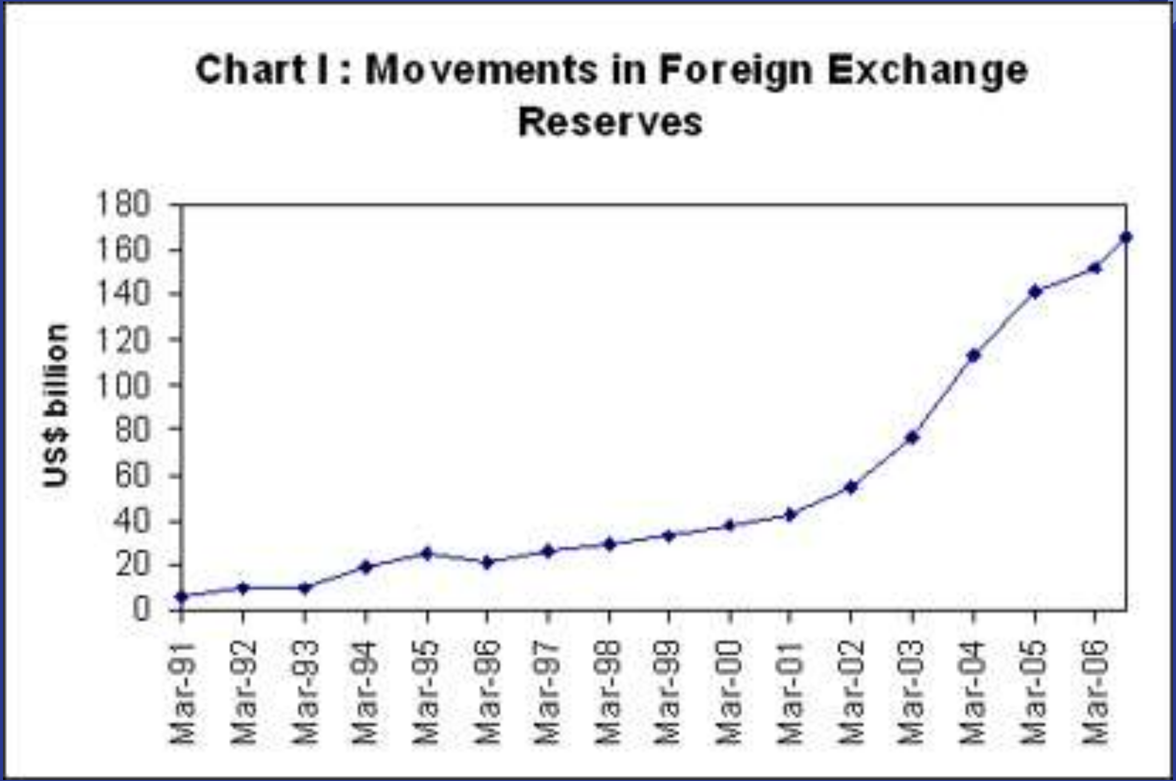
Dr.Manmohan Singh.

Budget Speech,

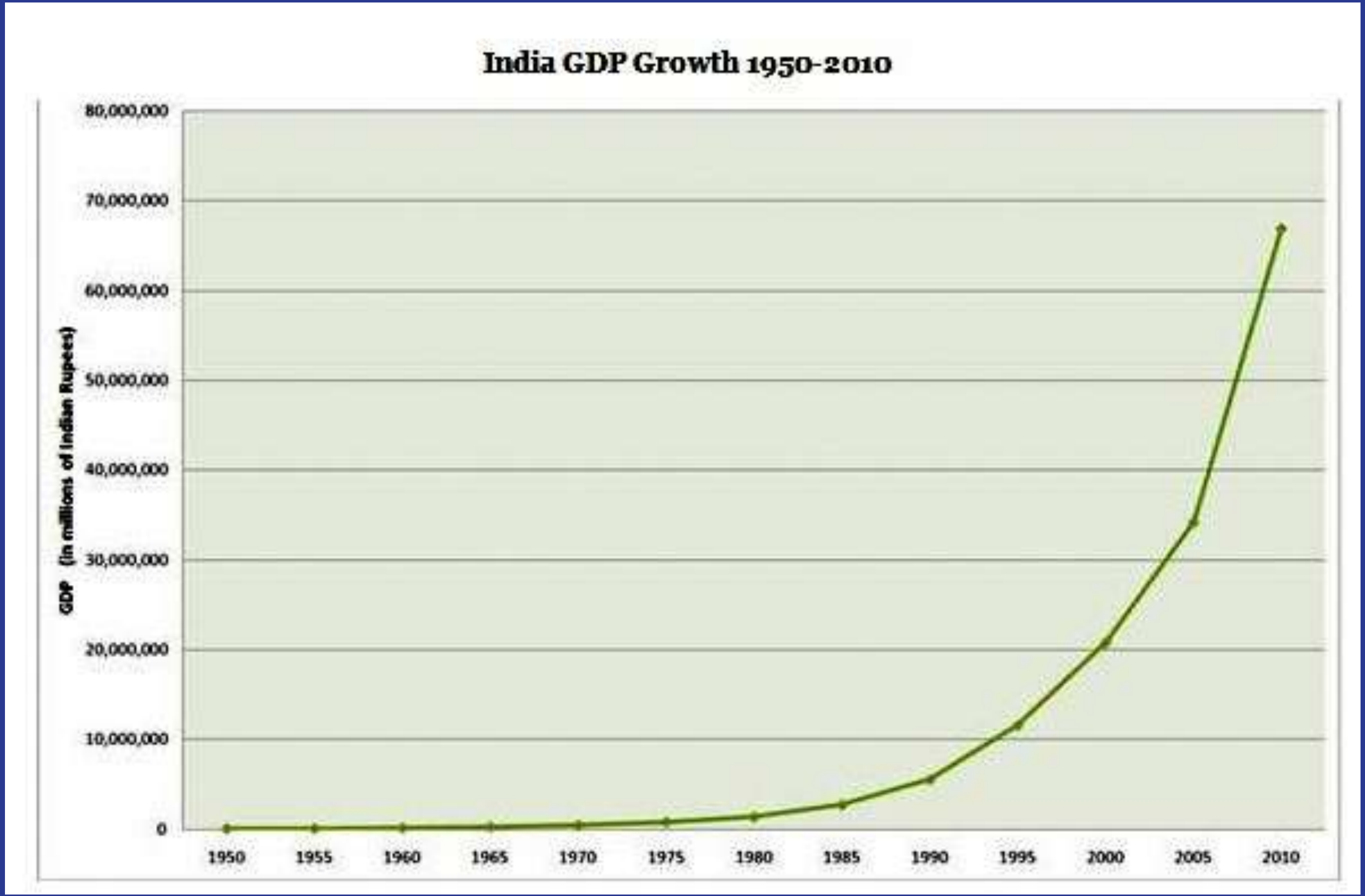
July 24, 1991

(After proposing the reforms)

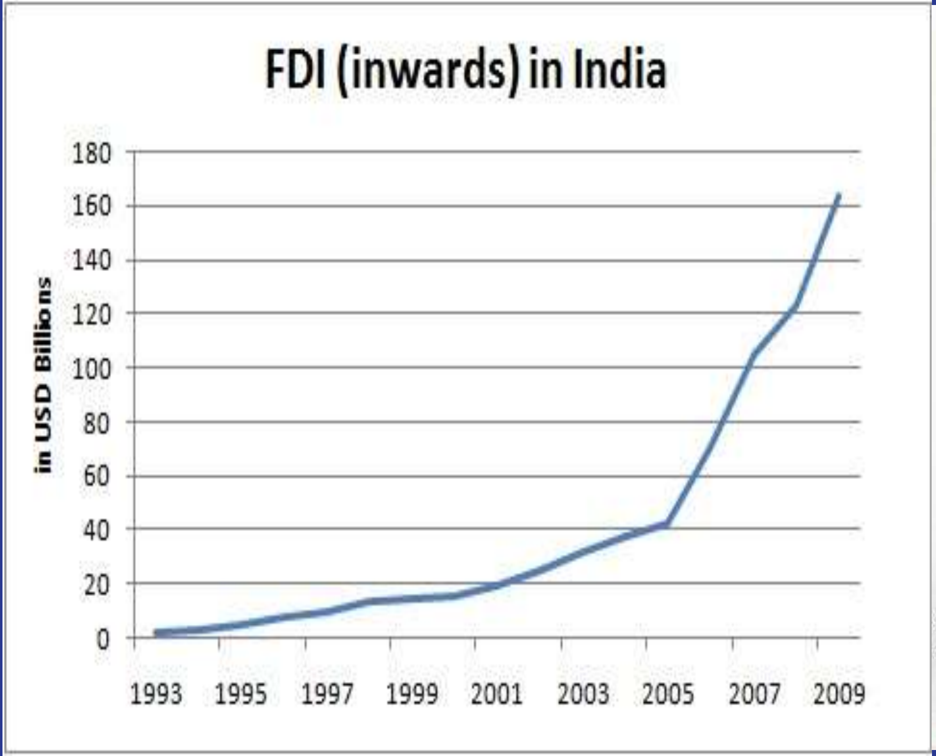
Assessment of Economic reforms:



Increase in Foreign Exchange reserves

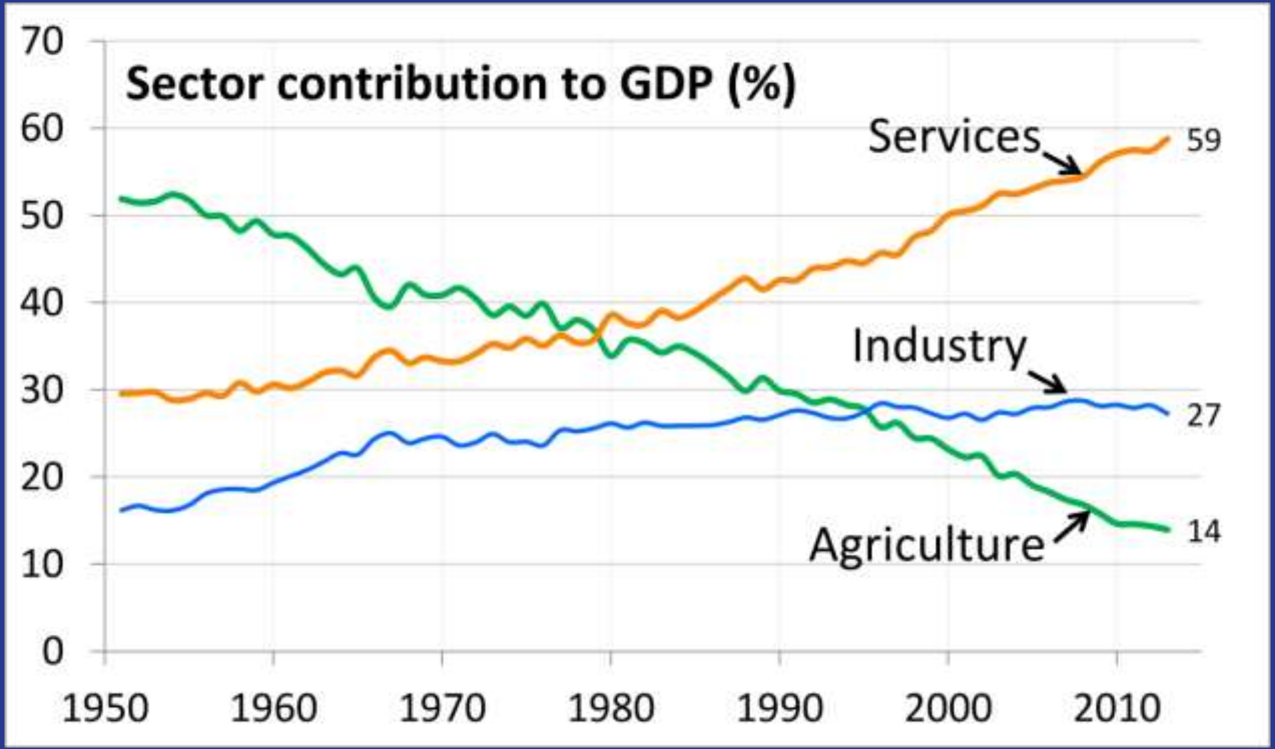


Growth of GDP in India



Growth of FDIs in India

Criticism over FDI



Share of GDP over various sectors

- This graphs show that the New economic policy helped in the development of service sector but was unable to develop both agricultural and industrial sectors.

The cartoon criticising that the New economic Policy was unable to reduce the inequalities and in curbing poverty and unemployment.

THANK YOU