INDIAN ECONOMIC DEVELOPMENT

Class 12 | Chapter 3

LPG Reforms

Liberalisation, Privatisation and Globalisation

New Economic Policy 1991 | CBSE Board | KCC Notes

Chapter Overview

Topic No.	Topic	Importance
1	Background — Economic Crisis of 1991	High
2	New Economic Policy (NEP) 1991 — Introduction	Very High
3	Liberalisation — Meaning, Measures, Effects	Very High
4	Privatisation — Meaning, Methods, Effects	Very High
5	Globalisation — Meaning, Measures, Effects	Very High
6	WTO and India	High
7	Outsourcing	High
8	Critical Evaluation of LPG Reforms	Very High
9	Important Board Questions	Very High

1. Background — Economic Crisis of 1991

By the late 1980s and early 1990s, India was facing a severe economic crisis. The government had to take bold reform measures to stabilise and restructure the Indian economy.

Causes of the 1991 Crisis

CRISIS INDICATORS (1990-91): Foreign Exchange Reserves: Only enough for 2 weeks of imports Fiscal Deficit: Very high — government spending far exceeded revenue Inflation: Rising rapidly — prices of goods increasing fast Balance of Payments: Severe deficit — more imports than exports External Debt: India had to pledge 67 tonnes of gold to Bank of England and Union Bank of Switzerland to raise loans

- The Gulf War (1990-91) caused oil prices to rise sharply, worsening India's import bill
- Remittances from Indian workers in Gulf countries fell sharply
- Excessive government spending and fiscal mismanagement
- Inefficient public sector enterprises running at losses
- Rigid licence-permit raj stifling private sector growth

Response: New Economic Policy (NEP), 1991

Under the guidance of Prime Minister P.V. Narasimha Rao and Finance Minister Dr. Manmohan Singh, India announced a New Economic Policy in July 1991, guided by the IMF and World Bank conditions for a bailout loan. This policy introduced the famous LPG Reforms.

LPG = Liberalisation + Privatisation + Globalisation

Exam Tip: The 1991 crisis and the role of Dr. Manmohan Singh = 1-mark question very often! Remember: FM = Dr. Manmohan Singh, PM = P.V. Narasimha Rao.

2. Liberalisation (□□□□□□□□)

Meaning

Liberalisation refers to the process of freeing the economy from unnecessary government controls, restrictions, and regulations. It means giving greater freedom to businesses to make their own decisions.

Measures of Liberalisation

Abolition of Industrial Licensing (Licence Raj)

Most industries were freed from the requirement to obtain a government licence before starting or expanding production. Only a few sensitive industries (defence, atomic energy, hazardous chemicals) still require licences.

> Example: A businessman can now start a textile factory without getting government permission.

Deregulation of Financial Sector

Interest rates were freed from government control. Banks were allowed to set their own rates. Entry of private and foreign banks was permitted.

> Example: Banks like HDFC and ICICI were allowed to enter and compete with government banks.

Tax Reforms

Income tax rates were reduced. Corporate tax was lowered. Indirect taxes were simplified and rationalised. Later, GST replaced multiple state and central taxes.

> Example: Corporate tax reduced from 45% to 30% to encourage business investment.

Foreign Exchange Reforms

The rupee was made partially convertible — businesses could freely convert rupees for trade purposes. FERA (Foreign Exchange Regulation Act) was replaced by the more liberal FEMA (Foreign Exchange Management Act) in 1999.

> Example: Importers could now buy foreign currency more easily for business purposes.

Removing Import Restrictions

Quantitative restrictions on imports were removed. Import licensing was abolished for most goods. Import duties were reduced significantly.

> Example: Companies could now import machinery and technology freely without quota restrictions.

Effects of Liberalisation

Positive Effects	Negative Effects
Increased industrial growth and production	Domestic industries faced intense foreign competition
Attracted foreign investment (FDI)	Small industries were threatened and many closed down
Greater efficiency in industries	Rising inequality — rich benefited more than poor
Wider consumer choice and lower prices	Job losses in protected industries
Technological upgradation in industries	Dependence on foreign capital increased

Exam Tip: Abolition of Licence Raj is the most important measure of Liberalisation. Explain it clearly with its significance.

3. Privatisation (■■■■■■■)

Meaning

Privatisation refers to the transfer of ownership, management, and control of public sector enterprises (PSEs) to the private sector. It reduces the role of the government in direct economic production.

Methods of Privatisation

Method	Meaning
Disinvestment	Government sells a part or all of its equity shares in a PSE to private investors through the stock mark
Denationalisation	Complete ownership of a PSE is transferred to the private sector. The government gives up all contro
Withdrawal of State from Certain Activities	Government stops producing certain goods/services and leaves these entirely to the private sector.
Privatisation by Stealth	Government reduces its budget allocations to PSEs, forcing them to raise funds from private markets.

Why Privatisation?

- Public sector enterprises were running at huge losses and needed heavy government subsidies
- Low efficiency and productivity in public enterprises due to lack of competition
- Private sector is more profit-driven and therefore more efficient
- Government needed funds — selling stakes in PSEs raised revenue
- To reduce government interference in day-to-day business decisions

Effects of Privatisation

Positive Effects	Negative Effects / Criticism
Improved efficiency and profitability of enterprises	Job losses as private firms reduce excess staff
Better quality goods and services for consumers	Profit motive may ignore social welfare and public interest
Reduced burden on government finances	Strategic sectors may fall into private/foreign hands
Increased competition leads to innovation	Monopoly power may be misused by large private firms
Better management and technology adoption	May increase inequality in society

Note: Disinvestment is the most commonly used form of privatisation in India. Examples: ONGC, SAIL, BHEL partial disinvestment.

Exam Tip: Distinguish between Disinvestment and Denationalisation — common 3-mark distinction question!

4. Globalisation (□□□□□□□□□)

Meaning

Globalisation is the process of integrating the domestic economy with the world economy. It involves the free flow of goods, services, technology, capital, and labour across national boundaries.

Measures of Globalisation in India

Reduction in Import Duties

Import tariffs were significantly reduced to allow foreign goods to enter India easily, increasing competition and consumer choice.

> Example: Custom duty on electronic goods reduced from 80% to 10-15%.

Foreign Direct Investment (FDI)

Foreign companies were allowed to invest directly in Indian businesses. FDI limits were increased in most sectors including insurance, retail, and telecom.

> Example: McDonald's, Samsung, and Amazon invested directly in India post-1991.

Foreign Institutional Investment (FII)

Foreign institutional investors (mutual funds, pension funds) were allowed to invest in Indian stock markets, bringing in large portfolio investments.

> Example: Foreign funds investing in Nifty50 companies through the stock market.

Removal of Quantitative Restrictions

Limits on the quantity of imports (quotas) were removed, allowing free trade in most goods.

> Example: India removed import quotas on agricultural products under WTO obligations.

Export Promotion

Various incentives were given to exporters — tax exemptions, special economic zones (SEZs), Export Processing Zones (EPZs).

> Example: Software companies in Noida SEZ export IT services worth billions of dollars.

Outsourcing

Indian companies began providing back-office, IT, and business process services to foreign companies — creating a massive IT/ITES industry.

> Example: Infosys, TCS, Wipro handling software development for US and European companies.

Effects of Globalisation

Positive Effects	Negative Effects / Criticism
Rapid growth of IT, ITES, and service sectors	Domestic industries — especially agriculture and small industries — harm
Increased exports and foreign exchange earnings	Increased inequality between rich and poor
Technology transfer and modernisation	Rising import dependence threatens domestic manufacturing
Consumer access to global goods and services	Cultural impact — western culture dominance

Positive Effects	Negative Effects / Criticism
Job creation in export-oriented sectors	Benefits not equally distributed across regions and classes

Exam Tip: IT sector boom in India = direct result of Globalisation. This is a very popular example in board exams!

5. World Trade Organisation (WTO) and India

Item	Detail
Full Form	World Trade Organisation
Established	1st January 1995
Replaced	GATT (General Agreement on Tariffs and Trade) — 1948
Headquarters	Geneva, Switzerland
India's Membership	Founding member since 1995
Main Objective	To promote free and fair international trade by reducing trade barriers (tariffs, quotas, subsidies) amo
Key Agreements	TRIPS (Trade Related Intellectual Property Rights), TRIMS (Trade Related Investment Measures), G

Impact of WTO on India

- **Positive:** India got access to global markets for its exports — especially textiles, IT, and pharmaceuticals
- **Positive:** India could challenge unfair trade practices of other countries through WTO dispute mechanism
- **Negative:** India had to open its own markets to foreign competition — hurt domestic agriculture and small industries
- **Negative:** TRIPS agreement forced stricter patent laws — made medicines more expensive
- **Issue:** Agricultural subsidies by developed countries (USA, EU) harm Indian farmers who cannot compete

Exam Tip: WTO full form, establishment year, and India's position = 1-mark question. WTO vs GATT is a common 3-mark distinction!

6. Outsourcing

Meaning

Outsourcing refers to the practice of hiring external firms (in the same or other countries) to perform business functions or services that were previously done in-house. It is a major component of India's globalisation.

Types of Outsourcing

Type	Full Form	Meaning	India's Role
BPO	Business Process Outsourcing	Outsourcing of back-office tasks like data entry, payroll, HR	Large BPO centres in Bangalore, Hyderabad, Pune
KPO	Knowledge Process Outsourcing	Higher-skill outsourcing — research, analytics, legal, finance	India provides research and analysis services to glob
ITES	IT Enabled Services	IT-based services — call centres, tech support, software	India is the world's largest ITES destination

Benefits of Outsourcing to India

- Created millions of jobs — especially for English-speaking graduates
- Earned large amounts of foreign exchange for India
- Developed India's IT infrastructure and skill base
- Increased India's global competitiveness in services

Note: India became the world's leading destination for outsourcing due to: Large English-speaking skilled workforce, Lower labour costs, Strong IT infrastructure, and Favourable time zone.

7. Critical Evaluation of LPG Reforms

While LPG reforms brought significant economic growth, they also faced criticism for not benefiting all sections of society equally. Here is a balanced assessment:

Achievements of LPG Reforms

Achievement	Details
High GDP Growth	India's GDP growth rate increased significantly — averaged 6-7% after 1991, making India one of the
Forex Reserves	Foreign exchange reserves increased from crisis level (2 weeks of imports in 1991) to over 600 billion
Control of Inflation	Inflation was brought under control through better monetary policy and increased production due to co
IT and Service Sector Boom	India became a global IT superpower — IT exports grew from nearly zero to over USD 200 billion, cre
Poverty Reduction	Poverty headcount ratio fell significantly from over 45% in 1993 to under 22% by 2011 (official estima
Increased FDI	Foreign direct investment increased dramatically, bringing capital, technology, and management expe

Criticisms / Failures of LPG Reforms

Criticism	Details
Rising Inequality	The gap between rich and poor widened. The benefits of growth were not equally distributed — urban
Jobless Growth	GDP grew but employment did not grow proportionally. Many call this 'jobless growth' as the economy
Agricultural Crisis	Farmers suffered as agricultural subsidies were reduced and cheap imports hurt domestic prices. Far
Neglect of Social Sector	Spending on health, education, and social welfare was reduced to control fiscal deficit — hurting the p
Deindustrialisation of Small Industry	Small and medium enterprises could not compete with large domestic or foreign corporations and ma
Environmental Concerns	Rapid industrialisation and FDI inflows led to increased environmental degradation in many parts of In

Exam Tip: Critical evaluation = must for board exam. Write 3 achievements and 3 criticisms each with brief explanation = 6-mark answer!

8. LPG Reforms — Quick Comparison

Feature	Liberalisation	Privatisation	Globalisation
Meaning	Freeing economy from government control	Transfer of public enterprises to private sector	Integration of Indian economy with world e
Main Focus	Internal freedom for businesses	Reducing government ownership	Opening to international trade and investr
Key Measure	Abolition of industrial licensing (Licence Raj)	Disinvestment of public sector enterprises	Reduction of import duties + FDI allowanc
Hindi Term	Udaarikaran (■■■■■■■■)	Nijikaran (■■■■■■■)	Vaishvikaran (■■■■■■■■■)
Benefit	More business freedom, efficiency, competition	Less government burden, better management	Access to world markets, technology, cap

9. Important Board Exam Questions

1-Mark Questions

- Who was the Finance Minister when NEP 1991 was introduced?
- What does LPG stand for?
- When was WTO established? What did it replace?
- What is meant by Disinvestment?
- What is meant by Outsourcing?
- Define Globalisation.
- Name one major cause of the 1991 economic crisis in India.

3–4 Mark Questions

- Explain any THREE measures of Liberalisation introduced after 1991.
- Explain the concept of Privatisation. State any TWO methods of privatisation.
- Distinguish between Disinvestment and Denationalisation.
- What is the WTO? Explain its impact on India.
- Explain the concept of Outsourcing. How has it benefited India?
- What were the main causes of the 1991 economic crisis in India?
- Explain any THREE effects of Globalisation on the Indian economy.

5–6 Mark Questions (Long Answer)

- Explain the LPG reforms introduced in India in 1991 under the New Economic Policy.
- Critically evaluate the impact of LPG reforms on the Indian economy.
- Explain the measures of Globalisation adopted by India after 1991.
- Explain the measures and effects of Liberalisation in India.
- What is Privatisation? Explain its advantages and disadvantages.

Topic	Board Marks	Priority
LPG Reforms Overview (all three)	5-6 marks	Very High
Measures of Liberalisation	3-4 marks	Very High
Privatisation methods and effects	3-4 marks	Very High
Globalisation — measures and effects	4-6 marks	Very High

Topic	Board Marks	Priority
Critical evaluation of LPG	5-6 marks	Very High
WTO — meaning and India	3 marks	High
Outsourcing — meaning and benefits	3 marks	High
1991 Crisis — causes	3 marks	High

All the Best! You Will Definitely Score Well! *

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