Chapter - 3
LPG POLICY 1991
NEW ECONOMIC POLICY
ECONOMIC REFORMS

Introduction

To manage the economic crisis of 1991, Indian govt approached the international bank for reconstruction and development (IBRD) (World Bank) and IMF (international monetary fund) and received a loan of \$7 Billion.

To avail this loan world bank and IMF expected India to follow certain conditions.

a) Remove restrictions and license on private sector.

b) Reduce the role of government sector in economic development.

c) Remove trade restrictions.

India agreed to the conditions of world bank and IMF and announced new economic policy LPG policy.

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Crisis will start on Jan 1991.
LPG Policy promote in July 1991.

LPG

MEASURES OF ~~economic~~ POLICY:

The new economic policy was announced in July 1991. The main aim of this policy was to create a competitive environment in the economy to remove trade barriers.

New Economic policy has two kinds of measures:

1. **Stabilization Measures:**
It refer to short term measure which aim at:
- To maintain the balanced BOP.
- To control the inflation.

2. **Structural Reform measures:**

It refer to long term measures which aim at:
- To improve the efficiency of economy.
- To increase foreign competition.

V.Imp

NEED FOR LPG POLICY

OR

NEED FOR ECONOMIC REFORMS

1. **Poor Performance of Public sector:**

During 1950 to 1990 public sector played an important role in economic development. However the ~~all~~ overall performance of public sector was very disappointing and public sector enterprises suffered huge losses. Thus govt recognised the need for LPG Policy.

2. Deficit BOP :

BOP can be deficit when imports exceeds exports. even after imposing heavy taxes on imports there was a significant rise in imports and export rises at a very slow rate. Thus indian govt need private sector and LPG Policy to develop a strong export sector.

3. Inflation :

There was a continous rised in the price level in the economy due to shortage of essential goods.

4. Fall in Foreign Currency Reserves :

In 1991 foreign currency reserves fell to the lowest level. Foreign exchange reserves declined to a level where it was not adequate even to finance the imports and even to pay the interest only.

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5. Huge Burden of Debts :

The expenditure of the govt was much higher than revenue. As a result govt had to borrow money from various sources and thus created a huge burden of debt.

6. Inefficient Management :

The management of indian economy was inefficient and the govt was not even able to generate sufficient revenue to meet the expenditures.

CONTENTS OF LPG POLICY

1. L - liberalization
2. P - Privatisation
3. G - Globalization

LIBERALISATION

imp.

Def. liberalization means removal of entry and growth restrictions on private sector.

liberalisation involves deregulation and reduction of govt control and freedom of private investment to make the economy more competitive.

The purpose of liberalisation was two fold:

a) To unlock the economic potential by encouraging private sector.

b) To introduce much more competition into the economy.

Liberalisation includes the foll. reforms:
1. Industrial sector Reforms.
2. Financial sector reforms.
3. Tax reforms / fiscal reforms
4. Foreign exchange reforms / External sector reforms
5. Trade and investment policy reforms.

1. Industrial Sector Reforms:

Govt introduced the new industrial policy on 24th July '1991. Industrial sector reforms include the following:

a) Reduction of industrial licensing

This new policy abolished industrial licensing for all the projects except liquor, cigratte, Defence equipments, industrial explosives and dangerous chemicals.

Now no license is needed to set up a business, to expand a business and to diversify a business.

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However, license is required for industries related to security.

b) Decrease in the role of public sector

There was significant reduction in the role of public sector for the development of industries. Now only three industries are ~~are~~ exclusively reserved for govt - defence equipments, atomic energy and railway.

c) De-Reservation Under Small Scale Industries

Many goods produced by small scale industries only are now de-reserved. The market was allowed to determine the price through demand and supply force and not through govt policy.

d) MRTP Act (Monopoly and restrictive trade practices Act)

With the introduction of liberalisation policy, following rules were eliminated:
i) Approval for merger
ii) Approval for amalagamation and joint venture.

2. Financial Sector Reforms:

Financial sector includes financial institutions like commercial banks, investment banks,

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Stock exchanges and foreign exchange market. The financial sector in India is controlled by RBI. Financial sector reforms includes the following:

a) Change in Role of RBI:

The role of RBI was reduced from regulator to facilitator. Now financial sector was allowed to take decisions on many matters without the consultation of RBI.

b) Origin of Private Banks:

The financial sector reforms lead to the establishment of private sector banks. It increased the competition and provided benefit to clients by offering lower interest rates on loan.

c) Increase in the limit of foreign Investment

The limit of foreign investment in banks was increased to 51%. Foreign Institutional investors are now allowed to invest in Indian financial market.

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d) Expansion Process

Banks were given freedom to set up new branches without the approval of RBI.

3. Tax Reform / Fiscal Reforms:

Tax reform refers to the reforms related to govt. taxation and expenditure policy. It is also known as fiscal policy. Taxes are of two types:

1) Direct Tax:
It refer to those taxes which are imposed on the income of individual as well as on the profit of companies i.e income tax.

II) Indirect taxes:

It refer to those taxes which are imposed on the goods and services that is on consumption.

Tax Reform includes the followings:

1. Reduction in Taxes:

Since 1991 there has been a continous reduction in income taxes. Due to lower rate of taxes there is encouragement of savings and investment.

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2. Reform on Indirect Taxes :
Due to significant reform on indirect taxes, it facilitate the establishment of common national market for goods.

3. Simplification of Process :

In order to encourage tax pairs, many procedures have been simplified :

GST

The GST act was passed in the parliament on 29 Mar, 2017 to introduce unified tax system in India. The GST Act implemented on 1st July 2017. GST is expected to generate additional revenue for the government, reduce tax evasion and create one nation, one tax, one Market.

4. Foreign Exchange Reform
OR
External Sector Reform

a) Devaluation of INR.

Devaluation means reduction in the value of domestic currency in terms of foreign currency. To overcome the deficit BOP govt devalued the indian rupee in order to increase the exports and inflow of foreign currency.

b) Market Determination of Exchange Rate:

Govt allowed market force of demand and supply to determine the exchange rate.

5. Trade And Investment Policy Reform:

Before 1991 Tariff and Quotas were imposed on the imports to protect the domestic industries. Due to this domestic industries faced inefficiency and less competition in the market.

Trade and investment policy reform was introduced to increase the competition in India, to promote foreign investment and to promote efficiency of domestic industries.

Trade and investment Policy reforms include the following:

a. Removal of Quota:
Under the LPG Policy the Quota on export and import were reduced. Quota on import of consumer goods and agricultural goods were fully removed from April 2001.

b) Removal of Export duty:

Export duties were removed to increase the position of Indian goods in the foreign market.

c). Reduction of Import Duty:

Import duties were reduced to improve the position of domestic goods in the foreign market.

d). Abolition of Import licensing system:

The import license was abolished except in case of hazardous goods. This encouraged domestic industries to be more competitive.

PRIVATISATION

It means transfer of ownership of public sector enterprises to the private sector.

Privatisation implies greater role of Private Sector in the development of economy.

It can be done in two ways:

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a) Transfer of ownership of public sector companies to the private sector

b) By selling off part of equity shares to the general public or to the private sector. This is called ~~as~~ disinvestment.

The motive of privatisation was to improve financial discipline and to facilitate modernisation. It must be noted that private managerial capabilities will surely improve the performance of public sector companies.

V. Imp. BENEFITS AND LOSS OF PRIVATISATION

BENEFITS :

1. Privatisation helped in the reduction of deficit budget. Public Companies were putting large burden on the economy due to huge losses. Privatisation helped in reducing the burden.

2. Privatisation abolished the monopoly of govt and helps in improving the competition of economy.

3. The policy of privatisation was helpful in the decision making process due to no interference of govt.

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4. The survival of private sector depends on the satisfaction of customer. Thus privatisation leads to choices for the consumers.

LOSSES :

1. Privatisation neglected social welfare because they mainly operate for the profit maximisation.

2. Private sector does not take any interest in the projects which are risky. It leads lop-sided growth of economy i.e unbalanced growth.

3. Privatisation leads to concentration of economic power i.e power in few hands.

4. Privatisation increases the risk of unemployment because there is always a fear of retrenchment of workers.

Ques Write a short note on Maharatnas, Navratnas and Miniratnas?

ans Govt made attempts to improve the efficiency of public sector undertakings by giving managerial decisions autonomy to the ~~[illegible]~~

private sector.

Some PSU have been granted special status like Navratnas, maharatnas and miniratnas.

In order to enable PSU to be more competitive govt granting navratnas status to them.

The granting of Navratnas status resulted in better performance of these companies.

Apart from this other profit making companies were granted financial and managerial autonomy and they were referred as miniratnas.

As on 13th sep. 2017 there are 8 maharatnas 16 navratnas and 74 miniratnas.

GLOBALISATION

join
Globalisation means integrating our economy with the world economy by removing barriers on trade.

It involves creation of network and activities joining economic, social and geographical boundaries. Globalisation aims to create a borderless world.

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Strategies Promoting Globalisation :

(OR)

Changes Made By Globalisation In The Indian Economy

1. The new economic policy prepared a list of priority industries in which automatic permission will be avaliable for FDI upto 51% of foreign equity.

2. In respect of foreign technology agreement automatic permission is provided i.e no permission is required for hiring foreign technicians.

3. Rupee was devalued by 20% which encouraged exports and discouraged imports.

4. The peak rate of custom duty has been reduced from 250% to 10%.

5. This policy remove all the restrictions and barriers and allowed demand and supply force to play a greater role.

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Advantages of globalisation :

1. Greater access to the global market.

2. Advanced Technology

3. Better future opportunities for large industries.

Disadvantages from Globalisation :

1. Benefits of globalisation are mainly for developed countries because only developed countries are able to expand their market.

2. Globalisation compromises with the welfare of people belonging to poor countries.

3. Globalisation increases the economic disparities among the people.

V.Imp. OUTSOURCING (4)

Outsourcing refers to contracting out some of its activities to a third party which ~~are~~ were earlier performed by organisation itself.

For eg: Many companies have started outsourcing security services to a third party.

For eg : Many companies have started

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Outsourcing calling work to third parties like call center.

Outsourcing is the important outcome of Globalisation.

Outsourcing has developed in recent times because of growth of communication and IT.

India has a favourable destination of outsourcing for various multinational companies because of low wages and availability of skilled workers.

Some of the services outsourced to india

a) call center and BPO
b) Record keeping
c) Accountancy
d) Banking service
e) Music recording
f) film editing
g) clinical advice

IMPORTANT MEANINGS

1. Bilateral Trade:

Trade between two countries is known as bilateral trade.

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2. Multilateral Trade:
Trade between more than two countries is called multilateral trade.

3. Tariff Barrier:
The barrier which are imposed on imports to make the imports costlier and to increase the domestic production.

4. Non-Tariff Barrier:
The Barrier which is imposed on the amount of exports and import.

V.Imp **WTO [World Trade Organisation]:**

(General agreement on trade & tariff)

Prior to WTO, GATT was established as a trade organisation in 1948 with 23 countries.

GATT was set-up to control all the multi-lateral trade agreements by providing equal opportunities to all the countries in the international market.

WTO was founded in 1995 as the organisation to the GATT.

WTO agreements cover trading of goods as well as of services. At present there are 164 member countries of WTO and all the members are required to follow laws and policies of WTO.

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India as a member of WTO fulfilled all the committments and take reasonable steps for removing tariff and Quota.

Functions Of WTO

1. To provide international trade by removing all the tariff and non-tariff barriers.

2. To establish rule based trading regime.

3. To enlarge production and trade of services.

4. To protect the environment.

5. To ensure optimum utilisation of resources.

Ques Should India be a member of WTO?

Some scholars are of the view that there is no use for a developing country like india to be a member of WTO. According to them

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1. Major volume of trade occurs among the developed nations and not among the developing nations.

2. Developing countries are being cheated as they are influenced to open the market for developed countries.

Arguments in Favour of LPG Policy

1. Increase in the rate of Economic Growth: The growth rate of GDP was 5.6% during 1986 to 1991. During 2017-18 the growth rate in GDP was 6.7% and During 2018-19 the growth rate in GDP was 7.2%.

During the reform period the growth of agriculture has decline, industrial sector reported fluctuation and the growth of service sector has gone up.

Service sector showed highest growth rate of 10.3% in 2014-15.

2. Inflow of foreign Investment:

The opening up of economy lead to rapid increase in FDI. The FDI increased from 100 million dollars in 1991 to 73.5 billion dollars in 2014-15

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With the launch of make in india in Sep. 2014 ~~on~~ the FDI inflow in india increased by 48%.

3. **Rise in foreign Exchange Reserves:**

There has been increase in foreign exchange reserves from 6 billion dollars in 1991 to 321 billion dollars in 2014-15.

4. **Rise in Exports:**

During the LPG period india experienced significant increase in exports of autoparts, engineering goods, IT ~~sofo~~ software and textile.

5. **Control On Inflation / check on Inflation:**
Due to LPG policy the annual rate of inflation reduced from the peak level of 17% 1991 to 5.48% in 2015-16-

Arguments against LPG Policy

1. **Growing Unemployment:**

The GDP growth rate has increased after the LPG Policy but such growth failed to generate sufficient employment in the economy.

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**** (4M) 2. Neglect of Agriculture:

The new economic policy has neglected the agriculture sector as compared to industries and service sector.

a) Reduction of public investment

Public investment in agriculture has been reduced especially in infrastructure like irrigation, roads, power supply etc.

b) Removal of Susidy:

Removal of subsidies increased the cost of production which adverself affect the small farmers.

c) Reduction of Import Duty:

Due to reduction of import duty on agricultural goods and removal of quotas on imports, indian farmers now faced tough competition.

d) Due to LPG Policy the production shifted from food grains to cash crops.

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3. (3M) **Low level of Industrial growth :**

Industrial growth recorded a slow down due to following two reasons:

a) Cheaper Imported goods

Due to globalisation import duty was heavily reduced cheaper imports replaced the demand for domestic goods and domestic producers started facing competition.

b) The infrastructure facility mainly power supply was inadequate.

4. **Ineffective Disinvestment policy:**

The govt fixed a target for disinvestment of PSU. The target was 56,000 Cr. and the achievement was only 34,500 Cr. The assets of PSU's were undervalued and sold to private sector.

Proceedings from disinvestment were used to compensate the shortage of loan.

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