

Chapter 3

Economic Reforms Since 1991

Economic Scenario in 1991

Since the early days of independence, we were accustomed to a highly protected economy. We protected our economic enterprises, our investment, our currency, our commodity and capital markets, and our trade.

The Indian economy was characterised by large scale investments in the public sector and a comparatively lesser role for the private sector, restriction of foreign direct investment and regulation. The consequences of the pre-reform economic policy were :

- The high rate of inflation especially sharp rise in the prices of essential goods.
- Fiscal Deficit (Borrowing requirement of government i.e. excess of the total government budgeted expenditure over government budgeted receipts other than borrowings) was alarmingly high.
- High level of internal and external debt burden => the government was not able to make repayments on its borrowings from abroad.
- Unfavourable Balance of payment:- India was facing an adverse balance of payment crisis, import bill was continuously rising along with a fall in export, causing an increase in borrowing requirements and fall in foreign exchange reserve.
- Very low level of foreign exchange reserve:- **foreign exchange reserves**, which India has to maintain to import petrol and other important items, dropped to levels that were not sufficient for even a fortnight import bill of essential items such as fuel, medicines, food etc.

Roots of all the above consequences were

- **Inward looking policy:** Our inward-looking focus on industrialisation, the excessive protection to industries through licensing and import tariffs discouraged the competition and efficiency in the economy.
- **Controls and subsidies:** Controls on production, licensing restrictions along with high protective walls had fostered monopolistic trends in our industries also act as a discouragement to invest in innovations, research and development. While subsidies and concessions increased the costs and burden on the exchequer.
- **Red Tapism:** Red Tapism refers to the requirement of excessive procedure, formalities and routine for government official decision. It is dominant in every public sector enterprise, due to this decision-making delayed causing continuation use of obsolete technologies and slow decision- making public-sector productivity were extremely low.

Bailout Package from World Bank

As already mentioned, **foreign exchange reserves**, which India has to maintain to import petrol and other important items, dropped to levels that were not sufficient for even a fortnight import of essentials items.

India approached the **World Bank (also known as IBRD- International Bank for Reconstruction and Development)** and the **International Monetary Fund (IMF)** for the loan to manage its economic crises. World Bank and IMF agree to extend \$7

billion as a loan to manage the economic crisis on certain conditions, which are :

1. To open up the economy by removing restrictions on the private sector (**Privatisation**),
2. To liberalise and reduce the role of the government in many areas (**Liberalisation**) and
3. To remove trade restrictions between India and other countries (**Globalisation**).

New Economy Policy: Liberalisation, Privatisation & Globalisation

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- To remove trade restrictions between India and other countries (**Globalisation**).

India agreed to the conditionalities of the World Bank and IMF and announced the **New Economic Policy (NEP)**.

New Economic policy can broadly be classified into two groups:

1. The stabilisation measures and
2. The structural reform measures.

Stabilisation measures:

Stabilisation measures are short- term measures, with the main objectives:

1. To maintain sufficient foreign exchange reserves,
2. To correct the balance of payments and
3. To check inflation under control.

Structural reform measures:

Structural reform measures are long-term measures, with the main objectives :

1. To improve the efficiency of the economy and
2. To increase its international competitiveness by removing the rigidities in various segments of the Indian economy.

The government initiated a variety of policies which fall under three heads :

1. Liberalisation
2. Privatisation and
3. Globalisation

Liberalisation

Liberalisation means removing all unnecessary controls, regulation and restrictions like permits, licenses, protectionist tariffs, quotas, etc. imposed by the government.

Few liberalisation measures were introduced before 1991, in the 1980s in areas of industrial licensing, export-import policy, technology up-gradation, fiscal policy and foreign investment. However, reform policies initiated in 1991 were more comprehensive Includes:

1. Deregulation of the Industrial Sector,
2. The financial sector,

3. Tax reforms,
4. foreign exchange markets and
5. trade and investment sectors.

Deregulation of the Industrial Sector

(Industrial Reforms) Before deregulation of the Industrial sector:

1. There was the Industrial licensing system, under which every entrepreneur had to get permission from government officials not only to open the production unit but even to increase the production.
2. The private sector was not allowed in many industries
3. Some goods could be produced only in small scale industries and
4. There were controls on price fixation and distribution of selected industrial products.

After the deregulation policies introduced in and after 1991 many of these restrictions had been removed:

1. Industrial licensing was abolished for almost all but product categories — alcohol, cigarettes, hazardous chemicals industrial explosives, electronics, aerospace and drugs and pharmaceuticals.
2. The only industries which are now reserved for the public sector are defence equipment, atomic energy generation and railway transport.
3. Many goods produced by small scale industries have now been de-reserved.
4. In most of the industries, the market has been allowed to determine the prices.

2 Financial Sector Reforms

The financial sector includes financial institutions, such as commercial banks, investment banks, stock exchange operations and foreign exchange market.

In India, the financial sector is regulated by various norms and regulations of the Reserve Bank of India (RBI). During liberalisation, there was a substantial shift in the role of the RBI from 'a regulator' to 'a facilitator' of the financial sector.

Following are the major reforms in the financial sector:

1. The financial sector allowed to take decisions on many matters without consulting the RBI.
2. Banking Sector opened for the private sector (both Indian and foreign).
3. Foreign investment limit in banks was raised to around 50 per cent
4. Those banks which fulfil certain conditions have been given the freedom to set up new branches without the approval of the RBI
5. Foreign Institutional Investors (FII), such as merchant bankers, mutual funds and pension funds, are now allowed to invest in Indian financial markets.

3 Fiscal Policy Reforms (Tax Reforms)

Fiscal policy is the policy of general govt regarding controlling its public expenditure & public receipts to achieve certain economic objectives such as.

Fiscal policy has two major components:

1. Revenue policy (Taxation policy is the major component of revenue policy of government)

2. Expenditure policy

Fiscal Policy Reforms are mainly associated with the reforms in the Public Receipts policy (mainly the government's taxation policy) and Public Expenditure policies.

The data reveals that fiscal deficit during 1990-91 was as large as 8.4 % of GDP.

Set of reforms were introduced to contain government expenditure and increase public revenues.

Tax Reforms

Tax Revenue: A tax is a compulsory payment made to the government by the people to meet the expenditure incurred on providing common benefits to the people.

Taxes are classified in two main groups (i) direct taxes and (ii) indirect taxes.

Difference between Direct Tax and Indirect Tax

Direct tax	Indirect Tax
1. Direct taxes are those taxes which are imposed on the income & wealth of a person.	1. Indirect taxes are those taxes which are imposed on goods services either at the time of their production, distribution or selling.
2. The person on whom direct tax is imposed not only pays it to the government but also has to bear its burden.	2. Those who pay taxes to the government do not bear the whole burden, and they shifted them wholly or partly to others.
3. Direct taxes are normally progressive.	3. Indirect taxes usually are of proportionate or regressive nature.
4. For example Income Tax, Wealth Tax.	4. For example GST, Excise duty, import duty etc.

Before Liberalisation measures: Rates of both direct and indirect taxes were exceedingly high, and it was considered as the main reason for tax evasion and provided disincentives to honest taxpayers. Filing of tax returns was also overly complicated as there were many compliances.

Tax Reforms :

1. There has been a continuous fall in the taxes on individual incomes since it was felt that high rates of income tax were one of the main reasons for tax evasion.
2. The rate of corporation tax, which was very high earlier, has been gradually reduced.
3. Reforms also take place in indirect taxes, taxes levied on commodities has been reduced and efforts are made to make it uniform to facilitate the establishment of a common national market for goods and commodities.
4. To encourage better compliance on the part of taxpayers, many procedures have been simplified.
5. To simplify and introduce a unified indirect tax system in India, the Parliament of India passed a law, Goods and Services Tax Act 2016, This law came into effect from July 2017. The main objectives of GST are to generate additional revenue for the government, reduce tax evasion and create 'one nation, one tax and one

market’.

Reduction in Subsidies: Some of the important policy initiatives introduced for correcting the fiscal imbalance by reducing public expenditure, it includes a reduction in fertilizer subsidy, the abolition of subsidy on sugar.

All the above measures helped to reduce Fiscal deficit significantly which was as high as 8.4 % of GDP before New Economic Policies.

4 Foreign Exchange Reforms

In 1991, India was facing the balance of payments crisis, India’s import bill was rising cause an increase in the outflow of foreign exchange and country’s export was falling result in fall of foreign exchange. All this led to falling foreign exchange reserve.

To correct the balance of payment crises, the rupee was devalued against foreign currencies as an immediate measure. Due to the Devaluation of Domestic currency, Goods and Services of the country become relatively cheaper for other countries which results in the rise of exports, increasing the inflow of foreign exchange. And for residents of the country, goods and services of other countries become expensive. So, demand for imports fallen down, resulting fall in the outflow of foreign exchange

“Devaluation of currency states the deliberate reduction in currency’s value under Fixed Exchange rate system.”

Due to the Devaluation of Domestic currency, Goods and Services of the country become relatively cheaper for other countries which results in the rise of exports, increasing the inflow of foreign exchange. On the other hand, for residents of the country, goods and services of other countries become expensive. So, demand for imports fallen down, resulting fall in the outflow of foreign exchange.

Result: Devaluation of domestic currency helps the countries to increase in their foreign exchange reserve.

Flexible exchange rate method adopted for the determination of the foreign exchange rate, in this market determine exchange rates based on the demand and supply of foreign exchange. It allows automatic adjustment in inflow and outflow of foreign exchange. It reduced the compulsion of maintaining foreign exchange reserve.

5. Trade and Investment Policy Reforms

Before 1991, India followed a protectionist policy to protect domestic industries by quantitative restrictions and high tariffs on imports, import licensing and export duties. This reduced efficiency and competitiveness. It led to very slow growth of industries.

The liberalisation of trade and investment regime was initiated in 1991 with the following objectives:

1. To increase the international competitiveness of industrial production and foreign investment.
2. To increase the international competitiveness of industrial production
3. To increase the flow of foreign investments and new technology into the economy.
4. To promote the efficiency of local industries and the adoption of modern technologies.

In trade policy reforms following measures were taken by the government:

1. Removal of quantitative restrictions on imports and exports
2. Tariff rates reduced significantly.
3. licensing procedures for imports also abolished except in case of hazardous and environmentally sensitive industries.
4. Quantitative restrictions on imports of manufactured consumer goods and agricultural products were also fully removed from April 2001.
5. Export duties have been removed to increase the competitive position of Indian goods in the international markets.

Privatisation

Privatisation is defined as the transfer of a function, activity or organisation from the public to the private sector”.

Government companies are converted into private companies in two ways:

- (i) By the withdrawal of the government from ownership and management of public sector companies.
- ii) By the outright sale of public sector companies.

Privatisation of the public sector enterprises by selling off part of the equity of PSEs to the public is known as disinvestment.

The main objectives of the privatisation were:

1. To improve financial discipline.
2. To introduce efficiency and profitability in Public Sector Undertakings (PSUs).
3. To facilitate modernisation.
4. To utilise private capital and managerial capabilities effectively to improve the performance of the PSUs.
5. To reduce the budgetary deficit due to loss-making PSUs.
6. To introduce accountability and responsibility in PSUs.

Disinvestment

Disinvestment is the sale of a part of equity holdings held by the government in any public sector undertaking to the private investors. Disinvestment has been a major strategy by which the government can finance its fiscal deficit. Besides financing the fiscal deficit, the economic motivation behind it is to improve the efficiency of PSUs.

Government has been disinvesting by many methods. Two main methods are:

- **Minority sale.** In this method, equity is offered to investors through domestic public issue.
- **Strategic sale.** In this method, the government offloads above 51 per cent stakes of Public Sector undertaking to a private enterprise who control and manage the strategic sale.

Navratnas Policy

In 1996, Government adopted Navratna Policy for profit-making Public Sector Undertakings (PSUs) intending to improve efficiency, infuse professionalism and enable PSUs(public sector undertakings) to compete more effectively in the liberalised

global environment.

The government chose nine PSUs and declared them as *navaratnas*. They were given greater managerial and operational autonomy, in taking various decisions to run the company efficiently and thus increase their profits. The government also allowed them to expand themselves in the global markets and raise resources by themselves from financial markets.

Greater operational, financial and managerial autonomy had also been granted to 97 other profit-making enterprises referred to as *mini ratnas*.

The first set of *navaratna* companies included:

1. Indian Oil Corporation Ltd (IOC),
2. Bharat Petroleum Corporation Ltd (BPCL),
3. Hindustan Petroleum Corporation Ltd (HPCL),
4. Oil and Natural Gas Corporation Ltd (ONGC),
5. Steel Authority of India Ltd (SAIL),
6. Indian Petrochemicals Corporation Ltd (IPCL),
7. Bharat Heavy Electricals Ltd (BHEL),
8. National Thermal Power Corporation (NTPC) and
9. Videsh Sanchar Nigam Ltd (VSNL).

Later, two more PSUs—Gas Authority of India Limited (GAIL) and Mahanagar Telephone Nigam Ltd (MTNL)—were also given the same status.

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

Globalisation

Meaning: Globalisation refers to growing economic interdependence among countries in the world with regard to technology, capital, information, goods, services, etc. The term Globalisation has four parameters:

1. Reduction of trade barriers to permit the free flow of goods and services across national
2. Creation of an environment in which free flow of capital can take place. Transfer of wealth across national boundaries, particularly financial transfers, is made possible by large organizational network and new electronic technologies.
3. Creation of an environment to allow free flow of technology among the nation
4. Creation of an environment in which free movement of labour can take place in different countries of the world.

Advantages of Globalisation

➤ **Adoption of New, Flexible Production Methods:**

Globalisation raises allocation efficiency, especially in underdeveloped and developing countries by reducing capital-output ratio; Raising labour productivity; Developing export culture; Raising capital flow; Modernizing technology and Increasing the competitive edge of firms.

➤ **Raise Foreign Capital:**

Globalisation attracts foreign capital which led to technological up-gradation.

➤ **Quality Improvement:**

In order to withstand competition offered by other firms, the quality enhancement take

place

➤ **Rise in Employment.**

It is expected that integration between different sectors will lead to more production in the home country. This will raise employment opportunities.

➤ **Rise in Banking and Foreign Sector Efficiency:**

Banking and foreign sector of the home country raise their competitive skill and efficiency in order to have a competitive edge over foreign banks.

➤ **Accelerate Human Development**

Education and skill training are the most important components of globalization. Knowledge and technology rule the global market. To face the competition offered by the global market, the quantity and quality of education will improve.

Disadvantages of Globalisation

➤ **The devastation of Local Producers**

Globalisation has devastated local producers since they are unable to compete with cheap imports.

➤ **Mounting Strikes:**

Globalisation has led to mounting workers unrest. Workers have protested against low wages, poor working conditions, autocratic management rule, long working days hours and fall in social benefits

➤ **Public Employees are Worse Off:**

Globalisation has made public employees worse off. Public employees are adversely affected by budget cuts, privatisation, and massive loss of purchasing power.

➤ **Small Businesses are Adversely Affected:**

Small business class are adversely affected by the fall of public subsidies, de-industrialisation and floods of cheap imports.

➤ **The decline in Income:**

During the globalization phase, about half a billion people in South Asia have experienced a decline in their income. Data shows that it is the poor who have suffered most.

➤ **Raising Depth of Inequality:**

The global village appears deeply divided between the street of the haves and those of the have-nots. The average person in Norway (which has the highest human development) and the average person in countries such as Niger (which has lowest human development) seems like lives different human districts of the global village.

Outsourcing

Outsourcing means obtaining goods and services by contract from an outside source. Especially with the growth of information technology (IT) outsourcing has acquired an international dimension and it has intensified in recent times. The main services which are being outsourced from India by developed countries are voice-based business processes (known as BPO or Call Centres), banking services, railway inquiry,

record-keeping, accountancy, music recording, book transcription, clinical advice, teaching etc. Genpact, HCL BOP, Wipro BPO are some topmost companies offering BOP services in India.

India is as the favourite destination for outsourcing.

India can provide a ready supply of skilled people at a relatively lower price.

India has the advantage of time difference as it is located on the other side of the developed countries.

Effects of Outsourcing in India

India is now much more integrated with the world economy. It has benefited from this integration in much ways-another success story is that of IT-enabled services (ITES) It has demonstrated what Indian skills and enterprise can do- given the right environment. India has a 65% share of the global offshore market and a 46% share of the global business process offshoring (BPO) industry.

World Trade Organization (WTO)

The General Agreement on Tariffs and Trade (GATT) was established in Geneva to pursue the objective of free trade in order to help in the growth and development of all member countries. In 1947, 23 countries signed GATT. India was one of the founder members of GATT. In 1994, 118 countries were members of GATT. The main purpose of GATT was to ensure competition in commodity trade by the removal of trade barriers. A preparatory committee was set-up by GATT which in turn set-up the World Trade Organisation (WTO) in 1995. The WTO acts as a permanent watchdog of international trade

Features of WTO

- The WTO is global in it at present there are 153 member countries.
- It has a much wider scope than its predecessor GATT. Each member of WTO has a single voting right.
- It is a full-fledged international organization in its own
- The representatives of the members of WTO enjoy international privileges

Objectives of WTO

- To raise the standard of living in member countries by ensuring full employment and by expanding production and trade in goods and services.
- To develop an integrated, viable and durable multilateral trading system.
- To promote sustainable development in member countries by the optimal use of resources.
- To help the developing countries to get a share in the growth of international trade.
- To reduce tariff and non-tariff barriers and to eliminate discriminatory treatment in international trade relationships.
- To ensure linkages between trade policies, environmental policies and sustainable development

Impact of NEP on India

“ACHIEVEMENTS OF THE POLICY OF LPG”

- **Rise in GDP Growth:** Since the introduction of economic reforms in 1991, the country has shown a rise in the GDP growth rate. In 1991-92, the growth rate of GDP was 1.3%. In the 9th Plan, GDP grew at 5.5% and in 10th Plan at 7.2%. In 2009-10, it grew at 8%.
- **Rise in Foreign Exchange Reserve:** Foreign exchange reserves which were the only US 5.8 billion dollars in 1991 have shown a tremendous rise to US 292.9 billion dollars in 2010-11.
- **Control of Inflation:** The plus point of economic reforms is that it has controlled inflation from 16.8% in 1991 to 11.4% in 2009-10.
- **Rise in Inflow of Foreign Capital:** One of the benefits derived from global integration is the increased inflow of foreign direct investment (FDI). FDI was at US 33.1 billion dollars in 2009- 10.
- **Rise in Integration with the World Economy:** India is now much more integrated with the world economy and has benefited from this integration in many ways. The outstanding success of IT and IT-Enables Services (ITES) has shown what Indian skill and enterprise can do – given the right environment
- **Rise in Competitiveness of Industrial Sector:** Sectors such as auto components, textiles and pharmaceuticals are the pillars which show the strength of the industrial sector.

“Challenges of the policy of LPG”

Agricultural There has been a deceleration in agricultural growth. This deceleration is the root cause of the problem of rural distress that reached a crisis in some parts of the country. Farmers find themselves into crippling debt due to low farm incomes combined with low prices of output and lack of credit at reasonable prices. This has led to widespread distress migration.

Economic reforms have not been able to benefit the agricultural sector because:

- Public investment in the agriculture sector, especially in infrastructure which includes irrigation, power, roads, market linkages and research, has been reduced in the reform period.
- Liberalisation has forced the small farmers to compete in a global market where prices of goods have fallen while removal of subsidies has led to an increase in the cost of production. It has made farming more expensive.
- Various policy changes like reduction in import duties on agricultural products, removal of minimum support price and lifting of quantitative restrictions have increased the threat of international competition to the Indian farmers.
- The export-oriented growth has favoured increased production of cash crops rather than food grains. This has increased the prices of food grains.

Changing Employment Pattern. There is the inadequacy of widely dispersed and sustainable off- farm productive employment opportunities. This is a basic cause of most divides and disparities. Growth without jobs can neither be inclusive nor can it bridge divides.

Providing Essential Public Services to be Poor. We cannot be satisfied with only universal primary education – the challenge is to provide universal secondary education as soon as possible. In the area of health, there continues to be a lack of basic services such as the availability of clean drinking water. **Inadequacy of Physical Infrastructure:** Our roads, railways, ports, airports, power supply, communication are not comparable to the standards prevailing in competitor countries. Quality infrastructure is still a challenge facing our country today.

Protecting the Environment. Our concern for environmental issues is growing along the lines of global concerns. The threat of climatic changes poses a real challenge to future generations.

Agricultural sector during reforms

During the era of reforms, the agricultural sector was completely neglected and adversely affected mainly due to the following reasons.

- i) Reduction in investment in agriculture:
During the reform period, the government decreased the investment in irrigation, power, roads and market linkages. The government of India reduced the subsidy on fertilisers which made farming comparatively costlier. Poor farmers were not able to buy fertilisers without subsidy. This further affected the growth of agriculture.
- ii) Significant changes in policies:
After India became a member of the World Trade Organization, there was a significant change in policies. The government reduced the import duty on agricultural products and abolished the minimum support price for agricultural products. Indian farmers faced severe international competition as quantitative restrictions were withdrawn on agricultural products. Thus, the condition of Indian farmers became worse.
- iii) Export-oriented policy:
As the government adopted an export-oriented policy in agriculture, there was a drastic shift in the production for the domestic market to the international market. This led to the Commercialisation of agriculture, i.e. production of cash crops instead of food crops which further worsened the situation in the sense that India faced a shortage of food grains.

NCERT Questions

1. Why were reforms introduced in India?

After independence, the economic policies adopted by the government were unable to achieve the desired level of economic growth. Also, the Indian economy faced several problems such as economic recession, fiscal deficit and Unfavourable balance of payments. Hence, the New Economic Policy (NEP) was initiated in 1991 to tackle the economic crisis and to speed up economic

growth. Main reasons for introducing economic reforms in India:

- The high rate of inflation especially sharp rise in the prices of essential goods.
- Fiscal Deficit (Borrowing requirement of government i.e. excess of the total government budgeted expenditure over government budgeted receipts other than borrowings) was alarmingly high.
- High level of internal and external debt burden => the government was not able to make repayments on its borrowings from abroad.
- Unfavourable Balance of payment:- India was facing an adverse balance of payment crisis, import bill was continuously rising along with a fall in export, causing an increase in borrowing requirements and fall in foreign exchange reserve.
- Very low level of foreign exchange reserve:- **foreign exchange reserves**, which India has to maintain to import petrol and other important items, dropped to levels that were not sufficient for even a fortnight import bill of essential items such as fuel, medicines, food etc.

Therefore, economic reforms were introduced to increase the growth rate of the economy and to tackle the economic recession situation in India.

2. Why is it necessary to become a member of WTO?

The World Trade Organization (WTO) is an international organisation which came into existence on 1 January 1995. General Agreement on Trade and Tariffs (GATT), General Agreement on Trade in Services (GATS) and agreements on Trade-Related Investment Measures (TRIMS) and Trade-Related Aspects of Intellectual Property Rights (TRIPS) are managed by WTO. It is very important for a country to become a member of the World Trade Organization (WTO) for the following reasons:

It gives an opportunity to trade with other member countries with fewer restrictions from them.

It facilitates international trade through the removal of tariff and non-tariff barriers and provides access to all member countries. This substantially increases export opportunities and generates employment in the Indian economy.

Member countries of the World Trade Organization (WTO) can raise their voice against false economic activities. It helps in bringing fair rules and regulations at a global level and protects the interests of developing nations.

3. Why did RBI have to change its role from the controller to facilitator of the financial sector in India?

Reserve Bank of India (RBI) controls all the financial institutions in India

such as commercial banks, investment banks, stock exchange operations and the foreign exchange

market. It fixes the limit for the bank to maintain reserves, interest rates and the pattern of lending to the public. Financial sector reforms focused on changing the role of RBI from controller to facilitator of the financial sector. So, the RBI facilitated free play of the market forces in the following ways:

Financial institutions were allowed to take decisions of the interest structure without permission from RBI.

The limit of foreign investment in the banking sector was raised to 50%.

Some major banks were given authority to open new branches with the approval of RBI with respect to necessary conditions.

Liberalisation of commercial banks helped the financial sector to grow at a faster rate.

Commercial banks were permitted to generate resources within India and abroad through the capital market without affecting the interest of depositors.

Thus, the RBI performs the role of facilitator of the financial sector in India.

4. How is RBI controlling the commercial banks?

Commercial banks in India are controlled through the rules and regulations formulated by the Reserve Bank of India (RBI). RBI uses quantitative and qualitative instruments to control and regulate banking operations.

Quantitative instruments of credit control are designed to regulate the total volume of credit in an economy. It affects all the sectors making use of bank credit. It includes cash reserve ratios, open market operation, repo rates, reserve repo rates and bank rates.

Qualitative instruments of credit control are designed to regulate the direction of credit. It affects the flow of credit for a particular use. It includes margin requirements, moral suasion and selective credit controls.

Thus, the RBI controls commercial banks by using its quantitative and qualitative instruments of credit controls.

5. What do you understand by the devaluation of rupee?

Devaluation of rupee is a decrease in the price of domestic currency in terms of all foreign currencies under a fixed exchange rate system. This situation prevails when the government increases the exchange rate under the fixed exchange rate system.

For example, if the exchange rate rises from \$1 = Rs 45 to \$1 = Rs 60.

It increases the demand for exports because domestic goods become cheaper in terms of foreign currency.

During the time of foreign exchange reforms, the Indian currency was devalued against foreign currencies. This led to an increase in the supply of foreign currency in India by exporting more goods and services.

6. Distinguish between the following

- 1) Strategic and Minority sale
- 2) Bilateral and Multi-lateral trade
- 3) Tariff and Non-tariff barriers.

(i) Strategic and Minority sale

Strategic sale	Minority sale
It refers to PSUs stock selling of 51% or more than it to the private sector.	It refers to PSUs stock selling of 49% or less than it to the private sector.
Ownership of the public sector unit is transferred to the private sector.	Ownership of the public sector unit remains with the government.
It is relatively recent as started from March 2000.	It was a general practice from 1991 until 2000.
It is a process of competitive auctioning and followed by sale to the highest bidder.	It is a process of sale through public offers.

(ii) Bilateral and Multi-lateral trade

Bilateral trade	Multi-lateral trade
It refers to a trade agreement between the two countries.	It refers to a trade agreement among more than two countries.
Equal trade opportunity is given to both countries.	Equal trade opportunity is given to all the countries which are involved in international trade.
Individual negotiation is necessitated with each country.	Group negotiations with all the countries at one go to save time.
It promotes economic cooperation between the two countries.	It promotes globalised integration among countries.

(iii) Tariff and Non-tariff barriers

Tariff barriers	Non-tariff barriers
These are taxes imposed on the import of goods by a country to protect domestically produced goods.	These are restrictions imposed on the import of goods by a country to protect domestically produced goods.
They are imposed at reasonable prices by member countries of the World Trade Organization.	They are completely abolished (import quotas and voluntary export restraints) by the World Trade Organization.
More explicit in nature.	Not so explicit (such as sanitary facilities and labour issues).

7. Why are tariffs imposed?

A tariff is a tax imposed on goods imported by a country to protect domestically produced goods from import competition. The imposition of tariffs increases the price of imported goods. This is because the custom duty levied by the government on such goods is an indirect tax, so its burden shifts to consumers in the form of higher prices. It makes foreign goods costlier than domestically produced goods. This practice protects domestic producers from foreign competition. Also, the government earns revenue in the form of foreign exchange by imposing tariffs on foreign goods. Tariffs can also be imposed on imported goods which are socially undesirable.

8. What is the meaning of quantitative restrictions?

Quantitative restrictions are the limits imposed by countries on the quantity of goods and services which can be imported or exported. It is also a practice of regulating the production of a particular good and service. It includes import quota and voluntary export restraints signed by the exporters of foreign countries. It discouraged imports of goods and enabled to protect domestic producers from highly competitive cheaper and technologically advanced goods produced by other countries. It led to the slow growth of industries, and therefore, the trade policy reforms abolished these restrictions from April 2001, except for the hazardous and socially undesirable goods.

9. Those public sector undertakings which are making profits should be privatised. Do you agree with this view? Why?

Profit-making public sector undertakings are the main source of revenue of the government to be used in special welfare programmes. This enables to promote equality of income and wealth distribution among the public. The

PSUs which operate with social motive such as railways, water supply and postal services should be retained in the public sector. However, many PSUs incur losses. These loss-making units should be privatised to protect the financial condition of the government. However, profit-making industries should remain in the public sector only because the resources of these units can be used for developmental activities. The government should retain strategic industries to prevent the emergence of any monopoly in the private sector.

10. Do you think outsourcing is good for India? Why are developed countries opposing it?

Outsourcing is good for India because of the following reasons:

- 1) Outsourcing helped India to receive new ideas and technological knowledge from developed countries.
- 2) Employment generation is one of the most important aims of any developing nation. It helped to create new avenues for generating employment in India.
- 3) It improved human capital in India to a great extent with its positive effects. Employees received necessary training which enabled to develop skills and increased their scope for job advancement.
- 4) Infrastructure facilities in urban cities were developed to suit the requirements of BPO activities. This enabled India to benefit with high-end technology and best breed of infrastructure to remain a successful destination for outsourcing.

Developed nations opposed outsourcing because there is investment outflow to developing nations and unemployment level increases in developed countries.

11. India has certain advantages which makes it a favourite outsourcing destination. What are these advantages?

India is a favourite outsourcing destination because of the following reasons:

- i) Cheap labour: In highly populated India, the supply of labour is in surplus with a low wage rate. This enabled foreign companies to hire regular service from India and reduced the cost of operation.
- ii) Availability of skilled labour: Indians are highly educated, and they are able to acquire necessary skills from a wide range of training programmes to perform the task efficiently. They have a better understanding of the language which is required for providing services such as voice-based business process, accounting, teaching and clinical advice.
- iii) Lower cost of raw material: The cost of raw material is less in India, so it attracted multinational companies to outsource their businesses to

India.

- iv) Take advantage of government grants: Many foreign companies were attracted to India because the government provided grants to open up operations easily in India.
- v) Stable government regulation: India's stable political environment attracted foreign investors to invest.
- vi) Focus on core business competencies: When the company grows, there is a need for research and marketing along with the existing production activity. India is a flexible outsourcing place to find the service provider to perform non-core activities so that the company can focus on core activities.

12. Do you think the Navaratna policy of the government helps in improving the performance of public sector undertakings in India? How?

The government gave Navratna status to nine industries for substantial autonomy in its functioning. These are

- i) Bharat Heavy Electricals Limited
- ii) Videsh Sanchar Nigam Limited
- iii) Indian Oil Corporation
- iv) Bharat Petroleum Corporation Limited
- v) Steel Authority of India Limited
- vi) Indian Petrochemicals Corporation Limited
- vii) National Thermal Power Corporation Limited
- viii) Hindustan Petroleum Corporation Limited
- ix) Oil and Natural Gas Corporation

Later, this status was further extended to two more industries such as Mahanagar Telephone Nigam Limited and Indian Oil Limited. In 2009, the government declared maharatna and miniratna status to some industries to enhance efficiency and profitability.

Under the navratna policy, the government of India provided special treatment and positively affected the performance of these units. These units were given operational and managerial autonomy to run their businesses effectively and efficiently. Some of the navratna industries were major players in the global market. They produced goods at a cheaper cost. These enterprises not only served as an important source of employment but also formed an infrastructural base which induced private investment in a wide range of areas of industrial growth. Thus, the navratna policy of the government has definitely contributed to the development of public sector undertakings in India.

13. What are the major factors responsible for the high growth of the service sector?

- i) Major factors responsible for the high growth of the service sector in India:
- ii) Economic reforms in 1991: Economic reforms introduced in 1991 allowed MNCs to enter the Indian market. Its abolished restrictions on foreign investment and opened the doors for inflow of foreign capital. Government-liberalised policy enabled the increase of foreign direct investment drastically. It brought several changes in the Indian market.
- iii) Low labour cost: The cost of labour in India was comparatively lower than in developed nations. This attracted multinational companies to outsource their business service activities in India. Hence, the service industry was rapidly grown with the companies who identified the importance of business outsourcing process such as training, teaching and marketing to improve their business performance.
- iv) Growth of Information Technology (IT): Growth of the service sector was highly stimulated by the growth of information technology (IT) in India. IT helped perform vital service businesses of the country. Highly skilled software resources are found in India. Many state governments such as Andhra Pradesh, Madhya Pradesh, Karnataka, Maharashtra and Delhi emphasised on the importance of the IT sector.
- v) Structural changes: Structural changes were taking place in the Indian economy, i.e. transformation from the primary sector to the tertiary sector. This transformation caused an increase in the demand for the service sector.
- vi) Market orientation: The manufacturing sector faced many changes in the competitive condition and demand-supply forces in the market. This diverted their attention from production to market orientation. Further, it forced manufacturing organisations to conduct marketing research, accounting, auditing, human resource management, and research and development institutions to analyse market conditions. These were entirely service-based functions.

Agriculture sector appears to be adversely affected by the reform process. Why?

Reasons for the adverse effect on the growth of the agricultural sector:

- iv) Reduction in investment in agriculture: During the reform period, the government decreased the investment in irrigation, power, roads and market linkages. The government of India reduced the subsidy on fertilisers which made farming comparatively costlier. Poor farmers were not able to buy fertilisers without subsidy. This further affected the growth of agriculture.
- v) Significant changes in policies: After India became a member of the World Trade Organization, there was a significant change in policies.

The government reduced the import duty on agricultural products and abolished the minimum support price for agricultural products. Indian farmers faced severe international competition as quantitative restrictions were withdrawn on agricultural products. Thus, the condition of Indian farmers became worse.

- vi) Export-oriented policy: As the government adopted an export-oriented policy in agriculture, there was a drastic shift in the production for the domestic market to the international market. This led to the Commercialisation of agriculture, i.e. production of cash crops instead of food crops which further worsened the situation in the sense that India faced a shortage of food grains.

14. Why has the industrial sector performed poorly in the reform period?

The industrial sector performed poorly in the reform period because of the following reasons:

- i) Abolishment of tariff and non-tariff barriers on imported goods: The removal of tariff and non-tariff barriers made imported goods comparatively cheaper than domestically produced goods. It became difficult for domestic producers to compete with foreign producers. So, cheaper imports decreased the demand for domestic industrial goods.
- ii) The comparatively high cost of production: During economic reforms, there was an inadequate investment in infrastructural facilities such as power supply. This made production costlier. On the other hand, foreign producers could sell their goods and services at cheaper prices at a lower cost of production.
- iii) No access to the global market: Non-tariff barriers restricted entry of Indian producers in the global market. This drastically affected the growth of the industrial sector during economic reforms.
- iv) Globalisation: This created the condition of free movement of goods and services from foreign countries but affected the growth of domestic industries and employment generation in India.
- v) Thus, the industrial sector performed poorly in the reform period with the adverse effects of removing tariff and non-tariff barriers on imported goods.

15. Discuss economic reforms in India in the light of social justice and welfare.

- i) Economic reforms opened up new avenues for domestic producers and provided access to the international market and technology. However, these reforms adversely affected social justice and welfare in the following ways:
- ii) Farmers and domestic producers were severely affected by international competition at the time of economic reforms.

- iii) The gaps between the rich and the poor increased widely because economic reforms focused on the development of metropolitan cities rather than backward areas.
- iv) The quality of consumption increased only for the rich, and thus, economic growth was unable to reach the poor sections of society.
- v) Remote and rural areas remained underdeveloped as economic reforms benefited areas connected to urban cities.
- vi) Growth of the service sector increased significantly, but there was no growth in the agricultural sector.
- vii) The government of India focused more on the revival of the service sector than the agricultural sector even though about 65% of the total population depended on it.
- viii) Thus, economic reforms did not pay attention to social justice and the welfare of the people in India.