ECONOMIC POLICY-1991

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2 INTRODUCTION

- The New Economic Policy of India was declared by the then Finance Minister Dr. Manmohan Singh on July24, 1991 in his budget speech during P.V.Narsimha Rao's regime.
- It was the reaction to eliminate the drawbacks of closed economy and sluggish growth.
- It initiated the LPG(Liberalization, Privatization and Globalization) era in India.
- The nature of socialism- oriented mixed economy of India was changed .

3 FEATURES

- The major policy initiatives taken by the Government to fundamentally address the balance of payments problem and the structural rigidities were as follows-
- **Fiscal Reforms**: A key element in the stabilization effort was to restore fiscal discipline. The data reveals that fiscal deficit during 1990-91 was as large as 8.4 percent of GDP. The budget for 1991-92 took a bold step in the direction of correcting fiscal imbalance. It envisaged a reduction in fiscal deficit by nearly two percentage points of GDP from 8.4 percent in 1990-91 to 6.5 percent in 1991-92.

CONTD.-

- The budget aimed at containing government expenditure and augmenting revenues; reversing the downtrend in the share of direct taxes to total tax revenues and curbing conspicuous consumption. Some of the important policy initiatives introduced in the budget for the year 1991-92 for correcting the fiscal imbalance were: reduction in fertilizer subsidy, abolition of subsidy on sugar, disinvestment of a part of the government's equity holdings in select public sector undertakings, and acceptance of major recommendations of the Tax Reforms Committee headed by Raja Chelliah. These recommendations aimed to raise revenue through better compliance in case of income tax and excise and customs duties, and make the tax structure stable and transparent.

5 CONTD.-

- **Monetary and Financial Sector Reforms**: Monetary reforms aimed at doing away with interest rate distortions and rationalizing the structure of lending rates.
- The new policy tried in many ways to make the banking system more efficient. Some of the measures undertaken were-
- **Reserve Requirements**: reduction in statutory liquidity ratio (SLR) and the cash reserve ratio (CRR) in line with the recommendations of the Narasimham Committee Report, 1991. In mid-1991, SLR and CRR were very high. It was proposed to cut down the SLR from 38.5 percent to 25 percent within a time span of three years. Similarly, it was proposed that the CRR brought down to 10 percent (from the earlier 25 percent) over a period of four years.

6 CONTD.-

- **Interest Rate Liberalisation**: Earlier, RBI controlled the rates payable on deposits of different maturities and also the rates which could be charged for bank loans which varied according to the sector of use and also the size of the loan. Interest rates on time deposits were decontrolled in a sequence of steps beginning with longer term deposits, and liberalisation was progressively extended to deposits of shorter maturity.
- **Greater competition** among public sector, private sector and foreign banks and elimination of administrative constraints
- **Liberalisation** of bank branch licensing policy in order to rationalize the existing branch network
- Banks were given freedom to relocate branches and open specialized branches
- Guidelines for opening new private sector banks
- New accounting norms regarding classification of assets and provisions of bad debt were introduced in tune with the Narasimham Committee Report.

CONTD.-

- **Reforms in Capital Markets**: Recommendations of the Narasimham Committee were initiated in order to reform capital markets, aimed at removing direct government control and replacing it with a regulatory framework based on transparency and disclosure supervised by an independent regulator. The Securities & Exchange Board of India (SEBI) which was set up in 1988 was given statutory recognition in 1992 on the basis of recommendations of the Narasimham Committee. SEBI has been mandated to create an environment which would facilitate mobilization of adequate resources through the securities market and its efficient allocation.

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9 COND.-

- **Industrial licensing was abolished** for all projects except in 18 industries. With this, 80 percent of the industry was taken out of the licensing framework.
- The Monopolies & Restrictive Trade Practices (**MRTP) Act was repealed** to eliminate the need for prior approval by large companies for capacity expansion or diversification.
- Areas reserved for the **public sector were narrowed** down and greater participation by private sector was permitted in core and basic industries. The new policy reduced the number of areas reserved from 17 to 8. These eight are mainly those involving strategic and security concerns. (Example, railways, atomic energy etc.)
- The policy **encouraged disinvestment** of government holdings of equity share capital of public sector enterprises.
- The **public sector units were provided greater autonomy** and professional management that could be helpful for generating reasonable profits, through an MOU(Memorandum of Understanding) between the enterprise and the concerned Ministry, through which targets that the enterprise had to achieve were set up.

CONTD.-

- **Trade Policy Reforms**: Under trade policy reforms, the main focus was on greater openness. Hence, the policy package was essentially an outward-oriented one. New initiatives were taken in trade policy to create an environment which would provide a stimulus to export while at the same time reducing the degree of regulation and licensing control on foreign trade.
- The main feature of the new trade policy as it has evolved over the years since 1991 are as follow-
- **Freer imports and exports**: Prior to 1991, in India imports were regulated by means of a positive list of freely importable items. From 1992, imports were regulated by a limited negative list. For instance, the trade policy of 1 April 1992, freed imports of almost all intermediate and capital goods. Only 71 items remained restricted.

CONTD.-

- **Rationalization of tariff structure and removal of quantitative restrictions**: The Chelliah Committee's Report had suggested drastic reduction in import duties. It had suggested a peak rate of 50 percent. As a first step towards a gradual reduction in the tariffs, the 1991-92 budget had reduced the peak rate of import duty from more than 300 percent to 150 percent. The process of lowering the customs tariffs was carried further in successive budgets.
- **Trading Houses**: The 1991 policy allowed export houses and trading houses to import a wide range of items. The Government also permitted the setting up of trading houses with 51 percent foreign equity for the purpose of promoting exports. For instance, under the 1992-97 trade policy, export houses and trading houses were provided the benefit of self-certification under the advance license system, which permits duty free imports for exports.

CONTD.-

- **Promoting Foreign Investment**: The government took several measures to promote foreign investment in India in the post-reform period. Some of the important measures are:
- In 1991, the government announced a specified list of high technology and high-investment priority industries wherein automatic permission was granted for foreign direct investment (FDI) up to 51 percent foreign equity. The limit was raised to 74 percent and subsequently to 100 percent for many of these industries. Moreover, many new industries have been added to the list over the years.
- **Foreign Investment Promotion Board (FIPB)** has been set up to negotiate with international firms and approve direct foreign investment in select areas.
- Steps were also taken from time to time to promote foreign institutional investment (FII) in India

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- **Rationalization of Exchange Rate Policy**: One of the important measures undertaken to improve the balance of payments situation was the devaluation of rupee. In the very first week of July 1991, the rupee was devalued by around 20 percent. The purpose was to bridge the gap between the real and the nominal exchange rates that had emerged on account of rising inflation and thereby to make the exports competitive.

EVALUATION

- The 1991 economic reforms were focused primarily on the formal sector, and as a result, we have seen significant boom in those areas that were liberalized. Sectors such as telecom and civil aviation have benefited greatly from deregulation and subsequent reforms. However, liberalisation and economic reforms still have a long way to go, especially for the informal sector—including the urban poor who hold jobs as street vendors or rickshaw pullers, the agricultural sector, Micro, Small and Medium Enterprises (MSMEs) and tribals. The slow growth and stagnation in these sectors which have not seen any reform further highlights the significant role of the 1991 reforms in helping India's economy become what it is today.
- Source- www. http://indiabefore91.in/1991-economic-reforms