Unit 3 – Liberalization, Privatization and

Name: ____________________

Date: __/__/__

Introduction

India followed the mixed economy framework by combining the advantages of the market economic system with those of the planned economic system. Some scholars argue that, over the years, this policy resulted in the establishment of a variety of rules and laws which were aimed at controlling and regulating the economy and instead ended up hampering the process of growth and development.

Background of The Economic Reforms

The origin of the financial crisis can be traced from the inefficient management of the Indian economy in the 1980s. We know that for implementing various policies and its general administration, the government generates funds from various sources such as taxation, running of public sector enterprises etc. When expenditure is more than income, the government borrows to finance the deficit from banks and from people within the country and from international financial institutions. When we import goods like petroleum, we pay in dollars which we earn from our exports.

Development policies required that even though the revenues were very low, the government had to overshoot its revenue to meet problems like unemployment, poverty and population explosion. The continued spending on development programmes of the government did not generate additional revenue.

At times, our foreign exchange, borrowed from other countries and international financial institutions, was spent on meeting consumption needs. Neither was an attempt made to reduce such profligate spending nor sufficient attention was given to boost exports to pay for the growing imports. Foreign exchange reserves declined to a level that was not adequate to finance imports for more than two weeks. There was also not sufficient foreign exchange to pay the interest that needs to be paid to international lenders. India approached the International Bank for Reconstruction and Development (IBRD), popularly known as World Bank and the International Monetary Fund (IMF), and received $7 billion as loan to manage the crisis.

India agreed to the conditionalities of World Bank and IMF and announced the New Economic Policy (NEP). The NEP consisted of wide ranging economic reforms. The thrust of the policies was towards creating a more competitive environment in the economy and removing the barriers to entry and growth of firms. This set of policies can broadly be classified into two groups: the stabilisation measures and the structural reform measures. Stabilisation measures are short term measures, intended to correct some of the weaknesses that have developed in the balance of payments and to bring inflation under control. On the other hand, structural reform policies 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.

Liberalization

Liberalisation was introduced to put an end to these restrictions and open up various sectors of the economy. Though a few liberalisation measures were introduced in 1980s in areas of industrial licensing, export-import policy, technology upgradation, fiscal policy and foreign investment, reform policies initiated in 1991 were more comprehensive.

Deregulation of Industrial Sector: In India, regulatory mechanisms were enforced in various ways

(i) Industrial licensing under which every entrepreneur had to get permission from government officials to start a firm, close a firm or to decide the amount of goods that could be produced
(ii) Private sector was not allowed in many industries
(iii) Some goods could be produced only in small scale industries and
(iv) Controls on price fixation and distribution of selected industrial products.

Financial Sector Reforms: Financial sector includes financial institutions such as commercial banks, investment banks, stock exchange operations and foreign exchange market. The financial sector in India is controlled by the Reserve Bank of India (RBI). You may be aware that all the banks and other financial institutions in India are controlled through various norms and regulations of the RBI.

Tax Reforms: Tax reforms are concerned with the reforms in government's taxation and public expenditure policies which are collectively known as its fiscal policy. There are two types of taxes: direct and indirect. Direct taxes consist of taxes on incomes of individuals as well as profits of business enterprises.

Foreign Exchange Reforms: The first important reform in the external sector was made in the foreign exchange market. In 1991, as an immediate measure to resolve the balance of payments crisis, the rupee was devalued against foreign currencies.

Trade and Investment Policy Reforms: Liberalisation of trade and investment regime was initiated to increase international competitiveness of industrial production and foreign investments and technology into the economy.

Privatisation

It implies shedding of the ownership or management of a government owned enterprise. Government companies can be converted into private companies in two ways

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

Privatisation of the public-sector undertakings by selling off part of the equity of PSUs to the public is known as disinvestment.

Outsourcing

This is one of the important outcomes of the globalisation process. In outsourcing, a company hires regular service from external sources, mostly from other countries, which was previously provided internally or from within the country (like legal advice, computer service, advertisement, security — each provided by respective departments of the company). As a form of economic activity, outsourcing has intensified, in recent times, because of the growth of fast modes of communication, particularly the growth of Information Technology (IT).

World Trade Organisation (WTO)

The WTO was founded in 1995 as the successor organisation to the General Agreement on Trade and Tariff (GATT). GATT was established in 1948 with 23 countries as the global trade organisation to administer all multilateral trade agreements by providing equal opportunities to all countries in the international market for trading purposes.

Indian Economy During Reforms: An Assessment

The reform process has completed one and a half decades since its introduction. Let us now look at the performance of the Indian economy during this period. In economics, growth of an economy is measured by the Gross Domestic Product.

Growth of GDP and Major Sectors (in %)

Sector	*1980-91*	*1992-2001*	*2002-07 (Tenth Plan Projected)*
Agriculture	3.6	3.3	4.0
Industry	7.1	6.5	9.5
Services	6.7	8.2	9.1
GDP	**5.6**	**6.4**	**8.0**

Source: *Tenth Five Year Plan*

1. Growth and Employment: Though the GDP growth rate has increased in the reform period, scholars point out that the reform-led growth has not generated sufficient employment. opportunities in the country. You will study the link between different aspects of employment and growth in the next unit. Reforms in Agriculture: Reforms have not been able to benefit agriculture, where the growth rate has been decelerating. Public investment in agriculture sector especially in infrastructure, which includes irrigation, power, roads, market linkages and research and extension (which played a crucial role in the Green Revolution), has been reduced in the reform period.
2. Reforms in Industry: Industrial growth has also recorded a slowdown. This is because of decreasing demand of industrial products due to various reasons such as cheaper imports, inadequate investment in infrastructure etc. In a globalised world, developing countries are compelled to open their economies to greater flow of goods and capital from developed countries and rendering their industries vulnerable to imported goods.
3. Disinvestment: Every year, the government fixes a target for disinvestment of PSUs. For instance, in 1991-92, it was targeted to mobilise Rs 2,500 crore through disinvestment. The government was able to mobilise Rs 3,040 crore more. Critics point out that the assets of PSUs have been undervalued and sold to the private sector. This means that there has been a substantial loss to the government.
4. Reforms and Fiscal Policies: Economic reforms have placed limits on the growth of public expenditure especially in social sectors. The tax reductions in the reform period, aimed at yielding larger revenue and to curb tax evasion, have not resulted

Globalisation

Globalisation is the outcome of the policies of liberalisation and privatisation. Although globalisation is generally understood to mean integration of the economy of the country with the world economy, it is a complex phenomenon.