New economic policy

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INDIAN ECONOMY

Chapter 7 - Economic Reforms Since 1991 And Its Feature

Question 1(A):

Fill in the blanks with the appropriate option from the bracket.

1. India has adopted a _________ policy of economic development since 1991.
(liberal, restrictive, strict, normal)

2. At present there are only _______ industries under compulsory licensing.
(6, 10, 4, 12)

3. Due to globalisation, agricultural export__________
(increases, decreases, constant, zero)

ANSWER:

1. India has adopted a ***liberal*** policy of economic development since 1991.
Explanation-
Before 1991, economic activities in India were subject to various controls and regulations by the government. The majority of the industries were under the government control while the private sector played only a secondary role. However, such a policy led to several problems in the form of stagnation, imbalance, etc. In wake of this since 1991, India moved towards a liberal policy of economic development.

2. At present there are only ***6*** industries under compulsory licensing.

Explanation-
Currently, there are only 6 strategic industries that are under compulsory licensing due to social and security reasons. These include alcohol, cigarette, industrial explosives and pharmaceutical industries.

3. Due to globalisation, agricultural export ***increases***.
Explanation-
With globalisation, Indian farmers gained access to the global markets. This helped farmers increase their business network, which led to an increase volume of agricultural exports from India.

Question 1(B):

Match the pair

Group A	Group B
1. SEBI	a) Public sector
2. Liberalisation	b) Profit motive
3. BHEL	c) Removing restrictions
4. Privatisation	d) 1988

ANSWER:

The items in the two columns can be correctly matched as follows.

Group A	Group B
1. SEBI	a) 1988
2. Liberalisation	b) Removing restrictions
3. BHEL	c) Public sector
4. Privatisation	d) Profit motive

1. SEBI - 1988
Explanation-
SEBI was established in the year 1988 (made a statutory body in 1992) with

the objective of regulating the functioning of stock exchanges and mutual funds.

2. Liberalisation - Removing restrictions
Explanation-
Liberalisation implies the removal of trade restrictions and licensing system that obstruct economic growth and development. India adopted the liberalisation policy in 1991.

3. BHEL - Public sector
Explanation-
Bharat Heavy Electrical Limited (BHEL) is a public-sector enterprise. It is one of the industries that were given Navaratna status under the privatisation policy adopted by government.

4. Privatisation - Profit motive
Explanation-
Privatisation implies reducing the role of the public sector and increasing the role of the private sector in the economy. With greater role of the private sector , profit became an important motive of the economic activities.

Question 1(C):

State whether the following statements are true or false.

1. Economic reforms were introduced when Dr. Manmohan Singh was the finance minister.

2. *Laissez- faire* policy advocates minimum state intervention in a market economy.

3. The share of the manufacturing sector in GDP has decreased recently.

ANSWER:

1. This statement is true.
Explanation-
Economic reforms were introduced in India in 1991 under the guidance of the then Finance

Minister Dr. Manmohan Singh and the late Prime Minister Shri Narasimha Rao.

2. This statement is true.
Explanation-
The term *laissez-faire* was introduced by the renowned economist Adam Smith in 1776. A *laissez-faire* economy is one in which there is minimum intervention of the government in the market.

3. This statement is true.
Explanation-
An analysis of the post reform period indicates that the annual average growth rate of the industrial sector has decreased. During the post reform period the annual average growth rate was 6.2% as against 7.6% in the pre-reform period.

Question 2(A):

Define or explain the concepts.

1. Industrial sector

2. F.D.I

3. FEMA

ANSWER:

1. The industrial sector, also known as the secondary sector, is responsible for manufacturing finished goods in an economy. It includes manufacturing, processing and construction activities related to metal working and smelting, automobiles, textiles, chemicals, electrical and electronic goods.

2. FDI or Foreign Direct Investment refers to direct investment in the business of a domestic country by a foreign business. It is either done by buying the domestic business by the foreign company or by extending the operations of a business in other countries. As a part of the liberalisation policy, India laid high emphasis on encouraging FDI.

3. The Foreign Exchange Management Act (FEMA) was enacted by the Indian government to allow free movement of goods and services from and to other countries. This Act provides Indian companies access to global markets and allows them to avail loans in foreign currencies.

Question 2(B):

Give reasons for the following:

1. Privatisation was encouraged in the New Economic Policy.

2. Under the New Economic Policy, inflow of foreign capital was encouraged.

3. Indian farmers are shifting cultivation from food grains to non-food grains.

ANSWER:

1. Prior to the reforms the public sector was accorded priority in the industrial development while the private sector played only a secondary role. However, such a policy did not yield positive effects and problems such as stagnation, inflation and imbalance grew immensely. The rate of growth of the economy was quite low. It was realized that to overcome the situation the role of public sector must be curtailed while the private sector must be encouraged. Accordingly, in the economic reforms of 1991, privatisaition formed an important component. For this measures that were taken were dereservation policy, establishment of BIFR (Board of Industrial and Financial Reconstruction), creation of NRB (National Renewal Board), disinvestment policy.

2. Prior to the reforms the foreign investment was highly restricted in India. In the post reform period, foreign capital was encouraged in India with the basic objective of pushing up the growth process. In this regard various measures were taken such increasing the equity limit of foreign capital, setting up special economic zones (SEZ) and passing the Foreign Exchange Management Act (FEMA).

3. As a result of the economic reform process, the agriculture sector in India benefitted in the form of diversification of cropping pattern. While earlier the farmers primarily grew food and staple crops as per the domestic demand, with the opening up of the economy, demand for non-food items such as horticulture, medicinal plants, etc. have also increased. Accordingly, the farmers have also switched towards the production of such crops.

Question 3(A):

Distinguish between the following:

1. Liberalisation and privatisation

2. Public sector and private sector

3. Agriculture and industry

ANSWER:

1.

Basis of Difference	***Liberalisation***	***Privatisation***
Meaning	Refers to the freedom of the economy from direct or physical controls (such as, industrial licensing, price control, import licence, etc) imposed by the government	Refers to the process of increasing the involvement of the private sector in the ownership or operation of a state-owned enterprise
Measures taken	Measures taken- delicensing policy, encouraging FDI, passing FEMA, establishing SEBI, etc.	Measures taken- dereservation policy, establishing *BIFR,* NRB, disinvestment, etc.

2.

Basis of Difference	***Private sector***	***Public sector***
Ownership	The ownership of industry/assets is in the hands of private individuals.	The ownership of industry/assets is in government.
Motive	Activities are guided by the motive of earning profits	Activities are guided by welfare motiv
Example	Tata Iron and Steel Company Limited (TISCO) and Reliance Industries Limited (RIL)	Railways and postal service

3.

Basis of Difference	***Agriculture***	***Industry***
Meaning	It is the sector that directly uses the natural resources. materials for consumption or for re-use in other industries	It is the sector that uses the products of the primary sector for it to be processed further into final products.
Another name	Primary sector	Secondary sector.

Examples of produce of the sector	Food grains, cotton, oil seeds, etc.	Clothing, oil, etc.

Question 3(B):

Write short notes

1. Need for NEP (New Economic Policy) of 1991

2. Liberalisation.

ANSWER:

1. The following points highlight the need for NEP in India.

    1. India was experiencing a ***rising fiscal deficit*** since 1980's because of the fact that while the expenditure of the government grew continuously (due to interest payments, defence expenditure, etc.), the revenue could not rise much. As a result there was instability in the economy.
    2. Prior to the reforms the exports and imports as well as the foreign exchange transactions were highly restricted. This resulted in ***adverse BOP situation***.
    3. The ***Gulf war*** in 1991 that resulted in the rise in the prices of oil further worsened the BOP situation.
    4. The ***foreign exchange reserves fell*** to an extremely low level.
    5. India was caught in a situation of ***debt trap*** wherein total debt amounted to 62.5% of the GDP of India.
    6. Due to high restrictions and controls the ***industrial sector suffered from inefficiency and lack of competitiveness***.
    7. The ***growth rate was extremely low*** and even reached negative in 1991.
    8. ***Collapse of the Soviet Union*** that was the major trading partner of India also affected the Indian economy.
    9. ***Inflation*** rose to extremely high levels.

To overcome such situation the Indian Government approached IMF and World bank for short-terms loans. However, the institutions agreed to grant loans on the conditions that India would introduce structural reforms in the country and remove restrictions on trade, thereby, open up the economy. In accordance with this New Economic Policy was introduced in 1991.

2. Liberalisation refers to the freedom of an economy from direct or physical controls (such as industrial licensing, price control, import licensing, etc) imposed by the government. It implies greater dependence on the market for taking various economic decisions. In other words, it refers to a gradual move from a planned socialist economy towards a market economy. As part of its liberalisation policy, India has adopted a delicensing policy, encouraged inflow of FDI and foreign technology, passed FEMA, established SEBI and abolished the MRTP Act.

Question 4.1:

Answer the following questions.

What are the positive and negative effects of LPG (Liberalisation, Privatisation and Globalisation) on agriculture?

ANSWER:

Positive effects
a. Increase in agricultural production– With globalisation, Indian farmers were able to buy the best quality seeds and other agricultural inputs at competitive prices. This, in turn, helped in increasing increased productivity per hectare.
b. Diversification in cropping pattern– Initially, Indian farmers only produced traditional food crops like rice and wheat. But with the advent of globalisation, farmers also engaged in horticulture and floriculture.
c. Better prices– As the quality of the produce improved the farmers were able to command a better price for their crops.
d. Increase in exports– Over the years the volume of exports of the agriculture sector has increased tremendously.

Negative effects
a. Shift towards cash crops and lack of food grains– The export-oriented production strategies led to the shift of agricultural production from food grains to cash crops, such as cotton, jute, etc. This led to reduced availability of food grains in the country.
b. Instability in prices– As the Indian economy was opened up, fluctuations in international prices and production patterns affected domestic prices and created problems for producers

and consumers.
c. Adverse effect on poor farmers– The benefits of globalisation remained concentrated among the rich framers who increased the production of exportable crops, while the poor farmers were left out.

Question 4.2:

Answer the following questions.

What are the factors needed for globalisation?

ANSWER:

Globalisation refers to the process of integration of an economy with other economies of the world. It is a process associated with increasing openness, growing economic independence and promotion of economic integration among the world economies. The following factors are needed for globalisation:
i. Advancement of communication- Globalisation requires technological advancement in the communication sector, so *t*hat people are able to access the happenings and activities that take place across the world.
ii. IT- Information technology is an important factor required for globalisation such that the developing countries are able to access the information about developed countries and learn the best out of it.
iii. Development in transport- Globalisation requires improvement in transport so that competitive goods are efficiently made available in the global market.

Question 5.1:

State with reasons whether you agree not.

Globalisation does not have any effect on the service sector.

ANSWER:

No, globalisation, in fact, affects the service sector in many ways. The following are a few of these effects:
a. Advanced technology and growth of IT- Due to globalisation, the advancements and

innovations in the IT sector have enabled the use of the Internet and telecommunications and facilitated electronic transactions. All these have contributed to the growth of the service sector in India.
b. Growth of tourism- The tourism industry in India has experienced a rapid growth due to the increased incomes of the people and the liberal reforms adopted by the government.
c. Increased volume of trade- The service sector has also benefited from the low tariff and non-tariff barriers on imports by Indian firms.

Question 5.2:

State with reasons whether you agree not.

Government of India did not take any measures to privatise the economy.

ANSWER:

No, the Indian government has taken many measures to privatise the economy. The following are some of these measures:
a. Disinvestment- Disinvestment refers to selling off only part of equity or share by the Public Sector Undertakings (PSU's) to the private investors For disinvestment, the government adopted two methods: sale of *a part of the equity of PSUs and* strategic sale of a number of companies, such as Modern Foods India, Bharat Alluminium Company (BALCO) and Maruti Udyog Ltd.
b. *Navratna* Policy- Selected PSUs were given Navaratna status and were provided full financial and managerial freedom to perform better and become global giants.
c. Creation of NRB- The National Renewal Board (NRB) was set up to tackle the problem of unemployment created by the closure of sick public sector units.
d. Establishment of BIFR (Board of Industrial and Financial Reconstruction): This was set up take important decisions with regard to the sick PSUs. If, according the analysis of the board there is no possibility of revival of a sick unit, then it is allowed to privatise.
e. Dereservation- As a part of privatization, the number of industries that were exclusively reserved for the public sector were drastically reduced. At present there are only three industries that are under the exclusive purview of the public sector.

Question 6.1:

Answer in detail.

What are the features of NEP (New Economic Policy) of 1991?

ANSWER:

The following are some of the main features of the New Economic Policy of 1991:
a. Encouragement to Small Scale Industries (SSIs)- Under NEP, the investment limit in SSIs was increased from Rs.1 crore to Rs. 5 crores. This was done in order to increase the competitiveness of these industries and to encourage them to use new technologies.
b. Disinvestment- Through disinvestment of public sector enterprises (PSEs), the government reduced its stakes in these PSEs and encourage greater participation of the private sector and the general public.
c. Reduction in the role of the public sector- The number of industries reserved for the public sector fell from 17 to 8. This ended state monopoly and released capital that was stuck in sick PSUs.
d. Encouragement to foreign investment- The NEP aimed at increasing foreign investment in India by permitting FDI up to 51%, 74% and even 100% in certain industries.
e. Abolition of the MRTP Act- The Monopolies and Restrictive Trade Practices Act (MRTP) was abolished to promote industrial growth and development.
f. Promotion of exports- The government enacted the EXIM policy and established Special Economic Zones (SEZs) and Agri Export Zones (AEZs) in order to encourage exports from India.
g. Abolition of licensing: The system of industrial licensing was abolished for most of the industries. Presently, only six industries are under the compulsory licensing system.
h. Allowing foreign technology: The imports of foreign technology were also liberalized in order to help improve the quality as well reduce the cost of goods and services.
i. Entry of foreign bank: Foreign banks were allowed operations in the country. Thus, the number of private foreign banks have increased greatly.
j. Setting up of SEBI: The Securities and Exchange Board of India was set up in 1988 to regulate the operations of stock exchanges and mutual funds.
k. System of online trading: The system of online trading and dematerialized trading was introduced which helped in reducing the risk associated with paper transactions as well as saved time and costs.
l. Insurance sector reforms: The Insurance Regulatory Development Authority (IRDA) Act was passes under which licenses were given to private sector insurance companies fo the insurance business.
m. Import liberalization: Imports were liberalized and such controls as import licensing were abolished (except for consumer goods).
n. Export promotion: Export were encouraged through various incentives as announced

under the EXIM policy. In addition, SEZ (Special Economic Zones) have been set up for the promotion of exports. Similarly, Agri export zones have been set up for encouraging agricultural exports.

Question 6.2:

Answer in detail.

What are the effects of economic reforms on the industrial sector.

ANSWER:

The following were some of the major effects of economic reforms on the industrial sector in India:

Positive effects

a. Enhanced growth- Due to liberalisation of the economy, the private sector was set free from government interference. This helped private industries grow and operate efficiently.

b. Increased exports- The reforms allowed integration of the industrial sector with the world markets. This gave entrepreneurs and industrialists a chance to export their goods to overseas markets and reap the benefits of globalisation.

c. Improved trade relations- Globalisation helped India trade and improve its relations with countries like China, Japan and America.

d. Liberalisation of imports: With liberalization of imports the problem of scarcity, thereby, the problem of inflation can be solved to a large extent.

Negative effects

a. Stiff competition: The domestic industrial products faced stiff competition from the cheap imported goods, which were also superior in quality.

b. Lack of investment: Due to lack of investment in infrastructure, such as adequate power and good roads, domestic firms could not compete with their foreign counterparts in terms of cost and quality of goods.

c. Unemployment- Many Indian industries were not able to face the stiff competition from other countries and thus, were forced to shut down due to huge losses. This contributed to the problem of unemployment and poverty in India.

d. Loss of welfare: As the private sector is profit driven, it often leads to loss of overall welfare.

NCERT QUESTION/ANSWER

DEEPAK SIR…..