MODULE-I

1. NEW ECONOMIC POLICY-1991

Q:1 Explain the Rationale OF New Economic Policy 1991?

(A) **Introduction :-** Since 1951, Indian economy is functioning as mixed economy where government is Controlling most Strategic Industrial sectors. The Public sector Played a very important role in creating more employment and Providing many goods and services at Low cost. But due to mismanagement of resources, Lack of accountability, many Public enterprises suffered Huge Lossess.

India Faced a Problem of Balance of Payment and many Factors were responsible like-

- Fiscal Imbalance
- Slow Growth of Exports
- High Imports,
- Slow Industrial Growth
- Inflation
- Low Foreign Exchange etc.

Due to above these Problems, there is need for a system to Change.

Thus our government introduced New Economic Policy of 1991 with - Liberalisation, Privatisation & Globalisation.

(B) RATIONALE OF NEW ECONOMIC POLICY-1991 :-

1. **Fiscal Crisis :-** Fiscal imbalance is increasing due to widening gap between Revenue and Expenditure of the government. This gap is filled by Public debt which

again increase burden of Interest. The Macro Management of economy was defective which Lead to 1990. crisis.
Fiscal deficit was increase to 7.7 OF GDP & Internal Debt of central government was 48.6% of GDP in 1990-91.
Thus for reducing Fiscal Deficit, New Economic Policy of 1991 was Passed.

2) **Balance Of Payment Crisis :-** During 1990, Gulf Crisis was increased due to Gulf war. During this Period Oil Prices were increased. In 1991 BoP Crisis reached to its Peak, when Foreign Exchange Reserve had reduced about $1 billion. Current account Deficit was increased to 9.7 billion US dollars.
Again Political Uncertainity in a Country Coupled with rising deficit. Thus by June-1991, The BoP crisis had become a Severe Crisis of international Confidence, absence of Confidence in government ability. Thus Unfavourable BoP was important objective of New Economic Policy.

3) **High InFlationary Pressure :-** In 1980's the Price rise was not alarming. Inflation rate was 6.67% p.a. In 1990-91, rate of inflation was double - 10.2%. This inflation was observed due to rise in Price of Petroleum Products and High Indirect Taxes ~~of~~ on goods and Services.
The Avg. Inflation Rate was between 10% to 14% till 1994-95.

Q:2 Explain Important Policy Changes in NEP 1991.?

OR Short Note – Macro Economic Stabilisation
Industrial sector Reforms
Financial Sector Reforms.

(A) Important Policy Changes in NEP-1991

- (I) Macro Economic Stabilisation (Demand side Management)
- (II) Structural Reforms (Supply side Management)
  1. Industrial Sector Reform
  2. Public sector Reform
  3. Trade and Capital Flow Reforms
  4. Financial Sector Reforms.

The New Economic Policy was introduced under the Prime Minister P.V. Narasimha Rao in June-1991.

(I) MACRO ECONOMIC STABILISATION (Demand side Management)

These measures are short Term measures on demand side to control inflation and bring stability. They are –

(1) **Control of Inflation** :– To bring down the high inflation rate, Combination of Fiscal and Monetary Policies are Used.

(e.g) In 1990-91 Fiscal Deficit was 7.7% of GDP which was reduced to 4.9% in 1995-96.

RBI increased Bank rate, CRR and SLR to make borrowing Costlier. It reduced inflation Rate to 8% in 1995-96.

2. Fiscal Correction :- To reduce the Fiscal imbalance, Fiscal Reforms were introduced since 1991.

Government had reduced
- Non-Productive Expenditure,
- Cut down Subsidies
- Reduce Administrative Exp.
- Reduce Defence Expenditure.
- Retire Public Debt to reduce interest burden etc.

Beside above measures govt. increased Revenue through Tax Reforms. (e.g) Service Tax was introduced 1994-95

3. Balance of Payments Adjustment :- Several measures were taken to improve BOP Position.

The rupee was devalued and LERMS was introduced in 1992-93. Under this System, a Dual Exchange Rate was fixed under which 40% of Foreign Currency was to Surrendered at Official rate and remaining 60% can be converted at market determined rate.

RBI adopt Managed Floating Exchange Rate System.

Imports were Liberalised and Export were increased. This will help government to improve BOP Position.

II Structural Reforms (Supply Side Management)

These are Long Term measures which improve Supply Side of economy. They are—

1. Industrial Sector Reforms :- With the announcement of New Industrial Policy - 1991, various reforms were introduced. They are—

(i) Abolition of Industrial Licensing :- This Policy abolished industrial Licensing for all industries except 18 industries. At Present there are only 5

industries Under Compulsory licensing.
e.g. Alcohol, Cigarettes, Hazardous Chemicals, Electronic Aerospace and Defence Equipment & Industrial explosives

ii) **Permitted Foreign Investment and Foreign Technology :-**
This Policy encouraged FDI and Foreign Technology. Initially FDI upto 51% was allowed but now it is raised upto 100% for many industries.

iii) **Role of Public Sector :-** The New Policy reduced the number of Industries reserved for Public Sector from 17 to 3 at Present. They are - Arms and ammunition, Atomic Energy and Railways.

iv) **Removal of MRTP Act :-** Under MRTP Act, Companies with Assets of ₹ 100 crores and above were not allowed to expand their business. But New policy has removed this Limit.
At Present MRTP Act is replaced by Competition Act - 2002.

2) Public Sector Reforms and Disinvestment :-

The Public Sector wants to reach at Commanding height of economy. But Performance of PSUs was not good due to heavy Losses; Fall in efficiency, Drain in government Budget etc.
So Public Sector Reforms include disinvestment of government equity to Private Sector.

3) Trade and Capital Flows Reforms :-

Indian government openup economy to Foreign Competition and Foreign investment as Follows ____

a) **Liberalisation Of Imports :-** After 1991, imports of various goods and services were Liberlised except Few consumer goods.

b) **Reduction in Tariff :-** Import duty on Non-Agricultural goods was reduced From 300% to 150% in 1991-92 In 2004-05 it was 20% & in 2007-08 it was 10%.

c) **Promotion OF Exports :-** NEP-1991 gave more incentives to exporters to increase export trade.

d) **Liberalised Capital InFlow :-** Government has Liberalised Capital InFlow in FDI and Foreign PortFolio Investment.

e) **Change in Exchange Rate Policy :-** Foreign Exchange Rate was determined by Demand and supply of Foreign currency. The RBI intervenes in Foreign Exchange market to reduce excess burden of market.

f) **Current Account Convertibility :-** Government introduced Convertibility of rupee, first on Trade account and later on entire current account. It increased the availability of Foreign currency to Exporters, Importers, Travelling, medical Expenses etc.

(4) Financial Sector ReForms :-

The Indian Financial Sector include- Banking sector, Insurance Sector and Capital market. Financial Sector Reforms were made to make our Indian market strong and Transparent. Reforms in Financial Sector are-

(a) **Banking Sector Reforms :-** Based on the recomendations of Narasimham Committee, Following reforms were taken in banking Sector —

i) **Reduce CRR :-** The Cash Reserve Ratio was reduced from 15% in 1991 to 4.5% in June 2013.
At Present 4% in April 2018.

ii) **Reduce SLR :-** Statutory Liquidity Ratio has been reduced slowly. As on April-2018 it was 19.5%.

iii) **De regulation of Interest Rates :-** Commercial Banks have been given Freedom to fix interest rates on the basis of Deposits. This will bring healthy Competition among banks

iv) **Prudential Norms :-** RBI introduced New Prudential norms in respect of income, Classification of assets etc. This will show accurate Financial Position of Commercial banks.

v) **Capital Adequacy Norms :-** Capital Adequacy ratio measure a bank capital in relation to its risk-weighted assets.

vi) **Access to Capital Market :-** Nationalised Commercial banks are allowed to raise Funds through Public issue in Capital Market.

vii) **New Private Sector Banks :-** Entry of New Private Sector banks must be allowed. It Provide more Funds and healthy Competition with Public Sector Banks.

viii) Freedom of operation :- Commercial Banks have been given freedom to open new branches and to close non-profitable branches other than in rural areas.

ix) Special Recovery Tribunals :- For fast recovery of Bad Loans, government has setup special Recovery Tribunals.

(b) Capital Market Reforms :-

"Capital market is the market where medium and Long Term loans and funds can be raised through debt and Equity"

The important Reforms in Capital market are—

i) SEBI :- SEBI made statutory body in 1992. It authorised to regulate all merchant banks, Mutual Fund & working of Stock Exchange in India.

ii) Primary Market Reform :- Capital raising capital in Primary market are required to disclose all information

iii) Online Trading and Dematerialised Trading :- SEBI has introduced Online Trading & Dematerialised Trading. It will reduce time, cost and risk.

iv) NSE :- National stock Exchange was setup in Nov-1992. But it became operational in 1994. It has helped to bring transparancy and efficiency in secondary market.

v) Rolling Settlement :- From Jan 2000, SEBI has introduced rolling settlements. In this system, Trading cycles has been reduced to a day and traders have to settled within Two working days

Vi) Derivative Trading :- In 2000, Trading in Equity derivatives was introduced.

e.g Stock Future, Stock option, Index Future, Index Options.

Vii) Foreign Institutional Investors (FIIs) :- FIIs are allowed to invest in all types of securities in Primary and Secondary markets.

Viii) Government Securities Market :- Many measures were taken to improve Government Securities market.

ix) National Securities Clearing Corporations (NSCC)

In 1996 — NSCC was set up. It provide guarantees all trades on NSE.

x) Investor Protection :- In Oct-2001, the Investor Education and Protection Fund (IEPF) has been established to Protect investor.

C) Insurance Sector Reforms :- In 1999, IRDA Act was Passed. This Act ended monopoly of govt. in insurance sector. The IRDA has given licences to many Private Sector Companies to do insurance business.

IRDA → Insurance Regulatory and Development Authority.

Thus due to New Economic Policy -1991 & its Various reforms, integrated Indian economy with world economy.