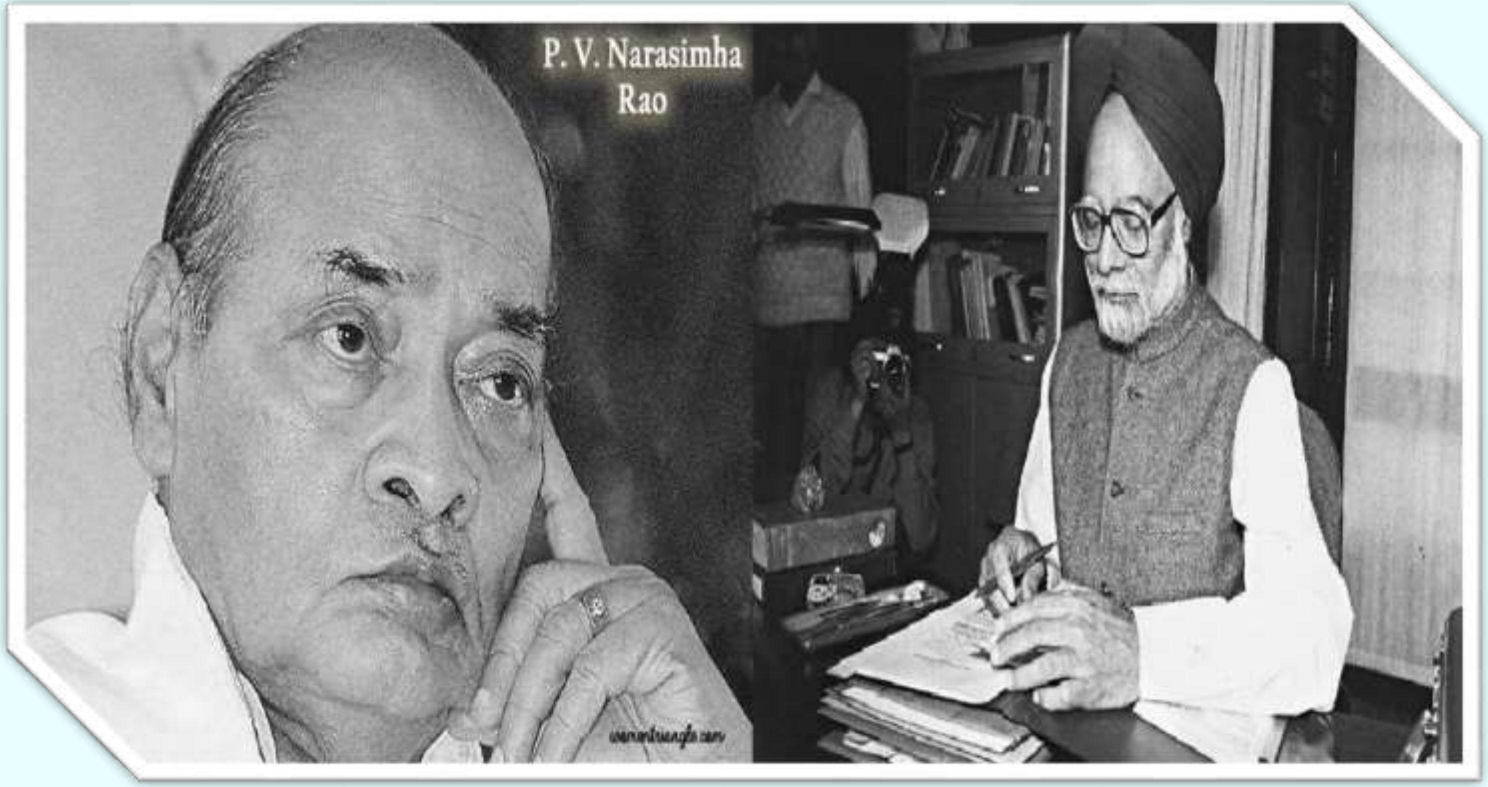
MODULE I
TOPIC:

OVERVIEW - NEW ECONOMIC POLICY OF INDIA 1991



Prime Minister
P. V. Narasimha Rao

Dr. Manmohan Singh
Finance Minister

PRE 1991 ECONOMIC SCENARIO IN INDIA

- India adopted a mid way between Capitalism & Socialism – Mixed Economy regime
- India would be a socialist society with a strong public sector but also with private property and democracy
- India adopted a centralised planning approach

Protectionism

State intervention (‘permit Raj’)	Import substitution	Small private sector

DRAWBACKS OF PRE-1991 ECONOMIC POLICY

"Before the process of reform began in 1991, the government attempted to close the Indian economy to the outside world. The Indian currency, the Rupee, was inconvertible and high tariffs and import licensing prevented foreign goods reaching the market. The labyrinthine bureaucracy often led to absurd restrictions—up to 80 agencies had to be satisfied before a firm could be granted a license to produce and the state would decide what was produced, how much, at what price and what sources of capital were used."

BBC on the Pre-1991 economic policy

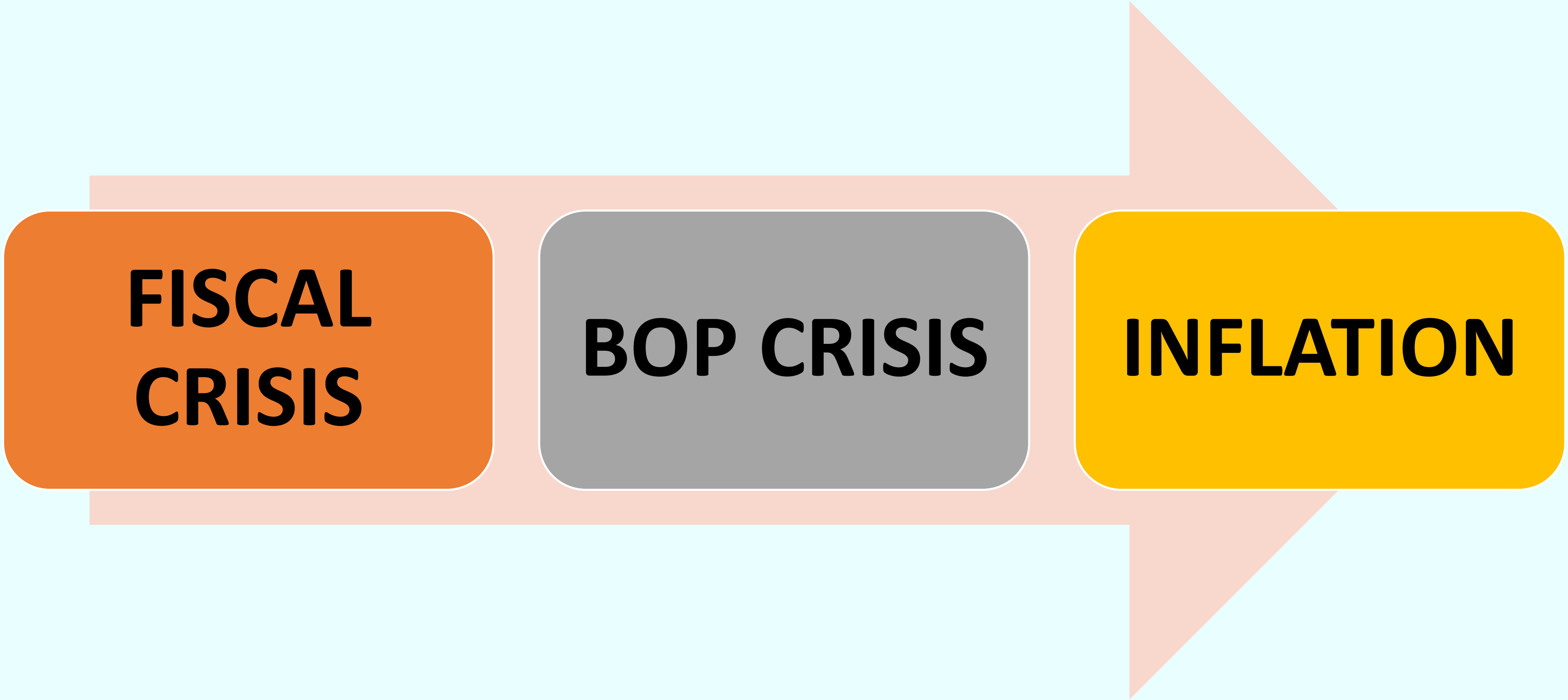
- The **“License Raj”** or “Permit Raj” was the elaborate system of licenses, regulations required to set up and run businesses in India between 1947 and 1990

- **Import substitution** is a trade and economic policy which advocates replacing foreign imports with domestic production.

- ISI is based on the premise that a country should attempt to reduce its foreign dependency

- The local production of industrialized products and was intended to promote self reliance.

RATIONALE OF NEP 1991



It is the outcome of economic crisis of 1990-991
There was a macroeconomic imbalance
India faced economic crisis on the following macro variables

1. **Fiscal crisis**

- **Huge widening of gap between expenditure and income of the govt**
- **It was mainly the result of increase in non developmental exp**
- **Fiscal deficit was as high as 7.7% of GDP in 1990-91**
- **Major portion of the debt was financed by internal borrowings**
- **Interest burden was 29% of revenue exp. of the central govt**
- **The excessive fiscal deficits of 1980s caused the crisis of 1990-91**

GOVT EXP > GOVT REVENUE

2. Balance of payments (BOP) crisis

- The Gulf crisis of 1990, resulted in tremendous increase in oil prices
- Forex reserves in India were just about $ 1 billion
- The current account deficit (CAD) was 3.2% of the GDP in 1990-91
- Forex reserves depleted to $ 896 m by 1991, it was a result of sharp rise in imports of POL
- There was also outflow of NRI deposits
- The BOP crisis was called “crisis of confidence” because the govt was unable to finance CAD of $ 9.7 billion in 1991
- A default of payments was almost a possibility by June 1991

3. Inflationary pressure

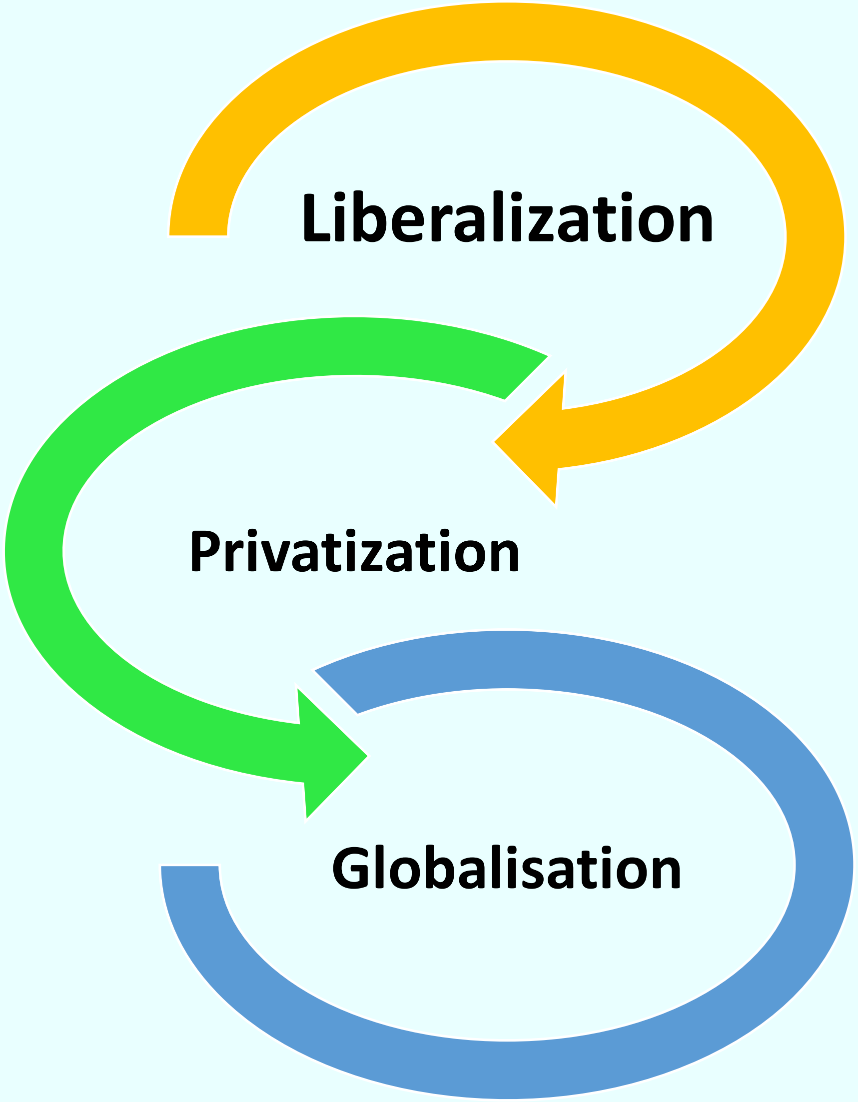
- The wholesale prices in India rose at an annual rate of 8.2 %from 1981-82 to 1993-94
- By 1990-91 inflation rate crossed double digit figure 10.2%
- It was a result of rising admin exp., POL imports and indirect taxes on G & S
- The avg annual rate of inflation till 1994-95 hovered between 10% to 14%

1991 Economic reforms

- Structural reforms
  - Privatisation
  - Liberalisation
    - Deregulation
    - Financial sector
    - Tax reforms
    - Forex reforms
    - Trade policy
  - Globalisation
- Stabilisation measures

FISCAL REFORMS

MONETARY REFORMS



KEY POLICY CHANGES IN NEP 1991

A. Macro economic stabilisation (Demand m'gmt)

Three measures were introduced

1. **Control of inflation**

- **A combination of fiscal & monetary methods were used**
- **Fiscal def was reduced from 7.7% to 4.9% of GDP by 1995-96**
- **SLR was raised to 38.5% in sept. 1990**
- **CRR to 11% in 1991**
- **BR to 12% in oct.1991 to curb excess liquidity**
- **With the recommendations of Narsimhan committee & other measures import of essential supplies were allowed**
- **By 1996-97 inflation was brought down to 4.6%**

A. Macro economic stabilisation (demand m'gmt)

2. Fiscal correction

- Fiscal reforms were introduced in 1991 to correct fiscal imbalance
- Unproductive exp's. like subsidies, defense, admin were cut down
- budgetary support to PSEs were reduced
- Introduction of rationalization & simplification of tax rates, procedures, rules & regulations
- Widening of tax bases
- Introduction of service tax in 1994
- income taxes, corporate income tax, custom duty were reduced under tax reforms

Structural reforms (supply side mgmt)

1. **Industrial sector reforms**

- The new NIP 1991 was introduced with the following reforms
- Abolition of industrial licensing
- Permitted foreign invest. & foreign tech
- Reduced the role of public sector
- Removal of MRTP limit

2. **Public sector reforms & disinvestment**

- Partial disinvestment of equity in PSEs
- PSEs to raise equity from markets
- Public monopolies to face comp from pvt. sector
- Greater autonomy to ‘ navratna’ companies

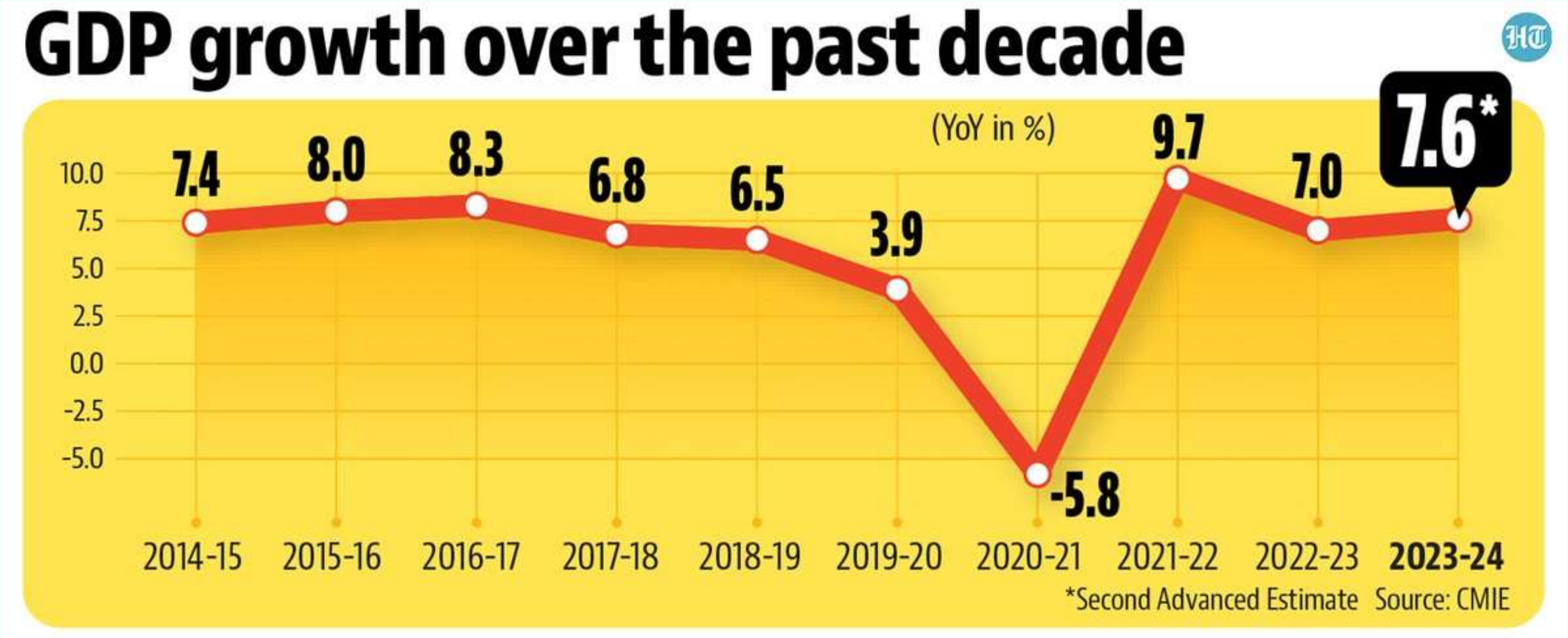
B. Structural reforms (supply side mgmt)

3. Trade & capital flows reforms

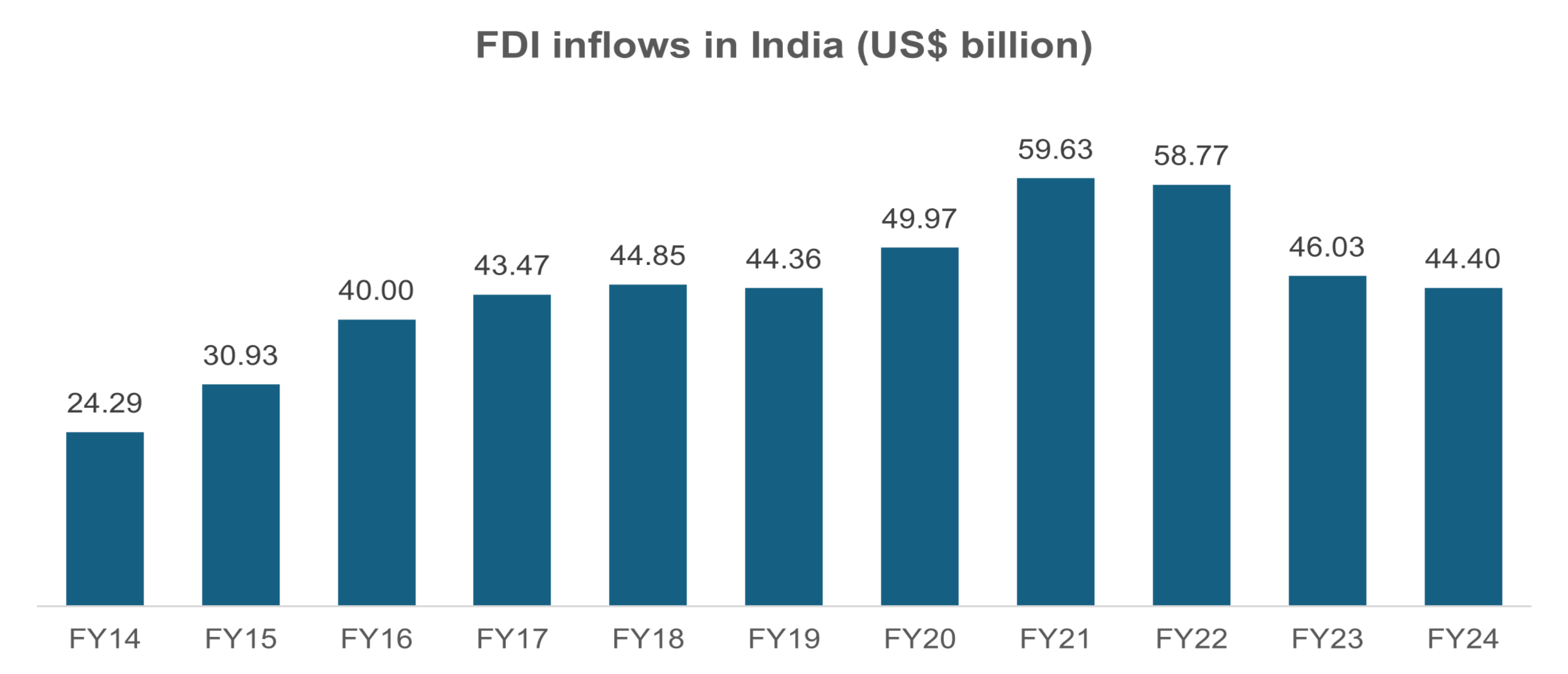
- **Liberalisation of imports**
- **Reduction in tariff structure**
- **Promotion of exports**
- **Change in exchange rate policy**
- **Introduced current acc. Convertibility**
- **Liberalised capital flows**

4. Financial sector reforms

- **Banking sector reforms**
- **Capital mkt reforms**



GDP growth over the past decade
HT
(YoY in %)
10.0
7.5
5.0
2.5
0.0
-2.5
-5.0
7.4
8.0
8.3
6.8
6.5
3.9
-5.8
9.7
7.0
7.6*
2014-15
2015-16
2016-17
2017-18
2018-19
2019-20
2020-21
2021-22
2022-23
2023-24
*Second Advanced Estimate
Source: CMIE


FDI inflows in India (US$ billion)
24.29
30.93
40.00
43.47
44.85
44.36
49.97
59.63
58.77
46.03
44.40
FY14
FY15
FY16
FY17
FY18
FY19
FY20
FY21
FY22
FY23
FY24

B. Structural reforms (supply side mgmt)

4. Insurance sector reforms

- it was the monopoly of the govt sector
- Insurance regulatory & Development Authority (IRDA) act was passed in 1999
- The IRDA has given licenses to a number of pvt sector cos. to do insurance business