25

RECENT ECONOMIC REFORMS AND THE ROLE OF PLANNING

25.1 INTRODUCTION

The year 1991 will remain a year of notable and widespread changes in the policy for economic development in India. In this year the economy faced an economic crisis which was unprecedented. This crisis put into doubt the effectiveness of economic planning in India. It was felt that some of the measures of policy that were followed so far needed a change. The changes that were made in economic policy gave a different direction to the policy as compared to the policy that was followed so far. As such these changes have been given the name of economic reform by some writers. We shall learn in the present lesson the role of economic planning in India after these economic reforms.

25.2 OBJECTIVES

After going through this lesson you will be able to :

- point out some of the factors that created a crisis like situation in 1991;
- identify the policies that had to be changed;
- list some of the major changes in economic policy;
- give an account of the nature of the changes in 1991;
- explain the future role of economic planning in the context of economic reforms.

25.3 ECONOMIC SITUATION AT THE BEGINNING OF THE DECADE OF NINETIES

We learnt in the previous lesson that the economic planning in India was a mixture of achievements and failures. While the rate of economic growth showed some increase, it was slower than anticipated. There was not enough reduction in economic inequalities. Poverty continued to persist and more than one-third of the population lived below the poverty line. The improvement in the quality of life was not satisfactory. Industrial growth, modernisation, technological developments were quite satisfactory. But there was more scope for achievements even in these areas. The economy had made satisfactory progress in the area of building up social and economic infrastructure.

(a) Problems

Some of the problems that the Indian economy was facing at the beginning of the decade of nineties were as follows :

1. Inflationary pressure

Indian economy was facing a strong inflationary pressure. Prices of essential commodities were rising rapidly. Since this raised the cost of living of the working class, they asked for higher wages which raised industrial costs. The industrial costs were also rising because of the rising costs of materials. High industrial costs and prices were leading to stagnation in the demand for their products both in the domestic market as well as abroad.

2. Shortage of finance

The economy was experiencing shortages of finance for industrialisation etc. There were also shortages emerging in the economy in the area of transportation, communication. These shortages were suppressing industrial growth.

3. Shortage of foreign exchange

One of the most important areas of shortages was that of foreign exchange. Indian economy had experienced some rise in exports in the preceding decade. But the rise in imports was far more. Thus the economy demanded more foreign exchange than was available. The prices of 'foreign currencies' were, therefore, rising persistently.

4. Unemployment

Even though industrial growth was taking place, employment in industry was not increasing proportionately.

5. Decline in the share in the world trade

In the world economy India's share in the world trade was declining. At the beginning of the era of economic planning India had 2 per cent share in the world trade. By the beginning of the decade of nineties, this share had declined to less than half a percent i.e. 0.5 percent. Further, in the past few decades, India was experiencing an expansion of trade with former Soviet Union and other socialist countries of Europe. After the political changes in these countries, they were opening up their economies to the other European and industrially advanced economies. It was quite clear that India will have to compete with some of the industrially advanced economies of the world if it has to expand its share in the world trade.

6. Higher rate of economic growth in other countries

Some of the other developing countries like South Korea, Philippines, Hong Kong, Singapore, Malaysia, Indonesia, China were experiencing a far higher rate of economic and industrial growth than India.

(b) Policies responsible for problems

It may also be noteworthy that some of the policy measures followed in the past were considered responsible for these problems of the Indian economy. We may enumerate some of these policy measures:

1. System of licensing

Government was controlling and regulating the growth of industry through a system of licensing.

2. Some industries in the hands of government only

A number of industries were meant to be developed only by the government. Some of these industries notably power-generation and transmission, transportation and communication, mining, heavy machinery etc. were to be expanded only by the government.

3. Restrictions on foreign technology

Government had placed several restrictions on the import of foreign technology and prior approval of the government was required if an industrial enterprise was to import technology from a foreign firm.

4. Restrictions on foreign investment

There were several restrictions on the participation by foreign investors in the Indian industries. They were not allowed to invest in any one enterprise more than 25 percent of the total capital.

Prices of foreign currencies in terms of the Indian rupee were fixed. This was known as the official exchange rate. Since the demand for foreign currencies was more than their supply and the demand for these currencies was increasing more than the increase in their supply. Their open market (what is known as black market in our country) prices were increasing. The growing gap between the officially fixed exchange rate and the market demand and supply determined exchange rate was leading to growing black market in foreign exchange. Those who earned foreign exchange through exports of goods or services did not report their entire earnings of foreign exchange. Those who wanted to import from abroad would prefer to obtain all the foreign exchange from the Reserve Bank of India because the official rate was lower. Hence the earnings of foreign exchange were not enough but the withdrawals were far more.

5. Protection from foreign competition

Indian industry had been protected from competition with foreign industry by imposing heavy import duties on competing foreign goods. Indian industry had, however, not increased its competitive strength in view of this protection that it received through high import duties. For increasing exports, Indian industry was demanding more and more of subsidies from the government.

INTEXT QUESTIONS 25.1

1. State whether the following statements are true or false:

   (i) Indian economy was experiencing rising prices at the end of the decade of eighties.

   (ii) India's share in the world trade was rising.

   (iii) The only shortage that India experienced at the beginning of the decade of nineties was that of foreign exchange.

2. Fill in the blanks with appropriate words from the brackets:

   (i) Rise in the prices of essential commodities raises the ______________ of industrial workers. (cost of living, income)

   (ii) There were controls on the growth of industries through a______________ system. (market, licensing)

   (iii) Before reforms, prior approval of the government was ______________ for the import of technology. (required, not required)

   (iv) There______________restrictions placed on the participation of foreign capital. (were, were not)

25.4 CRISIS OF 1991 AND ECONOMIC POLICY REFORMS

At the beginning of 1991, India faced a severe foreign exchange shortage. As you have learnt in the earlier section, there was a growing gap in the officially fixed exchange rate of the rupee with other currencies and the market determined rate. Since the market determined rate was very high and was rising, there was growing incentive not to report the foreign exchange earned to the official agencies i.e. Reserve Bank of India. At the same time there was an increasing demand for withdrawal of foreign exchange from official sources because it was cheaper. The foreign exchange reserves were, therefore, depleting rapidly.

At the beginning of 1991, because of a war between Kuwait and Iraq, there was a shortage of petroleum products. Their prices rose. India's earnings from these and other Gulf countries were suddenly blocked as Indian's workers in these countries were not allowed to transfer incomes to India. Moreover, there was a large number of workers who returned to India because of the war.

Indian political situation was also not very stable. There was a minority government at the centre. Those depositors who had deposited their foreign currency in India started withdrawing their deposits. There was, therefore, a growing withdrawal of foreign exchange.

The situation became so difficult that India had to take drastic measures to meet the foreign exchange requirements. Reserve Bank of India mortgaged its gold reserves to borrow foreign currencies to meet the requirements of the country. India also sought loans from the International Monetary Fund.

In the domestic economy also the situation called for a change. Indian industry needed to become more competitive and efficient so that it could compete in the world market. Dependence of exports on subsidies was a burden on the government.

The government, therefore, thought of bringing about a massive change in its policy. Industrial policy was modified. Foreign exchange control system was changed. Government's role in the economy was reduced considerably. We may note some of the policy measures that were taken.

(a) Industrial Policy Changes

(i) Delicensing of industries

(i) There was a delicensing of all industries except a few whose growth had harmful impact on the environment. This introduced an element of competition within the economy. It was expected that there will be expansion of industry and industrial efficency would improve.

(ii) Freedom to import technology

Indian industry was given freedom to import technology from abroad. It was expected that the best technology will be imported and there will be continuing improvement in technology.

(iii) Freedom of foreign investment

Foreign investors were given freedom to enter into selected industries with upto 51 percent of the total capital. This would not only bring finance from other countries but will also help bring the latest technology, management methods etc. in Indian industry.

(iv) Restriction on large industry removed

Restrictions placed on large industry in order to prevent the growth of monopoly were removed. Large industrial houses were free to expand their activities in several directions.

(v) Industries reserved for government open for the private sector

Industries which were reserved for development by government were now opened up for the private sector except for some of the industries producing defence goods and other similar industries.

(b) Trade and Foreign Exchange Policy Changes

(i) Reduction in import duties

There was systematic reduction in import duties on several items of imports. This increased the competition between the domestic producers and foreign producers.

(ii) Import licensing liberalized

Many of the items of imports were put on the category which did not require any license for imports.

(iii) Controls on foreign exchange removed

Initially the price of foreign currencies in terms of the Indian rupee was raised officially. Later controls on foreign exchange were removed. Now foreign exchange is available in the open market only and there are no differences between the official and market rates. This would compel the importers to keep the actual cost of foreign exchange in view while planning for imports. Moreover, variations in the prices of foreign exchange will bring about a balance between the supply and demand for foreign exchange.

(c) Fiscal Policy Changes

Government also brought about several changes in fiscal policy.

(i) Reduction in excise duties

There was a reduction in excise duties on a number of items. This enabled to increase their competitiveness with imported goods for which the import duties were reduced.

(ii) Reduction in the rates of direct taxes

There was a gradual reduction of direct tax rates to improve the compliance of tax payment. It was expected to raise the total tax revenue as it was expected that the evasion of taxes will not be beneficial any more.

(iii) Reduction in government expenditures

The government was expected to reduce its avoidable expenditure so as to increase its ability to invest.

(iv) Sale of government capital

The government also decided to sell a part of the capital of some of its enterprises. This was done to mobilise resources for meeting the expenditure requirements of the government.

On the whole there was a general environment of relaxation of controls, opening the sectors reserved for government, investment to private sector, opening up the economy to foreign investment and technology inflow, reduction of taxes, etc.

This has been given the nomenclature of 'liberalisation' although the government statements called the entire policy framework as the 'structural adjustment programme'.

The objective of introducing more competition among producers was to increase the efficiency of resource use, improve the quality of products and bring it to the international standards.

The relaxation of controls on imports, opening up of industries to foreign investment and measures to encourage the foreign capital to build up industries in India has been called 'globalisation' programme. Ten objective of these measures is to make the Indian industry competitive in the world market and find more and more avenues for export.

INTEXT QUESTIONS 25.2

1. State whether the following statements are true or false:

   (i) War between Kuwait and Iraq caused the foreign exchange crisis of 1991.
   (ii) The change in policy in 1991 was a part of the policy of economic planning.
   (iii) The purpose of delicensing of industry was to increase competition and promote growth.
   (iv) By reducing import duties, the government reduced the protection granted to Indian producers.

2. Fill in the blanks:

   (i) Reduction of excise duties aimed at increasing the ________________ of Indian industry with foreign goods.
   (ii) Many items of production were put in a category which did not require any license for their ________________
   (iii) By allowing freedom to import technology the new policy hoped that the ________________ technology will be imported.
   (iv) Industries which were reserved for government have been now ________________ for private sector.

25.5 ECONOMIC REFORMS AND THE ROLE OF ECONOMIC PLANNING

In this part of this lesson, we shall learn about the effects of the new economic policy adopted in 1991 and later on the role of economic planning in India.

Let us recall the economic planning in India had certain objectives before it. We have also learnt that the achievement of these objectives was a mixed bag of successes and failure. It is, therefore, important for us to ask whether the new economic policy will facilitate the achievement of those objectives at a greater speed?

We have noted that the new policy or the economic reform is aiming at acceleration in growth of the industrial sector. The new policy aims at reducing and eliminating all the difficulties that may have been created by government controls on the growth of the Indian industry. Once again the emphasis is rapid industrial growth so that economic growth also becomes rapid.

By reducing the controls and regulation of the economy the government is expecting that the economic progress will be faster. The need for fast economic progress is as strong as it was in the decade of fifties when economic planning was started. The only change is the change in policy to ensure fast economic progress. It is, therefore, that the then Finance Minister, called the new industrial policy as a 'policy of change with continuity'.

(a) Role of the government reduced

Since the role of government in the economy has been considerably reduced, it is now limited to indicate the targets to be achieved during each five year plan. The fulfilment of those targets is now the task of private sector. It is, therefore, that the eighth five year plan stated that now the nature of economic planning in India is 'indicative planning'.

But as we have already learnt that economic planning does not aim at securing a higher growth rate. The basic objectives of reduction of economic inequalities, self-reliance, modernisation, reduction of unemployment and balanced regional growth are equally important. Economic growth without the fulfilment of these other objectives will not result in the economic progress that the economy needs.

(b) Private sector to take initiative

The new policy is leaving the economic growth to the initiative of the private sector. Since private sector is motivated by 'the desire for profit making' the rate of economic growth will depend upon its ability and capacity to earn profits. But such a policy can lead to the inequalities increasing over time rather than reducing. Government will, therefore, have to step in to reduce inequalities.

(c) The new role of government

The need for eradication of poverty is as strong as ever. The role of economic planning to start and carry on programmes for the elimination of poverty and improvement in the quality of life will now be the responsibility of the government.

The new policy also does not ensure that unemployment will be reduced. The private industry will adopt technology which enables it to earn more profits and not necessarily create more employment opportunities. Reduction of unemployment will, therefore, depend upon how quickly does industry expand and how far does it spread. Government will have to take steps to encourage industry to spread rapidly and into various states as well as rural areas.

Thus, the role of economic planning is not reduced by the adoption of the new economic policy. It is only changed. The government will not be concentrating on increasing industrial production itself now. It will be concerned with making plans such that industrial progress is accompanied by reduction of inequalities, removal of poverty, reduction of unemployment and balanced regional growth.

INTEXT QUESTIONS 25.3

1. State whether the following statements are true or false :

(i) Economic growth is the only objective of economic planning after 1991.

(ii) The objective of reduction of inequalities is important even after the adoption of economic reform.

(iii) Economic growth will largely be the responsibility of the private sector after the economic reforms.

(iv) Government will be concentrating on increasing industrial production itself after the adoption of economic reforms.

2. Which five year plan called economic planning in India as 'indicative planning'?

WHAT YOU HAVE LEARNT

- Indian economy was facing several problems at the beginning of the decade of nineties. These were :
  - (i) High rate of inflation.
  - (ii) Rising industrial costs and prices.
  - (iii) Shortages of finance for development, power, transport facilities.
  - (iv) Foreign exchange shortage.
  - (v) Employment was not increasing.
  - (vi) India had lost its share in the world trade and was likely to lose more in view of the changes in the former Soviet Union and other socialist countries.
  - (vii) Other developing countries were growing at a much faster rate.
- Some of the policy measures responsible for this were :
  - (i) Control and licensing of industry.
  - (ii) Reservation of infrastructure for the government.
  - (iii) Exchange control and other trade restrictions as well restrictions on the inflow of technology and foreign capital, fixity of the rate of exchange, protection from foreign competition.
- The crisis of 1991 was gradually building up due to excess of imports over exports. It was precipitated by the gulf war, the political instability and the changes in former Soviet Union and other European socialist countries.
- The foreign exchange crisis was accompanied by inflationary pressure in the domestic economy. The changes in policy in the from of relaxation of controls, reduction of the role of government enterprises, relaxation of foreign exchange controls, fiscal and other measures were all aimed at accelerating the growth of industries and increase their competitive strength.
- New economic policy appears to reduce the role of government.
- It aims at promoting industrial growth so as to speed up economic progress.
- The objectives of reduction of inequalities, reduction of unemployment, balanced regional growth have to be achieved.
- Government will find its role changed to ensuring the fulfilment of these objectives.

TERMINAL EXERCISE

1. Briefly state the factors that caused the economic crisis of 1991.
2. What was the justification for the economic policy reforms in 1991?
3. State the main changes in economic policy in 1991.
4. What can you say about the role of economic planning in India after the introduction of economic reforms?

ANSWER

Intext Questions 25.1

1. (i) True, (ii) False, (iii) False
2. (i) cost of living (ii) licensing (iii) was required (iv) were

Intext Questions 25.2

1. (i) False, (ii) False, (iii) True, (iv) False
2. (i) competition (ii) production (iii) latest (iv) open

Intext Questions 25.3

1. (i) False, (ii) True, (iii) True, (iv) False
2. Eighth Five Year Plan

Terminal Exercise

1. Read section 25.3 (b)
2. Read section 25.3 (a)
3. Read section 25.4
4. Read section 25.5