**New Economic Policy of 1991: Objectives, Features and Impacts**

The year 1991 is an important landmark in the economic history of post-Independent India. The country went through a severe economic crisis triggered by a serious Balance of Payments situation. The crisis was converted into an opportunity to introduce some fundamental changes in the content and approach to economic policy.

The response to the crisis was to put in place a set of policies aimed at stabilisation and structural reform. While the stabilisation policies were aimed at correcting the weaknesses that had developed on the fiscal and the Balance of Payments fronts, the structural reforms sought to remove the rigidities that had entered into the various segments of the Indian economy. Former Prime Minister Manmohan Singh is considered to be the father of New Economic Policy of India.

**Main Objectives of New Economic Policy – 1991, July 24**

**The main objectives behind the launching of the New Economic policy (NEP) in 1991 by the union Finance Minister Dr. Manmohan Singh are stated as follows:**

**1.**The main objective was to plunge Indian economy in to the arena of ‘Globalization and to give it a new thrust on market orientation.

**2.**The NEP **(New Economic policy)** intended to bring down the rate of inflation and to remove imbalances in payment.

**3.**It intended to move towards higher economic growth rate and to build sufficient foreign exchange reserves.

**4.** It wanted to achieve economic stabilization and to convert the economic in to a market economy by removing all kinds of unnecessary restrictions.

**5.**It wanted to permit the international flow of goods, services, capital, human resources and technology, without many restrictions.

**6.** It wanted to increase the participation of private players in the all sectors of the economy. That is why the reserved numbers of sectors for government were reduced to 3 as of now.

Beginning with mid-1991, the govt. has made some radical changes in its policies bearing on trade, foreign investment exchange rate, industry, fiscal discipline etc. The various elements, when put together, constitute an economic policy which marks a big departure from what has gone before.

The thrust of the **New Economic Policy** has been towards creating a **more competitive environment** in the economy as a means to **improving the productivity and efficiency** of the system. This was to be achieved by removing the barriers to entry and the restrictions on the growth of firms.

[**List of all Five Year Plans of India**](http://www.jagranjosh.com/general-knowledge/list-of-all-five-year-plans-of-india-1468309723-1)

**Main Measures Adopted in the New Economic Policy**

Due to various controls, the economy became defective. The entrepreneurs were unwilling to establish new industries ( because laws like MRTP Act 1969 de-motivated entrepreneurs). Corruption, undue delays and inefficiency risen due to these controls. Rate of economic growth of the economy came down. So in such a scenario economic reforms were introduced to reduce the restrictions imposed on the economy.



**Following steps were taken under the Liberaliation measure:**

**(i) Free determination of interest rate by the commercial Banka:**

Under the policy of liberalisation interest rate of the banking system will not be determined by RBI rather all commercial Banks are independent to determine the rate of interest.

**(ii) Increase in the investment limit for the Small Scale Industries (SSIs):**

Investment limit of the small scale industries has been raised to Rs. 1 crore.  So these companies can upgrade their machinery and improve their efficiency.

**(iii) Freedom to import capital goods:**

Indian industries will be free to buy machines and raw materials from foreign countries to do their holistic development.

**(v) Freedom for expansion and production to Industries:**

In this new liberalized era now the Industries are free to diversify their production capacities and reduce the cost of production. Earlier government used to fix the maximum limit of production capacity. No industry could produce beyond that limit. Now the industries are free to decide their production by their own on the basis of the requirement of the markets.

**(vi) Abolition (official end) of Restrictive Trade Practices:**

According to Monopolies and Restrictive Trade Practices (MRTP) Act 1969, all those companies having assets worth Rs. 100 crore or more were called MRTP firms and were subjected to several restrictions. Now these firms have not to obtain prior approval of the Govt. for taking investment decision.

**1**. **Liberalisation**

**Removal of Industrial Licensing and Registration:**

Previously private sector had to obtain license from Govt. for starting a new venture. In this policy private sector has been freed from licensing and other restrictions.

**Industries licensing is necessary for following industries:**

**(i)**Liquor

**(ii)** Cigarette

**(iii)** Defence equipment

**(iv)** Industrial explosives

**(v)**Drugs

**(vi)**Hazardous chemicals. (injurious to health and environment)

***2.*Privatisation*:***

Simply speaking, privatisation means permitting the private sector to set up industries which were previously reserved for the public sector. Under this policy many PSU’s were sold to private sector. Literally speaking, privatisation is the process of involving the private sector-in the ownership of Public Sector Units (PSU’s).

The main reason for privatisation was in currency of PSU’s are running in losses due to political interference. The managers cannot work independently. Production capacity remained under-utilized. To increase competition and efficiency privatisation of PSUs was inevitable.

**Step taken for Privatisation:**

**The following steps are taken for privatisation:**

**1**.**Sale of shares of PSUs:**

Indian Govt. started selling shares of PSU’s to public and financial institution e.g. Govt. sold shares of Maruti Udyog Ltd. Now the private sector will acquire ownership of these PSU’s. The share of private sector has increased from 45% to 55%.

**2. Disinvestment in PSU’s:**

The Govt. has started the process of disinvestment in those PSU’s which had been running into loss. It means that Govt. has been selling out these industries to private sector. Govt. has sold enterprises worth Rs. 30,000 crores to the private sector.

**3. Minimisation of Public Sector:**

Previously Public sector was given the importance with a view to help in industralisation and removal of poverty. But these PSU’s could not able to achieve this objective and policy of contraction of PSU’s was followed under new economic reforms. **Number of industries reserved for public sector was reduces from 17 to 3.**

**(a)**Transport and railway

**(b)** Mining of atomic minerals

**(c)** Atomic energy

***4.*Globalization:**

Literally speaking Globalisation means to make Global or worldwide, otherwise taking into consideration the whole world. Broadly speaking, Globalisation means the interaction of the domestic economy with the rest of the world with regard to foreign investment, trade, production and financial matters.

**Steps taken for Globalisation:**

**Following steps are taken for Globalisation:**

**(i) Reduction in tariffs:**

Custom duties and tariffs imposed on imports and exports are reduced gradually just to make India economy attractive to the global investors.

**(ii)** **Long term Trade Policy:**

Forcing trade policy was enforced for longer duration.

**Main features of the policy are:**

**(a)** Liberal policy

**(b)** All controls on foreign trade have been removed

**(c)** Open competition has been encouraged.

**(iii)** **Partial Convertibility of Indian currency:**

Partial convertibility can be defined as to convert Indian currency (up to specific extent) in the currency of other countries. So that the flow of foreign investment in terms of Foreign Institutional Investment (FII) and foreign Direct Investment (FDI).

**This convertibility stood valid for following transaction:**

**(a)** Remittances to meet family expenses

**(b)**Payment of interest

**(c)** Import and export of goods and services.

**(iv) Increase in Equity Limit of Foreign Investment:**

Equity limit of foreign capital investment has been raised from 40% to 100% percent. In 47 high priority industries foreign direct investment (FDI) to the extent of 100% will be allowed without any restriction. In this regard Foreign Exchange Management Act (FEMA) will be enforced.

If the Indian economy is shining at the world map currently, its sole attribution goes to the implementation of the new economic policy in 1991.

# What are the Economic Reforms in India since 1991?

The process of economic reforms was started by the government of India in 1991 for taking the country out of economic difficulty and speeding up the development of the country. The centre of economic reforms has been liberalisation, privatisation and globalisation these three terms are explained as follows:

**(A)** **Liberalisation:**

Liberalisation means to unshackle the economy from bureaucratic cobweb to make it more competitive. Following are its chief features:

(i) To do away with the necessity of having a license for most of the industries

(ii) Freedom in determining the scale of business activities

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(iii) Removing restrictions for the movement of goods and services from one place to another

(iv) Freedom to fix the prices of goods and services

(v) Reduction in the rate of taxes

(vi) Freedom from unnecessary control over economy

(vii) Simplifying import-export procedure

(viii) Simplifying the process of attracting foreign capital and technology.

**(B)** **Privatisation:**

In brief, privatisation means such an economic process through which some public sector undertaking is brought either partially or completely under private ownership.

Broadly speaking, establishing a new enterprise in private sector instead of public sector is also privatisation. Not only this, depriving public sector of the job of production which was earlier reserved for it or transferring its production, without depriving it, to the private sector also amounts to privatisation. Its chief features are given below:

(i) Reducing the role of public sector and increasing the role of private sector

(ii) Reducing fiscal burden of the government

(iii) Reducing the size of the government machinery

(iv) Speeding up economic development

(v) Improving management of enterprises

(vi) Increase in government treasury

(vii)Increasing competition by opening industries reserved for the public sector to the private sector.

**(C) Globalisation:**

Globalisation means integrating the economy with the rest of the world. Following are its chief features:

(i) Free flow of goods and services in all the countries

(ii) Free flow of capital in all the countries

(iii) Free flow of information and technology in all the countries

(iv) Free movement of people in all the countries

(v) The same conflict-solving technique in all the countries.

# 1991: ECONOMIC REFORMS

The strategy of reforms introduced in India in July 1991 presented a mixture of macroeconomic stabilization and structural adjustment. It was guided by short-term and long-term objectives. Stabilization was necessary in the short run to restore balance of payments equilibrium and to control inflation. At the same time changing the structure of institutions themselves through reforms was equally important from long term point of view.

The new government moved urgently to implement a programme of macroeconomic stabilization through fiscal correction. Besides this, structural reforms were initiated in the field of trade, industry and the public sector.

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| PM PV Narasimna Rao with Finance Minister Manmohan Singh and others |
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**Objective of Reforms**

As per the Discussion Paper on Economic Reforms brought out by the Ministry of Finance in July 1993, the objectives of the reforms were:

“…to bring about rapid and sustained improvement in the quality of the people of India. Central to this goal is the rapid growth in incomes and productive employment… The only durable solution to the curse of poverty is sustained growth of incomes and employment… Such growth requires investment: in farms, in roads, in irrigation, in industry, in power and, above all, in people. And this investment must be productive. Successful and sustained development depends on continuing increases in the productivity of our capital, our land and our labour.

Within a generation, the countries of East Asia have transformed themselves. China, Indonesia, Korea, Thailand and Malaysia today have living standards much above ours… What they have achieved, we must strive for.”

**Major Steps in the 1991 Reforms**

The major policy initiatives taken by the Government to fundamentally address the balance of payments problem and the structural rigidities were as follows:

* **Fiscal Reforms:** A key element in the stabilization effort was to restore fiscal discipline. The data reveals that fiscal deficit during 1990-91 was as large as 8.4 percent of GDP. The budget for 1991-92 took a bold step in the direction of correcting fiscal imbalance. It envisaged a reduction in fiscal deficit by nearly two percentage points of GDP from 8.4 percent in 1990-91 to 6.5 percent in 1991-92.

The budget aimed at containing government expenditure and augmenting revenues; reversing the downtrend in the share of direct taxes to total tax revenues and curbing conspicuous consumption. Some of the important policy initiatives introduced in the budget for the year 1991-92 for correcting the fiscal imbalance were: reduction in fertilizer subsidy, abolition of subsidy on sugar, disinvestment of a part of the government’s equity holdings in select public sector undertakings, and acceptance of major recommendations of the Tax Reforms Committee headed by Raja Chelliah. These recommendations aimed to raise revenue through better compliance in case of income tax and excise and customs duties, and make the tax structure stable and transparent.

* **Monetary and Financial Sector Reforms:** Monetary reforms aimed at doing away with interest rate distortions and rationalizing the structure of lending rates.

The new policy tried in many ways to make the banking system more efficient. Some of the measures undertaken were:

* + Reserve Requirements: reduction in statutory liquidity ratio (SLR) and the cash reserve ratio (CRR) in line with the recommendations of the Narasimham Committee Report, 1991. In mid-1991, SLR and CRR were very high. It was proposed to cut down the SLR from 38.5 percent to 25 percent within a time span of three years. Similarly, it was proposed that the CRR br brought down to 10 percent (from the earlier 25 percent) over a period of four years
	+ Interest Rate Liberalisation: Earlier, RBI controlled the rates payable on deposits of different maturities and also the rates which could be charged for bank loans which varied according to the sector of use and also the size of the loan. Interest rates on time deposits were decontrolled in a sequence of steps beginning with longer term deposits, and liberalisation was progressively extended to deposits of shorter maturity
	+ Greater competition among public sector, private sector and foreign banks and elimination of administrative constraints
	+ Liberalisation of bank branch licensing policy in order to rationalize the existing branch network
	+ Banks were given freedom to relocate branches and open specialized branches
	+ Guidelines for opening new private sector banks
	+ New accounting norms regarding classification of assets and provisions of bad debt were introduced in tune with the Narasimham Committee Report
* **Reforms in Capital Markets:** Recommendations of the Narasimham Committee were initiated in order to reform capital markets, aimed at removing direct government control and replacing it with a regulatory framework based on transparency and disclosure supervised by an independent regulator. The Securities & Exchange Board of India (SEBI) which was set up in 1988 was given statutory recognition in 1992 on the basis of recommendations of the Narasimham Committee. SEBI has been mandated to create an environment which would facilitate mobilization of adequate resources through the securities market and its efficient allocation.
* **Industrial Policy Reforms:** In order to consolidate the gains already achieved during the 1980s, and to provide greater competitive stimulus to the domestic industry, a series of reforms were introduced in the Industrial Policy. The government announced a New Industrial Policy on 24 July 1991. The New Industrial Policy established in 1991 sought substantially to deregulate industry so as to promote growth of a more efficient and competitive industrial economy. The central elements of industrial policy reforms were as follows:
	+ Industrial licensing was abolished for all projects except in 18 industries. With this, 80 percent of the industry was taken out of the licensing framework.
	+ The Monopolies & Restrictive Trade Practices (MRTP) Act was repealed to eliminate the need for prior approval by large companies for capacity expansion or diversification.
	+ Areas reserved for the public sector were narrowed down and greater participation by private sector was permitted in core and basic industries. The new policy reduced the number of areas reserved from 17 to 8. These eight are mainly those involving strategic and security concerns. (Example, railways, atomic energy etc.)
	+ The policy encouraged disinvestment of government holdings of equity share capital of public sector enterprises.
	+ The public sector units were provided greater autonomy and professional management that could be helpful for generating reasonable profits, through an MOU(Memorandum of Understanding) between the enterprise and the concerned Ministry, through which targets that the enterprise had to achieve were set up
* **Trade Policy Reforms:** Under trade policy reforms, the main focus was on greater openness. Hence, the policy package was essentially an outward-oriented one. New initiatives were taken in trade policy to create an environment which would provide a stimulus to export while at the same time reducing the degree of regulation and licensing control on foreign trade.

The main feature of the new trade policy as it has evolved over the years since 1991 are as follows:

* + Freer imports and exports: Prior to 1991, in India imports were regulated by means of a positive list of freely importable items. From 1992, imports were regulated by a limited negative list. For instance, the trade policy of 1 April 1992, freed imports of almost all intermediate and capital goods. Only 71 items remained restricted.
	+ Rationalization of tariff structure and removal of quantitative restrictions: The Chelliah Committee’s Report had suggested drastic reduction in import duties. It had suggested a peak rate of 50 percent. As a first step towards a gradual reduction in the tariffs, the 1991-92 budget had reduced the peak rate of import duty from more than 300 percent to 150 percent. The process of lowering the customs tariffs was carried further in successive budgets.
	+ Trading Houses: The 1991 policy allowed export houses and trading houses to import a wide range of items. The Government also permitted the setting up of trading houses with 51 percent foreign equity for the purpose of promoting exports. For instance, under the 1992-97 trade policy, export houses and trading houses were provided the benefit of self-certification under the advance license system, which permits duty free imports for exports.
* **Promoting Foreign Investment:** The government took several measures to promote foreign investment in India in the post-reform period. Some of the important measures are:
	+ In 1991, the government announced a specified list of high technology and high-investment priority industries wherein automatic permission was granted for foreign direct investment (FDI) up to 51 percent foreign equity. The limit was raised to 74 percent and subsequently to 100 percent for many of these industries. Moreover, many new industries have been added to the list over the years.
	+ Foreign Investment Promotion Board (FIPB) has been set up to negotiate with international firms and approve direct foreign investment in select areas.
	+ Steps were also taken from time to time to promote foreign institutional investment (FII) in India.
* **Rationalization of Exchange Rate Policy:** One of the important measures undertaken to improve the balance of payments situation was the devaluation of rupee. In the very first week of July 1991, the rupee was devalued by around 20 percent. The purpose was to bridge the gap between the real and the nominal exchange rates that had emerged on account of rising inflation and thereby to make the exports competitive.

The 1991 economic reforms were focused primarily on the formal sector, and as a result, we have seen significant boom in those areas that were liberalized. Sectors such as telecom and civil aviation have benefited greatly from deregulation and subsequent reforms. However, liberalisation and economic reforms still have a long way to go, especially for the informal sector—including the urban poor who hold jobs as street vendors or rickshaw pullers, the agricultural sector, Micro, Small and Medium Enterprises (MSMEs) and tribals. The slow growth and stagnation in these sectors which have not seen any reform further highlights the significant role of the 1991 reforms in helping India’s economy become what it is today.