Class Notes

Class: XII	Topic Unit II- Need for Economic reforms
Subject: ECONOMICS	

After forty years of planned development, in 1990s India was able to achieve a strong industrial base and became self-sufficient in the production of food grains. Nevertheless, a major segment of the population continued to depend on agriculture for its livelihood. While public sector enterprises became the breeding Centers of corruption and inefficiencies,private sector failed to modernize or diversify.

In 1991, a crisis in the balance of payments led to the introduction of economic reforms in the country.

Economic Reforms refer to the fundamental changes that were launched in 1991 with the plan of liberalising the economy and to quicken its rate of economic growth. The Narasimha Rao Government, in 1991, started the economic reforms in order to rebuild internal and external faith in the Indian economy.

It was based on the assumption that market forces would steer the economy into the path of growth and development.Economic reforms were initiated in 1991 because of the following reasons:

The reforms intended at bringing in larger cooperation of the private sector in the growth method of the the Indian economy. Policy changes were proposed with regard to technology up gradation, industrial licensing, removal of restrictions on the private sector, foreign investments and foreign trade. The essential features of economic reforms are – Liberalisation, Privatisation and Globalisation, commonly known as LPG.

1. Fall in foreign exchange reserve : As imports grew faster than exports India's foreign exchange reserve fell too low in 1990-91 and it was insufficient to pay for an import bill for 2 weeks and to pay the interest that needs to be paid to the international lenders. So Government had to think about policy of liberalisation. Govt. had to mortgage Gold reserves with the world bank to discharge its foreign debt servicing obligations. So Government had to think about policy of liberalisation.

2.Adverse balance of payments resulted in repayment crisis : The difference between total exports and imports of a country in called Balance of Payments. total imports exceed total exports, problem of adverse balance of payments arise. Though incentives are given for export promotion yet the desired results cannot be achieved. It is due to the fact that our export goods could not compete in price and quality. To cover the balance of payment deficit large amount of foreign loans had to be obtained .So liability of loan and its interest payment went on increasing. It made balance of payments further adverse.

3.Mounting fiscal deficit : Due to increase in non- development expenditure fiscal deficit of the Government had been increasing. To cover the fiscal deficit, the Government has to raise loans and pay interest on it.. In 1991 interest liability became 36.4% of total govt. expenditure. The Government was caught in debt trap. So Government had to resort to economic reforms.

4.Failure of public enterprises:-Except for few PSUs,the overall performance of PSUs was very disappointing. These couldn't perform well due to political interference and became big liability for Government.

5.Gulf crisis increased crude oil prices which negatively affected BOP. In 1990-91, war in Iraq broke, and this led to rise in petrol prices. The flow of foreign currency from Gulf countries stopped and this further aggravated the problem.

6.Rise in prices : Inflation rate increased from 6.7% to 16.7%.Prices of many essential goods rose sharply. Main reason for inflation was rapid increase in money supply. It was due to deficit financing

7.Inefficient management of the Indian Economy :

- Government was not able to generate sufficient revenue from internal sources such as taxation,running of public enterprises etc.
- Government expenditure began to exceed its revenue by such large margins that it became Unsustainable
- At times ,the foreign exchange borrowed from other countries and international financial institutions was spent on meeting consumption needs.

Crisis of 1991 : India was forced to take financial help from IMF and World Bank

To manage the economic crisis of 1991,Indian government approached the International Bank for Reconstruction and Development (IBRD) ,popularly known as World Bank and the International Monetary Fund (IMF) and received $ 7 Billion as loan.

For availing the loan, these international agencies expected India to liberalise and open the economy by

- Removing the restrictions on private sector
- Reducing the role of government in many areas
- Removing trade restrictions between India and other countries

India agreed to the conditionalities of the World Bank and IMF and announced the **New Economic Policy**