

Indian Economy: Some Contemporary Perspectives
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Lecture-04
Indian Economy: Economic Planning 4

Okay, so welcome back. We are now going to talk about the new aspects of India's industrialization policy. So, now we will be having a New Industrial Policy that was introduced in 1991. So, this particular policy has a special significance in India's economic history. And that is why it is really important to note about how we can understand the different policy measures that were undertaken. So, these are the drastic measures. So, for the first time Government of India had gone for such type of measures.

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○ Indian Economic Development: Some Historical Perspectives

- **India's 1991 Crisis?**
 - In 1990-91, India experienced large Current Account Deficit (CAD) due to following reasons:
 - India's political instability
 - After Congress refusal, Janata Dal formed the coalition government under V.P. Singh
 - Caste and religious disputes overshadowed the economic progress.
 - A caretaker govt. was put in place and election was declared in May 1991.
 - Rajiv Gandhi was assassinated on May 21, 1991, created further uncertainty and gloomy outlook for economic expansion.

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So, before that, I would like to highlight one, I will come back to this this particular slide when we will discuss the post 1990-91 scenario. So, in this particular context, there is a lot of talk about what is 1991 crisis that India had to face. So, there was a balance of payment crisis/ Balance of payment crisis started with some reasons, it was not just that we were not doing good and we had our own domestic conditions. Though domestic conditions were also responsible, but it is not just the domestic conditions, it is outside conditions also that were worth examining. So, that is why it is important that we should at least try to understand that what is 1991 crisis.

So, in most of the government exams it is sometimes asked that explain the reasons of 1991 balance of payment crisis of India. People normally think that it just the balance of payment crisis, but you have to understand the underlying reasons that what were the underlying reasons why we did not do well, despite having so many dynamic industrialization measures that we had taken, there were a lot of emphasis on external side, there were a lot of emphasis on the domestic side, we were also looking at redistribution measures.

Despite these measures, we were not able to do and we ended up having a situation where we were about to default. So, we were about to default on external loans, external debt, and that would have been a disaster for the country. There was a whole lot of debate on that how we avoid it.

So, in 1991, India experienced in terms of balance of payment current account deficit crisis. It happened because of India's political instability, because at that time in the center, when Congress was in power, at that time when they came back they were not able to form the government with full majority, they declined with forming the government with collusion. Then the alternative governments were formed, alternative governments took some measures, extreme measures, and these measures backfired and then there was an issue of law and order.

And further, we had the assassination of Mr. Gandhi and then these uncertainties helped in terms of deteriorating the growth outlook of the country. So, India's political instability was one that after Congress' refusal when Janta Dal formed the collusion government and then at that time there was implementation of Mandal Commission recommendation also gave some kind of constitutional right in education and employment to the scheduled caste, scheduled tribes and other backward classes. So, that was also not easily accepted and there was a law and order issue.

And that also resulted in some kind of political instability at the center. So, ultimately, the government of VP Singh and CP Chandrasekhar was dwindled. And then the new date of election was announced, it was May 1991. And then in May 1991, Mr. Rajiv Gandhi was assassinated and after that there was a whole lot of political unfavorable developments happening, so this also added to our shock that we had.

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- **India's 1991 Crisis?**
 - In 1990-91, India experienced large current deficit due to following reasons:
 - Geopolitical crisis in the middle-east and its impact on the global oil supply.
 - India's import bill increased from 2 billion USD to 5.7 billion USD.
 - USSR's collapse and its adverse effect on exports.
 - Grim global economic outlook, growth declined from 4.5% to 2.5% during 1988-1991.
 - US also had the similar outlook; growth fell from 3.9% in 1988 to 0.8% in 1990.

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And apart from these domestic reasons, there were also external reasons. What were those external reasons? So external reasons were, first was the geopolitical crisis, the Gulf War. So, Iraq attacked Kuwait and Kuwait had a support from U.S. and allies, and then it led to the big war situation in the Gulf region. And this resulted in the global oil price increase.

Once the global oil price increased, the bill of import at that time, the petroleum products import bill increased from 2 billion Dollar to 5.7 billion Dollar. That also resulted in a whole lot of debate and discussion that how we will be able to survive. And thankfully, and at that time we had remittances received from Middle East countries, those Indians, our Indian own population working in those countries, they were also sending back money in terms of remittances. But because of these uncertainties due to Gulf War, people were evacuated and there was a huge fall in remittances, so that also become one of the reasons.

And then you have a USSR collapse, it was one of the largest trading partners, major products, mostly agriculture based and the textile and all. The USSR was a major market for India. And since the collapse of USSR as one of the trading partners, it also created a big shock for the external earnings, exchange earnings, and that is why it also created extra burden on the government.

Then we had a grim global economic outlook because of this USSR disintegration, and then we had we had a Gulf War, oil price upheavals. These unfavorable developments led to one more, it became a global economic shock. And because of that, global growth declined from 4.5 percent to 2.5 percent during 1988-1991. So, the economic outlook of global economy was also not that good.

U.S. was also one of the major trading partners and this U.S. trading partner we had the fall. So, U.S. also did not do well, it reported the GDP growth of only 0.8 percent, so that also resulted in some kind of export decline for India. So, these are the external shocks, these were not in the hands of the government. So, these shocks were completely coming from outside.

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- **India's 1991 Crisis?**
 - In 1990-91, India experienced large current deficit due to following reasons:
 - Credit rating agencies downgraded the economic outlook of the economy.
 - At the end of March 1990, India's had forex reserves to meet its two months of import requirements.
 - CAD increased from Rs. 11,350 crores in 1989-90 to Rs. 17,350 in 1990-91.

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Then subsequent or I would say consequently, most of the development that we saw, after these unfavorable events, we saw against India's economy. Moody's downgraded the India's rating below investment levels, so that was also one shock for the global investors. At the end of March 1990, India had only a 1 billion Dollar to meet, in somewhere in some textbook you find that India had the money to meet the import requirement of only two weeks, somewhere you find two months. Keeping aside, it was just 1 billion Dollar that India had at that time.

The current account deficit increased from Rs. 11,350 crores in 1989-90, to Rs. 17,350 crores in 1990-1991. So, you can say that within the span of just a one year we saw such a dramatic

change. Fiscal deficit also went up, it was around 8.4 percent and that was quite unsustainable keeping in mind that India's was one of the developing economy or just about to fall in that domain.

So, this 1991 crisis, if somebody asks you that what was the 1991 crisis, then you should be able to tell all these reasons. If you are attempting any exam, wherever you are supposed to explain, you should explain it in this way.

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The slide is titled "Indian Economic Development: Some Historical Perspectives" and focuses on "India's 1991 Crisis". It lists immediate rescue measures taken by Prime Minister Narasimha Rao and Finance Minister Dr. Manmohan Singh. The measures include a stabilization program with expenditure cuts and currency devaluation, and a two-stage devaluation of the currency against major international currencies in two strands: 7% to 9% on July 1, 1991, and 11% on July 3, 1991. The slide also includes a source citation and a footer with the text "INDIAN ECONOMY: SOME CONTEMP. PERSP." and a page number "35".

○ Indian Economic Development: Some Historical Perspectives

- India's 1991 Crisis
 - Immediate rescue measures
 - The Prime Minister Narasimha Rao and the Finance Minister Dr. Manmohan Singh took decisive measures:
 - They launched the stabilization program by cutting down on expenditures and hence fiscal deficits and a currency devaluation.
 - Government devalued the currency against major international currencies in two strands
 - 7% to 9% on first July 1, 1991
 - Again 11% on July 3, 1991
 - Popularly known as '*two-stage devaluation*'

Source: Ramesh, Jairam. (2015) '*To the Brink and Back: India's 1991 story*', Rupa Publications, India.

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The immediate rescue measure was that after these political developments, after the assassination of Mr. Gandhi, then we had a general election and then we had Prime Minister Narsimha Rao taking over, and then finance minister was Dr. Manmohan Singh. These two people took over and then they had a challenge of relieving the economy from these shocks.

At that time, India had to resort to all those multilateral institutions for extra loan and these multilateral institutions I had, for example, IMF had some kind of agreement that you will be going for a structural adjustment program, which is completely a market-oriented program, you have to open the economy on the terms and condition of these international monetary fund. And the World Bank also helped India, but it was not that much, that generous. Then India also resorted to Asian Development Bank, and so Asian Development Bank also helped.

IMF in the beginning had given around 2.2 billion Dollar support under SDR, special drawing rights, but that was not sufficient. Then the Government of India had to sell gold. And then at that time, when CP Chandrasekhar was Prime Minister, at that time also there was a lot of hue and cry that why India had to sell huge amounts of gold in the international market. And at that point of time it was also discussed that why, despite being the adverse scenario, the political uncertainties were not in favor, why the politician at that time they did not think about thinking about India's economy.

So, at that time government had gone for heavy expenditure cut, there was an expenditure cut across and that is why they were able to maintain the fiscal deficit. There was one controversy that was very much popular at that time, that was the devaluation of Indian rupee. The market sentiments were not really in favor and that is why the investors were feeling really low about it, and even though the equity market or the stock market was also not that much doing good.

But one instance of the development that was quite popular at that time was the devaluation of Indian currency. In the book, Jairam Ramesh, his book, *To the Brink and Back: India's 1991 Story*, he mentioned that there was some kind of difference between that time Finance Minister and the Prime Minister, and there was some miscommunication between the central bank and the Finance Minister, because of that the rupee was devalued two times, because Finance Minister was in favor of rupees devaluation and the Prime Minister was not in favor.

So, at that point in time government devalued the Indian rupee against all the major international currencies, and it was 7 percent to 9 percent on July 1, 1991, and again 11 percent on July 31, 1991. And this is what is called two stage devaluation. So, two stage devaluation was that first it was done on July 1, and immediately after one day, on July 3 again the rupee was devalued.


It was meant to expand the export or to boost the export, so that if devalue your currency then, of course, your domestically produced goods which are going to be exported, they will be cheaper in the international market, these goods will be more competitive. And as a result, you will have foreign exchange earnings.

But in case of India, it has never been the case that when we have devalued, it has resulted in higher exports. Even right now when we have rupee always going above Rs. 70, so we have the

depreciation, heavy depreciation, but still our export is not going in that direction, which we expected.

There is a whole lot of debate going on about the Aatmanirbhar Bharat and we are thinking of producing or going for import substitution. But how long this particular policy will be realized, it is some kind of long-term measure, so maybe after five to 10 years we may have a better scenario to look at.

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- India's 1991 Crisis
 - Immediate rescue measures
 - India sought financial assistance from multilateral institutions including IMF, World Bank and ADB.
 - Most of the measures related to industrial sector reforms were announced in the budget on July 24, 1991.

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So, in international financial assistance from multilateral institutions, including IMF, World Bank, ADB, most of the measures related to the industrial sectors reforms were announced in the budget of July 24, 1991, when Manmohan Singh had presented the budget. And since it was a midterm kind of issues, so that is why the budget was presented on July 24.

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- **New Industrial Policy -1991**
 - The New Industrial Policy (NIP) has a special place in the Indian economic history as it ushered a new era of economic reforms. Some of the broad measures were:
 - **End of License Raj or Red Tapism:** NIP had almost abandoned the industrial licensing system. Only 13 sectors were eligible for industrial licensing.
 - **Focus on the efficiency of PSUs:** NIP took restructuring measures and loss-making PSUs were up for disinvestment (through *Board for Industrial and Financial Reconstruction*) and even sold to private sector. PSUs were given more autonomy in their decision-making.
 - **Private sector entry to industrial sector:** Except atomic, mining and railways, all other sectors were eligible for private sector entry. This step is often known as 'Industrial deregulation'.
 - **Promotion to foreign investment:** Rules were relaxed to attract foreign investment and foreign technology. Foreign Direct Investment and Foreign Portfolio Investment were allowed.
 - **MRTA Act was abolished.**

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Then we will go back to what we have the New Industrial Policy. At that time, the New Industrial Policy has a lot of significance in India's economic history, even in contemporary context, because some of the policy measures were really, really useful. And we are still continuing in contemporary era. For example, disinvestment measures were taken and disinvestment measures were quite useful.

So, the New Industrial Policy, so Government of India had set up only 13 sectors reserved for industrial licensing, which means that these industries were of a strategic nature, they were also environmentally sensitive. So, government had reserved these for industrial licensing, mostly defense and infrastructure and environmentally sensitive sectors that we have.

Focus on the efficiency of PSUs. So, keeping in mind what we have discussed, the Sen Committee, here we found that on the similar lines the Government of India took measures to highlight that how they can think about measuring this or to bring the efficiency in the PSU. So, this was decided.

So, NIP took restructuring measures and loss-making PSUs were set up for disinvestments. So, for the first time we had gone for disinvestment, though in the beginning it was not very easy for the government to convince PSUs that if you are not doing good or if you are a sick unit, then you will be simply being sold to private sector because it was not easy.

But after a few years, we realized that it was success, because we had the BALCO case, where we had gone for disinvestment in BALCO. And then government also took measures in terms of restructuring that if you are not doing good then you have to bear the losses and government will not give you the 100 percent support.

At the same time, PSUs were also given autonomy in terms of procurement, in terms of expansion, in terms of labor laws, so some kind of freedom of autonomies were given to these PSUs so that they can compete with the internationally recognized firms, international market.

Private sector entry into the industrial sector, in this except for atomic energy and some strategic sectors, private sectors entry was given to almost all, and even states were directed that you facilitate, you should have the sufficient infrastructure, regulatory support, so that there will not be any kind of trouble for these firms. So, private sector was complete going for. So, this is called industrial deregulation, because this is where the chances were that all these private firms may have better time.

Promotion to foreign investment rules were relaxed to attract foreign investment, even if you want to import foreign technology for your import, so as an import substitution. So, imports are always not bad, if you are importing technology using it to produce output, exporting back again in the international market, it is considered always better. So, rules were relaxed.

Foreign direct investment and foreign portfolio investment. So, foreign direct investment and foreign portfolio, foreign direct investment comes with certain riders that you cannot withdraw if you are investing in real activity, it may come through joint venture, it may come through two firms coming together, it may come through setting up entirely new firm. And once you invest in real activities, you have a certain laggard period. So, it will not be easy to move out immediately in case of FDI.

FII's, FII's are basically institutional investors investing in equity market and whenever they want to get out of the market, they are allowed to do so, there will not be interference coming from the government. But there are checks only on FII's to invest in government securities market. When government, they cannot hold the government bonds, because of the reasons that we have the sovereign nation and national security comes into picture.

At the same time, the foreign institutional investors will also not be allowed to buy the shares of a particular company up to a certain extent, so 10 percent, 5 percent whatever is the norm, Government of India sets every time and they revisit on interval to see that whether the norms are being followed or not.

MRTTP Act was completely abolished here, by this New Industrial Policy 1991. So now, if you compare from the second Five Year Plan that we had, the industrial revolution of 1956 that we had, at that time we were thinking going for capacity creation, we were investing mostly in core sectors, the Mahalanobis model was supportive of the idea that the core sector should be in the hands of government even Bombay Plan at that time had supported that.

But after 1980s, we found that the idea of socialism did not work completely in case of India and government also had a very easy going with the private sector, because you just have to facilitate open and then they will be doing it, ultimately you will have the better growth scenario.

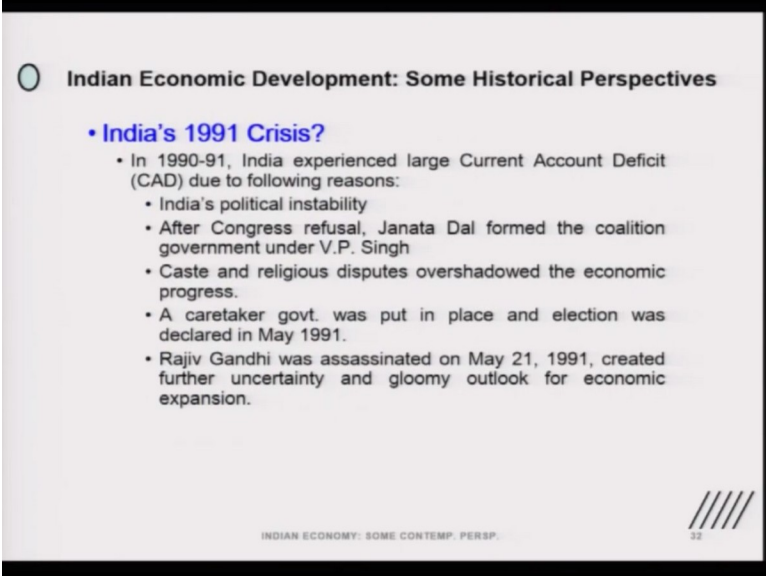
But the major challenge came, but it should not be or we as an economy, we should not give free hand to the government that since the public sector were doing not good and that is why you sold the public sector and you had gone for disinvestment. It was also that government was also finding it difficult to interact with the PSUs to bring change in these rigid intrusions. And that is why the PSUs are also somewhere or at that point of time PSUs were also responsible for their debacle.

So, that is why it is important to note that privatization is not the only solution that we always have in mind, we should have the robust government structure where we can think about. And in some cases, we may not agree with this viewpoint, but in some countries, state-owned enterprises are doing much better than privately owned enterprises. And they have a better say, they have a better investment strategy, they have better welfare norms, they have better labour laws and even they have a better financial management.

So, keeping that in mind, the leakages that we saw, we saw that it will not be able to sustain, the New Industrial Policy had a lot of impact on the landscape that we have these days, whatever we seen them in terms of industrial structure.

So, one of the objectives that I wanted to convey by doing this course, the Indian economy in contemporary perspective is that, we should not just have the idea of what was going on, we should be also able to analyze in the historical context and with the contemporary context that how and where we should be doing and where we missed the important moments.

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- **India's 1991 Crisis?**
 - In 1990-91, India experienced large Current Account Deficit (CAD) due to following reasons:
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 - A caretaker govt. was put in place and election was declared in May 1991.
 - Rajiv Gandhi was assassinated on May 21, 1991, created further uncertainty and gloomy outlook for economic expansion.

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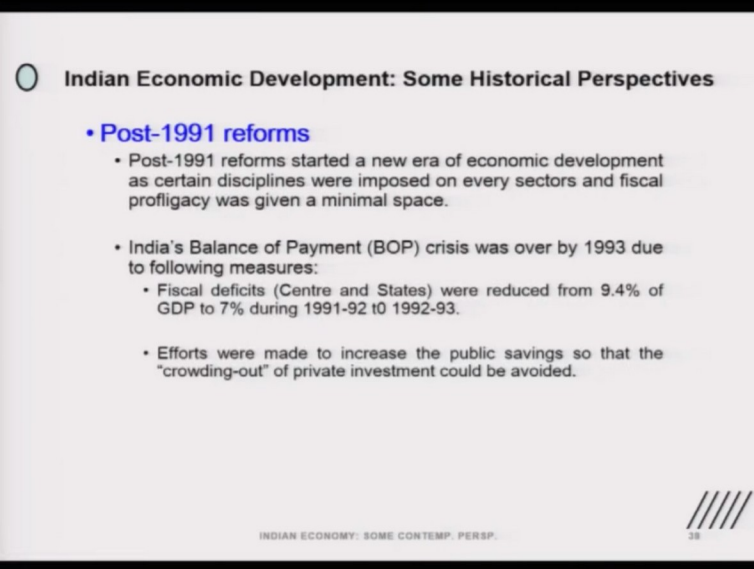
So, this was the case, these things we have already discussed. So, now, we are going for post-1991 reforms. So post-1991 reforms are really important in the light of new industrialization policy that we had.

So, post-1991 reform period started with the new economic development, new set of reforms. India's balance of payment crisis was over by 1993 due to the following measures. Fiscal deficits, including states, were reduced from 8.5 percent, somewhere it is mentioned 9.5 percent, 9.4 percent of GDP to 7 percent during 1991-1992, to 1992-93.

Efforts were made to increase the public savings which means that if the rate of interest is attractive, of course, people would like to go for saving, and if the government will go for huge amount of issuing debt, which means the bond, then of course the private investment will be completely wiped out because government will offer higher rate of interest, private sector will not be able to compete, private sector investment could be avoided.

The structural measures were taken to address the inefficiencies in the banking, financial and other segments of the economy. So, in the case of banking also we found a structural change happening. So, this was the case.

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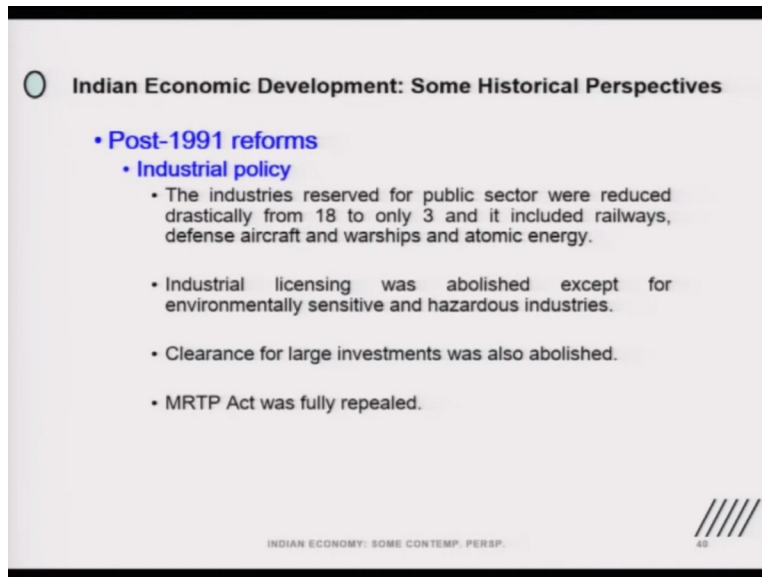
The slide is titled "Indian Economic Development: Some Historical Perspectives" and features a sub-section "Post-1991 reforms". It contains three bullet points: 1) Post-1991 reforms started a new era of economic development as certain disciplines were imposed on every sector and fiscal profligacy was given a minimal space. 2) India's Balance of Payment (BOP) crisis was over by 1993 due to following measures: a) Fiscal deficits (Centre and States) were reduced from 9.4% of GDP to 7% during 1991-92 to 1992-93. b) Efforts were made to increase the public savings so that the "crowding-out" of private investment could be avoided. The slide footer includes the text "INDIAN ECONOMY: SOME CONTEMP. PERSP." and a small logo consisting of four slanted lines.

- **Post-1991 reforms**
 - Post-1991 reforms started a new era of economic development as certain disciplines were imposed on every sector and fiscal profligacy was given a minimal space.
 - India's Balance of Payment (BOP) crisis was over by 1993 due to following measures:
 - Fiscal deficits (Centre and States) were reduced from 9.4% of GDP to 7% during 1991-92 to 1992-93.
 - Efforts were made to increase the public savings so that the "crowding-out" of private investment could be avoided.

And then post-1991 reforms, the Union Budget of 1991-92 incorporated these or took these measures also. What were these measures? These measures were reduction in fertilizer subsidy, abolition of subsidy on sugar, disinvestment of a part of the government's equity holdings on public sector undertakings, which means that government was trying to get rid of loss-making institutions, not the profit making.

The recommendation of tax reform, at that time the Tax Reform Committee, which was headed by Raja Chelliah, at that time this particular committee had recommended for going for major structural change in the tax reforms domain.

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- Post-1991 reforms
 - Industrial policy
 - The industries reserved for public sector were reduced drastically from 18 to only 3 and it included railways, defense aircraft and warships and atomic energy.
 - Industrial licensing was abolished except for environmentally sensitive and hazardous industries.
 - Clearance for large investments was also abolished.
 - MRTP Act was fully repealed.

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So, in the industrial policy post 1991, we had from 18 to 3 industries left for the garment sector, which was defense, and some infrastructure railways and we add environmentally sensitive sectors. So that is what, so we had railways, defense, aircraft, warships and atomic energy.

Industrial licensing was abolished except for environmentally sensitive sectors. Clearance for large investment was also abolished, which means that if you are going for setting up of large industry, for example, a power plant or anything, then you also do not need to get into clearance. MRTP was fully repealed, here again I have mentioned.

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- **Post-1991 reforms**
 - **Industrial policy**
 - Disinvestment commission was set-up in 1991-92 to work-out the disinvestment modalities.
 - Although the pace of very slow in the beginning, it pick-up later. During 1991-92 to 2002-03, only Rs. 78,300 crores was realized.
 - In 1997, Abid Hussain Committee also delisted around 800 products exclusively reserved for small-scale industries.

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Disinvestment commission was set up in 1991-1992, to work out the disinvestment modalities. And it also gave rise to the government and government became also greedy after some point of time, because they thought that instead of paying to them it is better to get money by selling them.

So, these PSUs were sold to the private sector, even in some cases there was a case of compromise that there was a chance that if they would have given some amount of money, these PSUs would have done well, but government took measures because of some or the other reasons. And now, still it is considered as one of the lucrative jobs for the government to go for disinvestment. You simply disinvest and then whatever money you have, you can utilize it.

So, although the pace was very low, so during 1991-1992 to 2002-2003, the amount was Rs. 78,300 crores. In 1997, Abid Hussain Committee also delisted 800 products further and it was made possible for this.

Now, after this we will also spend some more time on understanding the post 1991 reform because now we are quite comfortable with India's economic structure, India's economic history. And now I think we will be able to analyze better in terms of recent developments, contemporary developments plus the pre and post reform period.

So, in the post reform period we will be spending some more time, I will be taking one more session on that. And then after that we will be moving to the recent developments that we have. Thank you. Thank you. Thank you so much.