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Subject: GS 3

Syllabus: Indian Economy and Agriculture

Questions

Q1. What were the key goals and initiatives of the New Economic Policy of 1991? Examine the reforms' significant accomplishments and drawbacks during the previous 32 years.
(250 words) 15

Q2. What is Capital Account Convertibility (CAC)? Discuss the benefit it will entail if India goes for full CAC? Also enumerate the issues involved in CAC. (150 words) 10

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Model Structures

Q1. What were the key goals and initiatives of the New Economic Policy of 1991? Examine the reforms' significant accomplishments and drawbacks during the previous 32 years. (15 marks)

Introduction:

- The New Economic Policy of 1991 refers to economic liberalisation or relaxation in the import tariffs, deregulation of markets or opening the markets for private and foreign players, and reduction of taxes to expand the economic wings of the country.

Main Body:

Key goals of NEP, 1991:

- Enter into the field of 'globalisation' and make the economy more market-oriented.
- Reduce the inflation rate and rectify imbalances in payment.
- Increase the growth rate of the economy and create enough foreign exchange reserves.

- Stabilise the economy and convert the economy into a market economy by the removal of unwanted restrictions.
- Allow the international flow of goods, capital, services, technology, human resources, etc. without too many restrictions.
- Enhance the participation of private players in all sectors of the economy. For this, the reserved sectors for the government were reduced to just 3.

Major initiatives of NEP, 1991

- **Initiatives for Liberalisation**
  - **Deregulation of the industrial sector**: removal of licences, deregulation of sectors for private entry, removal of price controls, De - reservation commodities meant for small scale industries.
  - **Financial sector reforms**: reduced role of RBI from regulator to facilitator, removal on foreign borrowing limits, foreign investment was allowed, private banks were allowed.
  - **Tax reforms**: rates were lowered for direct and indirect taxes to improve voluntary disclosure and compliance and procedures were simplified.
  - **Foreign exchange reforms:** devaluation of rupee, market determined exchange rates.
- **Initiatives for Privatisation**
  - **Government ownership of private companies was removed** by outright sale of P.S.U or removal of the government from management of these companies.
  - **Disinvestment** which meant selling a part of the equity to the private sector was started as private capital and managerial capabilities could be effectively utilised to improve the working of P.S.Us.
  - P.S.Us were granted status of Navratnas and Maharatnas to grant operational autonomy to them.
- **Initiatives for Globalisation**
  - **Outsourcing became an outcome of Indian policies.** The foreign companies hired cheap Indian talent.

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        - The growth of the IT industry further fueled this. The low wage rates and availability of degree of skill and accuracy also influenced this phenomenon.
    - The World Trade Organization [W.T.O] was founded as a successor to the General Agreement on Trade and Tariff [G.A.T.T] in the Uruguay convention. India was a founder member and has been instrumental in deciding policies.
        - W.T.O aims to reduce tariff and non tariff barriers amongst nations and ensure all countries take advantage of world's trade.

Accomplishments of NEP, 1991:

- **Short Term**
    - Inflation reduced from a peak of 17% in August 1991 to about 8.5% within 2.5 years
    - Forex reserves increased from $1.2 billion in June 1991 to over $15 billion in 1994
    - GDP growth increased from 1.1% in 1991-92 to 4% in 1992-93
    - Fiscal deficit reduced from 8.4% in 1990-91 to 5.7% in 1992-93
    - Exports more than doubled from 1990-91 to 1993-94
- **Long term**
    - **GDP:** Once admonished for its "Hindu rate of growth– post-reforms, India remained the second fastest growing economy in the world, behind China until 2015.
    - **FDI:** except for occasional blips between 1997 and 2000 and 2008 and 2012 – owing to the global economic slowdown. As of 31 March 2016, the country has received a total FDI of $371 billion.
    - **Free flow of capital:** Liberalisation has improved flow of capital into the country which makes it inexpensive for the companies to access capital from investors.
    - **Foreign Reserves:** It was India's dismal state of forex reserves that forced the government to bring in economic reforms.
        - Now, forex reserves are at a record high. In 1991, it stood at just $5.8 billion. As of 2021, the country's forex reserves are at $608 billion.

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- **Stock Market Performance:** Generally, when a country relaxes its laws, taxes, the stock market values also rise.
- **Political Risks Reduced:** Liberalisation policies in the country lessens political risks to investors. The government can attract more foreign investment through liberalisation of economic policies.
- **Diversification for Investors:** In a liberalised economy, Investors get benefit by being able to invest a portion of their portfolio into a diversifying asset class.
- **Impact on Agriculture:** In the area of agriculture, the cropping patterns have undergone a huge modification, but the impact of liberalisation cannot be properly measured.
  - It is observed that there are still all-pervasive government controls and interventions starting from production to distribution for the produce.
- **Impact on exports:** Exports climbed to USD 26.38 billion by the end of that year itself. Recently, India achieved the feat of exporting agri products worth $400bn.
- **Impact on environment:** Due to more connected world environmental laws got strengthened like Kyoto Protocol, Biodiversity act etc.
- **Impact on human development:** India's gross national income per capita has more than doubled since 2005, and the number of "multidimensionally poor" people fell by more than 271 million in the decade since 2005-06 due to economic growth, creation of employment opportunities etc.

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Drawbacks of NEP, 1991:

- **Destabilisation of the economy:** tremendous redistribution of economic power and political power leads to destabilising effects on the entire Indian economy.
- **Impact of FDI in Banking sector:** Foreign direct investment allowed in the banking and insurance sectors resulted in decline of government's stake in banks and insurance firms.
- **Threat from Multinationals:** Prior to 1991 MNC's did not play much role in the Indian economy.
  - Multinationals are quite big and operate in several countries which has turned out to be a threat to local Indian Firms.

- **Technological Impact:** Rapid increase in technology forces many enterprises and small-scale industries in India to either adapt to changes or close their businesses.
- **Rising inequality:** Since 1991, the year of liberalisation, wealth inequality has steadily increased and reached 42.5% in 2020.
  - Oxfam International claimed that in 2021 India's top 1 per cent owned about 77 per cent of the country's wealth.
- **Growth of service sector and Jobless growth:** With just about 25% to more than 50% of GDP, the service sector garnered the most benefit of NEP, 1991.
  - The main contributor in India's GDP is the service sector which is not labour intensive and thus adds to jobless growth.

Way forward:

- **Sustaining Public Expenditure:** In the short term, sustaining public expenditure is a key to reviving growth.
- **Mutually Supportive Reforms:** The 1991 reforms succeeded because they were structured around a core package of mutually supportive reforms.
  - Thus, the need is to move away from a long list of reforms towards a more strategic approach, focussing on the most critical reforms needed immediately.
- **Improving Investment Climate:** Investment is a key source of aggregate demand and economic growth.
  - The policy framework must be supportive of fresh investments so that entrepreneurs are encouraged to take risks.
- **Maruti Model of Disinvestment:** The government should reduce its ownership to 26% in each undertaking, including banks, to strategic partners, like it did under the Maruti disinvestment following 1991 reforms.
- **Multi-stakeholders Approach:** Today's reforms also require much more discussion and consensus-building.
  - The central government needs to work in tandem with state governments and consult different stakeholders impacted by reform decisions.

Conclusion:

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The 1991 reforms helped the economy stave off a crisis and then bloom. It is time to outline a credible new reform agenda that will not just bring GDP back to pre-crisis levels, but also ensure growth rates higher than it had when it entered the pandemic.

Q2. What is Capital Account Convertibility (CAC)? Discuss the benefit it will entail if India goes for full CAC? Also enumerate the issues involved in CAC. (10 marks)

Introduction

- Capital account convertibility (CAC) involves **freedom to convert national currency and financial assets into any foreign currency and foreign assets** for transactions in a capital account. This is done on the basis of the market-determined exchange rate.
- Capital account convertibility as a measure was recommended by **S.S. Tarapore committee** and India has taken few steps in this regard.

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Main Body

Benefits provided by full Capital Account Convertibility:

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- Better lending and borrowing scenario for Indian banks to and from foreign banks in foreign currencies.
- Any debt denominated in foreign currency is easy to manage and this will help Indian businesses when it comes to issuing debt to local Indian investors.
- Easier trade in buying and selling of gold, and offering of gold-based loans with higher or no limit.
- Liquidity in financial markets bodes well for participation of businesses and investors and further infusion of capital for investment.
- Full convertibility will smoothen real time redressal of trade imbalances and current account deficit.
- For improving the flow of foreign capital to ensure a better investment scenario, free flow of capital can be ensured by full convertibility rather than relying on expensive borrowing.

But there are issues involved in full convertibility which has led to events like the 2008 crisis and South Asian crisis. These **issues** include:

- Indian exports are competitive due to current regulations on exchange rates and once these regulations are taken away, there can be a negative impact on balance of trade and exports.
- Full convertibility results in a highly volatile scenario because issues in global situations might result in outflow of foreign funds. Sudden exit of capital results in cascading impact on various sectors of the economy.
- There is a risk of an increase in foreign debt burden because raising foreign debt is easy for businesses which makes them prone to the risk of repayments.
- Full convertibility is effective when robust regulations and infrastructure is in place. But there are some challenges in India like bureaucratic complexities, rising population, import dependency etc.

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Conclusion

- To ensure the negative impacts of full convertibility are minimized, it must be done in a phased manner, fiscal deficit be minimal, issue of NPAs must be addressed and inflation must be moderate.

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