LPG reforms in India

December 10, 2019
Source: *Economic Times*

Manifest pedagogy: LPG reforms of 1991 is a strategic shift in Indian economy which changed the very Nature of Indian reality today. This topic forms the foundation for Indian Economy today. Having a fair idea about the change it brought in Indian economy and international events which lead to it is important for the Mains across disciplines.

Placing it in syllabus: Indian economy and LPG reforms

Static dimensions:

- Nature of Indian economy in the pre reform era
- Factors which led to 1991 economic reforms
- International events associated with Indian reforms

Current dimensions:

- Nature and scope of reforms
- Outcome of the LPG reforms

Content:

Nature of Indian economy in the pre reform era:

Indian economic policy after independence was influenced by the colonial experience, which emphasised on **industrialization under state monitoring, state intervention** in labour and financial markets, a large public sector, **business regulation, and central planning.**

Indian economy was a closed one. Licence Raj was prevalent to set up business in India. The **Indian rupee was inconvertible**e and high tariffs and import licensing prevented foreign goods reaching the market.

The central pillar of the policy was **import substitution**, the **belief that India needed to rely on internal markets for development, not international trade**. There was **restriction of foreign investment and technology** and government controlled finance and capital markets.

There were high duties and taxes with multiple rates and large dispersion. **PSUs were considered as the engine of growth.** There were **restrictions on Foreign Direct Investment (FDI)** and Multinational corporations (MNCs).

Factors which lead to 1991 economic reforms:

- **Rise in Prices:** The **inflation rate increased from 6.7% to 16.7%** due to rapid increase in money supply and the country's economic position became worse.
- **Rise in Fiscal Deficit:** Due to **increase in non-development expenditure** fiscal deficit of the government increased. Due to rise in fiscal deficit there was a rise in public debt and interest. **In 1991 interest liability became 36.4% of total government expenditure.**
- **Increase in Adverse Balance of Payments:** In 1980-81 it was Rs. 2214 crore and rose in 1990- 91 to Rs. 17,367 crores. To cover this deficit **large amount of foreign loans** had to be obtained and the interest payment got increased.
- **Iraq War: In 1990-91, war in Iraq broke, which led to a rise in petrol prices. The flow of foreign currency from Gulf countries stopped and this further aggravated the problem.**
- Dismal Performance of PSUs: These were not performing well due to political interference and became big liability for government.
- Fall in Foreign Exchange Reserves: India's foreign exchange reserve fell to low ebb in 1990-91 and it was insufficient to pay for an import bill for 2 weeks.

International events associated with Indian reforms:

- The **Soviet Union was collapsing** at the time, proving that more socialism could not be the solution for India's ills.
- **Deng Xiaoping had revolutionized China with market-friendly reforms.**
- **1990-91 Iraq war** led to the stoppage of flow of foreign currency from Gulf countries.
- To tide over the Balance of Payment **(BoP) issues**, India borrowed huge amount from **International Monetary Fund (IMF).**
- The **Asian financial crisis of 1997-99** laid India low.
- The **dot-com collapse and global recession of 2001,** and the huge global uncertainty created in the run-up to the **invasion of Iraq in 2003.**
- The **global boom of 2003-08 spearheaded by China.**

Nature and scope of reforms:

India's New Economic Policy was **announced on July 24, 1991 known as the LPG** or Liberalisation, Privatisation and Globalisation model.

- **Liberalization-** It refers to the process of making policies less constraining of economic activity and also reduction of tariff or removal of non-tariff barriers.
- **Privatization-** It refers to the transfer of ownership of property or business from a government to a privately owned entity.
- **Globalization-** It refers to the expansion of economic activities across political boundaries of nation states.

The **main objective** was to plunge Indian economy into the arena of "Globalization" and to give it a new thrust on market orientation. The policy was intended to move **towards higher economic growth rate** and to build sufficient foreign exchange reserves.

It wanted to achieve **economic stabilization** and to convert the economy into a **market economy** by removing all kinds of unnecessary restrictions. The policy aimed at increasing the **participation of private players in all sectors** of the economy.

Salient features of LPG Policy:

- Abolition of Industrial licensing/ Permit Raj
- Public sector role diluted
- MRTP limit goes
- Beginning of privatisation
- Free entry to foreign investment and technology
- Industrial location policy liberalized
- Abolition of phased manufacturing programmes for new projects
- Removal of mandatory convertibility cause
- Reduction in import tariffs
- Deregulation of markets
- Reduction of taxes

Outcome of the LPG reforms:

Positive outcomes:

- **India's GDP growth rate increased.** During 1990-91 India's GDP growth rate was only 1.1% but after 1991 reforms GDP growth rate increased year by year and in 2015-16 it was estimated to be 7.5% by IMF.
- Since 1991, India has firmly established itself as a lucrative foreign investment destination and **FDI equity inflows in India** in 2019-20 (till August) stood at US$ 19.33 billion.
- In 1991 the unemployment rate was high but after India adopted new LPG policy **more employment got generated** as new foreign companies came to India and due to liberalisation many new entrepreneurs started companies.
- **Per Capita income increased** due to an increase in

employment.

- **Exports** have increased and stood at USD 26.38 billion as of October, 2019.

Negative outcomes:

- In 1991, agriculture provided employment to 72 percent of the population and contributed 29.02 percent of the GDP. Now the **share of agriculture in the GDP has gone down drastically to 18 percent.** This has resulted in a lowering the per capita income of the farmers and increasing the rural indebtedness.
- Due to opening up of the Indian economy to foreign competition, **more MNCs are competing local businesses and companies** which are facing problems due to financial constraints, lack of advanced technology and production inefficiencies.
- Globalization has also contributed to the **destruction of the environment** through pollution by emissions from manufacturing plants and clearing of vegetation cover. It further affects the health of people.
- LPG policies have lead to **widening income gaps within the country**. The higher growth rate is achieved by an economy at the expense of declining incomes of people who may be rendered redundant.