CLASS 12 ECONOMICS

INDIAN ECONOMIC DEVELOPMENT

CHAPTER-3

LIBERALISATION, PRIVATISATION AND GLOBALISATION: AN APPRAISAL

TOPIC- LIBERALISATION REFORMS (PART 2)

INSTRUCTIONS:

STEP 1 : Read Liberalisation Reforms from NCERT book "Indian Economic Development".

Learning Objectives
After going through this lesson, you shall be able to understand the following concepts.
• Meaning of Liberalisation
• Features of Liberalisation with Respect to the Various Sectors of the Economy.

The following topics are covered in this lesson:

i. Meaning of liberalisation
ii. Industrial sector reforms
iii. Financial sector reforms
iv. Tax reforms
v. Foreign exchange reforms?External Sector Reforms

STEP 2: Following are the **Main points of the liberalization reforms**.

Meaning of Liberalisation

Liberalisation of the economy means its freedom from direct or physical controls imposed by the government.

Objectives of Liberalisation

The main objectives of liberalisation policy are

- To increase competition among domestic industries.

- To increase foreign capital formation and technology.
- To decrease the debt burden of the country.
- To encourage export and import of goods and services.
- To expand the size of the market.

Economic reforms under liberalisation- In brief

(i) Industrial Sector Reforms
- Abolition of industrial licensing.
- De-reservation of production areas.
- Expansion of production capacity.
- Freedom to import goods.

(ii) Financial Sector Reforms

Liberalisation implied a substantial shift in the role of the RBI from a regulator to a facilitator of the financial sector.

(iii) Fiscal Reforms Fiscal reforms relate to revenue and expenditure of the government.

Tax reforms are the principal component of fiscal reforms. Broadly taxes are classified
- Direct Taxes and
- Indirect Taxes

(iv) External Sector Reforms It include Foreign exchange reforms and Foreign trade policy reforms.

Economic Reforms Under Liberalisation (In detail)

Reforms under liberalisation were introduced in many areas.

Industrial Sector Reforms

The following steps were taken to deregulate the industrial sector:
(i) Abolition of Industrial Licensing: Government abolished the licensing requirement of all industries, except for the five industries, which are
- Liquor
- Cigarettes
- Defence equipment
- Industrial explosives
- Dangerous chemicals, chugs and pharmaceuticals.

(ii) Contraction of Public Sector The number of industries reserved for the public sector was reduced from 17 to 8.. Presently, only three industries are ’ reserved for public sector. They are

- Railways
- Atomic energy
- Defence

(iii) De-reservation of Production Areas The production areas which were earlier reserved for SSI were de-reserved.

(iv) Expansion of Production Capacity The producer's were allowed to expand their production capacity according to market demand. The need for licensing was abolished.

(v) Freedom to Import Capital Goods The business and production units were given freedom to import capital goods to upgrade their technology.

Financial Sector Reforms

The financial sector, including the commercial banks, investment banks and stock exchange operations is controlled by the RBI. RBI controls the commercial banks of the country via various instruments such as Statutory Liquidity Ratio (SLR), Cash Reserve Ratio (CRR), Bank Rate, Prime Lending Rate (PLR), Repo Rate, Reverse Repo Rate, deciding the nature of lending to various sectors, etc. These are those ratios and rates that are fixed by the RBI. It is
mandatory for all the commercial banks to follow or maintain these rates as per the direction of the RBI. All these measures control the commercial banks' operations and also control money supply in Indian economy. The following are reforms undertaken in the financial sector.

a. Shift in role of RBI: With liberalisation, the role of RBI has changed from a controller to a mere facilitator of the operations of the financial sector.This implies that the financial sector was free to make its own decisions on various matters without consulting the RBI. This opened up the gates of financial sector for the private sector.

b. Increasing role of the private sector: The private sector was allowed greater role in the financial sector. A number of private sector banks (both Indian and foreign) were established. Moreover, the limit for foreign investment was increased to 50%. Banks now enjoyed the freedom to set up new branches without prior permission of the RBI.

c. Foreign institutional investment: Foreign Institutional Investors (FII) such as merchant bankers, mutual funds, pension funds were encouraged to invest in India. It should
be noted that despite the reforms, certain functions such as printing of new currency notes, custody of foreign exchange, etc. were still retained with the RBI with the aim of safeguarding the welfare of the nation.

Tax Reforms/Fiscal Reforms

Fiscal reforms refer to the reforms in the taxation and expenditure policy of the government. Some of the reforms taken in this direction are discussed below.

a. Reduction in direct tax rates: Attempts have been made to reduce the tax rates for direct taxes (such as income tax and corporation tax). It was realised that high tax rates encourages evasion of taxes by people. As against this, moderate tax rates encourage saving and investment. In light of this view, as part of the fiscal reforms, the tax rates were lowered.

b. Simplification of tax structure: Prior to the reforms in the year 1991, the structure of tax was very complicated. This scenario consequently resulted in high evasion of tax by the tax payers. Thus, efforts were made to simplify the tax procedures.

c. Reforms in indirect taxes: Reforms were initiated in the indirect taxes with the aim of establishing an integrated national market. Recently, the Goods and Services tax was introduced in july 2017.This is expected to generate additional revenue for the government, reduce tax evasion and create "one nation, one tax and one market".

Foreign Exchange Reforms/External Sector Reforms

External sector reforms include reforms relating to foreign exchange and foreign trade. The following reforms were initiated in this sector

(i) Devaluation of Rupee Devaluation implies a fall in the value of rupee against some foreign currency. In 1991, the rupee was devalued to increase our country's exports and to discourage imports.

(ii) Market determined exchange rate After the devaluation of rupee in 1991, the determination of exchange rate was left to the forces of market (that is, demand and supply). That is, the foreign exchange system was shifted from a fixed exchange rate system to a floating exchange rate regime. Under the flexible exchange rate, the exchange rate is determined by the demand and supply of the foreign exchange.

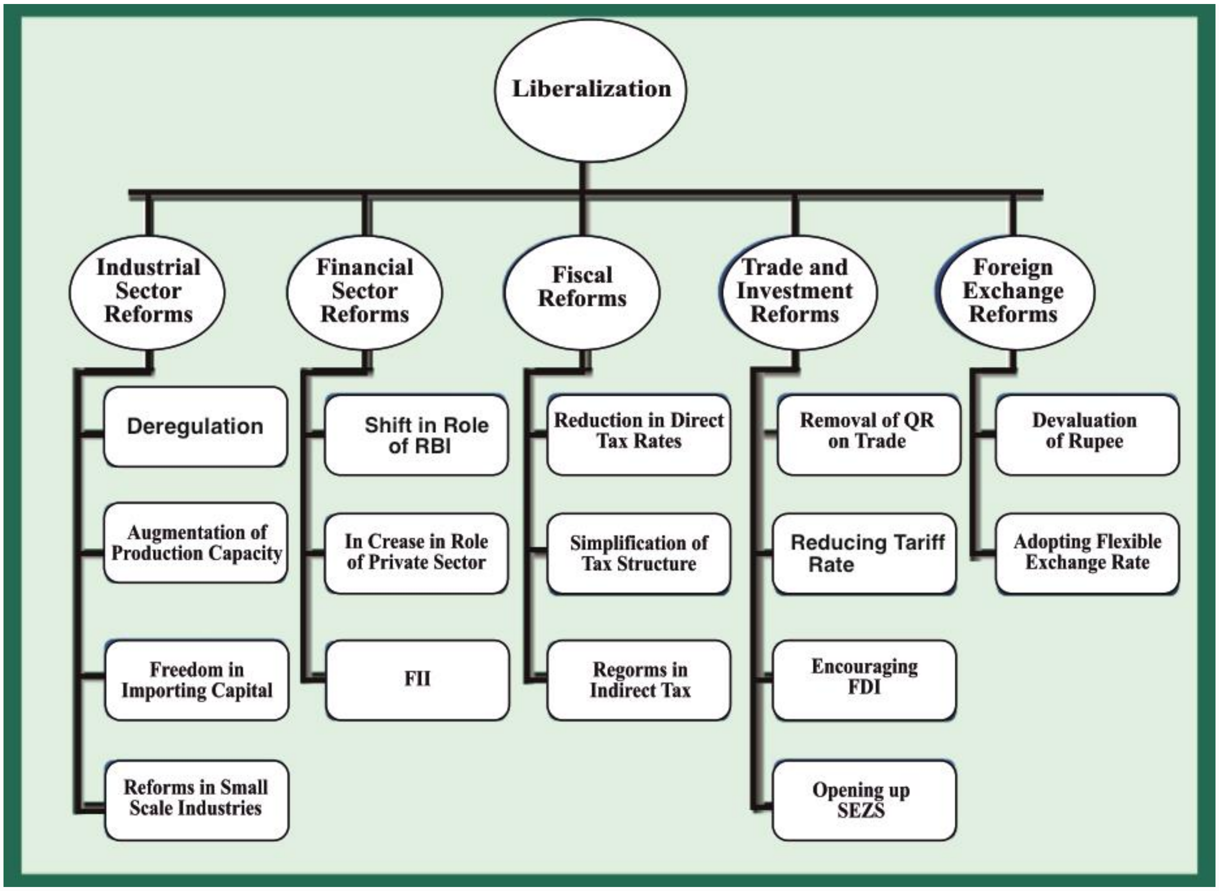
(iii) Other Measures

- Import quotas were abolished.
- Policy of import licensing was almost scrapped.
- Import duty was reduced.
- Export duty was completely withdrawn.

STEP 3 : Watch the video on Liberalisation Reforms through the following link for further understanding and clarity of the topic:

https://youtu.be/GVGBKBODCOQ

STEP-4: Following is the **Mindmap** for this topic:



STEP-5 Attempt the following questions related to the topic:

ASSIGNMENT

Q1 ___________ means removing all unnecessary controls and restrictions like permits, licenses, quotas etc. imposed by the government.
a. Liberalisation b. Privatisation c. Globalization d. None of the above
Q.2- Which of the following reforms are included under liberalisation taken by the government?
a. Industrial Sector Reforms

b. Financial Sector Reforms

c. Tax Reforms

d. All of the above

Q3 The trade reforms were:

a. Removal of quotas
b. Taking away control over foreign exchange use
c. Both a and b
d. None of these.

Q4FDI means:

(a) Forex direct investment

(b) Foreign deregulated investment

(c) Foreign direct investment

(d) Forex deregulated investment

Q5 In _________tax, the liability to pay tax and burden of tax is borne by the same person.

Q6 Tariffs on imports was __________ to enable free trade.

Q7 Devaluation of domestic currency improves the BOP position. True/false(give reason).

Q8 Short –Answer Type questions. (3/4 marks)

(i) Why are tariffs imposed on imports?
(ii) Why did RBI change its role from a controller to facilitator of financial sector in India.
(iii) State any three measures introduced in 1991 to reform the industrial sector in india.
(iv) How were the fiscal reforms able to increase the tax net?
(v) Discuss the trade policy and foreign exchange reforms of 1991.
(vi) What do you understand by the devaluation of rupee?