CBSE Test Paper-02

Chapter 08 Economic Reforms Since 1991

1. The economic reforms were intended to take the Indian economy into three specific directions which are **(1)**
   a. LDG
   b. DLP
   c. LPG
   d. DPG
2. Fiscal deficit is that part of total government expenditure which is met by **(1)**
   a. Borrowings
   b. All
   c. Imposing more taxes
   d. Selling shares held by government
3. Industrial policy of 1991 was **(1)**
   a. Anti-public sector policy
   b. Pro-public sector policy
   c. Pro-private sector policy
   d. Anti-private sector policy
4. PSU is **(1)**
   a. Producing sector undertaking
   b. Private sector undertaking
   c. Public sector undertaking
   d. None
5. Why are structural reforms also referred to as 'microeconomic structural adjustment measures'? **(1)**
6. Why has government decided to retain the Navratnas in the public sector? **(1)**

7. Why does government need to generate funds? **(1)**
8. Mention any two reasons responsible for the initiation of economic reforms in India. **(1)**
9. Why are tariffs imposed? **(3)**
10. Write a short note on foreign exchange reforms. **(3)**
11. India has certain advantages which makes it a favourite outsourcing destination. What are these advantages? **(4)**
12. Why there was need for economic reforms? **(4)**
13. The objective of new economic policy was privatisation. Discuss. **(4)**
14. Agricultural sector appears to be adversely affected by the reform process. Why? **(6)**
15. By manipulating statistics, we can prove that economic reforms are great success and we also prove that economic reforms are a total failure. So, are they a success or a failure? **(6)**

CBSE Test Paper-02
Chapter 08 Economic Reforms Since 1991

Answers

1. c. LPG

   Explanation: The economic reforms, popularly known as the NEP (New Economic Policy) of 1991 were intended to take the Indian economy in the direction of Liberalisation, Privatisation and Globalisation (LPG) by removing the restrictions on trade, private sector and reduce the role of government in many areas.
2. a. Borrowings

   Explanation: Fiscal deficit arises when government expenditure is more than government revenue and therefore the balance is met through borrowings.
3. c. Pro-private sector policy

   Explanation: The industrial policy of 1991 dereserved many of the industries which were previously reserved only for the public sector allowing the entry of the private sector. There are only 3 industries which are now reserved for the public sector.
4. c. Public sector undertaking

   Explanation: PSU stands for Public Sector Undertaking. These are also known as Public Sector Enterprises. It is the name given to the state owned enterprises in India.

5. Structural reforms are also referred to as ‘microeconomic structural adjustment measures’ as they are targeted at specific sectors of the economy. These measures are related to the changes made in industrial policy, trade policy, public sector policy, price policy and tariff policy. Since these reforms impact the structure of individual units of the economy, they are microeconomic measures.

6. Government has decided to retain the ‘Navratnas’ in the public sector since they are profit making and help the government to raise financial resources for themselves. It helped PSU's in increasing its efficiency. Seeing their performance government decided to retain these industries in the public sector to make them highly competitive in domestic as well as international market.

7. The government needs to generate funds to implement various policies and to meet its general administration expenses. In other words, funds are required to regulate the public sector and to benefit general masses.

8. Two reasons responsible for the initiation of economic reforms in India are:

   i. Increase in fiscal deficit: In 1991 interest liability became 36.4% of total govt. expenditure. The Govt. caught in a debt trap. So Govt. has to resort to economic reforms.
   ii. Unfavourable Balance of Payments: Deficit of balance of payments had been rising continuously. 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.

9. Tariffs are taxes imposed on the imports by a country for providing protection to its domestic industries. Imposition of tariffs increases the price of imported goods in the domestic country. The rise in price discourages consumption of imported goods by consumers and thus, domestic industries are able to compete with imports from other countries. Tariffs may also be imposed on those imported goods which are socially undesirable. For example, in India, customs duty is imposed on imports. Tariffs are also imposed on those goods that the government thinks to be socially unwanted and imports of which will exert unnecessary burden on the scarce foreign exchange reserves.

10. The first important reform in the external sector was made in the foreign exchange market. Exchange rate reforms have proceeded gradually beginning with a two- stage cumulative devaluation of rupee by about 20 percent effected by July 1991. The net result was an effective devaluation of the rupee by around 35 percent in nominal terms and 25 percent in real terms between July 1991 and March 1993.
    In 1991, as an immediate measure to resolve the Balance of Payments (BoP) crisis, the rupee was devalued against foreign currencies.
    This led to an increase in the inflow of foreign exchange. After liberalisation policy of 1991

    i. Approval was given for direct foreign investment up to 51% foreign equity in high priority industries.
    ii. Automatic permission was given for foreign technology agreements in high priority

industries up to a lump sum payment of Rs.1 crore.

11. Most multinational corporations and even small companies are outsourcing their services to India because of the following advantages:

    i. **Availability of Cheap Labour :** India is a country with a large population and thus has abundant supply of labour. Due to this reason, labour in India is available at low wage rates. This helps the foreign companies in reducing their cost of operation by outsourcing their business processes to India.
    ii. **Skill and Accuracy:** India has made a pool of talent in the form of educated and trained youth who have the required skill and can work with accuracy in the business processes such as accounting, record keeping, IT consultancy, etc. There is an availability of English speaking persons and skilled human resources are plenty in India. They are highly conscious towards quality.
    iii. **Continuity and Risk Management :** Periods of high employee turnover add uncertainty to the operations of a company. Outsourcing will provide a level of continuity to the company while reducing the risk that a substandard level of operation would bring to the company.
    iv. **Reduced Overhead:** Overhead costs of performing back office functions are extremely high but due to the outsourcing these costs can be reduced.
    v. **Advanced Technology:** There is availability of advanced technology at par with western countries.
    vi. **Flexible Human Resource:** We have flexible human resource to work in various time zones.
    vii. **Multilingual Support:** Indians can also offer multilingual support to their customers.

12. Ans. Need for economic reforms or the New economic policy was felt mainly because of the following measures:

    i. **Mounting fiscal deficit**: Prior to 1991, fiscal deficit of the government had been mounting year after year on the account of continuous increase in its non-development expenditure. Fiscal deficit means difference between the total expenditure and total receipts .Due to persistent rise in fiscal deficit there was corresponding rise in public debt and interest payment liability. There was possibility that the economy might lead to debt-trap situation. Thus it becomes essential for the government to reduce its non-development expenditure and restore fiscal discipline in the economy.

ii. **Adverse balance of payment:** Balance of payments is the systematic record of country's exports and imports with rest of the world. When receipts of foreign exchange fall short of their payments, the problem of adverse balance of payment arises. Despite the restrictive policy adopted by the government till 1990 import substitution and export promotion the desired result could not be met. Our export could not compete in terms of price and quality in the international market. As a result there was slow growth of export and rapid increase in imports. Accordingly, the burden of foreign debt services increased tremendously and led to depletion of foreign exchange reserves.

iii. **Gulf Crises:** On account of Iraq war in 1990-91 prices of petrol shot-up. Besides, India used to receive huge amount of remittances from gulf countries in terms of foreign exchange which stopped due to this war. Gulf crisis thus further accentuated the already adverse balance of payments position.

iv. **Poor performances of PSUs:** Due to poor performances of public sector undertakings, they degenerated in to a liability. Most of public sector undertakings were incurring loss and their performance was quiet satisfactory.

v. **Rise in price:** Due to rise in prices of foodgrains there was pressure of inflation prior to 1991, which deepen the economic crisis from bad to worse.

vi. **Fall in foreign exchange reserves:** In 1990-91 India's foreign exchange reserves fell to such a low level that there was not enough to pay for an import bill of even 10 days. The situation grew so acute that Chandrashekhar had to mortgage country's gold to discharge its foreign debt servicing obligations. In such situation the government had to helplessly resort to policy of liberalisation as suggested by international institutions, in order to secure loans from them. On the account of the above compelling factors, it became inevitable for the govt. to adopt New Economic Policy.

13. When we analyse, we find that privatisation is common to liberalisation and globalization. Without privatisation, an economy can neither be globalized nor liberalised. Findings of many studies demonstrated that privatization did not contribute to growth but helped to reduce income inequality, inflation contributed negatively to both economic growth and income equalization.
    The New Economic Policy was introduced with the objective to deregulate the economy

and ensure economic development. So, privatisation was crucial for the success of this policy as it ensures high productivity, a competitive environment which promotes innovation and efficiency, diversification of activities and consumer sovereignty.
In order to encourage private sector, the following measures have been adopted:

i. The government through its economic policy reduced the number of industries reserved for public sector from 17 to 3 at present.
ii. It has now been planned to reduce the share of public sector investment to 45%. It increases the share of private sector to 55%.
iii. Financial corporations cannot force the industries for conversion of their loans into equity shares.
iv. It has now been decided to increase the participation of the general public and workers by selling them the shares of public enterprises.

14. Due to following reasons, agricultural sector appears to be adversely affected by the reform process:

i. Public investment in agricultural sector, especially in infrastructure which includes irrigation, power, roads, market linkages and research and extension has been reduced in the reform period. Investment on research and development was reduced considerably as compared to the Green Revolution time.
ii. The removal of fertiliser subsidy has led to increase in the cost of production, which has severely affected the small and marginal farmers.
iii. Due to adherence to WTO commitments, various changes in policies like reduction in import duties on agricultural products, removal of Minimum Support Price (MSP) and lifting of quantitative restrictions on agricultural products have increased the threat of international competition to the Indian farmers. Tough competition in the international market along with traditional techniques of farming adversely affected the poor farmers.
iv. Export-oriented policy strategies in agriculture have marked a shift from production for the domestic market towards production for the export market which has led to more focus on cash crops like cotton, jute etc. as compared to production of foodgrains. This led to reduced availability of food grains.
v. The shift towards the production of cash crops exerted an inflationary pressure on the prices of food grains. This resulted in and adverse effect on the agricultural sector's

performance as the cost of producing food grains became more expensive.

15. Nothing in this world is a pure success or pure failure. Each coin has two sides. Same is true for new economic policy. It has some achievements as well as some failures.

    Success: Indian companies are doing restructuring, merging and acquisitions at a large scale.
    - Many industries are now directing their efforts towards world market.
    - An improvement in work culture has been noticed. The workers have become more quality and cost conscious.
    - Many entities have graduated from being labour intensive to capital intensive.
    - Trade Unions and Workers have not responded in a hostile manner to the economic reforms.
    - There has been much awareness and stress on quality and R&D.
    - There has been much awareness and acceptance of the role of scale economies, rapid technological growth, and increased productivity.
    - Corporate are going for brand building in an increasingly competitive market place.
    - Consequent upon new economic policy there will be less deficit financing, rate of taxation will be slashed, supply of money contracted, expenditure will be cut and production increased. All these keep the prices under control.
    - There has been a decline in deficit of balance of payments after new economic policy.

    Failures: Failure to achieve fiscal deficits to a targeted level:
    - Failure to fully implement industrial deregulation
    - Not fully opening the economy to trade
    - Ad hoc and unplanned disinvestment.
    - Slow financial sector reforms.
    - Financing of infrastructure is inadequate.
    - New Economic Policy seems to have ignored the significance of agricultural sector to the economy.
    - Failure to attach any significance to the development of internal resources as it gives more importance to external assistance.