BUSINESS ENVIRONMENT

UNIT-2

PART-I

PRE-REFORM SCENARIO OR ECONOMIC SCENARIO IN 1991

Since the early days of Independence, we were accustomed to a highly protected economy. The economy was characterised by large scale investments in the public sector and comparatively lesser role of the private sector, restriction of foreign direct investment and regulations in order to protect domestic industries from international competition.

The consequences of pre-reform economic policies were recurrent fiscal deficits, high levels of internal and external debt burden, low capital formation, increasing burden of subsidies on government exchequer, low FDI, uncompetitiveness and low productivity levels. The picture which had emerged, after the four decades of planning, was of a stagnant economy under the vicious circle of poverty, unemployment, inflation, black money, balance of payment disequilibrium, regional disparity, inefficiency and corruption.

The economic scenario in the country in year 1991 was, thus, very much depressing as the economy was on the brink of collapse. Prices of essential commodities were soaring high, exports were declining, foreign exchange reserves had declined to no more than two weeks' imports and industrial sector was virtually crippled. Foreign lenders and NRIs had lost confidence in our economy and capital was flying out of the country. Never before had the Indian economy been gripped by a crisis of this magnitude.

THE NATURE (OR DIMENSIONS) OF ECONOMIC CRISIS AND THE NEED FOR ECONOMIC REFORMS

The seriousness of the situation which emerged in 1990-91 and the need for economic reforms can be summarised as follows:

1. A continuous and increasing fiscal deficit

Fiscal deficit refers to borrowings of the government on account of excess of its 1 expenditure over revenue during a year. It is measured as a percentage of GDP. It is not healthy for an economy to have high fiscal deficits as it retards the growth of the country. If such borrowings are meant to finance non-developmental programs by the government it might result in inflationary trends in the economy. During 1990-91 the fiscal deficits were as high as 8.4 per cent of GDP. In recent past, there has been a widening gap between the income and expenditure of the government which led to mounting fiscal deficits.

2. High rate of inflation especially sharp rise in the prices of essential goods

India experienced three consecutive years of good monsoon and bumper crop till the year 1991. Despite this, the prices of food grains had tended to rise. Inflation which had begun to accelerate in 1990-91 (with annual rate of inflation at 12.1 per cent) had reached a peak level of 16.7 per cent in August 1991. Inflation during this period was the result of an increase in money supply to fund the budget deficits in previous years High rate of inflation was a cause of concern because price rise was huge in case of several essential commodities.

3. A high trade deficit and balance of payment crisis

BOP deficit is the difference between total receipts and payments on account of economic transactions between the residents of the country and the rest of the world in a particular period. BOP was adverse on account of high imports and low exports. As a result, India had to borrow from rest of the world which increased India's burden of foreign debt service (Repayment of loan and the interest on it). This resulted in a depletion in the forex reserves of the nation.

In 1990-91 India's foreign exchange reserves had declined to such a low level that these were not enough to pay for more than two weeks' imports. As a result of falling exchange rate and depletion in our foreign exchange reserves, the foreign investors starting losing confidence in our economy. The situation became so worse that India had to mortgage country's gold reserves with the Bank of England to repay loans taken from foreign countries.

4. Gulf crisis leading to high external debt.

On account of Iraq war there was an increase in the prices of crude oil and petroleum products. It widened our trade deficit (due to huge outflow of foreign exchange on this account). Also, a decline was there in remittances from non-resident Indians after the gulf war. This added to our vulnerability.

5. Poor performance of PSUS

The PSU's (Public Sector Undertakings) in India were facing the problem of low productivity and poor rates of return. A huge amount was invested in their growth and development. Initially, their performance was quite satisfactory but thereafter most of these undertakings started recording losses. Because of their poor performance, public sector undertaking turned into a liability.