BUSINESS ENVIRONMENT

UNIT-2

PART-II

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ROOTS OF THE CRISIS

What went wrong and what were the reasons of the 1990-91 crisis? The main reasons are listed below.

1. **Controls and Subsidies:**

   Controls on production, licensing restrictions along with high protective walls had fostered monopolistic tendencies in our industries. That is why it was said that licence-permit-control raj was bad. But so was the raj of preferences, reservations and subsidies.

2. **Inward-looking Policy:**

   Our inward-looking policy of industrialisation, excessive protection to industries through licensing and import tariffs discouraged the competition and efficiency in the economy.

3. **Burden of Foreign Debts:**

   Accumulation of a huge foreign debt and the consequent rise in debt service payments further weakened our balance of payments position.

4. **Non-developmental expenditure by the Government:**

   With the new wave of ushering in the 21st century, we had a series of financial excesses-large increase in defence expenditures, quantum jump in public salaries, unbridled growth of subsidies and concessions increased costs and burden on the fiscal front of the economy.

In order to overcome this crisis, the government of India approached the World Bank and IMF (International Monetary Fund) for help. They gave the loan to manage the crisis but imposed the condition that India should liberalise the economy and private sector should be given more freedom to operate. India accepted these conditions and consequently announced the New Economic Policy (NEP).

REASONS FOR ECONOMIC REFORMS

The economic condition of India in the year 1991 was very miserable. It was due to the cumulative effect of number of reasons. Let us discuss the various reasons, which aroused the need for making major economic reforms in the country:

1. Poor Performance of Public Sector.

In the 40 years period (1951-90), public sector was assigned an important role to work for the economic development of India. However, except for few public enterprises, the overall performance was very disappointing. Considering the

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huge losses incurred by a good number of public sector enterprises, the Government recognised the need for making necessary reforms.

2. Deficit in Balance of Payments (BOP):

Deficit in BOP arises when foreign payments for imports exceed foreign receipts from exports. Even after imposing heavy tariffs and fixing quotas, there was a sharp rise in imports. On the other hand, there was slow growth of exports due to low quality and high prices of Indian goods in the international market.

3. Inflationary Pressures.

There was a consistent rise in the general price level in the economy due to increase in money supply and shortage of essential goods.

4. Fall in foreign exchange reserves:

Foreign Exchange Reserve (also termed as Forex Reserves or FX Reserves) are external assets (like convertible foreign currencies, Gold, Special Drawing Rights, etc.) held by the Central Bank for direct financing of external payments imbalances. In 1991, foreign exchange reserves fell to the lowest level and it led to the foreign exchange crisis in the country. Foreign exchange reserves declined to a level that was not adequate:

- To finance imports for more than two weeks; and
- To pay the interest that needs to be paid to international lenders.

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- Moreover, no country or international funder was willing to lend to India.

5. Huge burden of debts:

The expenditure of the government was much higher than revenue. As a result, government had to borrow money from banks, public and from international financial institutions.

6. Inefficient Management.

The origin of the financial crisis can be traced from the inefficient management of the Indian economy.

- The government had to generate surplus revenue to meet challenges like unemployment, poverty and population explosion. However, there was no additional revenue due to continuous spending on development programmes by the government. Moreover, government was not able to generate sufficient revenue from internal sources such as taxation, running of public sector enterprises, etc.
- Government expenditure began to exceed its revenue by such large margins that it became unsustainable.
- At times, the foreign exchange borrowed from other countries and international financial institutions was spent on meeting consumption needs. Moreover, neither any attempt was made to reduce such profligate

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or reckless spending nor sufficient attention was given to boost exports to pay for growing imports.

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