



CHAPTER - 7

ECONOMIC REFORMS IN INDIA



Unit 1

Economic Reforms in India

Learning Objectives

At the end of this unit, you will be able to:

- ◆ know the background behind economic reforms in India.
- ◆ know the sectors in which economic reforms were carried out.
- ◆ understand the reforms in the industrial sector, financial, external and fiscal sectors.
- ◆ understand how reforms have fared since their introduction in India.

1.0 BACKGROUND

After Independence, India followed the policy of planned growth and for this it pursued conservative policies. The public sector was given dominant position and was made the main instrument of growth. The fiscal policy was framed in a way that it mobilised resources from the private sector to finance development programme and public investment in infrastructure. Similarly, monetary policy sought to regulate financial flows in accordance with the needs of the industrial sector and to keep the inflation under control. Foreign trade policy was formulated to protect domestic industry and keep trade balance in manageable limits. These conservative policies continued for decades, but it was noticed as early as in 1980s that there was:

- excess of consumption and expenditure over revenue resulting in heavy government borrowings;
- growing inefficiency in the use of resources;
- over protection to industry;
- mismanagement of firms and the economy;
- mounting losses of public sector enterprises;
- various distortions like poor technological development and shortage of foreign exchange; and imprudent borrowings from abroad and mismanagement of foreign exchange reserves.

Realising these drawbacks, economic reforms were set in motion though on a modest scale in 1985. However, measures undertaken were ad-hoc, half-hearted and non serious. As a result, sign of crisis began to manifest themselves in 1991. These were:

Low foreign exchange reserves: The available foreign exchange reserves were just sufficient to finance imports of three weeks.

Burden of National Debt: National Debt constituted 60 percent of the GNP in 1991. The large fiscal deficits in the previous five years meant that the government was borrowing increasingly to meet the shortfall of the revenue account.

Inflation: Gulf war, hike in the administrative prices of many essential items and excess liquidity in the economy led to very high rate of inflation in the country. The wholesale prices increased at an annual average rate of 12 percent during the year.



The government responded to the crisis by introducing economic reforms in the country. Reforms were introduced in all major sectors of the economy namely:

- Industrial sector
- Financial sector
- External sector
- Fiscal policy

1.1 INDUSTRIAL SECTOR

In the industrial sector, following reforms were undertaken:

- Industrial licensing was abolished for all projects except for 18 industries related to strategic and security concerns, social reasons, hazardous chemicals and over-riding environmental reasons and items of elitist consumption. At present there are only 6 industries which relate to health, strategic and security considerations remain under the purview of industrial licensing.

These are:

1. Distillation and brewing of alcoholic drinks.
 2. Cigars and Cigarettes of tobacco and manufactured tobacco substitutes.
 3. Electronic Aerospace and Defence equipment: all types.
 4. Industrial explosives including detonating fuses, safely fuses, gun powder, nitrocellulose and matches.
 5. Hazardous chemicals.
 6. Drugs and Pharmaceuticals (according to modified Drug Policy issued in September, 1994 as amended in 1999).
- Only 8 industries groups where security and strategic concerns pre-dominate would be reserved exclusively for the public sector. At present, there are only 3 industries which are reserved for the public sector. They are (i) atomic energy, (ii) the substances specified in the schedule to the notification of the Government of India in the Department of Atomic Energy, and (iii) rail transport. In 2001, defense production was dereserved and opened up to private participation through licensing. A minimum capital of Rs. 100 crore would be required by the companies seeking entry into defense production. Foreign investment up to 26% is being allowed.
 - In projects where imported capital goods are required automatic clearance would be given in the following cases:
 - (a) where foreign exchange availability is ensured through foreign equity. [It is no longer necessary for automatic approval by the RBI that the amount of foreign equity should cover the foreign exchange requirements for import of capital goods needed for the project.]

- (b) If the value of imported capital goods required is less than 25% of the total value of plant and machinery up to maximum of Rs. 2 crore.
- In locations other than cities of more than 1 million population, there would be no requirement of obtaining industrial approvals from the Central Government except for industries subject to compulsory licensing. Industries other than those of non-polluting nature such as electronics, computers, software and printing would be located outside 25 km. of periphery except in prior designated industrial areas.
 - The mandatory convertibility clause would no longer be applicable for term loans, from the financial institutions for new projects.
 - The system of phased manufacturing programmes approved on case by case basis would not be applicable to new projects.
 - Existing units would be provided a new broad banding facility to enable them to produce any article without any investment.
 - The exemption from licensing would apply to all subsequent expansion of existing units.
 - All existing schemes (the licenses registration, exempted registration, DGTD registration) would be abolished.
 - Entrepreneurs would henceforth only be required to file an information memorandum on new projects and subsequent expansions.

Foreign Investment

- Approval would be given for direct foreign investment up to 51 per cent equity in high priority industries.
- To provide access to international markets, majority foreign equity holding up to 51 per cent equity would be allowed for trading companies primarily engaged in export activities.
- A special empowered board would be constituted to negotiate with a large number of international firms.

As a consequence, a list of high priority industries (totaling 34) was prepared wherein automatic approval would be available for direct foreign investment up to 51 per cent foreign equity. In 1999, the Government decided to place all items under the automatic route for Foreign Direct Investment/NRI/OCB investment except for a small negative list. During the years 2000–03, 100 per cent FDI was allowed in Drugs and pharmaceuticals, hotels and tourism, courier services, oil refining, mass rapid transport system, airports, business to business E-commerce, special economic zones industries and certain telecom industries. Similarly, 100 per cent FDI was also allowed in internet services providers, net providing gateways (both for satellite and submarine cables) infrastructure providing dark fiber (IP category I), electronic mail and voice mail, advertising film sector, tea (subject to certain conditions) and for development of township (however with prior approval). 49% FDI was allowed in banking. Apart from this, 26% FDI has been allowed in defence production insurance, and print media. (This is of course, subject to certain conditions).



During 2004-05, foreign investment in the banking sector was further liberalised by raising FDI limit in private sector bank to 74 per cent under the automatic route. Similarly, there was increase in the FDI limits in 'Air Transport Services' up to 49 per cent through automatic route. Also, FDI ceiling in telecom sector in certain services was increased from 49 per cent to 74 per cent in 2005. Besides the above, guidelines on equity cap on FDI have been revised and FDI up to 100 percent is now permitted in many products *such as distillation and brewing up of potable alcohol, manufacture of industrial explosives, manufacture of hazardous chemicals, laying of natural gas lines / LNG lines, etc.*

FDI is prohibited in certain sectors as retail trading (except single brand product retailing), atomic energy, lottery business, gambling and betting, business of chit fund, Nidhi companies, trading in transferable development rights and activities/sectors not opened to private sector investment. Except these sectors, FDI is allowed in all the sectors of the economy at varying specified degrees either through government approval route or the automatic route of the RBI.

MRTTP Act

In the pre-reform period, companies with more than defined investment in assets were required to take prior approval of central government for establishment of new undertakings, expansion of existing undertakings, merger, amalgamation and take over and appointment of directors (under certain circumstances). Under the new Industrial Policy of 1991, this requirement was abolished. Thus, with this action, the constraints imposed on growth and restructuring of large business houses were removed.

1.2 FINANCIAL SECTOR

Financial sector reforms mainly relate to three categories as (a) banking sector reforms (b) capital reforms (c) Insurance sector reforms. Here, we will discuss banking sector reforms only.

Banking Sector Reforms

In the pre-reform period the banking system functioned in a highly regulated environment characterised by:

- Administered interest rate structure.
- Quantitative restrictions on credit flows.
- High reserves requirements under Cash Reserve Ratio (CRR). [Meaning of CRR is explained in chapter 8]
- Keeping significant proportion of lendable resources for the priority sectors under Statutory Liquidity Ratio (SLR). [Meaning of SLR is explained in chapter 8]

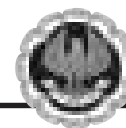
These restrictions resulted in inefficiency of the banks which in turn led to low or negative profits. As a result, measures were taken to reform banks. The important ones are:

- CRR was gradually lowered from its peak at 15 per cent during pre-reforms year to 4.5 per cent in June 2003 but raised to 5 per cent in 2004 *further to 7.5 per cent (in stages) in 2007*. In January 2009, CRR was again reduced to 5 per cent.
- SLR was reduced from its peak of 38.5% during 1990-1992 to 24 per cent in November 2008.

ECONOMIC REFORMS IN INDIA

- Prime lending rates of banks for commercial credit are now entirely within the purview of the banks and not set by the RBI. The rate of saving accounts and rates of interest on export credit are still subject to regulations. With effect from April 2001, PLR has been converted into a benchmark rate for banks rather than treating it as the minimum rate.
- Bank Rate has been reduced from 8 per cent to 6 per cent effective from April, 2003.
- Rate of interest on saving deposits of commercial banks was reduced from 4.5% in 1980's to 3.5% in recent years.
- In 1993, RBI issued guidelines for licensing of new banks in the private sector.
- Fresh guidelines for licensing new banks were issued in January, 2000. These guidelines mainly provided for raising initial minimum capital, increasing the contribution of promoters and keeping the NRI participation in the primary equity of a new bank to the maximum extent of 40 per cent.
- Public sector banks have been encouraged to approach the public to raise resources.
- Recovery of debts due to banks and other financial institutions Act, 1993 was passed and special recovery Tribunals were set up to facilitate quicker recovery of loans arrears.
- For achieving the objective of reducing non-performing assets (NPAs) banks have been advised to tone up their credit risk management system.
- The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act was passed for assisting banks in the recovery of their loans.
- A credit information bureau would be established to identify bad risks.
- Derivative products such as forward rate agreement (FRAs) and interest rate swaps have been introduced.
- The RBI has emphasised transparency, diversification of ownership and strong corporate governance practices to mitigate the fear of systemic risks in the banking sector.
- A roadmap for entry of foreign banks consistent with World Trade Organisation (WTO) has also been released by the RBI.
- The Basel II framework, has been operationalised by banks since March, 2008.
- The RBI has also issued detailed guidelines for the merger/amalgamation in respect of the private sector banks in 2005.
- Other measures include removing/relaxing credit restrictions for purchase of consumer durable, enlarging the coverage of priority sector to include software, agro-processing industries and venture capital.

The financial crisis that surfaced around August 2007 affected economies world wide. India could not insulate itself from the adverse developments in the international financial markets. There was extreme volatility in stock markets, exchange rates and inflation levels during a short duration necessitating reversal of policy to deal with emergent situations. In view of the apparent link between monetary expansion and inflation in first half of the 2008-09, the policy stance of the RBI was oriented towards controlling monetary expansion. This was done by



raising cash reserve ratio, repo rate, reverse repo rates. In the second half of 2008-09, the situation changed. There was liquidity crunch in the economy as there was outflow of foreign exchange and virtual freezing of international credit. As a result, monetary stance of RBI underwent abrupt change and it responded to the emergent situation by facilitating monetary expansion through decreases in the Cash Reserve Ratio, repo and reverse repo rates and statutory liquidity ratio.

1.3 EXTERNAL SECTOR

The foreign trade policy in India was made very restrictive after initiation of the programme of industrialisation in the Second Plan. Only import of capital equipment, machinery, components, spare parts, industrial raw material was allowed. Import of all inessential items was strictly controlled. Import of food grains was allowed from time to time in order to meet the domestic demand for them. This continued for the decade of sixties. In seventies few relaxations were made. In eighties however, special arrangements were made to liberalise imports in a big way. This was done in order to promote exports and increase competitive skills of the exports. Many fiscal and monetary concessions were granted to exporters. Many schemes such as duty draw back scheme, cash compensatory scheme, 100 per cent Export Oriented Units (EOUs) and Export Processing Zones (EPZs) were started to promote exports. A number of organisations such as The Export Promotion Council, Commodity Boards, The Federation of Indian Export Organisations, The Trade Fair Authority, The Indian Institute of Foreign Trade etc. were geared up to promote exports.

However, India continued to face deteriorating balance of payments situation in late 80's and early 90's. In order to rectify the situation, devaluation was carried out. It was followed by announcement of new foreign trade policy and foreign trade reforms.

Following are the major measures which have been undertaken to reform the external sector of the country:

Exchange Rate Stabilisation: The rupee was overvalued for most of the period prior to 1991 thus adversely affecting exports. The rupee was devalued [Devaluation means lowering the external value of the country's currency undertaken by the Government] twice in July, 1991 amounting to a cumulative devaluation of about 19 per cent.

The RBI used to control the foreign exchange in accordance with the Foreign Exchange Regulation Act, 1973, as amended periodically. With unification of exchange rates in March 1993, transactions on trade account were freed from foreign exchange controls. It was in 1994 that various types of current account transactions were liberalised from exchange control regulations with some indicative limits. Certain capital account transactions were also freed from exchange controls. *India is moving towards fuller capital account convertibility in a phased manner.*

Foreign Investment: Foreign investment had played a very limited role in India's economy prior to 1991. The restrictions on equity participation in Indian industries, the technology requirements and the then existing industrial licensing policy tended to discourage foreign direct investment (FDI) in India. New industrial policy and subsequent policy announcements liberalised the existing industrial policy. This led to liberalisation of FDI and foreign technology agreements.

Import Licensing: India's foreign trade policy was quite complex till the beginning of 1990s. There were various categories of import licenses and ways of importing. The process of liberalisation was given a push with the announcement of EXIM Policy in 1992. The policy allowed free trade of all items except a negative list of imports and exports. The EXIM policies of 1997-2002, 2002-07 and 2004-09 further pruned the list of restricted consumer goods by removing certain items. The number of import licenses has also been reduced.

Quantitative Restrictions: Quantitative Restrictions (QRs) were removed on 714 items in EXIM Policy of 2000-01 and on remaining 715 items in EXIM Policy of 2001-02. Thus except defence goods, environmentally hazardous goods and some other sensitive goods, gates of domestic markets have been opened to all kinds of imported consumer goods. EXIM Policies of 1997-2002, 2002-07 and 2004-09 further pruned the list and now only very few sensitive items are subject to QRs.

Tariff: Prior to 1991, Indian import tariff structure was among the highest in the world. India has lowered its average applied tariff rate from 125% in 1990-91 to 41% in 1995-96 and to 10% in 2007-08.

Export Subsidies: Direct subsidies are not provided to exporters in India. These are generally provided indirectly through duty and tax concessions, export finance, export insurance and guarantee and export promotion marketing assistance. Export subsidies were thought to be important to boost exports during the period 1980-81 to 1990-91. However, they involved considerable transaction costs, delays and corruption. Since 1991, the emphasis of the export incentive system has considerably changed and modified. The Cash Compensatory Scheme was abolished in July 1991. The EXIM Scrip scheme was abolished with the introduction of the dual exchange rate scheme. A new class of value-based duty exempt import license was introduced in which the exporter could import materials of his choice, rather than pre-defined precise values of certain categories of import, up to the permitted foreign exchange value of the license. A special scheme known as Export Promotion Capital Goods (EPCG) scheme originally introduced in 1990 was liberalised in April 1992 to encourage imports of capital goods. Finally, export income has been exempted from income taxes. EPCG scheme has been further improved by providing additional benefits to the exporters in the EXIM Policy 2004-09.

Special Economic Zones (SEZs) : Export Processing zone model for promoting exports was not much a successful instrument for export promotion. Therefore, a new policy called Special Economic Zones (SEZs) Policy was announced in 2000. SEZ Act, supported by SEZ Rules, came into effect in 2006. The main objectives of the Act are generation of additional economic activity, promotion of exports of goods and services, promotion of investment, creation of employment opportunities and development of infrastructure facilities. Till May 2009, as many as 568 SEZs have been accorded formal approval and 318 SEZs have been notified. Exports from SEZs in 2008-09 amounted to nearly Rs 100000 crore and employment generated as on 31st march 2009 was more than 387000 persons.

Foreign Exchange Reserves: The foreign exchange reserves of India consist of foreign currency assets held by the Reserve Bank of India, gold holdings of the RBI and Special Drawing Rights (SDRs). Foreign exchange reserves have been steadily built up from the low level of US \$1.1 billion in July 1991 to above US \$141.5 billion in 2004-05 and further to US \$314 billion at end May 2008.



From FERA to FEMA: Due to acute shortage of foreign exchange in the country, the Government of India had enacted the Foreign Exchange Regulation Act (FERA) in 1973. FERA remained a nightmare for 27 years for the Indian corporate world. It, instead of facilitating external trade, discouraged it. As a result, Foreign Exchange Management Act (FEMA) was made. FEMA sets out its objective as “facilitating external trade and payment” and “promoting the orderly development and maintenance of foreign exchange market in India.”

Other measures: The Foreign Trade Policy 2004-09 has identified certain thrust areas, like agriculture, handlooms and handicrafts, gems and jewellery, leather and footwear etc. Special schemes have been started to promote their growth. For example, ‘Vishesh Krishi Upaj Yojana’ has been started to promote agricultural exports. Similarly, to accelerate growth in exports of services so as to create a unique ‘Served from India’ brand, the earlier Duty Free Export Credit (DFEC) scheme has been revamped and recast into the ‘Served from India’ scheme.

In order to mitigate the effects of global recession, certain measures were taken in 2008-09. These included, elimination/reduction of import duties on certain goods, simplification of export licensing requirement in certain cases, withdrawing of exemptions from basic custom duty in certain cases, continuation of duty entitlement passbook scheme till December 31st 2009, allocation of additional funds for export incentive schemes and easing of credit terms etc.

1.4 FISCAL POLICY

Fiscal Policy means policy relating to public revenue and public expenditure and allied matters thereof. The unsustainable levels of government expenditures, insufficient revenues combined with poor returns on government investments led to fiscal excesses in 1980s. Fiscal reforms were therefore undertaken to deal with the crisis. They aimed at reducing expenditure, increasing revenues and earning positive economic returns on the investments. Following measures have been undertaken to bring fiscal discipline in the economy.

Tax Reforms

In August 1991, the Government of India constituted a Tax Reforms Committee (TRC) to recommend a comprehensive reform of both direct and indirect tax laws.

Income Tax Reforms: Following measures were taken to increase collection of income tax.

- Historically, rates of income tax in India have been quite high, almost punitive. For example, in 1973-94, the maximum marginal rate of individual income tax was as high as 97.7%. This proved to be counter productive. Consequent upon the recommendations of the TRC, the income tax slabs were reduced and the rates themselves have been scaled down.
- Prior to the assessment year 1993-94, taxation of partnership firm was rather cumbersome. For example, the method of taxation differed according to whether the firm was registered or not under the I.T. Act. Following the recommendations of TRC, 1991, the taxation of partnership firms was drastically modified through the Finance Act, 1992. In the recent years tax policy relating to partnership firms has been further rationalised.
- The tax rate for domestic companies has been reduced from 40 per cent *in early 90's* to 30 per cent now. The tax rate on foreign companies has also been reduced from 55% to 50%

(on royalty) and to 40% on other incomes. Surcharge is also payable at specified rate over and above the specified limits.

- The basic exemption limits for individuals and Hindu Undivided Families (HUFs) have been increased.
- Requirement of filing of return under the “one by six” scheme has been dispensed with.
- Individuals whose incomes fall below basic exemption limit are no longer required to file returns.
- Dematerialisation of TDS certificates would be made effective from 1.4.2008.
- Scheme for submission of returns through Tax Return Preparers has been introduced.
- Special tax benefits have been allowed to power sector, SEZs and shipping industries.
- Apart from the above many procedural simplifications and rationalisations have taken place to improve tax compliance.

Indirect Tax Reforms: Following are the main measures with regard to indirect taxes:

- Reducing the peak rate of customs duties.
- Rectifying anomalies like inverted duty structure.
- Rationalising excise duties with a movement towards a median CENVAT (Central Value Added Tax).
- Introduction of state-level VAT (Value-Added Tax) for achieving a non-cascading, self-enforcing and harmonised commodity taxation regime.
- Increasing productivity of expenditure by laying down monitorable performance indicators.
- Introducing innovative financing mechanism like creation of a special purpose vehicle for infrastructure projects.
- The Fiscal Responsibility and Budget Management Act (FRBMA), 2003 is in place and emphasises on revenue-led fiscal consolidation, better expenditure outcomes and rationalisation of tax regime to remove distortions and improve competitiveness of domestic goods and services in a globalised economic environment.

Recently further measures have been taken with respect to indirect taxes:

- Replacement of the single point state sales taxes by the VAT in all the states and union territories.
- Introduction of service tax by the Centre, and a substantial expansion of its base over the years.
- Rationalisation of the CENVAT rates by reducing their multiplicity and replacing many of the specific rates by ad valorem rates based on the maximum retail price of the products.
- Plan to introduce Goods and Service Tax (GST) in the coming years. The introduction of GST would entail a restructuring of state VAT and central excise tax. This reform measure would facilitate greater vertical equity in fiscal federalism and reduce cascading nature of commodity tax.



1.5 IMPACT OF ECONOMIC REFORMS ON THE INDIAN ECONOMY

The economic reform process has completed *more than* one and a half decades and available evidence indicates that the Indian industry has coped extremely well with the new competitive environment after having been sheltered in a protected economy for more than 40 years. From an average industrial growth rate of 8 per cent in the 1980s despite the slow down in some few years we can see the beginning of the possibility of new sustained growth of over 10 per cent. All the areas that were subjected to the fresh winds of the competition have indeed fared well. A great deal of re-engineering has taken place. New technologies have been imported at a rapid pace; quality is being upgraded all around. The removal of licensing has sped up firms' reactions, increased competition and has made growth the only protection against competition. The removal of import licensing and lowering of the tariffs have helped exporters compete internationally and facilitated value-added exports. There has been a considerable increase in the investment levels, foreign investment, and reduction in the formalities to be fulfilled after the onset of economic reforms in India.

- (i) Companies, no longer, feel shy of restructuring, merging and acquisitions.
- (ii) Many industries are now directing their efforts towards the world market.
- (iii) An improvement in work culture has been noticed. The workers have become more quality and cost conscious.
- (iv) Many entities have graduated from being labour intensive to capital intensive.
- (v) Trade unions and workers have not responded in a much hostile manner to the economic reforms.
- (vi) There has been much awareness and stress on quality and R&D.
- (vii) There has been much awareness and acceptance of the role of scale economies, rapid technological growth and increased productivity.
- (viii) Corporates are going in for aggressive brand building in an increasingly competitive market place.

These positive developments have encouraged the country to think in terms of strengthening these reforms further and move to second generation reforms. But there are certain hurdles which are to be cleared first. These are:

1. ***Failure to achieve fiscal discipline to the targetted level:*** Fiscal deficits are still very high and we need to reduce them. This requires
 - (i) Improving tax administration to raise larger revenues.
 - (ii) Reducing subsidies.
 - (iii) Downsizing of government.
 - (iv) Bolder privatisation.
 - (v) Re-prioritise plan schemes.

2. **Failure to implement fully industrial deregulation:** Dismantling of industrial licensing and opening of industry to foreign investment was an important part of first generation reforms. We have progressed a lot in this direction. But investors still face many problems in implementing projects. Moreover, there are some areas of industrial deregulation where further action is needed. It has been noticed that sectors which are reserved for SSI have grown more slowly than the unreserved SSI sectors. There is a strong need for immediately de-reserving these areas especially the ones which have a strong export potential.
3. **Not fully opening the economy to trade:** We should clearly identify the major tariff anomalies and lay down a phased programme for their elimination. Besides, our anti-dumping mechanism and procedures should also be strengthened to ensure that Indian industry is not subjected to unfair competition.
4. **Ad hoc and unplanned disinvestment:** The programme of privatisation and disinvestment has been carried out in an unplanned manner. Lack of transparency w.r.t. these programmes has led to suspicion in the minds of public. They have begun to question the need of economic reforms and privatisation. Therefore, it is necessary that the manner of the disinvestment and the rationale of the specific choice should be made transparent.
5. **Slow financial sector reforms :** The financial sector and banking reforms need to be pushed further.
6. **Financing of infrastructure:** Achieving rapid growth of the economy requires a very high quality of infrastructure. Unfortunately, our infrastructure consisting of roads, power, ports, telecommunications, etc. is inadequate. There are severe shortages in quantity and equally serious deficiencies in quality. Public investment will continue to have an important role in all these areas, but the scale of the need is such that it must be supplemented by private investment. But they need to be given sufficient incentives for this.

In addition to the above we need to

- Extend reforms to the States
- Amend labour laws to bring them in line with other countries
- Strengthen the legal system by scrapping outdated laws, shortening legal procedures so that justice is done in time, bringing clarity in language of cases/rules so that they are not subject to misinterpretation.

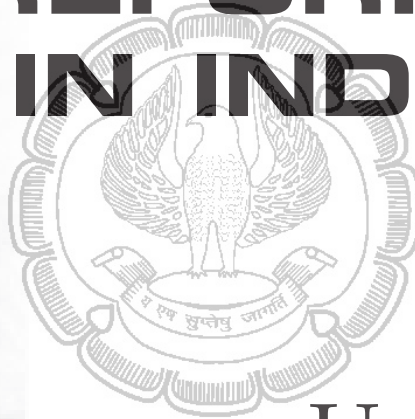
SUMMARY

Till mid eighties, the Indian economy was a controlled one in the sense the public sector was given a dominant role and the private sector was regulated with the help of a number of Acts like Industrial Development Regulation Act, Foreign Exchange Regulation Act, Monopolistic and Restrictive Trade Practices Act and many more. These Acts and regulations strangled the initiative of the private sector to grow and resulted in inefficiencies, corruptions, and mismanagement. To meet the challenge economic reforms were introduced in industrial, financial, external and fiscal areas. As a result of these reforms, many positive changes have taken place in India such as improved rate of growth, lesser prices, more efficiency and competition. But failure to have fiscal discipline, ad-hocism, slow financial reforms and not fully opening the economy still mar the progress of economic reforms.



CHAPTER – 7

ECONOMIC REFORMS IN INDIA



Unit 2

Liberalisation, Privatisation and Disinvestment

Learning Objectives

At the end of this unit, you will be able to:

- ◆ understand the meaning of liberalisation, privatisation and disinvestment.
- ◆ trace the progress of privatisation and disinvestment in India.
- ◆ know about the methods of disinvestment followed in India.

2.0 MEANING OF LIBERALISATION, PRIVATISATION AND DISINVESTMENT

Due to the inability of the Indian public sector enterprises in generating adequate resources for sustaining the growth process and due to other weaknesses, there had been an increasing demand for their liberalisation, privatisation and disinvestment. We shall explain the meaning of these terms in the following paragraphs:

Liberalisation: In general, liberalisation refers to relaxation of previous government restrictions usually in areas of social and economic policies. Thus, when government liberalises trade it means it has removed the tariff, subsidies and other restrictions on the flow of goods and services between countries. (Economic reforms discussed in the previous unit pertain to liberalisation measures in India).

Privatisation: Privatisation, in general, refers to the transfer of assets or service functions from public to private ownership or control and the opening of hitherto closed areas to private sector entry. Privatisation can be achieved in many ways—franchising, leasing, contracting and divestiture. Of the many forms privatisation could take, divestiture through equity sale is the most significant, since ownership is transferred to public/corporate entities. Certain preconditions should exist for privatisation to prove successful.

- Liberalisation and de-regulation of the economy is an essential pre-requisite if privatisation is to take off and help realise higher productivity and profits.
- Capital markets should be sufficiently developed to be able to absorb the disinvested public sector shares.

Arguments in favour of privatisation: Privatisation is favoured on the following grounds:

- (i) Privatisation will help reducing the burden on exchequer which results from the public subsidising of chronically loss making public sector units.
- (ii) It will help the profit making public sector units to modernise and diversify their business.
- (iii) It will help in making public sector units more competitive.
- (iv) It will help in improving the quality of decision-making of managers because their decisions will be made without any political interference.



- (v) Privatisation may help in reviving sick units which have become a liability on the public sector.
- (vi) Without government financial backing, capital market and international market will force public sector to be efficient.

Arguments against Privatisation: Privatisation is opposed on the following grounds:

- (i) Privatisation will encourage growth of monopoly power in the hands of big business houses. It will result in greater disparities in income and wealth.
- (ii) Private enterprises may not show any interest in buying shares of loss-making and sick enterprises.
- (iii) Privatisation may result in lop-sided development of industries in the country. Private entrepreneurs will not be interested in long-gestation projects, infrastructure investments and risky projects. It may retard growth of capital good industries and other industries where the profit margin is less.
- (iv) The limited resources of the private individuals cannot meet some of the vital tasks which alter the very character of the economy. Private individuals prefer to invest money in trade, real estate and other services areas which allow small investments and where capital obtains quick returns. But for changing the very structure of the economy, the investment should go to strategic sectors of economy.
- (v) The private sector may not uphold the principles of social justice and public welfare. They may look for maximising their short run profits ignoring the needs of the economy.
- (vi) Given its commitments to W.T.O., the government of India cannot avoid foreign competition nor can it favour particular firms in the private sector. Under such circumstances, some of our public sector giants are best bets for becoming globally competitive firms.
- (vii) It is contended that liberalisation and deregulation are very important if any firm is to deliver higher profits. Since public sector enterprises exist in a regulatory framework, they are not able to deliver higher productivity and profits. Had they been given unbridled freedom to decide prices, product-mix etc. they would have behaved like private sector and showed higher efficiency and higher returns. It is not the ownership which is important but the competitive environment. Thus, the belief that privatisation *per se* leads to better results itself is questionable.

Privatisation offers both opportunities and threats to the economy. We have to privatise in such a manner that we make the maximum of opportunities while at the same time minimising the threats to the economy.

Disinvestment: Disinvestment means disposal of public sector's unit's equity in the market or in other words selling of a public investment to a private entrepreneur.

2.1 PRIVATISATION AND DISINVESTMENT IN INDIA

Privatisation in India generally is in the form of disinvestment of equity. In general, here privatisation has not led to 100 per cent transfer of control from public sector to private sector unit. Only in exceptional cases, 100 per cent privatisation has taken place (e.g. Centaur Hotel). Following are some of the cases of privatisation in India.:

1. Lagan Jute Machinery Company Limited (LJMC).
2. Modern Food Industries Limited (MFIL).
3. Bharat Aluminicum Company Limited (BALCO).
4. CMC Limited (CMC).
5. HTL Ltd. (HTL).
6. IBP Company (IBP).
7. Videsh Sanchar Nigam Limited (VSNL).
8. India Tourism Development Corporation (ITDC).
9. Hotel Corporation of India Limited. (HCI).
10. Paradeep Phosphates Limited (PPL).
11. Jessop and Company Limited (JCL).
12. Hindustan Zinc Limited (HZL).
13. Maruti Udyog Limited (MUL).
14. Indian Petrochemical Corporation (IPCC).
15. National Thermal Power Corporation (NTPC)

**2.2 METHODS OF DISINVESTMENT**

In order to achieve the various objectives of disinvestment many methods of disinvestment have been formulated and implemented. Initially, equity was offered to retail investors through domestic public issues. This was followed by issuance of the Global Depository Receipts (GDRs) to tap the overseas markets. Other methods included cross-holding (the government simply selling part of its shares in one PSU to other PSUs), warehousing (government's own financial institutions buying government's stake in select PSUs and holding them until any third buyer emerged) and retaining golden share (retaining government's stake up to 26 per cent in the PSU to protect its interest). Of late, the government was pursuing the Strategic Sale method. Under this method, the government sells a major portion of its stake to a strategic buyer and also gives over the management control. Under the strategic sales method, disinvestment price would be market based and not prefixed, PSUs shares' sale would be under the Department of Disinvestment and disinvestments would be delinked from the Union Budget exercise.

Later the government decided to call off the divestment of stake through strategic sale in 13 profit-making central public sector enterprises. It is considering the public offer route to sell minority stakes in these enterprises. Disinvestment was put on hold for some times for some



political reasons. The last public sector undertaking to tap the stock market was Rural Electrification Corporation in February 2008.

The government's divestment programme is all set to take off again. To begin with, National Hydroelectric Power Corporation (NHPC) would tap the capital market with their initial public offering (IPOs) [sale of 5 per cent government equity along with issuance of fresh shares totalling 10 per cent]. State-owned Oil India Ltd, Coal India and Bharat Heavy Electricals Ltd, Rail India Technical and Economic Services, Cochin Shipyard Limited, Telecommunications Consultants India Limited, Manganese Core India Limited, Rashtriya Ispat Nigam and Satluj Jal Vidyut Nigam are also in the disinvestment queue.

It is to be noted that the government, while supporting disinvestment in loss-making PSUs, plans to retain the existing navratna companies in the public sector.

2.3 PROGRESS OF DISINVESTMENT

The disinvestment programme was started in 1991-92 but the disinvestment carried out so far has been half-hearted. By the year end 2007-08, the Government could auction off very small portion of its investment in the public sector, raising Rs. 51,608 crore in the process. It has been too insignificant to affect either the structure of management or the working environment of the PSUs. In fact, it has been pointed out that the government carried out the whole exercise of disinvestment in a hasty, unplanned and hesitant way. It launched the programmes without creating the conditions for its take off. It did not get public enterprises listed on the stock exchange. Adequate efforts were not made to build up the much needed linkage between the public enterprises and the capital market.

The procedures adopted for disinvestment have suffered from ad hocism in the absence of a long-term policy of disinvestment. It narrowly focused only on disinvestment of shareholdings without taking into consideration other important issues such as the initial price offers, involvement of strategic partners, setting up of a trust, employees stock ownership and participation, handing over the enterprises to workers' unions/cooperatives and management buy-outs etc.

It has been pointed out by many economists that the government has been undertaking disinvestment of enterprises which have been earning profits – mostly they are those which belong to the category of Navratnas or Mini-ratnas. A close perusal of the 39 PSUs which had been chosen for disinvestment/privatisation during 1991-98 revealed that out of them only 3 PSUs viz. Hindustan Cables Ltd., Hindustan Copper Ltd. and Hindustan Photo Films Manufacturing Co. Ltd. posted losses in 1997-98 but in all other 36 cases (e.g. BPCL, EIL, GAIL, HMT, BEL, etc.) the divested PSUs had been earning profits. The process of disinvestment has been referred privatisation of the profits of the profit-making enterprises and the nationalisation of losses of the loss-making enterprises.

In most of the years, the government has failed to raise the budgeted disinvestment in the capital market. Many reasons may be ascribed for this failure, but the most important is the non-acceptability of the shares of PSUs in the capital market. The token privatisation to the extent of 8-10 per cent of the share of PSUs did not enthuse the investors to buy these shares because they could hardly exercise any control on PSUs.

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Thus, during the entire disinvestment programme, the public equity has been under-priced and thus has been sold for a fraction of what it could actually fetch. This is true for not only enterprises which were loss-making but also the high profile companies such as Oil and Natural Gas Corporation, Steel Authority of India, Indian Maruti Udyog Limited, VSNL and IPCL and Oil Corporation and Shipping Corporation of India etc.

As a result, the total realisation of the government from various rounds of disinvestment has been much below the target most of the times. This would be clear from the table given below:

Table : Disinvestment of Equity in Public Sector Enterprises (Rs. crores)

Year	Target	Realisation
1991-92	2,500	3,038
1992-93	2,500	1,913
1993-94	3,500	0
1994-95	4,000	4,843
1995-96	7,000	362
1996-97	5,000	380
1997-98	4,800	902
1998-99	5,000	5,371
1999-00	10,000	1,892
2000-01	10,000	1,869
2001-02	12,000	5,632
2002-03	12,000	3,342
2003-04	14,500	15,547
2004-05	4,000	2,765
2005-06	Not Fixed	1,567
2006-07	Not Fixed	-
2007-08	Not Fixed	2,367

SUMMARY

Liberalisation, privatisation and disinvestment are the outcomes of the modern economic world. Liberalisation refers to relaxation of government's restrictions in the arena of economic and social policies. Privatisation refers to partial or full transfer of ownership and control of PSUs to the private sector. Disinvestment is one of the methods of privatisation. It means selling of government share in one PSU to other PSUs or private sector or banks. In India, disinvestment has progressed slowly. It has been carried out in a hasty, unplanned and hesitant manner. As a result, the progress has been quite poor.



CHAPTER – 7

ECONOMIC REFORMS IN INDIA



Unit 3

Globalisation

Learning Objectives

At the end of this unit, you will be able to:

- ◆ understand the meaning of globalisation.
- ◆ know the pros and cons of globalisation.
- ◆ know the measures taken by Indian government towards globalisation.
- ◆ understand how globalisation has affected the Indian economy.

3.0 MEANING OF GLOBALISATION

Globalisation means integrating the domestic economy with the world economy. It is a process which draws countries out of their insulation and makes them join rest of the world in its march towards a new world economic order. It involves increasing interaction among national economic systems, more integrated financial markets, economies of trade, higher factor mobility, free flow of technology and spread of knowledge throughout the world.

In the Indian context, it implies opening up of the economy to foreign direct investment by providing requisites facilities, removing administrative and other constraints, allowing Indian companies to enter into joint ventures and foreign collaborations, bringing down quantitative and non-quantitative restrictions to trade, diluting the role of public sector and encouraging privatisation and so on. Beginning haltingly in 1980s, globalisation got the real thrust from the new economic policy of 1991 and it was further pushed forward by the coming up of the World Trade Organisation (WTO). Globalisation would eventually mean being able to manufacture in the most cost effective way anywhere in the world. It aims at integrating the world into one global village. As a result of globalisation efforts taken by India we find all types of goods available here. For example, Lee Cooper Shoes, Reebok-T shirts, Rayban sunglasses, Coca-Cola and Pepsi, Armani's shirt, INTEL's Pentium etc. have flooded the Indian market.

3.1 CASES FOR GLOBALISATION

- (1) It is argued that globalisation of under developed countries will improve the allocative efficiency of resources, reduce the capital output ratio and increase labour productivity, help to develop the export spheres and export culture, increase the inflow of capital and updated technology into the country, increase the degree of competition, and give a boost to the average growth rate of the economy.
- (2) It will help to restructure the production and trade pattern in a capital-scarce, labour-abundant economy in favour of labour-intensive goods and techniques.
- (3) Foreign capital will be attracted and with its entry, updated technology will also enter the country.
- (4) With the entry of foreign competition and the removal of import tariff barriers, domestic industry will be subject to price reducing and quality improving effects in the domestic economy.



- (5) It is believed that the main effect of integration will be felt in the industrial and related sectors. As a result cheaper and high quality consumer goods will be manufactured at home. Besides, employment opportunities would also go up.
- (6) It is also believed that the efficiency of banking and financial sectors will improve, as there will be competition from foreign capital and foreign banks.

3.2 CASES AGAINST GLOBALISATION

- (1) The globalisation process is in essence a tremendous redistribution of economic power at the world level which will increasingly translate into a redistribution of political power.
- (2) One study reveals that in the globalising world the economies of the world are ironically moving away from one another more than coming together.
- (3) With the lightening speed at which globalisation is taking place, it is increasing the pressure on economies for structural and conceptual readjustments to a breaking point.
- (4) It is becoming hard for the countries to ask their public to go through the pains and uncertainties of structural adjustment for the sake of benefits yet to come.
- (5) Globalisation is helping more the developed economies than the developing economies. Like in India, it is argued that it is true that letting in Cokes and Pepsis have led to opening doors for INTEL, AMD and CISCO, but the sum total of their investment has been very less in relation to their investment abroad. None of the multinationals has set up manufacturing plants in India or signed any technology transfer agreement with any Indian company.

3.3 MEASURES TOWARDS GLOBALISATION

To pursue the objective of globalisation, the following measures have been taken:

- (i) **Convertibility of Rupee:** The most important measure for integrating the economy of any country is to make its currency fully convertible i.e., allow it to determine its own exchange rate in the international market without any official intervention. As a first step towards full convertibility of rupee, rupee was devalued against major currencies in 1991. This was followed by introduction of dual exchange rate system in 1992-93 and full convertibility of the rupee on trade account in 1993-94. India achieved full convertibility on current account in August, 1994. Current account convertibility means freedom to buy or sell foreign exchange for the following transactions (i) all payments due in connection with foreign trade, other current account business, including services and normal short term banking and credit facilities, (ii) payment due as interest on loans and as net income from other investments (iii) payments of moderate amount of amortisation of loans or for depreciation of direct investment and (iv) moderate remittances for family living expenses. Certain steps towards full convertibility on capital account have also been taken like authorised dealers have been allowed to invest abroad their unimpaired Tier1 capital, they have been delegated powers to release exchange for opening of offices abroad, banks fulfilling certain criteria have been permitted to import gold for resale in India. Resident

individuals and listed companies have been permitted to invest in overseas companies listed on a recognised stock exchange (subject to certain conditions), limit on bank's investment from/in overseas markets has been raised, Indian companies are allowed to access ADR/GDR markets through an automatic route, Indian companies with a proven track record are allowed to invest up to 100% of their net worth in a foreign entity, ADs (Authorised Dealers) are allowed to issue international credit cards, NRIs are allowed to remit up to U.S. \$1 million per calendar year out of their Non-resident ordinary accounts/sale proceeds of assets and so on. *Committee on fuller capital Account convertibility (Tarapore Committee II) has chalked out a road map for capital account convertibility. Strong macro economic framework, strong financial systems and prudent regulatory framework are the preconditions for capital convertibility. A Five year time framework (2007-2011) has been given for full convertibility on capital account.*

- (ii) **Import liberalisation:** As per the recommendation of the World Bank, free trade of all items except negative list of imports and exports has been allowed. In addition, import duties on a wide range of capital commodities have been drastically cut down. The peak rate of custom duty (on non-agricultural goods) has been brought down from 150 per cent in early 90's to just 10 per cent in 2007-08 budget. Tariffs on imports of raw materials and manufactured intermediates have also been reduced. In addition to the phased reduction of import duties, India, being member of World Trade Organisation (WTO) has since April 2001, totally removed the quantitative restrictions on foreign trade. Moreover, as a part of the Agreement on Trade Related Intellectual Property Rights (TRIPs), the Patents (Amendments) Act, 1999, was passed in 1999 to provide for Exclusive Marketing Rights (EMRs).
- (iii) **Opening the economy to foreign capital:** The government has taken a number of measures to encourage foreign capital in India. Many facilities and incentives have been offered to the foreign investors and Non-Resident Indians in the new economic policy. The Foreign Direct Investment floodgates have been opened. Foreign Direct Investment up to 26%, 49%, 51%, 74% and even up to 100% has been allowed in different industries. These include drugs and pharmaceuticals, hotels and tourism, airport, electricity generation, oil refineries, construction and maintenance of roads, rope-ways, ports, hydro-equipment and many more. Even defence and insurance sectors have been partially opened.

Many other measures have also been announced from time to time. For instance, foreign companies have been allowed to use their trademarks in India and carry on any activity of a trading, commercial or industrial nature; repatriation of profits by foreign companies has been allowed, foreign companies (other than banking companies) wanting to borrow money or accept deposits are now allowed to do so without taking the permission of the RBI, foreign companies can deal in immovable property in India, restrictions on transfer of shares from one non-resident to another non-resident have been removed, reputed Foreign Institutional Investors (FIIs) have been allowed to invest in Indian capital market subject to certain conditions, etc. All these initiatives are supposed to integrate the Indian economy with the world economy.



3.4 EFFECT OF GLOBALISATION ON INDIAN ECONOMY

The process of globalisation initiated in 1991 and far reaching changes in industrial and other policies have led to considerable changes. The following achievements have been claimed especially on the external front:

- (i) India's share in the world *exports* which had fallen 0.53 per cent in 1991 from 1.78 per cent in 1950, has shown reversed trends and has improved to 1 per cent in 2005 and further to 1.1 per cent in 2007 and 2008.
- (ii) Our foreign currency reserves which had fallen to barely one billion U.S. dollars in June, 1991 rose substantially to about 310 billion U.S. dollars at March, 2008 and but declined to U.S. \$ 252 billion at end March 2009.
- (iii) Exporters are responding well to sweeping reforms in exchange rate and trade policies. This would be clear from the fact that as against a fall in the dollar value of exports by 1.5 per cent in 1991-92, export grew in the range of 18-21 per cent per annum during 1993-96. However, export growth slowed down during 1996-2002. The annual average growth rate during this period was around 8 per cent. Since 2002-03, however, exports have picked up once again. The average growth of export has been *more than 20 per cent per annum since 2002-03*.
- (iv) Exports now finance *nearly 65 per cent* of imports, compared to only 60 per cent in the latter half of the eighties.
- (v) The current account deficit was over 3 per cent of GDP in 1990-91. It had fallen to less than 1 per cent in 2000-01. During 2001-04 we even had surplus in current account ranging between 0.7-2.3 per cent of GDP. *In 2004-05, 2005-06, 2006-07, 2007-08 we again had current account deficit of (-) 0.4, (-) 1.1 per cent, (-) 1 per cent and (-) 1.5 per cent respectively.*
- (vi) At the time of crisis, our external debt was rising at the rate of \$8 billion a year. After that its growth has been arrested. From 1996-2006, it grew only by *about \$3 billion per year*. Since 2006, however its growth has picked up again.
- (vii) Contrary to what many feared, the exchange rate for the rupee has remained almost steady despite the introduction of full convertibility of rupee.
- (viii) International confidence in India has been restored. This is indicated by swelling foreign direct and portfolio investment. FDIs were just 155 million dollars in 1991. They increased to around U.S. \$ 8.9 billion dollars in 2005-06 and further to U.S. \$ 23 billion in 2006-07 and further to U.S. \$ 34.4 billion in 2007-08.
- (ix) Certain benefits of globalisation have accrued to the Indian consumer in the form of larger variety of consumer goods, improved quality of goods and in some cases and reduced prices of consumer durable.
- (x) Markets have started responding to the movements abroad. A fluctuation in U.S. market or U.K. market has started affecting Indian market. Unlike before, the SENSEX and other stock market indices now move in line with fluctuations in similar indices in other parts of the globe.

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- (xi) The rating agencies, which rate investment risks in countries for global investors, have upgraded India's rating.
- (xii) Programmes of quality management and research and development are systematically conducted by corporate sector.
- (xiii) More and more companies are opening branch offices/subsidiaries in other countries and making their presence felt. Asian Paints, Tatas, Sundaram Fasteners, Ranbaxy, Dr. Reddy's Laboratories, Infosys etc. are examples of Indian companies operating abroad.

The critics, however, point out the country's business houses were no doubt offered opportunities to enter foreign markets. But the superior economic and financial clout of the multinational corporations was so great, that these opportunities could hardly be availed of in the face of their competition. The competition was not among equal but between the financially strong corporations and the economically weak Indian corporates. Thus, while the multi-national corporations of Europe and the U.S. entered India in a big way with foreign exchange resources used for investments in financial markets, a few large Indian corporates could enter a few foreign countries and raise capital abroad at relatively low cost.

It is also pointed out that globalisation policy is not a free lunch. Globalised economies or outwardly oriented economies tend to perform well during a period of dynamism and high growth in the world economy whereas they are prone to severe dislocation and collapse during a downturn in international economic activity. On the contrary, internal oriented economies are likely to be less damaged by the slow down in world trade.

3.5 MAIN ORGANISATIONS FOR FACILITATING GLOBALISATION

There are many international organisations which have facilitated the process of Globalisation. We shall study three main organisations here. These are International Monetary Fund (IMF), the World Bank and the World Trade Organisation (WTO).

3.5.0 The International Monetary Fund

The International Monetary Fund (IMF) was organised in 1946 and commenced its operation in March, 1947. It was set up with the following main objectives:

- (i) the elimination or reduction of existing exchange controls;
- (ii) the establishment and maintenance of currency convertibility with stable exchange rate;
- (iii) the widest extension of multilateral trade and payments.
- (iv) the solving of short-term balance of payments problems faced by its member nations.

The Fund is an autonomous organisation affiliated to the UNO. Starting from the initial membership of 31 countries at the time of inception, the Fund now has a membership of 186 countries. It is financed by the participating countries, with each country's contribution fixed in terms of quotas according to the relative importance of its prevailing national income and international trade. The quotas of all the countries taken together constitute the total financial resources of the Fund. Moreover, the contributed quota of a country determines its borrowing rights and voting strength.



Functions of the IMF: The following are major functions of the IMF:

- (i) It functions as a short-term credit institution.
- (ii) It provides machinery for the orderly adjustment of exchange rates.
- (iii) It is a reservoir of the currencies of all the member nations who can borrow the currency of other nations.
- (iv) It is a sort of lending institution in foreign exchange. However, it grants loans for financing current transactions only and not capital transactions.
- (v) It also provides machinery for altering sometimes the par value of currency of a member country.
- (vi) It also provides machinery for international consultations.
- (vii) *It monitors economic and financial developments of its members and provides policy advice aimed at crisis preventions.*

3.5.1 The World Bank

The International Bank for Reconstruction and Development (IBRD) more popularly known as the World Bank was formed as a part of the deliberations at Bretton Woods in 1945. The World Bank was floated in order to give loan to members' countries, initially for the reconstruction of their (world) war-ravaged economies, and later for the development of the economies of the poorer member countries. The World Bank provides its member countries (186 in numbers) long term investment loan on reasonable terms. By far the bulk of the World Bank loans have been for financing specific projects. In recent years, it has also been engaged in giving structural adjustment loans to the heavily indebted countries. The World Bank is an inter-governmental institution, corporate in form, whose capital stock is entirely owned by its member governments. The World Bank Group consists of, apart from the World Bank itself, the International Development Association (IDA), the International Finance Corporation (IFC), and the Multi-lateral Investment Guarantee Agency (MIGA) and the International Centre for Settlement of Investment Disputes (ICSID).

The International Development Association (IDA) is the part of the World Bank that helps the world's poorest countries. Established in 1960, IDA aims to reduce poverty by providing interest-free credits and grants for programs that boost economic growth, reduce inequalities and improve people's living conditions. IDA is also called soft lending arm of the World Bank since it gives interest free loans to the poor countries.

IDA complements the World Bank's other lending arm—the International Bank for Reconstruction and Development (IBRD)—which serves middle-income countries with capital investment and advisory services.

IFC provides investments and advisory services to build the private sector in developing countries.

Created in 1988, MIGA helps encourage foreign investment in developing countries by providing guarantees to foreign investors against loss caused by non commercial risks.

ICSID was founded in 1966. It is an autonomous body which facilitates the settlement of disputes between foreign investors and their host countries.

Objectives of the World Bank

The World Bank works in 186 countries with the primary focus of helping the poorest people and the poorest countries. It emphasises the need for -

- Investing in the people, particularly through basic health and education.
- Focusing on social development.
- Protecting the environment.
- Supporting and encouraging private business development.
- Promoting reforms to create a stable macro-economic environment, conducive to investment and long-term planning.

Functions of the World Bank: The main functions of the World Bank are:

- (i) To help its member countries in the reconstruction and developmental of their territories by facilitating the investment of capital for productive purposes.
- (ii) To encourage private foreign investment and credit by providing guarantee of repayment of the private investors. If private capital is not forthcoming at reasonable terms, to make loans for productive purposes out of its own resources or funds borrowed by it.
- (iii) To promote the long-term balanced growth of international trade and the maintenance of equilibrium in balance of payments of its member countries.

3.5.2 The World Trade Organisation

As told before, it was the World Trade Organisation which gave a real push to the process of globalisation. The World Trade Organisation (WTO) came into existence on 1st January, 1995. The WTO is a powerful body which broadly aims at making the whole world a big village where there is free flow of goods and services and where there are no barriers to trade. It is the only global international organisation which deals with the rules of trade between nations. At its heart are the WTO agreements, negotiated and signed by the bulk of the world's trading nations and ratified in their parliaments.

Features of WTO

- The WTO is the main organ of implementing the Multilateral Trade Agreements.
- The WTO is global in its membership. Its present membership is 153 countries and with many other considering accession.
- It is the forum for negotiations among its member. In this forum, the member-nations discuss issues related to the Multilateral Trade Agreements (MTAs) and associated legal instruments. It is also the forum for negotiations on terms of the Plurilateral Trade Agreements (PTAs). In fact, it is the third economic pillar of world-wide dimensions along with the IMF and the World Bank.
- It has a far wider scope than its predecessor GATT, bringing into the multilateral trade system, for the first time, trade in service, intellectual property protection and investment.
- It is a full-fledged international organisation in its own right.



- It administers a unified package of agreements to which all members are committed.
- The decision-making under the WTO is carried out by consensus. Where a consensus is not arrived at the issue shall be decided by voting. Each member has one vote.
- The WTO has legal personality. Members shall endow it with such legal capacity, privileges and immunities as are necessary for the exercise of its functions.
- The representatives of the members and all officials of the WTO enjoy International privileges and immunities.

Functions of WTO: The WTO has the following functions:

1. The WTO facilitates the implementation, administration and operation of world trade agreements.
2. The WTO provides the forum for trade negotiations among its member countries.
3. The WTO handles trade disputes.
4. The WTO monitors national trade policies.
5. It provides technical assistance and training to developing countries.
6. With a view to achieving greater coherence in global economic policy making, the WTO co-operates, as appropriate, with the IMF and IBRD and its affiliated agencies.

SUMMARY

A new thrust on international business has emerged recently although business transcending national boundaries has always been there in the past. Of late, there has been a growing realisation among countries of the significance of economics of markets and international competition. India is no exception. It has also embraced globalisation. Globalisation broadly implies free movement of goods and services and people across the countries. The global corporations of today conduct their operations world-wide as if the whole world were a single entity. Globalisation has thrown certain opportunities for India like it can raise capital from the world market, it can become a premier production centre and it can attract foreign investors etc. After globalisation, India is beginning to shed its insularity and trying to become a global giant.

There are many international organisations which have facilitated the process of globalisation. Chief among them are the IMF, the IBRD and the WTO.

MULTIPLE CHOICE QUESTIONS

1. Which of the following statements is correct?
 - a. The public sector was given a dominant position in the newly Independent India.
 - b. The foreign trade policy post Independence allowed free trade of all goods and services.
 - c. Monetary policy post Independence sought to keep the CRR at a very low level.
 - d. None of the above.

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2. All of the following developments were noticed during 1991 (when economic reforms were enforced) except one. Identify it.
- National debt was nearly 60 per cent of the GNP of India.
 - Inflation crossed double digits.
 - Foreign reserves were maintained at a very high level.
 - None of the above.
3. Which of the following statement is correct about the New Industrial Policy, 1991?
- It made it compulsory for the industry to obtain license for all projects.
 - It abolished licensing for all projects except 18 industries of strategic and security importance.
 - It gave dominant position to the public sector.
 - None of the above.
4. At present only _____ industries are reserved for the public sector.
- 5
 - 7
 - 8
 - 3
5. At present there are only _____ industries for which licensing is compulsory.
- 18
 - 6
 - 10
 - 9
6. At present, 100 per cent FDI is allowed in _____ .
- defence.
 - drugs and pharmaceuticals.
 - banks.
 - insurance.
7. In private banking _____ per cent FDI is allowed now.
- 100
 - 49
 - 74
 - 26



8. As a result of the New Industrial Policy, 1991:
 - a. prior approval of central government is required for establishing new undertakings, and expanding the present undertaking.
 - b. An industry intending to have more than 100 crore of assets is required to obtain the permission of the central government.
 - c. prior approval of central government for establishing new undertakings and expanding existing undertaking is not required.
 - d. Two or more companies deciding to amalgamate are required to take the prior approval of the central government.
9. Under the New Industrial policy, 1991:
 - a. The mandatory convertibility clause is applicable for all term loans.
 - b. The mandatory convertibility clause is applicable for term loans of more than 10 years.
 - c. The mandatory convertibility clause is applicable for term loans of less than 10 years.
 - d. The mandatory convertibility clause is no longer applicable.
10. As a result of the New Industrial Policy, 1991:
 - a. The public sector has been stripped off all its power.
 - b. The public sector has been given the commanding heights of the economy.
 - c. The public sector's portfolio will be reviewed with greater realism. The focus will be on strategic high tech and essential infrastructure industries.
 - d. The public sector's management has been passed over to the private sector.
11. In the pre-reform period, the banking sector:
 - a. Functioned in a highly regulated environment.
 - b. Functioned in a manner detrimental to the general public.
 - c. Concentrated on making huge profits.
 - d. None of the above.
12. Which of the following is correct in relation to banks in the post-reform period?
 - a. Bank rate has been increased to 10 per cent.
 - b. CRR has been increased to 20 per cent.
 - c. CRR has been reduced in stages.
 - d. Public sector banks have been asked to raise their funds from their private resources only.
13. Which of the following statements is correct with regard to external sector in the pre-reform period?
 - a. The foreign trade policy was very liberal; it allowed import of all types of goods.

- b. Import of foodgrains was strictly prohibited.
 - c. The balance of payments situation was quite comfortable.
 - d. None of the above.
14. Which of the following statements is correct with regard to external sector in the post reform period?
- a. Quantitative restrictions have been imposed on a number of tradable items.
 - b. Quantitative restrictions have been removed on most of the items except a few goods.
 - c. The tariff walls have been further raised.
 - d. Foreign investment is now being discouraged.
15. FERA stands for
- a. Foreign Export Revaluation Act.
 - b. Funds Exchange Resources Act.
 - c. Finance and Export Regulation Association.
 - d. Foreign Exchange Regulation Act.
16. FEMA stands for
- a. Foreign Exchange Management Act.
 - b. Funds Exchange Management Act.
 - c. Finance Enhancement Monetary Act.
 - d. Future Exchange Management Act.
17. As a result of the foreign trade reforms:
- a. The number of import licenses has increased.
 - b. Only a few types of goods and services can now be exchanged freely.
 - c. EPCG scheme has been abolished.
 - d. The average tariff rates have been reduced.
18. All of the following statements except one are correct about the Foreign Trade Policy, 2004-09. Identify the incorrect statement:
- a. Certain thrust areas like agriculture, handlooms, handicrafts etc. have been identified.
 - b. Vishesh Krishiupaj Yojana has been started.
 - c. 'Served from India' scheme has been started.
 - d. The entry of FDI in India has been restricted.
19. DFEC stands for
- a. Direct Foreign Exchange Control.



- b. Direct Finance Exchange Control.
 - c. Duty Free Export Credit.
 - d. Duty Free Exchange Credit.
20. EPCG stands for
- a. Export Promotion Capital Goods.
 - b. Expert Programme for Credit Generation.
 - c. Exchange Programme for Consumer Goods.
 - d. Export Promotion Consumer Goods.
21. FIEO stands for
- a. Foreign Import Export Organisation.
 - b. Federation of Import Export Organisation.
 - c. Forum of Indian Export Organisations.
 - d. Federation of Indian Export Organisations.
22. Fiscal policy means
- a. Policy relating to money and banking in a country.
 - b. Policy relating to public revenue and public expenditure.
 - c. Policy relating to non-banking financial institutions.
 - d. None of the above.
23. The unsustainable levels of government deficits in the late 80's can be attributed to:
- a. High levels of government expenditures.
 - b. Insufficient revenues.
 - c. Poor returns on government investments.
 - d. All of the above.
24. CENVAT stands for
- a. Common Entity Value Added Tax.
 - b. Corporate Entities Value Added Tax.
 - c. Central Value Added Tax.
 - d. None of the above.
25. The FRBMA stands for
- a. Foreign Regulation and Budget Management Act.
 - b. Fiscal Responsibility and Budget Management Act.

- c. Finance Regulations and Bonds Management Association.
 - d. Funds Reallocation and Budget Management Act.
26. The FRBMA, 2003 emphasises on:
- a. Revenue-led fiscal consolidation.
 - b. Better expenditure outcomes.
 - c. Rationalisation of tax regime.
 - d. All of the above.
27. The economic reforms have failed to
- a. Keep fiscal deficits to the targeted levels.
 - b. Fully implement industrial deregulation.
 - c. Fully open the economy to trade.
 - d. All of the above.
28. Under the New Industrial Policy, 1991:
- a. The system of phased manufacturing programme approved on case to case basis will not be applicable to new projects.
 - b. The system of phased manufacturing programme will be applicable to new projects.
 - c. The system of phased manufacturing programmes will be applicable to new projects costing more than 10 crores.
 - d. None of the above.
29. Before financials reforms, the banking system was characterised by all of the following except:
- a. Administered interest rates structure.
 - b. Quantitative restrictions on credit flow.
 - c. High revenue requirements.
 - d. Keeping very less lendable resources for the priority sector.
30. WTO stands for
- a. World Trade Organisation.
 - b. World Transport Organisation.
 - c. World Tariff Organisation.
 - d. Women Teachers Organisation.
31. _____ refers to relaxation of previous government restrictions.
- a. Privatisation.
 - b. Globalisation.



- c. Disinvestment.
d. Liberalisation.
32. _____ refers to the transfer of assets or services functions from public to private ownership.
- a. Globalisation.
b. Privatisation.
c. Disinvestment.
d. Liberalisation.
33. _____ refers to disposal of public sector's units in equity in the market.
- a. Globalisation.
b. Privatisation.
c. Disinvestment.
d. Liberalisation.
34. The pre-condition for privatisation to be successful requires
- a. Liberalisation and de-regulation of the economy.
b. Capital markets should be sufficiently developed.
c. None of the above.
d. (a) & (b) both.
35. Which of the following statements regarding privatisation is correct?
- a. Privatisation is panacea for all economic problems.
b. Privatisation always leads to attaining social and economic efficiency.
c. Privatisation may result in lopsided development of industries in the country.
d. None of the above.
36. Privatisation in India has taken place in all of the cases except
- a. CMC.
b. BALCO.
c. VSNL.
d. None of the above.
37. Which of the following statements is correct?
- a. The disinvestment programme has been successfully carried out in India.
b. Privatisation up to 100 percent has been carried out in all the PSUs in India.

ECONOMIC REFORMS IN INDIA

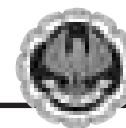
- c. Under strategic sale method of disinvestment, the government sells a major share to a strategic buyer.
- d. None of the above.
38. _____ means integrating the domestic economy with the world economy.
- a. Globalisation.
- b. Privatisation.
- c. Liberalisation.
- d. Disinvestment.
39. Match the following:

A. WTO	I Provides loans to address short-term balance of payments problems
B. RBI	II Multilateral trade negotiating body.
C. IMF	III Facilitating lending and borrowing for reconstruction and development
D. IBRD	IV Central Bank of India

40. Which of the following pairs is not correctly matched?

a. WTO	Generally forbids the use of quantitative restrictions on trade.
b. IMF	Provides finance to correct disequilibrium in balance of payments.
c. RBI	Promotes trade among south Asian countries.
d. IBRD	Gives long term loans for development.

41. In 2009, disinvestment programme took off with the IPO of _____.
- a. NTPC
- b. NHPC
- c. Oil India Limited
- d. Rural Electrification Corporation
42. SEZ Act came into effect in _____.
- a. 2002
- b. 2003
- c. 2006
- d. 2007



43. FDI is prohibited in all of the following except:
- a. atomic energy
 - b. Lottery business,
 - c. Gambling and betting
 - d. Banking operations
44. FDI is allowed in all of the following except:
- a. Lottery business
 - b. Banking operations
 - c. Insurance
 - d. Air transport services
45. Which is the soft lending arm of the World Bank?
- a. IDA
 - b. IFC
 - c. MIGA
 - d. ICSID



ANSWERS

1.	a	2.	c	3.	b	4.	d	5.	b	6.	b
7.	c	8.	c	9.	d	10.	c	11.	a	12.	c
13.	d	14.	b	15.	d	16.	a	17.	d	18.	d
19.	c	20.	a	21.	d	22.	b	23.	d	24.	c
25.	b	26.	d	27.	d	28.	a	29.	d	30.	a
31.	d	32.	b	33.	c	34.	d	35.	c	36.	d
37.	c	38.	a								
39.A	(II)										
B	(IV)										
C	(I)										
D	(III)										
40.	c	41.	b	42.	c	43.	d	44.	a	45.	a