



## 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 Country 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
- Taxation

## 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 5 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. Specified Hazardous chemicals.
- Only 8 industries groups where security and strategic concerns pre-dominate would be reserved exclusively for the public sector. At present, there are only 2 industries which are reserved for the public sector. They are (i) atomic energy, (ii) rail transport. In 2001, defense production was dereserved and opened up to private participation through licensing. Foreign investment up to 26% is being allowed.

Recently (July 2013), the government allowed increase in FDI in defense beyond 26 percent, but this will be on a case-to-case basis, and after clearance from the Cabinet Committee on Security headed by prime minister.

- In projects where imported capital goods are required automatic clearance would be given where foreign exchange availability is ensured through foreign equity and if the value of imported capital goods required is less than 25% of the total value of plant and machinery up to maximum of ₹ 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.

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- 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.

### MRTP Act

In the pre-reform period, under Monopolistic and Restrictive Trade Practice (MRTP) Act, 1969, 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. In 2002, the Competition Act, 2002 was enacted to replace MRTP Act. Under this Competition Commission of India was established to prevent activities that have an adverse impact on competition in India. The Act was amended once in 2007 and again in 2009.

## 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 to 7.5 per cent (*in stages*) in 2007. Since then it has been increased or decreased depending upon the requirements of the country. At present (July 2014) it is 4 per cent.
- SLR was reduced from its peak of 38.5% during 1990-1992 to 24 per cent in November 2008 but raised to 25 per cent in 2010. At present it is 22 per cent.(September 2014)
- 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 was reduced from 8 per cent to 6 per cent in April, 2003. At present (September 2014) it is 9 per cent
- Rate of interest on saving deposits of commercial banks was reduced from 4.5 per cent in 1980's to 3.5 per cent but since April 2011, it has been raised to 4 per cent.
- RBI issued guidelines for licensing new banks in 2001. These guidelines mainly provided for raising initial minimum capital and increasing the contribution of promoters. The RBI issued comprehensive guidelines for new bank licenses in 2013. The new guidelines allow corporates and public sector entities with sound credentials and a minimum track record of 10 years to enter the banking business. However, RBI's permission would be required for setting up the bank.
- Public sector banks have been encouraged to approach the public to raise resources.
- 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 has been established to identify bad risks.
- Derivative products such as Forward Rate Agreement (FRAs) and interest rate swaps were 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.
- The Basel II framework, which lays down norms to be followed by banks to ensure financial stability has been operationalised by banks since March, 2008.

Basel III is supposed to strengthen bank capital requirements by increasing bank liquidity and decreasing bank leverage. It has been introduced in 2013 and banks are required to implement it by 2019.

- The RBI has also issued detailed guidelines for the merger/amalgamation in respect of the private sector banks in 2005.

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

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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.

In view of the persistent high level of inflation in the years 2009-10 and 2010-11, the RBI has kept various rates at high level. Since then also depending upon the requirements in the economy the RBI has increased or decreased the various rates. At present, the bank rate is 10.25 per cent and CRR is 4 per cent in September 2014.

It is to be noted that although the Indian financial markets are more open and globalised, they still are under strict vigil of the Reserve Bank of India. That is the reason why the recent global financial turbulence did not affect India much.

### 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 twice in July, 1991 amounting to a cumulative devaluation of about 19 per cent. Devaluation means lowering the external value of the country's currency undertaken by the Government. This is different from depreciation of currency. Currency depreciation is the loss of value of a country's currency with respect to one or more foreign reference currencies due to market forces. This happens typically in a floating exchange rate system.

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 may take the form of direct investment or portfolio investment. Broadly speaking, FDI refers to investment made by the residents of one country in an enterprise of another country with the aim of gaining an effective voice in the management of the enterprise. It may take many forms, such as a direct takeover of a local firm by a foreign firm, mergers and acquisitions, construction of a new facility, entering into a joint venture or strategic alliance or acquiring shares in an associated firm. It usually involves transfer of technology and expertise. When residents of a country acquire securities in a foreign country's stock and bond market it is called Foreign Portfolio Investment (FPI). FPI is usually a short term investment (sometimes less than a year), as opposed to the FDI which is usually a long term investment. The most important characteristic of FDI, which distinguishes it from foreign portfolio investment, is that it is undertaken with the intention of exercising control over an enterprise. For example, if an American buys shares worth US \$1000 of an Indian company in Bombay Stock Exchange, it is FPI. But if an American company (example, Coca Cola) establishes a plant in India, it is FDI.

Foreign Portfolio investments may be made directly or through Foreign Institutional Investors (FIIs). FIIs are entities established or incorporated outside India which invest in India. These investments by the FIIs are made on behalf of sub accounts, which may include foreign corporates, individuals, funds like hedge fund, pension fund, mutual fund, banks, insurance companies, etc. For example, if a corporation or mutual fund from the United States or Europe puts money into the Indian markets for the purpose of making a profit, it is FII. The nodal agency for registration of FIIs is the Securities and Exchange Board of India (SEBI). Till now, In India, there was no clear cut distinguishing factor between FDI and FII. In order to remove the ambiguity, Union Budget 2013-14, proposed to follow the international practice and lay down a broad principle that, where an investor has a stake of 10 percent or less in a company, it will be treated as FII and, where an investor has a stake of more than 10 percent, it will be treated as FDI.

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.

At present, in India, FDI is allowed fully or partially in most of the sectors. For example, 100 per cent FDI is allowed in Agriculture and animal husbandry mining in specified substances, drugs and pharmaceuticals, hotels and tourism, courier services, oil refining, mass rapid transport system, airports, business to business e-commerce, special economic zones industries, electronic mail and voice mail, advertising film sector, tea and certain telecom industries and internet services providers, etc. Apart from this, 100 per cent FDI is now allowed in asset reconstruction companies, single brand retail trading, and basic and cellular services. But in these, while up to 49 % FDI is allowed through automatic route, FDI above this is allowed through government approval route i.e. after getting permission from Foreign Investment Promotion Board (FIPB).

Similarly, 74 per cent FDI is allowed in private sector banking (up to 49 per cent through automatic route, above that after getting FIPB permission), telecom sector in certain services,



service providers like Direct to Home (DTH) in broadcasting sector (increased from 49 per cent) and credit Information companies.

51 per cent FDI is now allowed in multi-brand retail, 49 per cent in the domestic carriers (by foreign airlines), and power exchanges.

26 per cent FDI is allowed in defence production, insurance, and print media. (This is of course, subject to certain conditions).

Only a handful of sensitive sectors fall in the prohibited zone.

20% percent FDB is allowed in public sector banking

FDI is prohibited in:

- i) Activities / sectors not open to private sector investment e.g. Atomic Energy and Railway Transport (other than Mass Rapid Transport Systems).
- ii) Lottery Business
- iii) Gambling and Betting including Casinos etc.
- iv) Business of Chit Fund
- v) Nidhi Company
- vi) Agricultural (excluding Floriculture, Horticulture, Development of seeds, Animal Husbandry, Pisciculture and cultivation of vegetables, mushrooms, etc. under controlled conditions) and Plantations activities (other than Tea Plantations)
- vii) Real Estate business or construction of Farm Houses.
- viii) Trading in Transferable Development Rights (TDRs).
- ix) Manufacture of cigars, cheroots, cigarillos and cigarettes, of tobacco or of tobacco substitutes.

*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 subsequent EXIM policies of subsequent years 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 subsequent years 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 tariff rate from 125 per cent in 1990-91 to 41 per cent in 1995-96 and to 10 per cent in 2007-08. The custom duty on non-agricultural product continues to be 10 per





cent in subsequent years.

*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 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. EPCG scheme has been further improved by providing additional benefits to the exporters in the EXIM Policy 2004-09 and EXIM policy 2009-14.

*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.

*Foreign Exchange Reserves:* Foreign exchange reserves have been steadily built up from the low level of US \$1.1 billion in July 1991 to above 140 billion in 2004-05 and further to US \$304 billion at end March 2014.

*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 identified certain thrust areas, like agriculture, handlooms and handicrafts, gems and jewellery, leather and footwear etc. Special schemes were started to promote their growth. For example, ‘Vishesh Krishi Upaj Yojana’ was 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 was revamped and recast into the ‘Served from India’ scheme.

The Foreign Trade policy of 2009-14 aims at reviving exports and to double India’s share in global trade by 2020. In order to meet these objectives, the Government would follow a mix of policy measures including fiscal incentives, institutional changes, procedural rationalization, enhanced market access across the world and diversification of export markets. Many new schemes have been started under the Policy. These include, Focus Market Scheme, Focus Product Scheme, Market Linked Focus Product Scheme and EPCG Scheme at Zero Duty etc. Many relaxations and benefits to exporters have been given under the existing schemes.

**1.4 TAX REFORMS**

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 1973-74, 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 were 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 is 40% *on incomes other than royalties. Different rates of Surcharge are also payable at specified rates over and above the specified limits.*
- The basic exemption limits for individuals and Hindu Undivided Families (HUFs) have been increased.
- Individuals whose incomes fall below basic exemption limit are no longer required to file returns.
- Dematerialisation of TDS certificates was 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.
- In order to further reform the taxation system in India, a Direct Tax Code (DTC) would be introduced. It would consolidate and amend laws relating to direct taxes i.e. income tax, dividend distribution tax and wealth tax. The aim is to establish an economically efficient, effective and equitable direct tax system which will facilitate voluntary compliance and help increase the tax to GDP ratio.

## 1.5 IMPACT OF ECONOMIC REFORMS ON THE INDIAN ECONOMY

The economic reform process has completed two decades and available evidence indicates that the Indian industry has coped well with the new competitive environment after having been sheltered in a protected economy for more than 40 years. 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.

According to the World Bank's 'Doing Business Report ' 2014, India ranks 134 out of 189 countries. That means due to numerous government interventions, formalities and procedures, it is not easy to do business in India. Therefore, there is a need to further simplify processes including those relating to tax policy and administration.

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

- After Independence India followed the policy of planned growth and for this it pursued conservative policies. Public sector was given the dominant position.
- Due to inefficiency in use of resources, over protection to industry, mismanagement, mounting losses of public sector, poor technology development, inflation, low foreign exchange reserves, mounting public debts etc. India faced severe economic problems.
- To overcome these problems, 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, more efficiency and competition.
- But failure to have fiscal discipline, ad-hocism, slow financial reform and not fully opening the economy still ruin 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 divesture. Of the many forms privatisation could take, divesture 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 helps reducing the burden on exchequer which results from the public subsidising of chronically loss making public sector units.
- (ii) It helps the profit making public sector units to modernise and diversify their business.
- (iii) It helps in making public sector units more competitive.
- (iv) It helps 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. There are mainly three different approaches to disinvestments :

**Minority Disinvestment :** A minority disinvestment is one in which at the end of it, the government retains a majority stake in the company, typically greater than 51%, thus ensuring management control. Of late, it was decided that all disinvestments would only be minority disinvestments via Public Offers. i.e. the Government would retain at least 51% and management control of the Public Sector Undertakings. Minority sale could be through auction or through an offer for sale. Examples of minority sales in India are Andrew Yule & Co. Ltd., CMC Ltd., Power Grid



Corp. of India Ltd., Rural Electrification Corp. Ltd., National Thermal Power Corporation (NTPC) Ltd., National Hydroelectric Power (NHPC) Ltd. etc.

In 2005, a 'National Investment Fund' (NIF) was constituted into which the realization from sale of minority shareholding of the Government in profitable CPSEs would be channelised. The income from the Fund would be used for :

- (a) Investment in social sector projects which promote education, health care and employment;
- b) Capital investment in selected profitable and revivable Public Sector Enterprises to improve the overall capital base of Public Sector in India.

*Majority Disinvestment* : A majority disinvestment is one in which the government, post disinvestment, retains a minority stake in the company i.e. it sells off a majority stake. Historically, majority disinvestments have been typically made to strategic partners. These partners could be other Central Public Sector Enterprises (CPSEs) themselves, a few examples being Madras Refineries Limited (MRL) and Bongaigaon Refinery and Petrochemicals (BRPL) to Indian Oil Corporation (IOC), and Kochi Refinery Limited (KRL) to Bharat Petroleum Corporation (BPCL). Alternatively, these can be private entities, like the sale of Modern Foods to Hindustan Lever, Bharat Aluminium Company (BALCO) to Sterlite, Computer Maintenance Corporation (CMC) to Tata Consultancy Services (TCS) etc.

*Complete Privatisation* : Complete privatisation is a form of majority disinvestment wherein 100% control of the company is passed on to a buyer. Examples of this include 18 hotel properties of India Tourism Development Corporation (ITDC) and 3 hotel properties of Hotel Corporation of India Limited (HCI).

It has now been decided that all cases of disinvestment would be decided on a case by case basis.

## 2.2 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 2013-14, the Government could auction off very small portion of its investment in the public sector, raising a little more than ₹ 1.5 lakh 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 whole exercise of disinvestment has been carried out in a hasty, unplanned and hesitant way. The programmes of disinvestment were launched without creating the conditions for their take off. 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 had 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.

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.

### SUMMARY

- Liberalisation, privatization and disinvestment are the outcomes of the modern economic world.
- Liberalization refers to relaxation of government's restrictions in the arena of economic and social policies.
- Privatization refers to partial or full transfer of ownership and control of PSUs to the private sector
- Privatization can be achieved by franchising, leasing, contracting and divesture.
- 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, the disinvestment is carried out in a hasty, unplanned and hesitant manner.



## 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. At 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.

### 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. The next step for India is to go for full convertibility on the capital account also. Under Capital Account Convertibility (CAC), any Indian or Indian company is entitled to move freely from the Rupee to another currency, to convert Indian financial assets into foreign financial assets and back, at an exchange rate fixed by the foreign exchange market and not by RBI. The CAC would help in, making available large funds necessary for economic growth, improved access to international financial markets and giving an incentive to Indians to acquire and hold international securities and assets. Accordingly, a committee

(Tarapore Committee) was set up which recommended full CAC by the year 2000. The outbreak of Asian financial crisis during that time also put a question mark on the suitability of CAC for India. It was thought prudent to have a cautious approach towards CPC and therefore the Second Tarapore Committee on fuller CPC was made and asked to chalk out a roadmap for it. *Committee on fuller capital Account convertibility (Tarapore Committee II) 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) was given for full convertibility on capital account. Since these conditions are still not met, move towards CAC has been slow in India.*

- (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 *recent years*. 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). The Act was further amended in 2005 and in 2014.
- (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, Banking 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 1.7 per cent in 2013.
- (ii) Our foreign currency reserves which had fallen to barely one billion U.S. dollars in June, 1991 rose substantially to about 304 billion U.S. dollars at the end March, 2014.
- (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. Since 2002-03, however, exports have picked up once again. The average growth rate of export was about 24 *per cent* per annum during the Tenth Plan. In the Eleventh Plan except for the negative growth of 3.5 per cent in the year 2009-10, the export sector has performed reasonably well even in the face of global crisis. In fact, India's export growth rate of 22 per cent in 2011-12 over and above the 40 per cent growth of 2010-11 is one of the highest in the world. In the Twelfth plan, however, export growth has slowed down.
- (iv) Exports now finance about 70 per cent of imports of goods and services compared to only 60 per cent in the latter half of the eighties. The combined share of exports and imports of goods increased from 14.2 per cent of GDP in 1990-91 to 45 per cent in 2013-14.
- (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. Since 2004-05, we again have current account deficit. In 2012-13 the current account deficit reached (-) 4.7 but it fell down to (-) 1.7 per cent in 2013-14 of GDP.
- (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. At March 2012 end, external debt amounted to Rs. 22,00,000 crore.
- (vii) Contrary to what many feared, the exchange rate for the rupee has not been as volatile as was feared despite the introduction of full convertibility of rupee.
- (viii) International confidence in India has been restored. This is indicated by the level of foreign direct and portfolio investment. Net FDI's 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. \$ 22 billion in 2008-09 but due to global financial disturbances fell to around U.S. \$ 11.8 billion in 2010-11 but increased to about U.S.\$ 22 billion in 2013-14.
- (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.

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- (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.
- (xi) Programmes of quality management and research and development are systematically conducted by corporate sector.
- (xii) 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 188 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 (188 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 188 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 160 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

- Globalisation means integrating the domestic economy with the world economy.
- Globalisation is supposed to improve allocation of resources, reduce the capital output ratio, improve export culture, usher in updated technology and increase labour productivity etc.
- Globalizations has had the positive impact on India. India's share in world export has improved, its current account deficit has reduced, consumers have benefitted from varieties of products, markets have responded well and development of research and development centres etc. has taken place
- There are three main international organizations which have facilitated the process of globalisation. International Monetary Fund (IMF), World Bank and World Trade Organization.

## 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.
  - a. National debt was nearly 60 per cent of the GNP of India.
  - b. Inflation crossed double digits.
  - c. Foreign reserves were maintained at a very high level.
  - d. None of the above.
3. Which of the following statement is correct about the New Industrial Policy, 1991?
  - a. It made it compulsory for the industry to obtain license for all projects.
  - b. It abolished licensing for all projects except 18 industries of strategic and security importance.
  - c. It gave dominant position to the public sector.
  - d. None of the above.
4. At present only \_\_\_\_\_ industries are reserved for the public sector.
  - a. 5
  - b. 7
  - c. 8
  - d. 2
5. At present there are only \_\_\_\_\_ industries for which licensing is compulsory.
  - a. 18
  - b. 5
  - c. 10
  - d. 9
6. At present, 100 per cent FDI is allowed in \_\_\_\_\_.
  - a. defence.
  - b. drugs and pharmaceuticals.
  - c. banks.
  - d. insurance.
7. In private banking \_\_\_\_\_ per cent FDI is allowed now.
  - a. 100
  - b. 49
  - c. 74
  - d. 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. Which of the following is also known as International Bank for Reconstruction and Development?
  - a. IMF
  - b. RBI
  - c. WTO
  - d. World Bank
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 20 per cent.
  - b. CRR has been increased to 20 per cent.
  - c. Public sector banks have been asked to raise their funds from their private resources only.
  - d. None of the above.
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. were identified.
  - b. Vishesh Krishiupaj Yojana was started.
  - c. 'Served from India' scheme was started.
  - d. The entry of FDI in India was 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.

## ECONOMIC REFORMS IN INDIA

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26. The FRBMA, 2003 emphasises on:
- Revenue-led fiscal consolidation.
  - Better expenditure outcomes.
  - Rationalisation of tax regime.
  - All of the above.
27. The economic reforms have failed to
- Keep fiscal deficits to the targeted levels.
  - Fully implement industrial deregulation.
  - Fully open the economy to trade.
  - All of the above.
28. Obtaining of Industrial License is compulsory for all of the below sector except:
- Clothes
  - Specified Hazardous chemicals
  - Electronic aerospace
  - Cigarettes of tobacco
29. Before financials reforms, the banking system was characterised by all of the following except:
- Administered interest rates structure.
  - Quantitative restrictions on credit flow.
  - High revenue requirements.
  - Keeping very less lendable resources for the priority sector.
30. WTO stands for
- World Trade Organisation.
  - World Transport Organisation.
  - World Tariff Organisation.
  - Women Teachers Organisation.
31. \_\_\_\_\_ refers to relaxation of previous government restrictions.
- Privatisation.
  - Globalisation.
  - Disinvestment.
  - Liberalisation.



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

## ECONOMIC REFORMS IN INDIA

38. \_\_\_\_\_ means integrating the domestic economy with the world economy.
- Globalisation.
  - Privatisation.
  - Liberalisation.
  - 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. The income of National Investment fund would be used for :

- Funding of National Games
- Investment in social sector projects
- Funding of Elections
- All of the above

42. SEZ Act came into effect in \_\_\_\_\_.

- 2002
- 2003
- 2006
- 2007

43. FDI is prohibited in all of the following except:

- atomic energy
- Lottery business,
- Gambling and betting
- 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.	d
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

