CHAPTER - I

An Overview of Market Reforms in Russia and India Since 1990

Both in Russia and India the market reforms started in its full swing during 1990's. Though the seeds of the reforms were sown in both these countries in 1980's, with the introduction of Perestroika, Glasnost, Privatisation, Structural Adjustment Programme (SAP) and Economic liberalisation, but actual process in both these countries began from 1991 onwards.

Russia became an independent successor state of the erstwhile Soviet Union in December 1991. After the disintegration of the Soviet Union, the new states that emerged were faced with acute crisis from other problems. Russian society was totally shaken. A major blow for the new states was the loss of super power status.¹ The fall of the Soviet Union had occasioned euphoric glee in the capitalist and imperialist circles while it brought gloom to all socialists and their friends. Terms such as privatisation, liberalism, free market, etc. became very common for the Russian society, and economists began to refer to these as market reforms.

Since historically there was hardly any precedence of an economy moving directly from a centrally planned system to a market economy, there was no single blueprint for reforms available to Russia. The theoretical knowledge of this emerging new branch of economics too was insufficient. As a result, the focus, in the initial few years, was on economic policy issues of stabilisation, liberalisation and privatisation, and sequencing and speeding up of these processes.

The Russian experience with regard to its economic transformation was not a very good one. The main problem was that despite the promising start in 1992, the rapid privatisation in 1994-95 and stabilisation in 1995, the overall results of the economic transformation were far from satisfactory.\(^2\) Macroeconomic stabilisation in Russia since 1992 had been constantly marked by ups and downs, rather than continuous improvement.

The basic aim of the reforms was to overcome the two problems which have constantly marred of Soviet economy - stagnation and shortages. The efforts however did not succeed. Bureaucratic intervention was cited as one of the hurdles in the way of the reforms. Monetary financing of the

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\(^2\) David Lipton and Jeffery Sachs, “Creating a Market Economy in Eastern Europe”, *Brooking Papers on Economic Activity*, vol.1, pp. 75-147.
budget and changes made in the pricing system increased inflation.³ Market economy and liberalisation were proposed as the best possible alternatives by Boris Yeltsin and those who backed him in the disintegration of the USSR.

**The Shock Therapy Practice**

On 1⁰ January 1992, President Yelstin announced the privatisation programme. Yegor Gaider as finance minister and acting Prime Minister steered the reforms. The World Bank and the IMF suggested steps for creating an instant free economy. Economist like Jaffery Sachs also popularized this programme. The recipe offered by the neo-liberal–IMF combine came to be known as the Shock Therapy model. (It was also known as the radical economic reform or big bang theory). This plan was adopted in Russia during early 1990’s. The reformers believed that coercion had to be used for reform, if necessary. This coercion was to come in the form of the carrot and stick policy of the World Bank.

Prices and administrative controls were lifted cutting state subsidies. Price controls on 90% of consumer goods were abolished and prices rose by 25%. This trend continued and by end of the year, inflation was on an estimated 2000%. The excess demand that had accumulated under the

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planned economy system of the Soviet days, with queues and shortages all vanished overnight. The surge in spending was held down by price increases and because of a plunge in real wages. Thus, consumer spending collapsed and with no stimulus from consumer demand, exports decreased. This initiated a slowdown and ultimately a virtual stop of capital formation. Statistical data reveals that in the first quarter of 1992, the production of food products declined by 25%, while the commodity turnover in comparable prices was only 37% of the level in the corresponding period of 1991. This trend continued as the reform progressed.

Companies were allowed to buy foreign exchange for imports at floating rates and in exchange they sold a share of export earnings to the government at a fixed rate. Russia’s currency, the ruble, was thrown into a state of intense fluctuation by the reform process. In 1989, one US dollar was worth about 2/3 of a ruble; in 1993 it was close to 1000 rubles and at the end of 1996 a dollar was over 5,000. Which showed an annual inflation rate of more than 350 per cent. As a consequence the budget had to be drawn up every quarter and with every budget there were cuts in food and other subsidies.

4 Commersant, no. 22 (Moscow: Ministry of Labour, 1993).


Privatisation

The Gaider team initiated privatisation schemes under the Shock Therapy (ST) programme. In Russia there were 28,000 large-scale enterprises, comprising over 90 per cent of the industrial production units. In July 1992, all state enterprises with more than 1000 employees or a book value of more than 50 million rubles were ordered to reorganise themselves as joint stock companies. In October 1992, the Government issued vouchers worth 10,000 rubles to each of Russia’s 148.7 million citizens to buy shares in the firms in the first stage of privatisation.7

Enterprises were privatised by converting the shares of the enterprises into a joint stock ownership through three options. The first was through open subscriptions; workers were given the right to receive free of charge non-voting stock at a 30 per cent discount from the book accounting value as assets. Top managers could purchase 5 per cent of voting stocks at book value. The attempt was to allow some amount of internal privatisation, but workers could not get a controlling stake. The second option allowed worker to retain the controlling share of stock. That is they could buy upto 51 per cent of the shares through closed

subscription at 1.7 times the book value of assets. And the third option
was for a restructuring of the enterprises.⁸

Eighty per cent of the firms opted for the second option, while five per
cent opted for the first and two per cent for the third. This was because
inflation has risen to about 2000 per cent during this time and the book
value of enterprises was reduced to lower level. For instance from
January 1992 to January 1993, prices rose by 2,500 per cent. However,
the nominal values of industrial enterprises remained frozen. Thus, the
municipal property (housing, shops, restaurants, kiosks, etc) were
privatised for cash auctions at market value while privatisation of large
and medium state enterprises, in contrast, was restricted to voucher
sales.⁹ Since the market values of vouchers were not determined, small
shops were sold for more than big industrial concerns.

The political and economic instability during this period led to great
fluctuations in the value of the vouchers. For instance, parliament's
decision to counter the July 1993 presidential decree on privatisation led
to a crash in the value of the vouchers in the market. These fluctuations
had benefited those who had accumulated capital during or after the


Soviet regime or were in influential positions of power, since they alone had the resources and the information about the privatisation process. Meanwhile, new Mafia group known as ‘Shadow Transnational Groups’ emerged and started buying up vouchers from the suddenly impoverished people at high prices. The bulk of the vouchers were thus sold away by the ordinary people in the black market for much needed cash.\textsuperscript{10} Since there was no safety net provided for the people during reform process by the government, the very logic of people getting a share in privatisation was thus distorted from the very beginning.

Within the first few years of the privatisation policies, the Russian society started undergoing cataclysmic social changes. As inflation took root and subsidies were removed, vulnerable sections of the population like the old and women, who were dependent on state support, and many others fell below the poverty line. With the privatisation of state-owned enterprises and closure of many industries, unemployment levels grew dramatically. By 1994, 10 per cent of the working population became unemployed and class differentiation too grew considerably. Thus, along with the privatisation process, number of related problems also cropped up.

\textsuperscript{10} \textit{RFE/RL Research Report}, vol. 2, no. 43, October 29, 1993, pp.43-53.
Table 1: Basic Indicators of the course of Privatisation in the Russian Federation till 1996

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<tr>
<td>State Enterprises having their own balance sheets (Units)</td>
<td>204,998</td>
<td>156,635</td>
<td>138,619</td>
<td>126,846</td>
<td>119,879</td>
<td>90,778</td>
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<td>Privatisation applications submitted (Units)</td>
<td>102,330</td>
<td>125,492</td>
<td>137,501</td>
<td>143,968</td>
<td>147,117</td>
<td>147,795</td>
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<td>Applications Rejected (Units)</td>
<td>5,390</td>
<td>9,985</td>
<td>11,488</td>
<td>12,317</td>
<td>12,876</td>
<td>13,295</td>
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<td>Applications in the Process of being sold (Units)</td>
<td>46,628</td>
<td>24,992</td>
<td>19,308</td>
<td>17,491</td>
<td>15,277</td>
<td>13,214</td>
</tr>
<tr>
<td>Applications Sold (Units)</td>
<td>46,815</td>
<td>88,577</td>
<td>103,796</td>
<td>112,625</td>
<td>117,406</td>
<td>118,797</td>
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<td>Selling prices of properties (billions of rubles)</td>
<td>57</td>
<td>752</td>
<td>1,107</td>
<td>1,867</td>
<td>2,091</td>
<td>2,510</td>
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<tr>
<td>Value of properties on sold applications (billion of ruble)</td>
<td>193</td>
<td>648</td>
<td>958</td>
<td>2,357</td>
<td>2,401</td>
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### De-Industrialisation

The fate of industries was left entirely to market forces in the paradigm advocated for privatisation. An economy based on planned growth under the Soviet state planning system was rooted out. No industrial policy or plan for restructuring or transformation of industry was advocated by the state policy.\(^{11}\) The market was to determine all. Reviews of privatisation showed that some industries were privatised faster than others. For instance, in the first phase of privatisation, public catering and consumer enterprises comprised 69 per cent of privatisation, light industry and construction comprised 9 per cent, heavy industry 2 per

cent and agriculture was also 2 per cent. Given the concentrated nature of Soviet industry, some regions, especially the urban ones, privatised faster than the rural areas. This trend continued and was indicative of uneven development between regions. It also confirmed that there was more emphasis in privatising sectors that would yield quick profits. The large infrastructure industries were either left for worker cooperatives or to the state. Given the fact that very little interest was shown either by the new class of privatisers, or by the state in industries that required heavy investments and longer gestation periods, such industries were allowed to declare themselves as sick units. This policy contributed to the decline of industrial output and resulted in quick de-industrialisation in Russia.

Due to non-availability of capital it became difficult to restructure or modernise industries after privatisation. Since Russia lacked a capitalist class with enough finances to buy up these enterprises, Russian industries declined at a fast pace. For example, with the first phase of privatisation in 1994, industrial production dropped 22.4 per cent in comparison to the previous year. GDP declined by 15 per cent, capital investment was down by 26 per cent and monthly inflation stood at 14

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per cent. Insolvency’ s increased every year by hundreds (800 in 1994), hitting the basic industries like transport, communication, agro-industries etc. Thus, in 1994, 11 per cent (45,000) of state businesses were shut. While the manufacturing industry suffered great losses, light industry did not fare better, and Russian made goods could not compete with foreign goods. The consequences of the privatisation policies made an adverse effect in Russia in the sense that by 1994, industrial output was reduced to less than half of what it was in 1990. The machinery industry slumped to two-thirds as compared to 1990. According to Russian analysts, research-intensive sectors of industrial output had fallen by as much as 90 per cent.14

The first phase of privatisation was marked by a struggled between the privatisation regime of Yeltsin and their effort to undo the Soviet economy and the attempt by the parliament, led by its speaker Khasbulatov and Vice President Rutskoi to slow down this process.15 Yelstin and his backers within and outside Russia then moved into next phase of privatisation, which was even more ruthless than the first.

The Second Stage of Privatisation

The second stage of privatisation was marked by cash auction of industries. It was characterised by the gradual pace of inflation, the sale of vouchers in the black market and the quick decline of industries. The collapse of many investment schemes led to the growth of secondary trading in vouchers and shares. This assisted the government's plan for the sale of enterprises without any resistance.

During this stage, the decline in industrial output continued. Many enterprises bought by worker co-operatives turned sick because of lack of investment and thereby, either closed down or changed hands. The new bankruptcy laws of March 1993 also assisted in liquidating many enterprises. Class differentiation continued to sharpen during this period. The number of people below the poverty line increased, while the numbers of the elite oligarchic class remained limited. The sudden impoverishment of large number of people and the emergence of new social classes led to class-based frictions and conflicts. By 1995, 55 per cent of Russian GDP came from the non-state sector. Russian authorities claimed that more than three-fifths of the GDP came from privatised sources. The situation was the direct result of the forced privatisation of state-owned property. In less than 2 years, more than 70 per cent of all state-owned property passed into the hands of new owners. But in the
majority of cases, the only thing that changed was the title of ownership.\textsuperscript{16} There were no real changes in the spheres of technology, organisation and management enterprises. Moreover many viable structures and complexes were destroyed under the pretext of demonopolisation and deconcentration. The Russian economy was thus well into capitalism during the second stage of privatisation and the reform process.

\textbf{Privatisation and Regional Desparities}

The process of privatisation in Russia was decentralised because of the great size of the state sector and because of the regional diversity. Enterprises were auctioned at regional levels by local authorities in charge of privatisation. The pace of privatisation between regions varied greatly. Different region adopted different approaches and policies vis-a-vis the privatisation process. This led to regional variations, since people living in far out regions could not use their vouchers in auctions in other regions, even though of some national auction schemes were attempted. Privatisation processes led to new disparities between regions.

Studies have shown that the gap between regions widened considerably. Wide regional disparities gave way to the development of rich and poor regions in Russia. Several regions have often attempted to follow

independent economic policies and even took taken steps to re-organise themselves. However, lack of regulation for the distribution of the prerogatives in the management of the economy between the federal centers and the subjects of the federation, as well as organs of local self-government, remained painful and dangerous to the nation.

Reforms in Trade Patterns

Liberalising the trading regime was a key steps for the globalising of the Russian economy. In Russia organised and unorganised retail trade had increased in the last decade. The proportion of imported goods has been 40-50 per cent, food imports have increased with every passing year. Oil exports continued to be stable even at the expense of lower prices. Vast quantities of goods were brought into the country illegally through tourism trade. Trade imbalances in Russia were also the result of foreign trade and currency regulation and because of incomplete foreign trade statistics. Problems for Russian trade have also arisen as the currency being smuggled abroad, the accumulated value of which, since 1990 was supposed to be $100 billion.17

A vast small and medium sector business that involved about 2 million enterprises and created an appreciable part of GDP had emerged in the

nation. This was a positive fact, but the state's influence on this sphere of the economy was far from optimal. Taxes and corrupt officialdom crushed small and medium scale business and it was practically impossible to do business in a law-abiding way. At the same time, the state economic management apparatus were highly inflated at both the central and local levels. Having concentrated on licensing and oversight functions primarily in its own hands, it affected from top to bottom by bureaucracy and corruption. Bribe taking became rampant, the metastasis of corruption also extended to law enforcement. It evoked a negative reaction in society and fueled the argument of fundamentalist forces by calling for a return to the command economy. 18

Finance and Tax Reforms

The financial reforms in Russia were left entirely to Market forces. The consequences were that the banking system in Russia became highly concentrated and uneven. Seven top banks enjoyed a hold on the Russian economy, on account of their close connections with the Government. While there were 1,700 banks operating in Russia, the top 5 among them accounted for 38 per cent of the aggregate assets of the entire system. Almost 44 per cent of the banks were in the Moscow region itself and held 84 per cent of the country's holdings. 19 This

monopoly on the financial control was negative for an economy which was undergoing reforms, especially one that was as shaky as Russia's.

In August 1998, the Government proposed taxes for commodities produced upon shipment and to cut off those enterprises that had not paid taxes from energy sources. However, the attempt to institutionalise a tax structure did not work out. The vast amount of transactions in the black economy and the political control of the Mafia have bled the country of financial resources. Declining tax collection in Russia caused a budget and financial crisis. Tax system was very complex, and there were many types of taxes at the same time the rate of taxes were very high, which had created uncertainty, discouraged domestic and foreign investment and accelerated the trend of tax evasion. Moreover, the barter system had also hampered the revenue collection, which in turn effected the economic growth and reform process.

**Reforms in the Russian Banking System**

In the Soviet Union a two-tier banking system was created in 1987 as part of the perestroika reforms. In December 1991, new laws for the central bank and commercial banks were adopted. Due to very liberal prudential regulations and weak banking supervision, the number of...

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commercial banks increased sharply and by the mid-1990s, the number of these banks exceeded to 2000. However, in November 1993, tight restrictions were imposed on foreign banks. The aggregate capitals of these banks were not allowed to hold more than 12 per cent of the total capital of the domestic banking system.21

The Russian banking system underwent a change with the Bank restructuring process, which resulted in the closure of 200 Banks while the licenses of another 300 banks were revoked in 1998. Further, relevant accounting standards and reporting requirements for commercial banks were introduced. However, Russia's commercial banks collapsed in August 1998 and were subsequently restructured.22 Russian banking system was too small to serve the financial needs of the private sector due to factors like hyperinflation, tax evasion, etc.

**Reforms in Foreign Direct Investment**

It was believed that foreign investment would come in "leaps and bounds" to Russia. But in reality foreign investment primarily went to raw material extraction sectors and to those areas where it could get the fastest returns. In the oil and gas sector negotiations for billions of dollars were made. But Goskomstat reports for 1993-94 showed that a

total of 1.2 billion dollars flowed into Russia for investment purposes, of which 86 per cent constituted direct investment. A breakdown of this foreign investment showed that $930 million went to the fuel energy sector, and some $80 million into commerce.\textsuperscript{23}

Russia had attracted less than 1 per cent of the world’s FDI in 1998; net FDI in Russia amounted to only about $2 billion.\textsuperscript{24} The reasons for this were political instability, absence of corporate governance, capricious and exorbitant taxes, lack of commercial infrastructure and poor protection of property rights and pervasive corruption.

\textbf{Increase in Black Economy}

There were several indicators pointing to the extent of the flight of capital from the Russian economy. In May 1995, Russian Parliament speaker Ivan Rybkin stated that a total of US$100 billion were illegally taken out of Russia between 1990-1994.\textsuperscript{25} These illegal transactions showed the extent of criminal control over the economy. Despite the massive outflow of capital, the Yelstin government took no steps to stop this capital flow out of the country. Current account convertibility was not stopped and no action was taken against the offenders, which showed, the


\textsuperscript{24} Evgeny Gavrilekov, Op.Cit., pp. 50-55.

government's complicity with the economic Mafia and their ineffectual control over the economy.

Illegal activities formed a major part of the Russian economy. The Russian Chamber of Industry and Trade's 1994 Annual Report cited that 70 per cent of commercial companies paid some form of "protection" ransom to criminal groups. The shadow economy was stated to be larger than the real economy. It was being legitimised as the "virtual economy" and liberals claimed that the two economies would overlap and lead to investment and growth. But statistics indicated that the Russian black economy had its own route, which in many instances lead to casinos or to foreign banks. And international experience showed that such "casino capitalism" lead neither to investment or growth.

Agrarian Reforms

Privatisation of agriculture was also an important agenda of the new Russian government. The reforms tried to de-collectivise the farming system and create an individual farmer or free peasant out of the collective farmer. However, there were several difficulties in de-collectivisation of land. For instance methods for the transformation of ownership remained unclear. There was an absence of a land market.

The value of agricultural land remained undetermined. Besides, a system of a state cadaster (land records) was not set up. Transfer deeds and sale records system was not in place. The attempt to privatise agriculture, thus, ran into difficulties from the very start. Though the number of individual farms increased in Russia after 1993, these farms which were carved out of the state and collective farms, were very small in size, ranging from 3 to 20 hectares. Hence, the farmers who opted out of the collective farms faced continuous difficulties.

Laws and decrees on agricultural reform issued by the president and the Duma contradicted each other. This not only led to confusion among local authorities, but regional authorities, and heads of local administration interpreted these laws to suit their own perceptions and interests. There had been a wide regional variation in agricultural reform and policy. In fact, the changes were introduced, and the confusion caused by these changes only worsened the condition of the agricultural sector. Hence, the overall result of the agricultural reforms has been negative. As reforms were implemented, agricultural production declined rapidly and the agrarian system started disintegrating.
Simultaneous with the reforms, there had been a marked decline in wages for agricultural workers. Agricultural production declined by 25 per cent between 1991-95. This decline was lower in the initial years because of the existence of state-provided infrastructure and resources. But, the removal of subsidies to agriculture and exhaustion of earlier resources provided by the government like pesticides, chemical fertiliser's, etc. greatly accelerated the fall in production every year. There had been a steady decline in the agricultural output. Plant cultivation, livestock breeding, meat production had declined massively. With declining productivity, Russia became increasingly dependent on imported goods. In fact, in 1996-97 almost, 40 per cent food was imported and this trend still continues.

The number of non-functioning farms also recorded increase. For example, from about 5,000 in 1993 there number had increased to 14,000 in 1994. Many specialists had left the agrarian sector and Russian farms were facing labour shortages. The Collective Farms Agrarian Union (AKKOR) had also closed down. No viable alternative had been institutionalised. Clearly the attempt to introduce capitalism in Russian agriculture had been disastrous and was not keeping with the

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Russian social, economic and cultural traditions. Economic liberalism had been directly responsible for the crisis of Russian agriculture.

**Decline in the Scientific-Technical Sphere**

Over a period of several decades, and with enormous efforts, the Soviet Union created a unique powerful scientific-technical potential, comparable with that of North America and West Europe. Research and developments were primarily oriented towards defense needs. The total decline of production after disintegration of the Soviet Union, especially in the military-industrial complex, paralysed the demand for research and development. At the same time, budget allocations for science dropped precipitously. As a result, the number of scientific research organisations, and especially the scientific-technical divisions of enterprises declined from 400 in 1991 to 276 in 1994. During the same period staff of scientific organisations also declined from 1,943,000 to 1,218,000 persons, amounting to 37.3%. The budget expenditures on science dropped to 0.32 per cent of GDP, which was 6 times lower than the national security threshold.

Science and science services changed from one of the most prestigious spheres of activity into one of the lowest paid branches. In 1996, the average wage in this sphere was 5 times lower than in the natural gas industry, the electric power industry and industry too was paid after long
delays. Scientific organisations and institutions were facing financial crunch. Purchase of instruments, equipment, and supplies were almost completely terminated and subscriptions to foreign literature and periodicals were canceled. The massive “brain drain” to other countries also took place during this period.

Table-2: Basic Economic Indicators of the Russian Economy

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<tr>
<td><strong>GDP</strong></td>
<td>0.3</td>
<td>0.5</td>
<td>14.5</td>
<td>8.7</td>
<td>12.6</td>
<td>4.2</td>
<td>3.5</td>
<td>0.8</td>
<td>4.6</td>
<td>3.2</td>
<td>7.5*</td>
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<tr>
<td><strong>Inflation</strong></td>
<td>6.0</td>
<td>160</td>
<td>1529</td>
<td>875</td>
<td>309</td>
<td>197</td>
<td>48</td>
<td>15</td>
<td>28</td>
<td>86</td>
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<tr>
<td><strong>Unemployment</strong></td>
<td>-</td>
<td>-</td>
<td>4.7</td>
<td>5.5</td>
<td>7.5</td>
<td>8.9</td>
<td>10.0</td>
<td>11.2</td>
<td>13.3</td>
<td>12.3</td>
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<tr>
<td><strong>Real GDP</strong></td>
<td>97.0</td>
<td>92.2</td>
<td>78.8</td>
<td>71.9</td>
<td>62.8</td>
<td>60.2</td>
<td>58.2</td>
<td>58.7</td>
<td>55.8</td>
<td>57.6</td>
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<td>(1989=100)</td>
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<tr>
<td><strong>Real Gross Capital</strong></td>
<td>100</td>
<td>84.5</td>
<td>49.4</td>
<td>36.7</td>
<td>27.1</td>
<td>24.6</td>
<td>20.4</td>
<td>18.9</td>
<td>17.7</td>
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<td>(1990=100)</td>
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<tr>
<td><strong>Real Gross Output</strong></td>
<td>99.9</td>
<td>91.9</td>
<td>75.4</td>
<td>64.7</td>
<td>51.2</td>
<td>49.5</td>
<td>47.5</td>
<td>48.5</td>
<td>46.0</td>
<td>49.7</td>
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<td>(1989=100)</td>
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# January to June 2000

*Ruble per dollar. The ruble was redenominated at 1:1000 from 1Jan. 1998.


**Conclusion**

For Russia the process of economic transformation from a centrally planned economy to a market economy had proved to be very painful and costly. Russian economy had refused to follow the pattern of the Central and Eastern Europe. The lack of structural reforms was one of the underlying reasons for the decline and stagnation of Russian economy. By August 1998, when economic and financial crisis hit the economy, the Russian economy had already reduced to half of what it was. It would take another decade to modernise Russia’s production facilities, infrastructure and labour force, and many more years for Russia to catch

| Exports (US$bn) | -- | -- | 53.6 | 59.7 | 68.1 | 81.3 | 88.4 | 86.7 | 73.9 | 75.1 | 49.1#
|-----------------|----|----|------|------|------|------|------|------|------|------|------|
| Imports (US$bn) | -- | -- | 43.0 | 44.3 | 50.5 | 60.9 | 61.5 | 66.9 | 59.5 | 40.2 | 20.7#
| Exchange rate   | 0.59 | 1.74 | 193 | 927 | 2204 | 4559 | 5121 | 5785 | 9.7 | 24.6 |
| Fiscal Balance  | -7.3 | -10.4 | -6.1 | -8.9 | -7.9 | -8.0 | (o/o of GDP) |


up with the West, provided it's economy grows at 6 to 8 per cent annually. Foreign indebtedness continues to exert pressure on Russia. Market reforms, which started in Russia during 1990's, are yet to show any positive results. While the country has failed to create a market friendly state, the overall condition of the country has deteriorated with the introduction of the reform process.

In India, it was in the mid-1991 that the Indian Government initiated macroeconomic reforms and structural adjustments in different areas of the economy, although trends towards structural adjustment and liberalisation in the Indian economy were apparent during 1980s. The process, took concrete shape in the mid-1991, when the economic condition of the country especially, in the external sector became unmanageable. The Indian Government had no option but to resort to full fledged macroeconomic reforms and structural adjustment in order to bring the economy back on rails. Economic reforms initiated in India during mid 1991 were broad based and comprehensive. They embraced vital sectors of the economy and consequently the policies like industrial, fiscal, monetary, financial and external which all underwent sea changes.
The Indian economy had witnessed a turbulent period in 1991. Various factors related to the Gulf War, domestic political uncertainty and recession in other industrialised countries overshadowed India's economic environment. The foreign exchange shortage too reached to the crisis level, while economic growth slowed down and inflation accelerated.

To control this situation, the Government introduced a sweeping policy reform package in July 1991, which aimed at achieving both macroeconomic stabilization and structural reform. The stabilisation measures were introduced to reduce the fiscal deficit and to curb inflation. The strategy of reform introduced in India in July 1991 presented a mixture of macroeconomic stabilisation and structural adjustment.\(^\text{30}\)

In the year 1992, the process of structural adjustment continued with sustained emphasis on fiscal consolidation, and further reforms in the trade, industry and financial sectors. Some progress was also made by extending the deregulation of domestic industry and by opening up the economy to greater international competition.

The new directions of Indian economic policy were strongly reaffirmed in the 1993 budget. This provided wide-ranging reductions in tariffs and increased investment incentives. In the years following 1994, the prospects for the Indian economy depended on its success in accomplishing a range of far-reaching and politically sensitive changes. The performance of Indian economy in 1994 was characterised by a revival of growth. In consolidating the recovery, the Indian economy faced several crucial challenges. The country's infrastructure, especially power, was inadequate. The fiscal deficit was still too large, and the progress made in public sector and labour market reforms also remained inadequate.

In the year 1995, India was able to sustain a high rate of economic growth. As the reforms, initiated in the wake of the macroeconomic crisis of 1991, took stronger hold, the economic recovery gained further momentum. The government continued its reform efforts through 1995, albeit at a more moderate pace. Initial measures were aimed at improving the efficiency of resource allocation and expanding the productive capacity of the economy. This was followed by the reforms of the financial and capital markets. However, in consolidating its programme of structural adjustment, the government faced a number of difficult issues. Although, the fiscal deficit had lowered in the years 1993 and 1994, it
was still too high and needed to be reduced further. Country's infrastructure also needs to be modernised.\textsuperscript{31}

The Indian economy grew strongly during early 1996, stimulated both by the liberalisation of the trade and by the external payments regimes. Reforms continued in 1996, albeit at a slower pace.\textsuperscript{32} After three successive years of growth averaging about 7 per cent per year during 1994-1996, it slowed down to about 5 per cent in 1997. However, it again picked up pace in 1998, largely because of a rebound in agricultural production, which had declined in 1997. However, the performance of the industrial sector deteriorated, in 1998.\textsuperscript{33} The basic goods sector, which included fertilizers, chemicals, cement, basic metals, electricity, mining and the consumer goods sectors, also continued to be adversely affected. The slow growth in consumer demand subdued export demand and infrastructure constraints continued in the following years.

\textbf{Structural Reforms & Labour Standards}

Structural reforms in public sector, in trade and in foreign investment policy as well as financial sector reforms have been undertaken to


improve the productivity performance of the Indian industrial sector.\textsuperscript{34} The policies have been reoriented to bring in greater competition from imports and at the same time inject market forces within the economy to generate more domestic competition. Policy towards foreign investment has been radically redesigned to enable foreign investment to play a crucial role in supplementing domestic saving and act as a conduit of modern technology by providing access to external markets and more generally helping the globalisation process.

Economic liberalisation and globalisation has had a checkered course in India. The reforms started with a bang in 1991, but since 1994 their pace slowed down. Industry, trade and finance have been liberalised considerably. The promise of structural adjustment with a human face has been belied. India exemplifies a country where high labor standards have been legislated and implemented for workers in the modern sector where the number of workers covered are barely eight per cent of the work force.\textsuperscript{35} The high labour standards and the privileged position of the trade unions in the modern-sectors have been strongly critisised for slowing down the growth of organised employment. The private sector has been able to achieve some measures of flexibility and reduce


employment. The public sector, on the other hand, continued to protect its employees and increase their emoluments even when the losses in some of the enterprises have wiped off their net worth many times more.\textsuperscript{36} It was feared that there was a net loss of employment in the organised sector due to downsizing, closures and Voluntary Retirement Schemes (VRS). Till 1993-94 there was evidence of decline in poverty, although the trend appeared is unlikely to continue.\textsuperscript{37}

\textbf{Fiscal Policy Reforms}

In the initial year of the reforms, that is 1991-92, the central government was able to make impressive progress in reducing its fiscal deficit, from 8.3 per cent to 5.9 per cent of the GDP. The fiscal stabilisation process almost came to a halt in 1992-93 and the subsequent years saw a significant deterioration in the fiscal deficit to a level of 7.5 per cent of the GDP, far exceeding the target of 4.7 per cent. Fiscal stabilisation at the central government level was achieved in 1991-92 by cutting down the fertiliser subsidy, eliminating the export subsidy and reducing planned expenditure. Over the five-years period, the percentage of the GDP declined from 2.3 per cent in 1990-91 to 1.3 per


cent in 1995-96. The defense expenditures declined from 2.9 per cent to 2.5 per cent. Interest payments, however, continued to rise rapidly to a level of 4.8 per cent of the GDP.

The central budget support for social sector expenditure, however, seemed to have been protected, even though the principal responsibility for these sectors was upon with the states, where such spending has been adversely effected by their resource crunch. After a decline in 1991-92 and 1992-93, Central plan expenditure on social sectors have slowly but steadily increased to reach a level of 1.2 per cent of the GDP in 1995-96 which was higher than the 1 per cent in 1990-91. While the government had raised its spending on health, education and rural development in the more recent period, it did not have the political courage to find the resources by cutting other wasteful expenditures except capital expenditures. 38

Reforms in the indirect tax regime began with the reduction in custom duties, a key element in the government’s strategy for opening the Indian economy to foreign competition. Indeed the government’s record on lowering the custom duty had been one of the open commitments and a

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consistent course of action.\textsuperscript{39} The Indian federal structure, with all its faults, had shown a high degree of flexibility in responding to felt needs over the past 50 years. Such steps held out hope that the Government might be able to meet the needs of the future by evolving new methods of countering the challenges ahead.

\textbf{Trade Policy Reforms}

Trade policy reforms were at the centre of the economic reforms launched during the 1990s. These reforms were implemented in India with the aim of eliminating discretionary controls on international trade transactions, to reduce the nominal and the effective protection available to domestic industry, and to bring domestic prices closer to world prices. As a step towards achieving there has been a rapid dismantling of quantitative restrictions on imports and exports. A substantial reduction of tariffs on imports, combined with an abolition of subsidies on exports, and several adjustments in the exchange rate have led to sizeable depreciation of the rupee. The presumption was that this process would shift resources from the non-traded goods sector to the traded goods sector and the exposure to international competition would be conducive to efficiency in domestic firms.

\textsuperscript{39} Dr. Singh Jagpal, \textit{Development Planning Free from Market Forces} (Dehra Dun: Samaya Sakshaya, 1999), pp.77-78.
Tariff reforms have been designed with a view to dismantle a highly protectionist regime, so that Indian industries could become globally competitive. The maximum tariff was brought down from over 250 per cent in 1991 to 50 percent in April 1995. The dispersion of tariff rates was also reduced, and by April 1995 there were eight rates of custom duty as opposed to 22 at the beginning of 1991. The import weighted tariff for the economy as a whole declined from 87 per cent in 1990 to 33 percent in 1994-95 and further to 27 per cent in 1995-96.\(^{40}\)

**Reforms in Foreign Investment Policy**

The process of economic reform was seeking to increase the degree of openness of the economy to integrate it as soon as possible with the world economy. The endeavour was, therefore, not confined to trade flows. It extended to capital flows and technology flows too. Consequently, the policy regime for foreign investment and foreign technology was liberalised at a rapid pace. The primary objective was to enlarge non-debt creating capital flows, while technology acquisition and market access were marked as secondary objectives.\(^{41}\) The liberal access to imports of technology was meant to facilitate technological upgradation and enhance international competitiveness in industry.

\(^{40}\) Majumder Bhaskar, "India and Globalisation: Some Reflection on India's Trade Link with G-7" *Journal of Indian School of Political Economy*, vol. 10, no. 2, April-June 1998, pp. 241-54.

The opening of the Indian economy to imports has been combined with a radical change in India's policy towards foreign investment. A major part of foreign investment was freely allowed in most industries. Even in industries reserved for the small-scale sector, foreign equity up to 24 per cent was permitted. Foreign equity up to 100 per cent was encouraged in export-oriented units in the power sector, electronics and software technology parks. In other industries foreign equity up to 100% was permitted on merit.\textsuperscript{42} There was no restriction on the use of foreign brandnames/trademarks for internal sale. Restrictive provisions earlier applicable to FERA companies, i.e. companies with more than 40 per cent foreign equity, were also abolished.

The changes initiated in the foreign investment policy evoked a favorable response in the total foreign direct investment (FDI), which was negligible earlier, but had virtually doubled in every succeeding year since 1991. For the first nine months of the fiscal year 1995-96 the inflow of direct foreign investment was $1.6 billion and was estimated to be close to $2 billion for the year as a whole.\textsuperscript{43} Liberalisation in India was the anticipation of an inward rush of foreign capital in the form of direct


investment. It was assumed that this would result in rapid growth, reduction in unemployment and rise in personal incomes. But, the Multinational Corporations were more interested in local buyouts and mergers than ingenuinely in new enterprises or export-oriented industries. Their concern was predominantly on entering the Indian domestic market. In 1996, the new multinational firms adopted a short run fly-by-night stance in the Indian market. They wanted to exert dominance and control with their one way approach. Their tendency was to import outdated or obsolete technology products.

**Table 3: New Foreign Business Collaborations**

<table>
<thead>
<tr>
<th></th>
<th>Number of Cases</th>
<th>Investment Rs crores</th>
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<tbody>
<tr>
<td>1990</td>
<td>666</td>
<td>128</td>
</tr>
<tr>
<td>1991</td>
<td>950</td>
<td>534</td>
</tr>
<tr>
<td>1992</td>
<td>1520</td>
<td>3888</td>
</tr>
<tr>
<td>1993</td>
<td>1476</td>
<td>8859</td>
</tr>
<tr>
<td>1994</td>
<td>1854</td>
<td>14187</td>
</tr>
<tr>
<td>1995</td>
<td>2337</td>
<td>32072</td>
</tr>
</tbody>
</table>

Source: Statistical Outline of India, 1997-98.

The rapid development in the production of computer software by a mixture of international and local firms, had also prompted a massive
brain drain to the West. Similar situation was observed in the field of agriculture too, where the lifting of export controls has led to highly capitalized farmers to look to overseas market for higher profits. The price of many food items which Indian people saw as treats, such as fragrant Basmati rice or the short season Alphonso mangoes, became luxury class items, as the world became aware of them. Many farmers, instead of growing grains for local consumption, switched over to the major cash crops like cotton and tobacco. Others turned to specialist cultivation like flowers and strawberries for the newly affluent local urbanites, and for export. Liberalising the economy had also let the hawala (laundered) money to be brought quietly into the realm of legality, as the rupee became negotiable.44

**Industrial Policy Reforms**

Industrial policy reforms had focused on increasing competition in the domestic economy and removing barriers to entry in the manufacturing sectors. The system of industrial licensing which involved permission from the government of India for new investments as well as capacity expansions has been abolished for all the industries, except for a few that were associated with defense and strategic areas, or where environmental considerations dominated.45

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The private sector had been provided a significantly larger scope for participating in the growth process. Only six areas covering defense, atomic energy, minerals for atomic energy, coal, mineral oils and railway transport were exclusively reserved for the public sector. Even in these areas, private investment was permitted on a case by case basis. The policy of reservation in production of small-scale units for certain items continued, in order to provide protection from large-scale units within Indian industry. But, with a growing perception that in industries such as garments, leather products and some food processing industries which had high export potential, reservation policy came in the way of exploiting India's comparative advantage for exports. Some developments in India suggested that acquisition, merger or takeovers by firms in the industrial sector had enabled the enlarged corporate entity to capture a preponderant market share. In India, the laws on monopolies had been diluted to abolish limits on growth, but were not strengthened to regulate monopolistic, restrictive or unfair trade practices. As such, it was nothing more than a watchdog without teeth.

**Public Sector Reforms**

Apart from the initiatives on Greenfield privatisation and marketisation, the government has continued with the MOU policy as an instrument of providing more autonomy to public sector enterprises and distancing the
administrative ministry from the day to day running of the enterprises. Privatization had not really formed part of the Indian government's liberalization strategy, although a high-powered committee (Rangarajan (1993)) as early as 1993 had clearly recommended privatization by disinvesting up to 74 per cent of the equity of the enterprises (barring the six sectors reserved for the public sector). 46

It is worth noting, that, of late, the state governments too have been giving lead on privatization of the state-owned public enterprises, even though the Indian government has been ambivalent. Andhra Pradesh, Haryana and Gujarat have seen some outright and successful privatization of their state-owned enterprises. This might well be because the state governments had begun to face hard budget constraints because of the resource crisis at the center. The Government of India seemed to have experienced a false sense of complacency because of the improved position with respect to foreign exchange and food reserves. 47

However, the aim of easing the burden imposed by the public sector on the exchequer was being pursued with vigor. The dominant motive


underlying the sale of Government equity in the public sector was the desire to mobilise resources for the exchequer. The capital receipts from such asset sales in the range of Rs.25 billion per annum have been absorbed in the Union Budget to reduce the borrowing needs; hence, the fiscal deficit of the Central Government. It was also a matter of concern that the modus operandi for the sale of shares of public enterprises was neither transparent nor at arms length. What was worse, many of these shares have been sold at prices that were significantly below their market value. At the same time, non-plan budget support to the public sector used mainly to finance losses had been progressively withdrawn and almost eliminated. This, obviously, reduced the government expenditure but had done nothing to ease the difficulties of such firms. This philosophy seemed to meet the needs of the government in the short run, rather than to solve the problems of the public sector, even though the long-term interest of the government coincided with the latter.

This approach to the public sector reform that emphasized asset sales and closures represented the most rudimentary forms of privatisation and restructuring, and thus, was neither adjustment nor reform. There was no systematic attempt to address problems and productivity.

Financial Sector Reforms

The banking sector reforms included a reduction in the mandatory reserve requirements from very high to more reasonable levels, thus freeing more resources for investment with commercial returns. Reforms in the capital market have been aimed at freeing the capital market from detailed direct government control. Efforts were being made to put in place a system of supervision aimed at ensuring better disclosure and greater transparency for investor protection. The government's decision to set up a Central Depository for expediting settlements was a major step in improving settlement systems.49

More generally, the financial sector reforms received a setback from the securities scam of 1992, which occurred during the transition from a highly regulated financial system to a more competitive one. While the long drawn process of investigation into the irregularities during the securities scam continued, it led to a slowing down of the pace of the reforms in the financial sector. Thus, the government embarked on deregulation and liberalisation in the financial sector without the necessary planning of its temporal sequence and without a careful

consideration of its wider implications. Some financial sector reforms in India were based on the premise that the commercial banking system and the domestic capital market were over-regulated and under-governed, this presumption was broadly correct. However, the process of reforms unfolded so far, suggests that deregulation has dispensed with the over-regulation but the system remained under-governed; because institutional and legal frameworks that would govern the market have not yet been put in place and this mismatch or asymmetry was fraught with risk.

**Downturn of Reforms**

In late 1990's, India has seen a downturn in the rate of growth. This could be attributed to the economic sanctions, which several countries imposed on India after the nuclear test in May 1998, and also due to the collapse of East Asia's demand for Indian products. But a large part could be seen as the failure of the new economic policy to provide any deep-rooted benefits for the mass of the people in India. The consumer boom could not be sustained because it was limited to a small section of the society and even that faction was becoming uncertain of its future. In December 1998, the country faced great depression announcing the longest downturn since the early 1990s. But it was not just a consumer

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recession, but also the pace of economic reforms, which had slowed down. A survey of people from the major cities with household income above Rs.3000 showed that people were becoming increasingly uncertain about their employment prospects and of sustaining their income level, besides having worries about inflation.

The downturn in the value of shares in the middle of 1990's had depleted faith in investment income. A collapse in the property market had left people with negative equity. Rising food prices were taking a larger portion of income and people were worried about spending on expensive consumer durable. Even among those who supported the new economic policy, there was a general acceptance that India was in deep recession. There was a feeling that reforms have played itself out, complaining that bureaucrats were infiltrating the independent regulatory bodies and thus, India suffered from delusions of grandeur on the world economic stage.51 The issues for policy debate have become more focused. In industrial policy, barriers to entry have largely gone but barriers to exit and industrial restructuring remained in question. Analyses of the obstacles in the way of the daunting task of industrial restructuring have focused attention on the need to modernise the legal framework. As regards the trade and foreign investment policy import of consumer

goods and foreign investments still evoked strong nationalist sentiments in some quarters. As far as the policy towards public sector was concerned, privatization has never been on the agenda but, faced with hard budget constraints, the states seemed to have shown the way towards a policy of outright and up-front privatization.

The progress on the financial sector reforms has been very slow after the securities scam of 1992. But gradual deregulation of the interest rates and the Central government’s decision to borrow at market interest rates to finance its deficit has meant that interest rates were high because of the heavy borrowing requirements of the Central government. Control of the fiscal deficit, therefore, was intimately linked not only with inflation control but also with growth. Insurance sector reforms were also long overdue, since they were seen as being potentially instrumental in increasing the flow of long-term funds into the economy.\(^{52}\)

In India, perceptions have been so strongly influenced by the counterproductive role of State intervention in the past that it has not yet recognised the possibilities of a creative interaction between the state and the market. Hence there was no attempt at rethinking and redefining the role of the state. This syndrome of rejection, rather than correction,

had other dimensions, which had serious implications. The perception of
the reformer's was that the strategy of the past four decades was a
complete mistake and that salvation lied in the new mantras, i.e., to get
prices right, rely on markets and integrate with the world economy.

**Conclusion**

The architects of economic liberalisation in India seem did not recognize
the significance of lessons, which emerge from experiences elsewhere. At
the same time, it was simply not possible to replicate development
experiences because economies were characterised by specificities in
time and space. Economic reforms, which were earlier welcomed and
regarded as a necessary feature for the India's development, have
changed the mindset of many due to the failure in the last few years. The
most important failures that emerged from the Indian market reform
experience were the neglect of human resources, and the neglect of
agrarian reforms. The agenda for reforms simply did not address these
failures because there was so little concern about development objectives
in the long term. It is worth noting that there was no mention of
education in the reform process, let alone human resource development.
Unless enough investment is done on human beings, productivity
increase might not follow structural reforms. And, in the absence of a
sufficiently developed human infrastructure, the benefits of integrating with the world economy might simply elude.

**Comparative Assessment**

Both in Russia and India, market reform strategies that were introduced in 1991 were based on a combination of measures aimed at economic stabilisation as well as structural reforms. In both these countries similarities were observed in reform process, as stabilisation was necessary to restore balance of payments equilibrium and to control inflation. The reform measures were equally important for their economy to grow and become competitive in the world. The similarities were also observed in the results: both these nations achieved results, which were far from satisfactory. The phase of crisis management both in Russia and India has come to an end as substantial progress has been made in bringing about fiscal correction. This was reflected by decline in inflation in the course of the years, but a great deal still remains to be done. Both for India and Russia, it is important to adopt a balance approach of liberalisation in its industrial and agricultural sectors. New opportunities need to be created in both the public and private sectors, and a greater flexibility and mobility also need to be adopted.