Chapter – 8
Conclusion & Suggestions

What Does Deregulation Mean?

The reduction or elimination of government power in a particular industry usually enacted to create more competition within the industry.

Economic development in India

The economic development in India followed a socialist-inspired policies for most of its independent history, including state-ownership of many sectors; extensive regulation and red tape known as "Licence Raj"; and isolation from the world economy. India's per capita income increased at only around 1% annualized rate in the three decades after Independence.[1] Since the mid-1980s, India has slowly opened up its markets through economic liberalization. After more fundamental reforms since 1991 and their renewal in the 2000s, India has progressed towards a free market economy.

In the late 2000s, India's growth has reached 7.5%, which will double the average income in a decade. Analysts say that if India pushed more fundamental market reforms, it could sustain the rate and even reach the government's 2011 target of 10%. States have large responsibilities over their economies. The annualized 1999-2008 growth rates for Gujarat (9.6%), Haryana (9.1%), or Delhi (8.9%) were significantly higher than for Bihar (5.1%), Uttar Pradesh (4.4%), or Madhya Pradesh (6.5%). India is the eleventh-largest economy in the world and the fourth largest by purchasing power parity adjusted exchange rates (PPP). On per capita basis, it ranks 128th in the world or 118th by PPP.

The economic growth has been driven by the expansion of services that have been growing consistently faster than other sectors. It is argued that the pattern of Indian development has been a specific one and that the
country may be able to skip the intermediate industrialization-led phase in the transformation of its economic structure. Serious concerns have been raised about the jobless nature of the economic growth.

Although living standards are rising fast, 75.6% of the population still lives on less than US$2 a day (PPP, around US$0.5 in nominal terms), compared to 73.0% in Sub-Saharan Africa. In terms of occupation, two-thirds of the Indian workforce earn their livelihood directly or indirectly through agriculture in rural villages. As a proportion of GDP, towns and cities make over two thirds of the Indian economy.

The progress of economic reforms in India is followed closely. The World Bank suggests that the most important priorities are public sector reform, infrastructure, agricultural and rural development, removal of labor regulations, reforms in lagging states, and HIV/AIDS. For 2010, India ranked 133rd in Ease of Doing Business Index, which is setback as compared with China 89th and Brazil 129th. According to Index of Economic Freedom World Ranking an annual survey on economic freedom of the nations, India ranks 124th as compared with China and Russia which ranks 140th and 143rd respectively in 2010.

**Industrial output**

An industrial zone near Mumbai, India.

India is fourteenth in the world in factory output. Manufacturing sector in addition to mining, quarrying, electricity and gas together account for 27.6% of the GDP and employ 17% of the total workforce. Economic reforms introduced after 1991 brought foreign competition, led to privatisation of
certain public sector industries, opened up sectors hitherto reserved for the public sector and led to an expansion in the production of fast-moving consumer goods. In recent years, Indian cities have continued to liberalize, but excessive and burdensome business regulations remain a problem in some cities, like Kochi and Kolkata.

Post-liberalisation, the Indian private sector, which was usually run by oligopolies of old family firms and required political connections to prosper was faced with foreign competition, including the threat of cheaper Chinese imports. It has since handled the change by squeezing costs, revamping management, focusing on designing new products and relying on low labour costs and technology.

**Services**

India is fifteenth in services output. Service industry employs 23% of the work force and is growing quickly, with a growth rate of 7.5% in 1991–2000, up from 4.5% in 1951–80. It has the largest share in the GDP, accounting for 57% in 2010 up from 20% in 1950. Business services (information technology, information technology enabled services, business process outsourcing) are among the fastest growing sectors contributing to one third of the total output of services in 2000. The growth in the IT sector is attributed to increased specialisation and availability of a large pool of low cost, highly skilled, educated and fluent English-speaking workers on the supply side and on the demand side, has increased demand from foreign consumers interested in India’s service exports or those looking to outsource their operations. India's IT industry, despite contributing significantly to its balance of payments, accounts for only about 1% of the total GDP or 1/50th of the total services.

The ITES-BPO sector has become a big employment generator especially amongst young college graduates. The number of professionals employed by IT and ITES sectors is estimated at around 1.3 million as on March 2006. Also, Indian IT-ITES is estimated to have helped create an additional 3 million job opportunities through indirect and induced employment.
Liberalisation in India

The Indian government headed by P.V. Narsimha Rao adopted the policy of economic liberalisation in 1991 with the aim of bringing prosperity to the country. Since then foreign investment worth billions of US$ has been made in the country but all this has only resulted into more poverty. The rural poverty has increased from 32 percent to 40 percent, and in States like Bihar, Maharashtra, and Karnataka and UP, the poor have become poorer. The economic liberalisation policy has only helped gone down during all these years of liberalisation.

Thousands of industrial units are lying closed, rendering millions of workers jobless. The new ventures are all going for very high tech projects, having a high degree of automation requiring minimal labour requirement. Every entrepreneur wishes to work with least labour component. As a result of all this the overall employment scenario has become very grim.

No wonder, then, that the forces of nationalism in India are against those who favour liberalisation. India has an annual GDP of $300 billion, vast natural resources, and as many highly educated, skilled middle class citizens as the total US population. For almost half a century, India's GDP grew by an average of less than 4 percent a year. Taiwan's GDP grew by an annual 8 percent during the same period, and South Korea's by 9 percent. Foreign direct investment in China, the world's largest Communist country, is now running at $37 billion a year, in India the figure is $2 billion. In India, the share of unemployed within the labour force is gradually on the rise, from 4.3 percent in 1991 to 5.5 percent in 1995. In the last two years, unemployment definitely must have gone up as the labour content of production has been declining. With employment opportunities stagnating and simultaneous growth in population, unemployment would naturally rise steadily. The Planning Commission of India has estimated that the labour force between the ages of 15 and 59 years would rise from 294.6 million in 1992 to 393.02 million in 2007. Creating jobs for them would really be a difficult task.

Even in China, where the process of liberalisation is said to be quite successful, the problem of joblessness has emerged as a big social problem,
inspite of the fact that around 70 million unemployed are covered by the "unemployment insurance". In China there are 150 to 160 million jobless people in the cities and villages. The high rate of unemployment is a direct consequence of the new path of economic liberalisation, or the so called, economic development. In the process of improving productivity, updating equipment and upgrading technology for modernisation, and of course for profit maximisation, they resort to laying off workforce making industrialisation or the modernisation a curse for these workers.

The process of the so called 'economic liberalisation' can never succeed in India if judicious use of resources, including the foreign investment, is not made and, if the labourforce is neglected the way it is presently being done.

India’s Liberalisation and Its Impact on India’s Economic Sense

India’s liberalisation, no doubt, has changed the economic landscape of Indian lives though to various degrees and levels. It overhauled India’s economy; government policies on economy, business, education, investment, foreign collaboration and privatisation; created billionaires owning multinational companies and acquired a competitive economic growth rate that poises the nation to be a world economic leader in the coming decade next to china.

But what has it done to the ordinary people of India?

Ideally, it would have transformed them into entrepreneurs, being able to make informed choices in doing business and managing various aspects of their lives. To make choices, they should be thinking rationally and acting freely; be creative, imaginative, good leaders, managers and decision makers, good individuals, role models to family, good politicians and good citizens.

And how many Indians have become anything of that?

In 1991, when a bankrupt India was initiated into economic liberalisation, hardly few Indians knew what it entailed and from the government’s side, it did very little to create any public awareness on the topic. So in all probabilities, the public was forced to take it as it came; as the opening up of the new consumer shops across the nation, availability of
foreign branded goods in the place of ugly, inefficient, non-consumer caring local products and the opening up of unprecedented job markets both locally and internationally.

It is in the Indian blood to be enthused by chances. This time the chance came in the highly advanced IT industries an industry key to the materialisation and advancement of the liberalisation and globalisation packages. Indians’ intuitive intelligence and flair for numbers made their overwhelming entry into the industry. When job opportunities in the industries soared up locally and internationally, so did the Indians qualifying out of universities and colleges for them. The industry added another dogma to the Indian communities around which they created a new religion the digital religion.

The industry also made many millionaires out of Indians.

Even earlier to liberlisation, Indian professionals were in great demand in the foreign nations. With the advent of liberalisation and the nations across the world embarking on massive developmental and construction projects their demand multiplied. Not only professionals, its blue colour force also gained demand overseas, especially in the Gulf regions.

The new riches brought in new challenges to the Indian communities, but the Indians never bothered about them. I shall discuss a few of those challenges here and in my future posts.

1. Indians adopted a new spendthrift economy.

Indians in all my presumption had traditionally maintained a spiritual relationship with money. I am no talking about India’s fake spiritual leaders’ canon that being rich is a spiritual outcome of their birth. Those who earned money through hard work, had realised that its transaction should be carried out in a religious manner. That is money is not simply material, rather a disciplined and moral approach should regulate its creation and consumption.

But for the contrivances of globalisation and market, money is purely material regulated by strange rules, morality not one among them. They tossed into Indian hands plenty money; foreign money, bribe money, charity
and aid money, black money, loan money and all with such ease that Indians dropped their traditional sense of economy to adopt a spendthrift one.

A major share of India’s growth profile comes from the consumer spending of its newly moneyed class. It comes to them as an ego boosting gala. One is tempted to strike a comparison between this gala and the old extravagance by India’s racist categories – the royals, the feudal chieftains, the princely classes and their satellites-through pillaging India’s national wealth. How devastating its impact was on the common man’s economy no words can explain. Yet to their peril India’s common man and woman have a piquant taste to follow their racial categories in attitude and lifestyle.

However, the good thing is that to the economic hold up, India’s fifty years of democracy, an extended version of its dynasty and colonial ruling had held its common man, globalisation has provided some answers. Without instilling any dent on India’s old feudal capital ownership, it created a new economic classification-the lower, middle and the upper among Indians against its old racial avarna-savrna categorization.

That is a credit to liberalisation. Global openings and the subsequent call for human skills gave the socially backward a new impetus to sell their skills in the lucrative markets, locally and internationally for good economic returns.

The new Indian dream is to scale down each of that economic category to reach top by whatever means. India’s civil servants’ answer to their dream is bribe. They no longer play tactics to lure customers into paying it but threaten them with the no bribe no service slap. Before, a few rupees, now it bypasses a portion of the customer’s wealth. In Kerala, the most literate state in India, almost hundred percent of its civil servants do not full fill their official duties for which they take a salary from the government, without receiving a bribe.

True, liberalisation unleashed Indian potential and created opportunities. It produced Indian millionaires and billionaires. It displaced the economic landscape of the country to the point of no return. However damaging their impacts are, they are going to stay on for a long period. It is
for the Indians to redefine their applications and use them on their own terms and need. And Indians are capable to do that.

**Economic Reforms in India since 1991: Has Gradualism Worked?**

India was a latecomer to economic reforms, embarking on the process in earnest only in 1991, in the wake of an exceptionally severe balance of payments crisis. The need for a policy shift had become evident much earlier, as many countries in east Asia achieved high growth and poverty reduction through policies which emphasized greater export orientation and encouragement of the private sector. India took some steps in this direction in the 1980s, but it was not until 1991 that the government signaled a systemic shift to a more open economy with greater reliance upon market forces, a larger role for the private sector including foreign investment, and a restructuring of the role of government.

India’s economic performance in the post-reforms period has many positive features. The average growth rate in the ten year period from 1992-93 to 2001-02 was around 6.0 percent, as shown in Table 1, which puts India among the fastest growing developing countries in the 1990s. This growth record is only slightly better than the annual average of 5.7 percent in the 1980s, but it can be argued that the 1980s growth was unsustainable, fuelled by a buildup of external debt which culminated in the crisis of 1991. In sharp contrast, growth in the 1990s was accompanied by remarkable external stability despite the east Asian crisis. Poverty also declined significantly in the post-reform period, and at a faster rate than in the 1980s according to some studies (as Ravalli on and Datt discuss in this issue).

However, the ten-year average growth performance hides the fact that while the economy grew at an impressive 6.7 percent in the first five years after the reforms, it slowed down to 5.4 percent in the next five years. India remained among the fastest growing developing countries in the second sub-period because other developing countries also slowed down after the east Asian crisis, but the annual growth of 5.4 percent was much below the target
of 7.5 percent which the government had set for the period. Inevitably, this has led to some questioning about the effectiveness of the reforms.

Opinions on the causes of the growth deceleration vary. World economic growth was slower in the second half of the 1990s and that would have had some dampening effect, but India’s dependence on the world economy is not large enough for this to account for the slowdown. Critics of liberalization have blamed the slowdown on the effect of trade policy reforms on domestic industry (for example, Nambiar et al, 1999; Chaudhuri, 2002). However, the opposite view is that the slowdown is due not to the effects of reforms, but rather to the failure to implement the reforms effectively. This in turn is often attributed to India’s gradualist approach to reform, which has meant a frustratingly slow pace of implementation. However, even a gradualist pace should be able to achieve significant policy changes over ten years. This paper examines India’s experience with gradualist reforms from this perspective.

We review policy changes in five major areas covered by the reform program: fiscal deficit reduction, industrial and trade policy, agricultural policy, infrastructure development and social sector development. Based on this review, we consider the cumulative outcome of ten years of gradualism to assess whether the reforms have created an environment which can support 8 percent GDP growth, which is now the government target.

Savings, Investment and Fiscal Discipline

Fiscal profligacy was seen to have caused the balance of payments crisis in 1991 and a reduction in the fiscal deficit was therefore an urgent priority at the start of the reforms. The combined fiscal deficit of the central and state governments was successfully reduced from 9.4 percent of GDP in 1990-91 to 7 percent in both 1991-92 and 1992-93 and the balance of payments crisis was over by 1993. However, the reforms also had a medium term fiscal objective of improving public savings so that essential public investment could be financed with a smaller fiscal deficit to avoid "crowding
out” private investment. This part of the reform strategy was unfortunately never implemented.

As shown in Table 2, public savings deteriorated steadily from +1.7 percent of GDP in 1996-97 to −1.7 percent in 2000-01. This was reflected in a comparable deterioration in the fiscal deficit taking it to 9.6 percent of GDP in 2000-01. Not only is this among the highest in the developing world, it is particularly worrisome because India’s public debt to GDP ratio is also very high at around 80%. Since the total financial savings of households amount to only 11 percent of GDP, the fiscal deficit effectively preempts about 90 percent of household financial savings for the government. What is worse, the rising fiscal deficit in the second half of the 1990s was not financing higher levels of public investment, which was more or less constant in this period.

These trends cast serious doubts on India’s ability to achieve higher rates of growth in future. The growth rate of 6 percent per year in the post-reforms period was achieved with an average investment rate of around 23 percent of GDP. Accelerating to 8 percent growth will require a commensurate increase in investment. Growth rates of this magnitude in East Asia were associated with investment rates ranging from 36-38 percent. While it can be argued that there was overinvestment in East Asia, especially in recent years, it is unlikely that India can accelerate to 8 percent growth unless it can raise the rate of investment to around 29-30 percent of GDP. Part of the increase can be financed by increasing foreign direct investment, but even if foreign direct investment increases from the present level of 0.5 percent of GDP to 2.0 percent -- an optimistic but not impossible target -- domestic savings would still have to increase by at least 5 percentage points of GDP.

Can domestic savings be increased by this amount? As shown in Table 2, private savings have been buoyant in the post-reform period, but public savings have declined steadily. This trend needs to be reversed. Both the central government and the state governments would have to take a number of hard decisions to bring about improvements in their respective spheres.

The central government’s effort must be directed primarily towards improving revenues, because performance in this area has deteriorated
significantly in the post reform period. Total tax revenues of the center were 9.7 percent of GDP in 1990-91. They declined to only 8.8 percent in 2000-01, whereas they should have increased by at least two percentage points. Tax reforms involving lowering of tax rates, broadening the tax base and reducing loopholes were expected to raise the tax ratio and they did succeed in the case of personal and corporate income taxation but indirect taxes have fallen as a percentage of GDP. This was expected in the case of customs duties, which were deliberately reduced as part of trade reforms, but this decline should have been offset by improving collections from domestic indirect taxes on goods and by extending indirect taxation to services. This part of the revenue strategy has not worked as expected. The Advisory Group on Tax Policy for the Tenth Plan recently made a number of proposals for modernizing tax administration, including especially computerization, reducing the degree of exemption for small scale units and integration of services taxation with taxation of goods (Planning Commission, 2001a). These recommendations need to be implemented urgently.

There is also room to reduce central government subsidies, which are known to be highly distortionary and poorly targeted (e.g. subsidies on food and fertilizers), and to introduce rational user charges for services such as passenger traffic on the railways, the postal system and university education. Overstaffing was recently estimated at 30 percent and downsizing would help reduce expenditure.

State governments also need to take corrective steps. Sales tax systems need to be modernized in most states. Agricultural income tax is constitutionally assigned to the states, but no state has attempted to tax agricultural income. Land revenue is a traditional tax based on landholding, but it has been generally neglected and abolished in many states. Urban property taxation could yield much larger resources for municipal governments if suitably modernized, but this tax base has also been generally neglected. State governments suffer from very large losses in state electricity boards (about 1 percent of GDP) and substantial losses in urban water supply, state road transport corporations and in managing irrigation systems. Overstaffing is greater in the states than in the center.
The fiscal failures of both the central and the state governments have squeezed the capacity of both the center and the states to undertake essential public investment. High levels of government borrowing have also crowded out private investment. Unless this problem is addressed, the potential benefits from reforms in other areas will be eroded and it may be difficult even to maintain the average growth rate of 6 percent experienced in the first ten years after the reforms, let alone accelerate to 8 percent.

Reforms in Industrial and Trade Policy

Reforms in industrial and trade policy were a central focus of much of India’s reform effort in the early stages. Industrial policy prior to the reforms was characterized by multiple controls over private investment which limited the areas in which private investors were allowed to operate, and often also determined the scale of operations, the location of new investment, and even the technology to be used. The industrial structure that evolved under this regime was highly inefficient and needed to be supported by a highly protective trade policy, often providing tailor-made protection to each sector of industry. The costs imposed by these policies had been extensively studied (for example, Bhagwati and Desai, 1965; Bhagwati and Srinivasan, 1971; Ahluwalia, 1985) and by 1991 a broad consensus had emerged on the need for greater liberalization and openness. A great deal has been achieved at the end of ten years of gradualist reforms.

Industrial Policy

Industrial policy has seen the greatest change, with most central government industrial controls being dismantled. The list of industries reserved solely for the public sector -- which used to cover 18 industries, including iron and steel, heavy plant and machinery, telecommunications and telecom equipment, minerals, oil, mining, air transport services and electricity generation and distribution -- has been drastically reduced to three: defense aircrafts and warships, atomic energy generation, and railway transport. Industrial licensing by the central government has been almost abolished except for a few hazardous and environmentally sensitive industries. The
requirement that investments by large industrial houses needed a separate clearance under the Monopolies and Restrictive Trade Practices Act to discourage the concentration of economic power was abolished and the act itself is to be replaced by a new competition law which will attempt to regulate anticompetitive behavior in other ways.

The main area where action has been inadequate relates to the long standing policy of reserving production of certain items for the small-scale sector. About 800 items were covered by this policy since the late 1970s, which meant that investment in plant and machinery in any individual unit producing these items could not exceed $250,000. Many of the reserved items such as garments, shoes, and toys had high export potential and the failure to permit development of production units with more modern equipment and a larger scale of production severely restricted India’s export competitiveness. The Report of the Committee on Small Scale Enterprises (1997) and the Report of the Prime Minister’s Economic Advisory Council (2001) had both pointed to the remarkable success of China in penetrating world markets in these areas and stimulating rapid growth of employment in manufacturing. Both reports recommended that the policy of reservation should be abolished and other measures adopted to help small-scale industry. While such a radical change in policy was unacceptable, some policy changes have been made very recently: fourteen items were removed from the reserved list in 2001 and another 50 in 2002. The items include garments, shoes, toys and auto components, all of which are potentially important for exports. In addition, the investment ceiling for certain items was increased to $1 million. However, these changes are very recent and it will take some years before they are reflected in economic performance.

Industrial liberalization by the central government needs to be accompanied by supporting action by state governments. Private investors require much permission from state governments to start operations, like connections to electricity and water supply and environmental clearances. They must also interact with the state bureaucracy in the course of day-to-day operations because of laws governing pollution, sanitation, workers’ welfare and safety, and such. Complaints of delays, corruption and harassment
arising from these interactions are common. Some states have taken
initiatives to ease these interactions, but much more needs to be done.

A recently completed joint study by the World Bank and the
Confederation of Indian Industry (Stern, 2001) found that the investment
climate varies widely across states and these differences are reflected in a
disproportional share of investment, especially foreign investment, being
concentrated in what are seen as the more investor-friendly states
(Maharashtra, Gujarat, Karnataka, Andhra Pradesh and Tamil Nadu) to the
disadvantage of other states (like Uttar Pradesh, Bihar and West Bengal).
Investors perceived a 30 percent cost advantage in some states over others,
on account of the availability of infrastructure and the quality of governance.
These differences across states have led to an increase in the variation in
state growth rates, with some of the less favored states actually decelerating
compared to the 1980s (Ahuwalia, 2002). Because liberalization has created
a more competitive environment, the pay off from pursuing good policies has
increased, thereby increasing the importance of state level action.
Infrastructure deficiencies will take time and resources to remove but
deficiencies in governance could be handled more quickly with sufficient
political will.

Trade Policy

Trade policy reform has also made progress, though the pace has
been slower than in industrial liberalization. Before the reforms, trade policy
was characterized by high tariffs and pervasive import restrictions. Imports of
manufactured consumer goods were completely banned. For capital goods,
raw materials and intermediates, certain lists of goods were freely importable,
but for most items where domestic substitutes were being produced, imports
were only possible with import licenses. The criteria for issue of licenses were
nontransparent; delays were endemic and corruption unavoidable. The
economic reforms sought to phase out import licensing and also to reduce
import duties.

Import licensing was abolished relatively early for capital goods and
intermediates which became freely importable in 1993, simultaneously with
the switch to a flexible exchange rate regime. Import licensing had been traditionally defended on the grounds that it was necessary to manage the balance of payments, but the shift to a flexible exchange rate enabled the government to argue that any balance of payments impact would be effectively dealt with through exchange rate flexibility. Removing quantitative restrictions on imports of capital goods and intermediates was relatively easy, because the number of domestic producers was small and Indian industry welcomed the move as making it more competitive. It was much more difficult in the case of final consumer goods because the number of domestic producers affected was very large (partly because much of the consumer goods industry had been reserved for small scale production). Quantitative restrictions on imports of manufactured consumer goods and agricultural products were finally removed on April 1, 2001, almost exactly ten years after the reforms began, and that in part because of a ruling by a World Trade Organization dispute panel on a complaint brought by the United States.

Progress in reducing tariff protection, the second element in the trade strategy, has been even slower and not always steady. As shown in Table 3, the weighted average import duty rate declined from the very high level of 72.5 percent in 1991-92 to 24.6 percent in 1996-97. However, the average tariff rate then increased by more than 10 percentage points in the next four years. In February 2002, the government signaled a return to reducing tariff protection. The peak duty rate was reduced to 30 percent, a number of duty rates at the higher end of the existing structure were lowered, while many low end duties were raised to 5 percent. The net result is that the weighted average duty rate is 29 percent in 2002-03.

Although India’s tariff levels are significantly lower than in 1991, they remain among the highest in the developing world because most other developing countries have also reduced tariffs in this period. The weighted average import duty in China and Southeast Asia is currently about half the Indian level. The government has announced that average tariffs will be reduced to around 15 percent by 2004, but even if this is implemented, tariffs in India will be much higher than in China which has committed to reduce
weighted average duties to about 9 percent by 2005 as a condition for admission to the World Trade Organization.

**Infrastructure Development**

Rapid growth in a globalized environment requires a well-functioning infrastructure including especially electric power, road and rail connectivity, telecommunications, air transport, and efficient ports. India lags behind east and Southeast Asia in these areas. These services were traditionally provided by public sector monopolies but since the investment needed to expand capacity and improve quality could not be mobilized by the public sector, these sectors were opened to private investment, including foreign investment. However, the difficulty in creating an environment which would make it possible for private investors to enter on terms that would appear reasonable to consumers, while providing an adequate risk-return profile to investors, was greatly underestimated. Many false starts and disappointments have resulted.

The greatest disappointment has been in the electric power sector, which was the first area opened for private investment. Private investors were expected to produce electricity for sale to the State Electricity Boards, which would control of transmission and distribution. However, the State Electricity Boards were financially very weak, partly because electricity tariffs for many categories of consumers were too low and also because very large amounts of power were lost in transmission and distribution. This loss, which should be between 10 to 15 percent on technical grounds (depending on the extent of the rural network), varies from 35 to 50 percent. The difference reflects theft of electricity, usually with the connivance of the distribution staff. Private investors, fearing nonpayment by the State Electricity Boards insisted on arrangements which guaranteed purchase of electricity by state governments backed by additional guarantees from the central government. These arrangements attracted criticism because of controversies about the reasonableness of the tariffs demanded by private sector power producers. Although a large number of proposals for private sector projects amounting to about 80 percent of existing generation capacity were initiated, very few
reached financial closure and some of those which were implemented ran into trouble subsequently.

Because of these difficulties, the expansion of generation capacity by the utilities in the 1990s has been only about half of what was targeted and the quality of power remained poor with large voltage fluctuations and frequent interruptions.

The flaws in the policy have now been recognized and a more comprehensive reform is being attempted by several state governments. Independent statutory regulators have been established to set tariffs in a manner that would be perceived to be fair to both consumers and producers. Several states are trying to privatize distribution in the hope that this will overcome the corruption which leads to the enormous distribution losses. However, these reforms are not easy to implement. Rationalization of power tariffs is likely to be resisted by consumers long used to subsidized power, even though the quality of the power provided in the pre-reform situation was very poor. The establishment of regulatory authorities that are competent and credible takes time. Private investors may not be able to enforce collection of amounts due or to disconnect supply for non-payment without adequate backing by the police. For all these reasons, private investors perceive high risks in the early stages and therefore demand terms that imply very high rates of return. Finally, labor unions are opposed to privatization of distribution.

These problems are formidable and many state governments now realize that a great deal of preliminary work is needed before privatization can be successfully implemented. Some of the initial steps, like tariff rationalization and enforcing penalties for non-payment of dues and for theft of power, are perhaps best implemented within the existing public sector framework so that these features, which are essential for viability of the power sector, are not attributed solely to privatization. If the efforts now being made in half a dozen states succeed, it could lead to a visible improvement within a few years.
The results in telecommunications have been much better and this is an important factor underlying India’s success in information technology. There was a false start initially because private investors offered excessively high license fees in bidding for licenses which they could not sustain, which led to a protracted and controversial renegotiation of terms. Since then, the policy appears to be working satisfactorily. Several private sector service providers of both fixed line and cellular services, many in partnership with foreign investors, are now operating and competing with the pre-existing public sector supplier. Teledensity, which had doubled from 0.3 lines per 100 population in 1981 to 0.6 in 1991, increased sevenfold in the next ten years to reach 4.4 in 2002. Waiting periods for telephone connections have shrunk dramatically. Telephone rates were heavily distorted earlier with very high long distance charges cross-subsidizing local calls and covering inefficiencies in operation. They have now been rebalanced by the regulatory authority, leading to a reduction of 30 percent in long distance charges. Interestingly, the erstwhile public sector monopoly supplier has aggressively reduced prices in a bid to retain market share.

Civil aviation and ports are two other areas where reforms appear to be succeeding, though much remains to be done. Two private sector domestic airlines, which began operations after the reforms, now have more than half the market for domestic air travel. However, proposals to attract private investment to upgrade the major airports at Mumbai and Delhi have yet to make visible progress. In the case of ports, 17 private sector projects involving port handling capacity of 60 million tons, about 20 percent of the total capacity at present, are being implemented. Some of the new private sector port facilities have set high standards of productivity.

India’s road network is extensive, but most of it is low quality and this is a major constraint for interior locations. The major arterial routes have low capacity (commonly just two lanes in most stretches) and also suffer from poor maintenance. However, some promising initiatives have been taken recently. In 1998, a tax was imposed on gasoline (later extended to diesel), the proceeds of which are earmarked for the development of the national highways, state roads and rural roads. This will help finance a major program
of upgrading the national highways connecting Delhi, Mumbai, Chennai and Calcutta to four lanes or more, to be completed by the end of 2003. It is also planned to levy modest tolls on these highways to ensure a stream of revenue which could be used for maintenance. A few toll roads and bridges in areas of high traffic density have been awarded to the private sector for development.

The railways are a potentially important means of freight transportation but this area is untouched by reforms as yet. The sector suffers from severe financial constraints, partly due to a politically determined fare structure in which freight rates have been set excessively high to subsidize passenger fares, and partly because government ownership has led to wasteful operating practices. Excess staff is currently estimated at around 25 percent. Resources are typically spread thinly to respond to political demands for new passenger trains at the cost of investments that would strengthen the capacity of the railways as a freight carrier. The Expert Group on Indian Railways (2002) recently submitted a comprehensive program of reform converting the railways from a departmentally run government enterprise to a corporation, with a regulatory authority fixing the fares in a rational manner. No decisions have been announced as yet on these recommendations.

Financial Sector Reform

India’s reform program included wide-ranging reforms in the banking system and the capital markets relatively early in the process with reforms in insurance introduced at a later stage.

Banking sector reforms included: (a) measures for liberalization, like dismantling the complex system of interest rate controls, eliminating prior approval of the Reserve Bank of India for large loans, and reducing the statutory requirements to invest in government securities; (b) measures designed to increase financial soundness, like introducing capital adequacy requirements and other prudential norms for banks and strengthening banking supervision; (c) measures for increasing competition like more liberal licensing of private banks and freer expansion by foreign banks. These steps have produced some positive outcomes. There has been a sharp reduction in the share of non-performing assets in the portfolio and more than 90 percent of
the banks now meet the new capital adequacy standards. However, these figures may overstate the improvement because domestic standards for classifying assets as non-performing are less stringent than international standards.

India’s banking reforms differ from those in other developing countries in one important respect and that is the policy towards public sector banks which dominate the banking system. The government has announced its intention to reduce its equity share to 33-1/3 percent, but this is to be done while retaining government control. Improvements in the efficiency of the banking system will therefore depend on the ability to increase the efficiency of public sector banks.

Skeptics doubt whether government control can be made consistent with efficient commercial banking because bank managers are bound to respond to political directions if their career advancement depends upon the government. Even if the government does not interfere directly in credit decisions, government ownership means managers of public sector banks are held to standards of accountability akin to civil servants, which tend to emphasize compliance with rules and procedures and therefore discourage innovative decision making. Regulatory control is also difficult to exercise. The unstated presumption that public sector banks cannot be shut down means that public sector banks that perform poorly are regularly recapitalized rather than weeded out. This obviously weakens market discipline, since more efficient banks are not able to expand market share.

If privatization is not politically feasible, it is at least necessary to consider intermediate steps which could increase efficiency within a public sector framework (see for example Ahluwalia 2002). These include shifting effective control from the government to the boards of the banks including especially the power to appoint the Chairman and Executive Directors which is at present with the government; removing civil servants and representatives of the Reserve Bank of India from these board; implementing a prompt corrective action framework which would automatically trigger regulatory action limiting a bank’s expansion capability if certain trigger points of financial
soundness are breeched; and finally acceptance of closure of insolvent public sector banks (with appropriate protection for small depositors). Unless some initiatives along these lines are taken, it is highly unlikely that public sector banks can rise to the levels of efficiency needed to support rapid growth.

Another major factor limiting the efficiency of banks is the legal framework, which makes it very difficult for creditors to enforce their claims. The government has recently introduced legislation to establish a bankruptcy law which will be much closer to accepted international standard. This would be an important improvement but it needs to be accompanied by reforms in court procedures to cut the delays which are a major weakness of the legal system at present.

Reforms in the stock market were accelerated by a stock market scam in 1992 that revealed serious weaknesses in the regulatory mechanism. Reforms implemented include establishment of a statutory regulator; promulgation of rules and regulations governing various types of participants in the capital market and also activities like insider trading and takeover bids; introduction of electronic trading to improve transparency in establishing prices; and dematerialization of shares to eliminate the need for physical movement and storage of paper securities. Effective regulation of stock markets requires the development of institutional expertise, which necessarily requires time, but a good start has been made and India’s stock market is much better regulated today than in the past. This is to some extent reflected in the fact that foreign institutional investors have invested a cumulative $21 billion in Indian stocks since 1993, when this avenue for investment was opened.

An important recent reform is the withdrawal of the special privileges enjoyed by the Unit Trust of India, a public sector mutual fund which was the dominant mutual fund investment vehicle when the reforms began. Although the Unit Trust did not enjoy a government guarantee, it was widely perceived as having one because its top management was appointed by the government. The Trust had to be bailed out once in 1998, when its net asset value fell below the declared redemption price of the units, and again in 2001.
when the problem recurred. It has now been decided that in future investors in the Unit Trust of India will bear the full risk of any loss in capital value. This removes a major distortion in the capital market, in which one of the investment schemes was seen as having a preferred position.

The insurance sector (including pension schemes), was a public sector monopoly at the start of the reforms. The need to open the sector to private insurance companies was recommended by an expert committee (the Malhotra Committee) in 1994, but there was strong political resistance. It was only in 2000 that the law was finally amended to allow private sector insurance companies, with foreign equity allowed up to 26 percent, to enter the field. An independent Insurance Development and Regulatory Authority has now been established and ten new life insurance companies and six general insurance companies, many with well-known international insurance companies as partners, have started operations. The development of an active insurance and pensions industry offering attractive products tailored to different types of requirements could stimulate long term savings and add depth to the capital markets. However, these benefits will only become evident over time.

Privatization

The public sector accounts for about 35 percent of industrial value added in India, but although privatization has been a prominent component of economic reforms in many countries, India has been ambivalent on the subject until very recently. Initially, the government adopted a limited approach of selling a minority stake in public sector enterprises while retaining management control with the government, a policy described as “disinvestment” to distinguish it from privatization. The principal motivation was to mobilize revenue for the budget, though there was some expectation that private shareholders would increase the commercial orientation of public sector enterprises. This policy had very limited success. Disinvestment receipts were consistently below budget expectations and the average realization in the first five years was less than 0.25 percent of GDP compared with an average of 1.7 percent in seventeen countries reported in a recent
study (see Davis et.al. 2000). There was clearly limited appetite for purchasing shares in public sector companies in which government remained in control of management.

In 1998, the government announced its willingness to reduce its shareholding to 26 percent and to transfer management control to private stakeholders purchasing a substantial stake in all central public sector enterprises except in strategic areas. The first such privatization occurred in 1999, when 74 percent of the equity of Modern Foods India Ltd. (a public sector bread-making company with 2000 employees), was sold with full management control to Hindustan Lever, an Indian subsidiary of the Anglo-Dutch multinational Unilever. This was followed by several similar sales with transfer of management: BALCO, an aluminium company; Hindustan Zinc; Computer Maintenance Corporation; Lagan Jute Machinery Manufacturing Company; several hotels; VSNL, which was until recently the monopoly service supplier for international telecommunications; IPCL, a major petrochemicals unit and Maruti Udyog, India’s largest automobile producer which was a joint venture with Suzuki Corporation which has now acquired full managerial controls.

The privatization of Modern Foods and BALCO generated some controversy, not so much on the principle of privatization, but on the transparency of the bidding process and the fairness of the price realized. Subsequent sales have been much less problematic and although the policy continues to be criticized by the unions, it appears to have been accepted by the public, especially for public sector enterprises that are making losses or not doing well. However, there is little public support for selling public sector enterprises that are making large profits such as those in the petroleum and domestic telecommunications sectors, although these are precisely the companies where privatization can generate large revenues. These companies are unlikely to be privatized in the near future, but even so, there are several companies in the pipeline for privatization which are likely to be sold and this will reduce resistance to privatizing profit-making companies.
An important recent innovation, which may increase public acceptance of privatization, is the decision to earmark the proceeds of privatization to finance additional expenditure on social sector development and for retirement of public debt. Privatization is clearly not a permanent source of revenue, but it can help fill critical gaps in the next five to ten years while longer term solutions to the fiscal problem are attempted. Many states have also started privatizing state level public sector enterprises. These are mostly loss making enterprises and are unlikely to yield significant receipts but privatization will eliminate the recurring burden of financing losses.

**Social Sector Development in Health and Education**

India’s social indicators at the start of the reforms in 1991 lagged behind the levels achieved in southeast Asia 20 years earlier, when those countries started to grow rapidly (Dreze and Sen, 1995). For example, India’s adult literacy rate in 1991 was 52 percent, compared with 57 percent in Indonesia and 79 percent in Thailand in 1971. The gap in social development needed to be closed, not only to improve the welfare of the poor and increase their income earning capacity, but also to create the preconditions for rapid economic growth. While the logic of economic reforms required a withdrawal of the state from areas in which the private sector could do the job just as well, if not better, it also required an expansion of public sector support for social sector development.

Much of the debate in this area has focused on what has happened to expenditure on social sector development in the post-reform period. Dev and Moolji (2002) find that central government expenditure on towards social services and rural development increased from 7.6 percent of total expenditure in 1990-91 to 10.2 percent in 2000-01, as shown in Table 4. As a percentage of GDP, these expenditures show a dip in the first two years of the reforms, when fiscal stabilization compulsions were dominant, but there is a modest increase thereafter. However, expenditure trends in the states, which account for 80 percent of total expenditures in this area, show a definite decline as a percentage of GDP in the post-reforms period. Taking central
and state expenditures together, social sector expenditure has remained more or less constant as a percentage of GDP.

Closing the social sector gaps between India and other countries in southeast Asia will require additional expenditure, which in turn depends upon improvements in the fiscal position of both the central and state governments. However, it is also important to improve the efficiency of resource use in this area. Saxena (2001) has documented the many problems with existing delivery systems of most social sector services, especially in rural areas. Some of these problems are directly caused by lack of resources, as when the bulk of the budget is absorbed in paying salaries, leaving little available for medicines in clinics or essential teaching aids in schools. There are also governance problems such as nonattendance by teachers in rural schools and poor quality of teaching.

Part of the solution lies in greater participation by the beneficiaries in supervising education and health systems, which in turn requires decentralization to local levels and effective peoples’ participation at these levels. Nongovernment organizations can play a critical role in this process. Different state governments are experimenting with alternative modalities but a great deal more needs to be done in this area.

While the challenges in this area are enormous, it is worth noting that social sector indicators have continued to improve during the reforms. The literacy rate increased from 52 percent in 1991 to 65 percent in 2001, a faster increase in the 1990s than in the previous decade, and the increase has been particularly high in the some of the low literacy states such as Bihar, Madhya Pradesh, Uttar Pradesh and Rajasthan.

The impact of ten years of gradualist economic reforms in India on the policy environment presents a mixed picture. The industrial and trade policy reforms have gone far, though they need to be supplemented by labor market reforms which are a critical missing link. The logic of liberalization also needs to be extended to agriculture, where numerous restrictions remain in place. Reforms aimed at encouraging private investment in infrastructure have worked in some areas but not in others. The complexity of the problems in this
area was underestimated, especially in the power sector. This has now been recognized and policies are being reshaped accordingly. Progress has been made in several areas of financial sector reforms, though some of the critical issues relating to government ownership of the banks remain to be addressed. However, the outcome in the fiscal area shows a worse situation at the end of ten years than at the start.

Critics often blame the delays in implementation and failure to act in certain areas to the choice of gradualism as a strategy. However, gradualism implies a clear definition of the goal and a deliberate choice of extending the time taken to reach it, in order to ease the pain of transition. This is not what happened in all areas. The goals were often indicated only as a broad direction, with the precise end point and the pace of transition left unstated to minimize opposition—and possibly also to allow room to retreat if necessary. This reduced politically divisive controversy, and enabled a consensus of sorts to evolve, but it also meant that the consensus at each point represented a compromise, with many interested groups joining only because they believed that reforms would not go “too far”. The result was a process of change that was not so much gradualist as fitful and opportunistic. Progress was made as and when politically feasible, but since the end point was not always clearly indicated, many participants were unclear about how much change would have to be accepted, and this may have led to less adjustment than was otherwise feasible.

The alternative would have been to have a more thorough debate with the objective of bringing about a clearer realization on the part of all concerned of the full extent of change needed, thereby permitting more purposeful implementation. However, it is difficult to say whether this approach would indeed have yielded better results, or whether it would have created gridlock in India’s highly pluralist democracy. Instead, India witnessed a halting process of change in which political parties which opposed particular reforms when in opposition actually pushed them forward when in office. The process can be aptly described as creating a strong consensus for weak reforms!
Have the reforms laid the basis for India to grow at 8 percent per year? The main reason for being optimistic is that the cumulative change brought about is substantial. The slow pace of implementation has meant that many of the reform initiatives have been put in place recently and their beneficial effects are yet to be felt. The policy environment today is therefore potentially much more supportive, especially if the critical missing links are put in place. However, the failure on the fiscal front could undo much of what has been achieved. Both the central and state governments are under severe fiscal stress which seriously undermines their capacity to invest in certain types of infrastructure and in social development where the public sector is the only credible source of investment. If these trends are not reversed, it may be difficult even to maintain 6 percent annual growth in the future, let alone accelerate to 8 percent. However, if credible corrective steps are taken on the fiscal front, then the cumulative policy changes that have already taken place in many areas, combined with continued progress on the unfinished agenda, should make it possible for India to accelerate to well beyond 6 percent growth over the next few years.

**GDP growth rate**

Since the economic liberalisation of 1991, India's GDP has been growing at a higher rate.

<table>
<thead>
<tr>
<th>Year</th>
<th>Growth (real) (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>5.5</td>
</tr>
<tr>
<td>2001</td>
<td>6.0</td>
</tr>
<tr>
<td>2002</td>
<td>4.3</td>
</tr>
<tr>
<td>2003</td>
<td>4.3</td>
</tr>
<tr>
<td>2004</td>
<td>8.3</td>
</tr>
<tr>
<td>2005</td>
<td>6.2</td>
</tr>
<tr>
<td>2006</td>
<td>8.4</td>
</tr>
<tr>
<td>2007</td>
<td>9.2</td>
</tr>
<tr>
<td>2008</td>
<td>9.0</td>
</tr>
<tr>
<td>2009</td>
<td>7.4</td>
</tr>
</tbody>
</table>

*Prime Minister's Economic Advisory Council* has projected the Indian economy to grow at 8.6% in 2010-11 and 9% in 2011-12 as of February 2011.
Companies 24

47 Indian companies were listed in the Forbes Global 2000 ranking for 2009. The 10 leading companies were:

<table>
<thead>
<tr>
<th>World Rank</th>
<th>Company</th>
<th>Industry</th>
<th>Revenue (billion $)</th>
<th>Profits (billion $)</th>
<th>Assets (billion $)</th>
<th>Market Value (billion $)</th>
</tr>
</thead>
<tbody>
<tr>
<td>121</td>
<td>Reliance Industries</td>
<td>Oil &amp; Gas Operations</td>
<td>34.03</td>
<td>4.87</td>
<td>43.61</td>
<td>35.95</td>
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<tr>
<td>150</td>
<td>State Bank of India</td>
<td>Banking</td>
<td>22.63</td>
<td>2.23</td>
<td>255.86</td>
<td>12.75</td>
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<tr>
<td>152</td>
<td>Oil and Natural Gas Corporation</td>
<td>Oil &amp; Gas Operations</td>
<td>24.04</td>
<td>4.95</td>
<td>35.35</td>
<td>28.91</td>
</tr>
<tr>
<td>207</td>
<td>Indian Oil Corporation</td>
<td>Oil &amp; Gas Operations</td>
<td>51.66</td>
<td>1.97</td>
<td>33.64</td>
<td>10.20</td>
</tr>
<tr>
<td>317</td>
<td>NTPC</td>
<td>Utilities</td>
<td>9.63</td>
<td>1.86</td>
<td>24.58</td>
<td>29.70</td>
</tr>
<tr>
<td>329</td>
<td>ICICI Bank</td>
<td>Banking</td>
<td>15.06</td>
<td>0.85</td>
<td>120.61</td>
<td>7.14</td>
</tr>
<tr>
<td>463</td>
<td>Tata Steel</td>
<td>Materials</td>
<td>32.77</td>
<td>3.08</td>
<td>31.16</td>
<td>2.46</td>
</tr>
<tr>
<td>508</td>
<td>Bharti Airtel</td>
<td>Telecommunications Services</td>
<td>6.73</td>
<td>1.59</td>
<td>12.28</td>
<td>23.63</td>
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<tr>
<td>582</td>
<td>Steel Authority of India Limited</td>
<td>Materials</td>
<td>9.82</td>
<td>1.89</td>
<td>10.54</td>
<td>6.14</td>
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<tr>
<td>689</td>
<td>Reliance Communications</td>
<td>Telecommunications Services</td>
<td>4.26</td>
<td>1.35</td>
<td>19.31</td>
<td>6.27</td>
</tr>
</tbody>
</table>

What Are The Advantages And Disadvantages Of Privatisation In Indian Economy?

The major advantages of privatization are as follows

1) It frees the resources for a more productive utilization.
2) Private concerns tend to be profit oriented and transparent in their functioning as private owners are always oriented towards making profits and get rid of sacred cows and hitches in conventional bureaucratic management.
3) Since the system becomes more transparent, all underlying corruptions are minimized and owners have a free reign and incentive for profit maximization so they tend to get rid of all free loaders and vices that are inherent in government functions.
4) It is less burdensome for the government.
5) Effectively minimizes corruption and optimizes output and functions.
6) Gets rid of employment inconsistencies like free loaders, or over employed departments reducing the strain on resources.

The major disadvantage of privatization is that private firms are less tolerant towards capitulations and appendages in government departments and hence tend to right size the human resource potential befitting the organization’s needs and may cause resistance and disgruntled employees who are accustomed to the benefits as government functionaries.

Per capital income in 1991 were 3.7 which were 7.3 in 2000 and almost ten times increase by 17.3 % in 2010.

Employment generation is also possible due to privatisation and government also introduce 100 days employment programme. The standard of living of people also growing as compare to past years.

Automobile industry car productions in 1991 were 533,149 which is increase to 2,814,584 which is 29.39 % increase in the year of 2010. Total
vehicle production in the year 1991 were 81,893 which is in the year 2011 3,536,783 i.e. 33.89% increase in comparison.

Slum clearance programmes, starvation fund to collector are also part of development in standard of living of the poor people as a part liberalisation.