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Economic Reforms for Globalisation of Indian Economy

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CHAPTER - IV

ECONOMIC REFORMS FOR GLOBALIZATION OF INDIAN ECONOMY

Introduction:

In the foregoing chapter a vivid discussion has been presented pertaining to the varied aspects of World Trade Organization (WTO) with special reference to India. The present chapter gives an extensive exposition regarding the economic reforms in India.

Economic reforms are indispensable tools of the modern age world economy. Economic reforms in India were initiated in July 1991 with three main objectives: stabilization, structural adjustments and globalization of Indian economy. These reforms mainly purported to correct the macro economic imbalances, which had destabilized the Indian economy in the 90's with ballooning inflation rate, high current account deficit, unsustainable fiscal deficit and acute shortage of foreign exchange reserves. As a result the government of India came out with a host of reform packages right from July 1991 in the following areas of business activities.

1. Economic Reforms in:
a. Capital market

b. Industrial reforms
   I) Industry
   ii) Trade policy related reforms
   iii) Infrastructure sector reforms
   iv) Foreign direct investment
   v) Foreign institutional investors

2. Financial Sector reforms

3. FERA and Multinational Corporations in India

4. Fiscal reforms

5. Insurance sector reforms

6. Banking reforms

**Capital Market And Globalization:**

The capital market of India has been witnessing a tremendous change with the inception of financial and economic reforms started in July 1991 to keep pace with the world economy. With the induction of globalization process changes in capital market started with a high speed to make conducive ground and atmosphere to bring it to the global standard. Unrestricted inflows and outflows of
funds due to the rupee convertibility have given a new
dimension to the growth and development of the capital
market. Indian capital market is being linked to
international markets with the introductions of Global
Depository Receipts (GDRs) and Foreign Currency
Convertible Bonds (FCCB). Indian capital market is a
multifaceted system having involved in numerous activities.
So changes in the capital market ensure improvement in
the infrastructure and institutional facilities provided by it
including clearance, settlement, depository procedures and
custodial facilities.\(^1\)

**Aims of Capital Market Reforms:**

The very first objective of reforms introduced in capital
market is to facilitate a rapid and sustained improvement
in the overall functioning of the capital market. To gain
investors confidence in the market by paying attention on
more and more transparent operation. To infuse new energy
as well as strengthen and sharpen the settlement process
and persistent uniform trading practices. To establish a well
and strong regulatory mechanism. To enhance and improve
the functioning of the capital market which eyes on the
mobilization of savings and channeling them into the most
appropriate productive uses. To make inroad for the issue of new types of equities and debt instruments. Capital market reforms also have the following motives. Modernization in comparison of other stock exchanges, efficient trading and clearance system, enhancing and sharpen the market efficiency, improving the system spreading information.$^2$

**Capital Market Reforms$^3$:**

Capital issues (control) Act, 1947, revoked, office of controller of capital issues abolished, and shares pricing decontrolled. The companies can approach capital market after clearance by SEBI.

Securities and Exchange Board of India (SEBI) was established in February 1992. SEBI was strengthening with necessary authority and powers for regulation and reform of the capital market.

A notification was issued under the Securities Contract (Regulation) Act, 1956, the power to guide and regulate stock exchanges, was entrusted to SEBI. This includes recognition, rules, and articles, voting rights, delivery contracts, stock exchanges listing and nomination of public representatives.
Reparation of complaints of investors is to be encouraged, sharing it with recognized investors associations. This will help in filing suits against companies involved in fault.

Permission has been given to Foreign Institutional Investors (FIIs) to operate in Indian capital markets, merely on registration with SEBI.

Investment regulations and procedures have been relaxed for NRIs, so that NRIs and corporate bodies can transact in share and debentures with prior permission of RBI.

Indian companies got permission to operate in international capital market through Euro-equity shares.

SEBI entrusted with the power of issuing regulations and file suits without prior nod of the central government.

Other organs of the capital market started functioning all over the country: These organs are Over The Counter Exchange of India (OTCE) and the National Stock Exchange of India with nation wide stock trading and electronic display, clearing and settlement facilities.

A code of conduct and regulatory framework was formulated to bring merchant banking under the SEBI regulations.

To protect the potential investors, the "Banker to the issues" brought under purview of SEBI.

The due diligence certificate by lead managers, regarding disclosures made in the offer document, has been made a part of the offer document itself for better accountability.

SEBI has transformed and improved disclosure standards; simplified norms and procedures have been formulated to accelerate overall system.

It was made a binding norm for companies to disclose all factual and specific risk factors attached with their projects while launching public issues.

Stock exchanges need to make it sure that concerned companies have a valid acknowledgement card issued by SEBI. SEBI should make a careful and critical examination of the offer document, to make it certain that all facts disclosed by the company in the offer document, at the time
the company applies for listing of its securities in the stock exchange, are in accordance with the prescribed norms.

Stock exchanges advised to amend the listing agreement to ensure that a listed company furnishes annual statement to stock exchanges, showing variations between financial projections and projected utilization of funds made in the offer documents and actual.

To discourage the use of stock-invest by institutional investors, the facility has been restricted to mutual funds and individual investors. SEBI issues a code of advertisement for public issues for ensuring truthful and fair disclosures.

To reduce the issue cost, underwriting by issuer made operational, subject to the condition that if an issue was not underwritten and was not able to collect 90 percent of the amount offered to the public, the entire amount collected would pay back to investors. The current guidelines for bonus shares have been slacked.

The practice of making preferential allotment of shares at prices unrelated to the prevailing market prices was stopped and fresh guidelines were issued by SEBI. An expert committee headed by Shri Y.H. Maligom entrusted
with the task of review the existing disclosure norms and issue procedures and suggested actions based on which new guidelines were issued.

SEBI to examine the draft prospectus within 21 days and mandatory period between the date of commend of the prospectus by the registrar of companies and the opening of the issue to be reduced to 14 days. The details of short prospectus to be thoroughly checked by SEBI before the issue of acknowledgement card.

SEBI reconstituted governing boards of the stock exchange, introduced capital adequacy norms for brokers and made rules for making the client/broker relationship more transparent, in particular, segregating client and broker accounts.

In 1996-97 the eligibility criteria for issuer was strengthen. Some measures have been taken to provide more flexibility in the issue process. Some stringent and detailed disclosure norms were prescribed, greater transparency in the issue of prospectus needed and separate criteria for financial companies have been introduced.

Criteria for accessing the securities market were strengthened. Issuers proposing to make first offer to the
public of equity, or any security convertible at a later date into equity are required to have a track record of dividend payment in three of the immediately preceding five years. Issuers not meeting this requirement can access to market, provided their projects is appraised by a scheduled commercial bank or a public financial institution with minimum 10 percent participatin in the project cost. Provided their securities are listed on the OTCEI. This requirement was also imposed in the case of issue made by listed companies where the post issue capital exceeds five times the equity capital prior the issue.

No entry restrictions for public sector banks to access market they have been permitted to comply with less strict criteria, public banks permitted to price issue at premium furnished they have a two year profitability record, as against the three year requirement for other issues.\(^6\)

Restriction was imposed on payment of any direct or indirect discounts or commissions to persons receiving firm allotment. Condition of 5 shareholders for every 1 lakh rupees of fresh issue of capital and 10 shareholders for every Rs. 1 lakh of offer for sale recommended as an initial and continuing listing condition. SEBI gave up vetting of
public issue offer documents. SEBI's comments on offer document, if any, will be communicated within 21 days of filing.

Debt issues not accompanied by an equity component allowed to be sold wholly by the book building system subject to guidelines prescribed in section 19(2)(b) of the Securities Contracts (Regulation) Rules.

The requirement of minimum shareholding are fulfilled, the need of 90 percent minimum subscription in case of "offer for sale" are no longer required. The 90 percent requirement is also not needed now in case of exclusive debt issue subject to certain disclosures and exemptions under the companies Act.

Housing finance companies deemed to be registered for issue purposes provided they were eligible for refinance from the National Housing Bank.

Corporate advertisements, between the date of issue of acknowledgement card and the date of closure of the issue have been permitted, subject to certain conditions, which include the disclosure of risk factors associated with the issue.
Promoters with a contribution exceeding Rs. 100 crore have been permitted to bring in their contribution in a phased manner, irrespective of their track record. Issuers have been permitted to list debt securities on stock exchanges without their equity being listed.8

No major changes have been brought down in the primary market in 1998-99. However, recommendations made by the “Informal Group on Primary Market” have been accepted and implementation commenced. Following are the main changes:1

1. After a specified date, the primary issues to be compulsorily made through the depository mode.

2. In the issues of Rs. 25 crore and above 100 percent book building permitted.

3. Reduction in the minimum number of mandatory collection centres in respect of issues above Rs. 10 crore to 4 metropolitan cities plus the place having the regional stock exchange.

SEBI decided to give some specific relaxation to public issue by infrastructure companies, in order to ensure more flow of funds to this sector.

The capital market in India has witnessed a sea change in operation of secondary market with the initiation and implementation of various reform packages right from July 1991. These reform measures are briefly adumbrated as under:

Regulations were introduced by SEBI which governs substantial acquisition of shares and takeovers and lays down conditions and terms under which disclosures and mandatory public offers are to be made to share holders.

'B' group securities renewal of transactions is prohibited so that transactions can be settled within 7 days.

Private mutual funds have now got permission and several have already been set up. All mutual funds allowed applying for firm allotment in public issues.

SEBI is authorized to control UTI. Fresh guidelines for advertising by mutual funds are issued and the requirement of pre-vetting of advertisements is removed.

To enhance the operation of area of investments by mutual funds, mutual funds are permitted to underwrite public issues and guidelines for investment in money market instruments are relaxed.
The procedure for lodgment of securities for transfer has been considerably relaxed for institutions through the introduction of 'jumbo' transfer deed and consolidated payment of stamp duty.

Stock exchanges are now required to take prior permission of SEBI, while introducing carry forward system. This is subject to effective monitoring and surveillance system and infrastructure.

The financiers funding the carry forward transactions being lenders of funds will not be allowed to settle their account till repayment of the loan. The carry forward situation shall be disclosed to the market, scrip-wise and broker-wise by the stock exchanges at the beginning of the carry forward session.

Capital adequacy norms of 3 percent for individual members and 6 percent for corporate members in their outstanding positions announced.

Those suggested by Patel Committee replace graded margins of 20 percent to 50 percent on carry forward transactions. Members doing financing of carry forward transactions will be subject to a limit of Rs. 10 crores.
The Depositaries Ordinance was promulgated in September 1995 to provide a legal framework for the establishment of depositories to record ownership details in book entry form.

The ordinance proposed to make consequential changes in legislation like the companies Act, Income Tax Act, SCRA, the Stamp act, etc. It provides for detailed regulations to be framed by SEBI as well as detailed byelaws to be framed by depositories with the consent of SEBI.

The reforms introduced in 1996-97 for secondary capital market is as follows:

Custodians of securities existing for a considerable period and engaged in providing services to a number of institutional investors can reach the required minimum net worth of Rs. 50 crore in a phased manner over a period of five years.

SEBI to have a custodian to appoint a compliance officer who will deal with the SEBI regarding complaint and reporting issues. Before incorporating any changes that have an impact on settlement of transactions of institutional investors, SEBI should have meetings with the Association of Custodial Agencies of India (ACAI).
Stock exchanges asked to modify the listing agreement to provide for payment of interest by companies to investors from the 30th day after the closure of public issues.

Uniform good-bad delivery norms and procedure for time bound resolution of bad deliveries through bad delivery cell prescribed. Bad delivery cell procedure has helped to standardize norms.

The National Stock Exchange should follow all exchanges to institute the buy-in or auction procedure.

In view of the falling percentage of deliveries, exchanges asked to collect 100 percent daily margins on national loss of a broker for every scrip, to restrict gross traded value to 33.33 time the broker's base minimum capital and to impose quarterly margins on the basis of concentration ratios.

A study group is made to recommend norms and procedures for greater transparency and fairness in buying negotiated deals.

Stock exchanges are required to establish a clearinghouse or clearing corporation. Stock exchanges are not allowed to renew cash group contracts of shares from
one settlement to another. A core group for enter-exchange market surveillance has been set up for coordinating action in case of abnormal valuation.

SEBI has been given permission for expansion of the trading terminals of screen-based trading systems of stock exchanges to non-stock exchange cities. Expansion of terminals has also been permitted in those cities where they already exist but they are required to a common understanding with the local stock exchange. Membership will be open to the brokers of the other local exchanges. It is expected to provide a sufficient system for settling investor complaints and for timely settlement of arbitration cases arising out of trades transacted on the extended terminals. The expansion of Bombay on Line Trading (BOLT) system of the stock exchange, Mumbai to the trading systems of other exchanges will be ensuring sufficient monitoring and observation system, stipulation of usual margins, capital adequacy, intra-day trading limits fixed for the broker stock exchange and the introduction of trade guarantees. The expansion of terminals will ensure more competition between various stock exchanges and enhance their efficiency.
The National Securities Clearing Corporation Limited (NSCCL) is given the task of guaranteeing settlement of trades in the capital market segment of the NSE. The NSSCL has gained a good progress in strengthening clearing facilities in other regions by setting up regional clearing facilities. This will enhance the efficiency of clearing system.

The Dave Committee on Over the Counter Exchange of India (OTCEI) has commended ease up in the maximum size of the issues that may be got listed on OTCEI, relaxation in listing criteria and a shift from a rolling (T+3) settlement to five day account period settlement being followed by other exchanges. Most of the recommendations made by Dave Committee for making OTCEI's functioning more flexible effective and viable have been considered by SEBI and they are in the process of implementation.\textsuperscript{12}

At the end of each day, short as well as long sales will have to be disclosed to the exchange. They would be controlled through the imposition of margins.

Scheme of stock lending has been started. Stock lending has been authorized in which short sellers can obtain securities from an intermediary before making such sales
The authorized intermediaries should have minimum net worth of Rs. 50 crore.

Reforms introduced in the secondary market in 1998-99 are as follows:

In secondary market reforms have been taken to enhance investor interest in the share market by providing facility of buy back of share. Other steps have taken by the government are as under:

(I) Amendment of SEBI Takeover Regulations,

(ii) Extension of damut trading to more scrips.

(iii) Introduction of rolling settlement in the damut segment.

(iv) More strict disclosure requirements and stipulation of additional margin requirements aimed at curbing excess volatility in share prices.

Securities and Exchange Board of India (SEBI):

The Securities and Exchange Board of India (SEBI) was formed on April 12, 1988, to accelerate orderly growth of capital market. The SEBI Act, 1992 gave statutory powers to the SEBI for the following purposes:
To control corporate and market intermediaries in a dynamic style, the government, on the 26th January 1992, empowered the SEBI to penalize inside traders. These powers were entrusted to the SEBI through promulgation of an ordinance amending the SEBI Act, 1992.

The government permitted reintroduction of options trading almost after 40 years, through the amendment made in the Securities Contract (Regulation) Act, 1956. Under new system, securities Appellate Tribunal has been set up to deal with the appeals made against penalties imposed by the SEBI. The amendments enable the SEBI, with regulatory powers over corporate in the issue of capital, transfer of securities and other concerned matters. The amendments also provide that a stock exchange can expand its trading floors only with the prior permission of SEBI.^^

Initiatives of SEBI^14:^  
1. SEBI has established guidelines and norms for the purpose of regulation and control.  
2. Corporations have recommended strict disclosure terms and conditions for compliance.  
3. Mandatory bar of credit rating has been imposed for issue of debentures etc.
4. The capital market of India is opened to foreign institutional investors.

5. In August 1995, government passed the depository system legislation.

6. The SHCIL has opened two companies - National Depository Corporation of India Limited (NDCIL) and Indian Securities Depository Nominee Company Ltd. (ISDNCL) - to render the introduction of a scripless trading mechanism in the Indian capital market.

**Securities Trading Corporation of India (STCI):**

In 1994 a Securities Trading Corporation of India was set up as a developing agent of secondary market in government securities. The STCI has started functioning from June 27, 1994.

Reserve Bank of India announced that a primary dealer mechanism is being set up in order to strengthen the secondary market structure. Primary dealers would work like the underwriter of the auctions of government securities. They will act as a 'market maker' by providing two way quotes and made securities accessible to final investors. The main focus of primary dealers would be to increase the turnover of government securities. Primary dealers got some
special facilities by the Reserve Bank of India, as the means of keeping liquidity in their operations. To avail of special facilities, the primary dealers are required to fulfill certain conditions. That is, they should have a satisfactory presence in the auctions. The primary dealers would also be subject to discretionary norms.

Role of SEBI:

SEBI is entrusted to create a conducive and proper ground required for raising funds from the capital market. The environment which is essential for raising money from the capital market, includes the rules, trade practices, regulations, customs and relations among institutions, brokers, companies and investors. SEBI should endeavour to held the trust of investors and safeguard the interest of investors in general and small investors in particular. This can be attained simply by matching the needs of the persons connected with the security market and maintaining a good coordination among three main bodies directly involved with its operations, namely (a) Investors, (b) Corporate sectors, and (c) Intermediaries.

SEBI should provide good and accurate information and it should also make investors aware of their rights in clear
and precise terms. It should also keep vigilance on the market liquidity. Safety and profitability of the securities.

SEBI should maintain a conducive investment environment and facilitate the corporate sector with better framework to raise industrial securities easily, efficiently and at affordable cost.

SEBI should maintain a good network of infrastructure, in order to facilitate expansion and growth of merchant bankers, brokers, commercial banks, mutual funds etc. It will provide efficient service to the investors and the corporate sector at a competitive price.

SEBI should develop framework and guidelines for more open, orderly and unbiased conduct in connection to takeover and mergers in the corporate sector to secure just and equal treatment to all the investors and to create an atmosphere conducive and smoothly going path for takeovers and mergers. It should ensure efficient and unbiased mechanism for more orderly conduct in relation to takeovers and mergers.\(^{15}\)

SEBI shall draw more effective and strong law in the existing set up as far as they relate to the industrial investment, mutual funds, investments in units, LIC savings
plan, Unit fund, industrial societies and corporations with the purpose of making investment in housing/industrial projects.

SEBI should act as an authoritative institution to ensure that the intermediaries are financially strong and furnished with professional and efficient personnel. SEBI should make laws with a specific role of objectives, single administrative authority and an integrated set of policy framework to handle all the aspects of the capital market. It shall adopt a two-stage system of disclosure at the time of initial issue and make obligatory for the corporate houses to furnish detailed information to all the stock exchanges, journalists and investors on demand.¹⁶

SEBI should make a sound relation with the Institute of Chartered Accountants of India, which ultimately will facilitate to devise more effective and modern accounting and auditing standards. It should attempt to impose disciplinary obligations on management, in financial reporting and deal strictly with cases where windows dressing and accounting prudence are employed to the loss of the interest of users of such financial reports and statements.
SEBI should make law-making mechanism flexible and dynamic to match with the changing market situations and circumstances. It should make sure that the regulatory framework is dynamic and non-rigid to provide automatic and self-sustain growth and development.

It will vet the flexibility of introducing dealers’ network by which securities can be easily bought or sold over the counter as in a retail shop. This will enhance liquidity and investment opportunities. There should not be any constrain over the transactions.

**Industrial Reforms:**

Various economic reforms initiated in 1991 to boost the overall growth of economy upto the standard of global economy. These reforms were mainly started to attain globalisation via liberalization. The following reforming steps have been taken in various sectors of the economy.  

**Industry:**

1. Various segments of industry have been delicensed, such as, coal, lignite, petroleum (other than crude) and its distillation products and bulk of drugs.

2. Sugar industry delicensed.

4. Companies are allowed to buy back their own shares subject to a limit of buy-back to twenty five percent of paid up capital and free services.

5. A national task force remitted its 108 points report on information technology and software development. Recommendations made by the Committee have been got nod of government, and proper line of action has been delivered to the department concerned, for its proper implementation.

6. Patent bill has been commended by Rajya Sabha and subsequently promulgated through an ordinance.

**Trade Policy Related Reforms:**

The following are the trade policy reforms:

1. By the April 1998 Exim Policy delicensed 340 items of import by shifting them from the restricted list to OGL.

2. An agreement on free trade was initiated on 28 December 1998 between India and Sri Lanka. It will result in zero import tariffs for most commodities on both sides by 2007.
3. Payment of interest on dues to exporters for delays in duty drawback/refund of duty beyond two months.

4. Extension of tax holiday for EOU/EPZ to 10 years.

5. With effect from August 1, 1998, India unilaterally removed all quantitative restrictions on imports of around 2300 items from SAARC countries.

6. Government has given permission to set up private Software Technology Parks (STPs) for exports.

7. The scope of Export Promotion Capital Goods scheme at zero duty has been enlarged further to certain specified biotechnologies and small scale engineering industry.

**Infrastructure Sector:**

1. A room has been made for private investment in power transmission, by amending the Indian Electricity Act, 1910 and Electricity (Supply) Act, 1948.

2. Of the various enactment of the Electricity Regulatory Commission Legislation, the Central Electricity Regulatory Commission was set up with good bunch of provisions for states to establish their own independent regulatory commissions.
3. A policy framework for issuing licences for providing Internet services has been pronounced. There will be no licence fee for the first five years and after five years a nominal license fee of rupee 1 will be charged.

4. A National Integrated Highway Project merging the golden quadrilateral connecting Delhi, Mumbai, Chennai and Calcutta with the East-West (Silchar to Saurashtra) and North-South (Kashmir to Kanya Kumari) corridors has been launched.

5. A new Telecom policy framework is under preparation.

6. The Urban Land (Ceiling and Regulation) Act, 1976, repealed through an ordinance.

**Foreign Direct Investment**

1. Projects in the following fields got nod of government for foreign equity participation upto 100 percent under automatic route: electricity generation, transmission and distribution, construction and maintenance of roads, highways, vehicles, tunnels and vehicular bridges, ports and harbours. The automatic route is subject to a ceiling of Rs.1500 crore on foreign equity.

2. Unlisted companies are allowed to float Euro issues subject to certain conditionalities.
3. Permission for FDI under non-banking financial services now includes "Credit and Business" and "Money Changing Business".

4. The companies providing Global Mobile Personnel Communication by Satellite (GMPCS) services have been allowed FDI upto 49 percent stake subject to licence.

5. Now Indian companies can issue GDRs/ADRs in the case of bonus or right issue of shares, or on genuine business reorganizations duly approved by the High Court.

6. End-use restrictions on GDR/ADR issue proceeds have been removed except those on investment in stock markets and real estate.

7. In private sector banks, multilateral financial institutions have been allowed to contribute equity to the extent of shortfall in NRI holdings within the overall permissible limit of 40 percent.

NRIs and Reforms:

1. The aggregate ceiling for investment in a company by all NRIs/PIOs/OCBs through stock exchanges has
been made separate and exclusive of the investment ceiling available for FII's.\textsuperscript{19}

2. Investment limit by a single NRI/PIO/OCB has been increased from 1 percent to 5 percent of the paid up capital.

3. For NRIs/PIOs/OCBs aggregate investment ceiling has been enhanced from 5 percent to 10 percent of the paid up capital of a company. This limit can be raised to 24 percent under a General Body Resolution for the listed Indian companies.

4. Permission has been granted to NRIs / PIOs / OCBs, to invest in unlisted companies, fulfilling certain conditions, norms, procedures and ceiling applicable in case of listed companies.

5. The Government is preparing a scheme for Persons of Indian Origin (PIO) for issue of PIOs card which would facilitate a visa free regime to them alongwith some special economic, educational, financial and cultural benefit.

**Financial Sector Reforms:**

1. Discreet rules regulations for banks have made tough to require provisioning for central and state
government securities, government guaranteed loans, and general provision for standard assets.

2. **Minimum Capital to Risk-weighted Assets Ratio (CRAR)** for banks to rise to nine percent by April 2000.

3. Conditionalities for public issue by infrastructure companies have been relaxed.

4. Risk weight of 25 percent for market risk of government securities, 20 percent for state government guaranteed advances in default and 100 percent for foreign exchange open position.

5. Assets in the substandard category to be clarified as doubtful after 10 months instead of 24 months, by March 31, 2001.

6. Regulatory framework for NBFCs rationalized companies, which solicit public deposits to comply with, revised norms.

7. Rolling settlement introduced for dematerialized shares. Number of companies whose shares must be traded in de-materialized form enhanced. 100 percent book building allowed for issues above 25 crore.
8. Bill has been introduced in parliament to have an independent insurance regulatory authority, and opening of insurance and pension funds to private companies. Proposal is under way to allow 26 percent foreign equity stake and additional 14 percent NRI and FII holding.

9. Primary issues to be compulsorily come through depository mode.

10. A bill introduced in parliament for amending the Securities Contracts (Regulation) Act, 1956, so as to enlarge the definition of “Securities” to cover derivative contracts.

11. A new bill have been introduced namely Foreign Exchange Management Act (FEMA), to replace FERA, for easing the foreign exchange related transactions.

**Foreign Exchange Regulation Act (FERA):**

Sweeping changes in the Foreign Exchange Regulation Act (FERA), 1973, have again demonstrated the Government’s resolve to continue with liberalization of the Indian economy to pave the way for accelerated foreign investment as well as to give a boost to the country’s foreign trade. Promulgation of an ordinance to amend the
Foreign Exchange Regulation Act 1973 (FERA) substantially dilutes its regulatory provisions to bring it in line with the new liberalized industrial trade and exchange rate policies. With the changes in FERA, announced on January 8, 1993 the Government has removed certain restrictions on foreign companies, allowed joint ventures abroad freely by Indian companies and has given more teeth to the Reserve Bank of India (RBI) to prevent violations of rules by authorized dealers.20

The ordinance has removed a large number of restrictions on companies with more than 40 percent non-resident equity, removed FERA controls on Indian firms setting up joint ventures abroad and allowed Indians to hold immovable property abroad, subject to certain conditions to be stipulated by RBI. The ordinance also incorporates into law all the changes, which have so far been made by issue of notification by the Reserve Bank of India or the Central Government. These changes pertain to facilities extended to FERA companies on the appointment of technical and management advisors, opening of branches, acquisition of immovable property by FERA companies in India, borrowing of money or acceptance of deposits by them etc.21
Facilities were also extended to non-resident Indian (NRIs), Indian companies and residents for opening of foreign currency accounts in India following the introduction of partial convertibility on the current account. Notifications were also issued exempting NRIs returning to the country from making declarations on their arrival in India regarding their assets abroad and from the requirement of prior approval for the acquisition of immovable property in India. The ordinance was issued not only to incorporate into the law all the changes, which were made by issue of notification, but also to delete sections that had lost their relevance over time and rationalize other sections, which were considered necessary, but should be amended to do away with the rigours of irrationalities experienced while administering the Act. In the process, about a dozen sections of FERA 1973 were deleted.

It is quite apparent that most of the changes are in tune with the repeated assurances from the government regarding full freedom for foreign investors. Indian firms, too, would find wider opportunities for investment abroad through joint ventures, which eventually should boost exports. As the changes meet the long-standing demand of the industry circles and the export organizations, the
ordinance has generally been welcomed. According to the Federation of Indian Export Organization (FIEO), various provisions would help Indian exporters make their presence felt in the international markets and generate additional exports. Liberalization in equity participation would help the Indian exports to be competitive vis-a-vis exports from Pakistan, Bangladesh, Indonesia, Thailand and other countries. It is almost certain that provisions regarding acquisition of immovable property in India coupled with easing of operational restrictions on FERA companies would open up immense possibilities for foreign investors. The investor would also have little reasons to feel constrained by the requirements of export earnings for repatriation of investment income. Likewise, deletion of Section 11 from the Act would enable the exporters to remit commissions to their overseas agents expeditiously. These should augur well for the country, which is under tremendous pressure of burgeoning trade deficit.\(^{22}\)

The government has recently initiated some institutional reforms. Rupee is now partially convertible in capital account. The government has also bringing the bill to replace FERA by Foreign Exchange Management Act (FEMA).
The details pertaining to capital account convertibility is discussed in the following paragraphs.

**Capital Account Convertibility:**

The induction of globalization process through the liberalization, initiated since 1991 has transformed the various aspects of the Indian economy in general and the external sector in particular. The domestic economy is now gradually keeping a good pace with the global economy. The foreign trade is almost deregulated; control remains only on consumer goods imports. Imports of gold and silver are now allowed legally. Tariffs on most capital and intermediary goods range between 0 and 25 percent, with an average of about 10 percent. The maximum tariff is now 50 percent. The average tariff on all imports, including consumer goods has declined to 25 percent.23

If rupee got the status of full convertibility then the market forces will govern all foreign exchange transactions. Market forces will decide the mode of exchange rate.

Presently all current account flows are transacted at market exchange rates. The RBI, in relation to FDI governs capital flows and financial inflows, the permission are
almost automatic. Full convertibility of rupee will imply the following.24

1. Market forces will control all current and capital account transactions with no restriction on inflow and outflow of capital by resident Indians and foreigners as well as NRIs.

2. Market forces will determine the exchange rate of rupee in relation to any foreign currency.

3. Foreign exchange transactions by the RBI and the government will be out of bound, quantity as well as cost.

4. Indians can operate foreign exchange accounts in Indian and foreign banks and they can withdraw or adjust the balance without any restrictions.

5. The RBI can interfere in the foreign exchange market only by buying and selling rupee and foreign currencies.

6. No restrictions on repatriation of capital by foreigners.

7. Indians as well as foreigners can buy and sell shares and debentures in foreign and Indian companies respectively.
The two valid arguments are here for the capital account convertibility. These are the following: capital account convertibility fits in with the need of reforms and liberalization. This is right thing to do and it does not require more justification.

Tarapore Committee examined the rupee convertibility in 1997. It recommended that the Capital Account Convertibility (CAC) should be introduced in three phases over a period of three years - 1997-98, 1998-99 and 1999-2000. The committee recommended that while having CAC the economy should fulfil the following conditions.\textsuperscript{25}

1. The Gross Fiscal Deficit (GDF) of the centre as a ratio to Gross Domestic Product (GDP) should be brought down from 4.5 percent to 3.5 percent, by the year 2000.

2. The average cash reserve ratio (CRR) of banks should be brought down from 9.3 percent to 3 percent, between 1997 to 2000.

3. The rate of inflation should be kept down to between three to five percent.

4. The non-performing assets (NPAs) of public sector banks should be reduced down to five percent from 13.7 percent.
5. The debt service ratio as a percentage of current account receipts must be brought down to 20 percent.

6. Interest should be deregulated. Only market forces should decide the rate.

7. Globally comparable and transparent procedures of financial accounting should be adopted.

8. The RBI should withdraw from primary government borrowing programmes and government must set up its own public debt office for mobilizing its own funds.

9. Creation of weak banks should be strictly banned.

10. There should be a consolidated sinking fund and disinvestment proceeds (from public sector undertakings) and RBI dividends should go into this fund.

The Committee understands that the economy is capable of attaining all the above mentioned conditions by the year 2000. But its recommendations have raised too many controversies. This is an instrument for complete financial sector reforms. There arise several questions in relation to the validity of these recommendations. First, are these criteria necessarily desirable, such as inflation rate? Second, if these preconditions are necessarily met, can these be attained within the time span of three years?
Third, how interpretations should be drawn from these preconditions? It is a matter of debate can we wait for all these conditions to happen? On capital account convertibility, there are five specific segments for which reforms are needed. The corporate sector, banks, non-banking financial institutions, individuals and financial markets. The validity of recommendation is however questionable. However, the coming days will decide the fate of CAC.26

There is a danger associated with capital Account convertibility. That it can encourage only inflow of capital, ignoring the possibility that once deregulation is introduced it may also lead to capital outflow. It is witnessed that initially inflow is more than outflow because foreigners take advantage of initial low prices of shares and properties. Besides domestic residents may also bring back illegal capital held in foreign. But if economic sectors of various economies do not improve, and lag behind the global economy, then capital later goes out. The capital outflow can be more because foreigners as well as domestic residents can enjoy the advantage so a watchful and prudent look is necessary before having CAC. But it is the need of the hour to have CAC.
Fiscal Reforms and Globalization:

Financial reform is co-related with the fiscal reform. In the changing atmosphere of global economy, financial system control holds a great significance for the overall growth and development. Without an easy accessibility of funds from the financial system the government can not fulfill diversified political and economic interests. High fiscal deficit therefore tends to be a big barrier to financial reforms.

At first when economic reform saw the dawn in India in 1991, fiscal deficit was sky rocketing. At that time it was realized that without fiscal reform the economy could not triggered off. Fiscal deficit can only be improved by either raising tax and non-tax resources or by chopping out the lot of expenditures. The structural adjustment programme (SAP) set gone in 1991, emphasise has been given on the pruning of government expenditure, particularly subsidies and bureaucratic expenditure.

The SAP also disapproved public investment. It was felt that public investment is an impediment for private investment.\textsuperscript{27}
The actual implementation of SAP varied between the centre and the states and also among the states. The speed and frequency of fiscal reform also surged over the years. Some states felt it very hard to implement SAP, particularly the poorer states.

**Insurance Sector and Reforms:**

The liberalization of insurance sector is the major feature of the next round of financial sector reforms and the government initiated the process early this year by setting up an Insurance Regulatory Authority (IRA) under the overall administrative control of the Ministry of Finance.

The IRA was set up as a follow up of the recommendations made by the Malhotra Committee on insurance sector reforms. The government announced its intention to evolve a broad consensus about the future direction and content of reforms in this sector and accordingly, discussions were held with the management and the unions of the insurance industry and also with different interest groups.

The report, especially the major recommendations was also discussed in the consultative committee attached to the Finance Ministry and the leaders of the major opposition
parties objected to the foreign companies entry in the insurance sector as also the equity dilution in the General Insurance Corporation and Life Insurance Corporation. Since, no consensus emerged in these discussions; the Finance Ministry could not take decision on the major recommendations of the Malhotra Committee.

Notwithstanding this government dilemma, the foreign insurance companies delegations visited India in a big way in the last few months and a number of memorandum of understandings (MoUs) were signed with the Indian companies for positioning themselves properly to take advantage of the sudden announcement on liberalization of the insurance sector.

As per the Malhotra Committee's recommendation, the private sector should be allowed to enter insurance sector and no company should be permitted to transact both life and general insurance business. The number of new entrants should be controlled and promoters holding could range from 26 percent to 40 percent of the paid up capital. No person other than promoters can hold more than 1 percent of the equity.
The Malhotra Committee also stipulated that if and when entry of foreign insurance companies is permitted, they should be required to float an Indian company for the purpose preferably as joint venture with the Indian partner.

Many of the leading Indian houses which were connected with the private insurance companies in the country in the prenationalisation days, have made preparations to enter the insurance sector again once it is opened up. But while, the government allowed the private sector to set up new banks through its guidelines in January 1993, no hasty decision was taken in respect of the insurance sector since the issue had serious political dimensions and the powerful trade unions, even those close to the ruling party, opposed vehemently the opening up of the industry to the private sector.

LIC, which is a statutory corporation, will be converted into a company registered under the Companies Act, if the Malhotra Committee's recommendations are to be implemented. The present capital of Rs. 5 core of LIC contributed entirely by the Centre has to be raised to Rs 200 crore with the government holding brought down to 50 percent thereof and the remainder being held by public at large including a portion for the employees.
Both the senior executives of the LIC and also the active trade unions oppose the recommendation. There has been repeated strike action in the insurance industry on opposing the Malhotra Committee recommendations.

The government has asked foreign insurance major to forward investment proposals in related or unrelated areas as a prerequisite for screening their applications for insurance licences.

These investment commitments will form a part of a total rating system that the Insurance Regulatory Authority (IRA) will adopt while issuing licences.

The government’s request is seen as a move to ensure that foreign insurance giants have a long-term commitment to the reforms programme of the country, and at the same time provide enough ammunition to the Centre to counter criticism that it is “selling the insurance sector to foreigners for a song”.\textsuperscript{28}

Apart from track record, solvency ratios and other specific indicators to gauge the health of an insurance company, commitments made by foreign players on investments in other related or unrelated sectors in the country will be taken into consideration. These will not only
boost foreign direct investment (FDI) but also be proof of their long-term commitment.

Many foreign insurance companies and industry intermediaries have drawn up investment plans in response to the government's call.

While other areas of the financial scoter provide viable investment options to foreign majors, they are of the opinion that such a stipulation was not unfair.

It is a clever way of roping in long-term players and eliminating political pressures. The government might be successful in attracting around $1 billion even before the first private licence is issued.

While life insurance companies have expressed their desire to set up Asset Management Companies (AMCs), general insurance majors are planning risk management firms.

Some foreign insurers have also assured the government that they would pursue their international clients to look at India as an investment option, apart from making available overseas funds for Indian projects.
Others are still unsure whether they should commit funds before a clear picture emerges on the exact number of licences IRA plans to issue.

Taking the lead in investment commitments are AIG of the US and Standard Life of the UK, which have already signed MoUs with the Tata Group and HDFC respectively.

AIG has already committed $ 90 million as a part of its $ 1.1 billion Asia Infrastructure Fund for India, while another $ 60 million is due to come in. AIG has also picked up an interest in the Tata-Bell Canada telecom venture and expects to commit direct and third party funds of around $ 250 million to India by the end of December 1999.

Standard Life has already envisaged interest in picking up around $ 40 million in private placements in HDFC, and is working on extending infrastructure funds to the country.

While Lloyd’s brokers Marsh and McLenan has applied to the Foreign Investment Promotion Board (FIPB) to set up a joint venture risk management company with Indian re-insurance brokers J.B. Boda, Commercial Union has already set up a representative office in New Delhi. Eagle Star, Legal, and General Assurance is also planning risk management divisions and intend to recruit Indian personnel
for training abroad. This is a step at developing in-house expertise in an industry, which has not witnessed much innovation on the product front.

Several other foreign players have already started purchasing office and residential space in the country and looking for investment opportunities that could help portray a long-term image. In fact, one of the world's largest broking houses, Sedgwick has already floated a joint venture - Sedgwick Parekh Health Care India Pvt. Ltd. The Government is aware that it will not attract huge FDI inflow only by allowing foreign insurance companies to set up shop.

A system of rating has been suggested for insurance companies, when the industry is finally thrown open and private and public sector companies enter the arena.

The recommendation is part of a report submitted to the Insurance Regulatory Authority. The rating system had been suggested to allay apprehensions of unethical practices by private insurance companies as had been practiced by some companies that had been in operation prior to the nationalization of the sector in 1972.29
The rating will be done on the basis of the quality of services provided by the company, payout of claims and handling of clients. It will also depend on financial parameters such as the net-worth, total business volume of the company, quality of investments and the general performance of the company.

In the general insurance category, the rating will serve as a guide to prospective clients about the financial stability of the insurance company whom they are approaching for a cover.

Since, after opening up of the industry, a company would be able to offer both general and life insurance covers, separate ratings are proposed to be introduced for the life insurance and general insurance segments because the risk profile in the two cases is totally different.

It has not yet been decided whether the rating would be done by the existing rating agencies such as CRISIL, CARE and ICRA or a separate body is to be formed catering exclusively to the insurance industry.

The performance of the companies would be periodically reviewed and the ratings updated. The ratings would be then made public so that both individuals and
organizations could exercise their choice on the basis of it.

The Insurance Regulatory Authority (IRA) of India will shortly announce a Regulatory Framework governing private and foreign participation in this sector. The government would have to amend the LIC and GIC Act before private entrance could be allowed into the Insurance Industry.

**Banking Reforms and Globalization:**

Since the inception of new economic policy in 1991, the government of India is trying to bring changes in all sectors of economy to harmonize it with the globalization process. Keeping in view the main objective of globalization government of India brought reforms in the banking sector. It has appointed a series of committees and working groups to study the current situation and recommend reform measures.

One of the most significant committees is the Narasimham Committee appointed by RBI in 1991. The committee recommended the following measures: \(^{30}\)

1. Reduction in statutory liquidity ratio (SLR) from 38.5 percent of demand and time liabilities of commercial banks in 1991 to 25 percent.
2. Reduction in cash reserve ratio (CRR) of commercial banks from 15 percent demand and time liabilities to 5 percent.

3. Phased deregulation of administered interest rates on bank deposits and advances and lending of term lending institutions.

4. Phasing out the directed credit and differential interest rates to priority and other sector.

5. Augmentation of capital base of commercial banks to the international norms of 8 percent deposits though public issue of shares; and

6. Prudential classification of assets and liabilities of commercial banks.

Committee also suggested certain guidelines to consolidated rural branches and makes them more viable in order to keep pace with globalization.

Since 1991 only a few reforms have been implemented in banking sector. These are as under:

1. Statutory Liquidity Ratio (SLR) on incremental net domestic demands and time liabilities (NDTL) declined from 38.5 percent to 25 percent.
2. SLR securities are continuously revealed and included in balance sheet.

3. Interest rates on deposits and advances of cooperative banks completely deregulated, subject to a minimum-lending rate of 12 percent.

4. Average cash reserve ratio (CRR) on NDTL reduced gradually from 15 percent to 10.5 percent and is further brought down to 10 percent in March 1998.

5. Commercial bank interest rate on loans above Rs. 2 lakhs completely deregulated and the number of administered interest rates on commercial bank advances reduced from more than 20 to only 2.

6. Interest rates on domestic term deposits above 2 years deregulated.

7. Nationalized commercial banks allowed raising capital through debt and equity to attain international capital adequacy norms; term lending institutions are allowed to raise capital from market.

8. Scheduled commercial banks are allowed to subscribe to shares and debentures in both primary and secondary markets subject to a maximum of 5 percent of incremental deposits in the previous year.
9. 13 public sector banks have attained a capital to risk weighted assets ratio of 8 percent. Full capital adequacy norm obtained by all foreign banks and many Indian banks.

10. Banks are permitted to lend foreign currency denominated loans under the foreign exchange risk is borne by the borrowers.

11. New private banks given license to operate and about 10 banks have come up since 1991.

12. CRR on non-resident Indian were first rationalized and finally removed with effect from 1996. Interest rate on term deposits under these accounts also completely deregulated since 1996.

SLR on deposits under these accounts brought down to 25 percent, at par with deposits in other accounts.

**Conclusion:**

Since the induction of new economic policy in 1991, Indian government adopted various modes to globalize its economy. The most significant changes have taken place in capital market. Capital market is an organization, which is playing a vital role in new economic arrangement. Reforms have been implemented in capital market, to attract more investors. Government of India established a
regulatory body namely SEBI to control and regulate activities of the capital market and ensure the interest of investors. Modernization of stock exchanges and buy back of shares are recent steps in this direction.

On industrial sector front, provisions and regulations have been specifically simplified in order to facilitate efficient production: concessions, tax relaxation and the holidays and various other facilities have been provided to the industrial units.

Government adopted many simple and easy procedures to attract more and more foreign investment. Special concessions and repatrability norms have been formulated to lure NRIs and MNCs.

Globalization is epicenter of all the changes. To globalize Indian economy, government adopted fiscal reforms on account of correcting balance of payment.

Banking sector, insurance sector, have also been witnessed similar trends. RBI announced reduction in CRR, SLR and time factors in various related transactions. Private banks invited to operate in banking services. In insurance sector foreign as well as domestic private companies can operate now onward.
With the changes in FERA, announced on January 3, 1993, the government has removed certain restrictions on foreign companies, allowed joint venture, abroad freely by Indian companies and given more teeth to the Reserve Bank of India (RBI) to prevent violations of rules by authorized dealers.

Most of the changes are in tune with the repeated assurances from the government regarding full freedom for foreign investors. All the FERA changes thus augur well for the country groaning under the pressure of burgeoning trade deficits year after year.

The Foreign Exchange Management (FEMA) Bill will replace FERA. FEMA bill introduced by the Finance Minister, Yashwant Sinha, in the Lok Sabha on August 4, 1998. On capital account convertibility front, government appointed Tarapore Committee and its recommendations are being implemented.

The domestic economy is now sufficiently strengthened and substantially integrated to the global economy. It also needs time to derive more fruits from the globalization.

The forthcoming chapter entitled "Globalization of Indian Economy: Perspective on MNCs", presents a vivid
analysis with regard to the MNCs operating in India especially in the post NEP period. It presents an account regarding modus operandi of MNCs in arrangements of subsidiaries, joint ventures, collaboration and mergers and acquisitions.

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