CHAPTER II

Economic Liberalisation in India –
An Overview
INTRODUCTION

The preceding chapter rendered a detailed account of the available literature on insurance, set out the statement of problem, scope and objectives of the study, and dealt with formulation of the hypothesis along with the research methodology adopted to critically study and examine the impact of economic liberalisation on insurance sector in India since 1991. The present chapter is devoted to present an overview the economic liberalisation in India.

The liberalisation policy of India is the precious gift of Dr. Manmohan Singh (the then Finance Minister) to the people of India at the time when the country was in the grip of unprecedented economic crisis and political turmoil. It was announced soon after the new government of Narasimha Rao came to power in June 1991. It is an outcome of widespread changes which had taken places in the international, social and economic order as well a direct offshoot of the management of an “equilibrium trade crisis” which knocked the door of Indian economy in the beginning of the Nineties.

For the first time in its history, India was faced with the unbearable pain of defaulting on its international commitments on account of adverse balance of payments having foreign exchange reserves barely enough for
two weeks of our imports, withdrawal of NRI deposits at a faster pace, closure of international commercial language and erosion in international confidence due to drastic falling foreign remittances.

The crisis became more grievous in the wake of joint consequences of the occurrence of gulf war which brought about the third oil price hike and dwindling down of foreign exchange reserves due to heavy payments for oil imports. In other words, we must state that Indian economy was almost sinking and groaning for relief in 1991 with foreign exchange reserve plummeting into an abnormally low level of $ 2.2 billion, inflation in the vicinity of 14 per cent and fiscal deficit rising to 8.4 per cent of GDP combined with current account deficit at $ 9.9 billion. All these developments forced the government to think of a major departure from the trade policy followed till then and to make a serious move towards further integration of the Indian economy with the rest of the world by announcing the agenda of economic reforms with a view to combat the several maladjustments prevailing in the different layers of the economy.

All the programmes of policy package of economic reforms are known as the New Economic Policy of India. In this way the new economic policy is a compulsory product of the management of economic crisis. The new economic policy means, an adoption of such type of
initiatives which aim at reduction of fiscal deficits, wiping out of the current account deficits, cutting down of government expenditures, rationalization of subsidies, control of insulation, alleviation of poverty and achievement of social equity. The fundamental objective of this policy is to bring about a qualitative and sustained innovation in the standard of living of the people of India.

The new economic policy was promulgated in 1991 to resolve the following problems:

- To boost growth for accelerated economic development.
- To help reduce external debts and service charges.
- To enhance efficiency of the economy by encouraging investment in technology and infrastructure.
- To minimize risks to investors by regulating capital and money markets.
- To create business friendly environment by abolishing redundant restrictions.
- To do away with the state monopoly by disinvesting public enterprises.
- To allow access to investors to national and international capital and money markets.
• To guarantee protection or rights to investments, trade and intellectual property.

• To promote foreign trade.

• To integrate the national economy with the world economy within the parameters of UNO and WTO.

• To follow schedule of payment and repayment of external debts.

GLOBALIZATION

The issue of globalization is one of the important issues of the package of reforms policies as being implemented in India. Which means the opening of the gate of economy for mutual global cooperation in the economic life of the country by way of reducing controls, removing licensing systems and bureaucratic delays, providing partial convertibility of rupee and placing the economy towards more market orientation. The scheme of globalization means the acceptance of outward-looking policy of economic development in place of inward-looking one. The usefulness of globalization is vivid from the fact that the process results in the detachment from the inward-looking policy experienced by several countries. The success of the outward-looking policy, particularly in the newly industrialized countries, created a strong desire for India to adopting such similar policy. For instance, Latin American countries which pursued inward-looking policy which did not succeed much in this
regard and adopted the policy of liberalisation for globalizing their economies to accelerate the tempo of economic development⁸. Denmark and Norway followed outward-looking policy soon after the second world war and established a record of development of their economies. Not only this, Southern Europe and Japan in the Mid Fifties and Korea, Singapore and Taiwan in the early Sixties started outward-oriented policies and achieved grand success by giving freedom to their entrepreneurs to choose between domestic and imported inputs and duty free imports of inputs for boosting the scale of exports and achieving the higher rate of economic growth. The experiences of these countries, which followed an outward-looking strategy of economic development have proved that the rate of capital productivity and the rate of growth are extremely higher in globalized economies than unglobalized economies are sufficient grounds for India to follow the path of globalization⁹.

In the following paragraphs an endeavour has been made to study, in detail, different phases of economic liberalisation in India.

**First Phase of Economic Liberalisation (1980-90):**

The attitude of Indian government has been frequently changing towards foreign direct investment since the dawn of independence. It has many distinct phases; one from independence upto the late 60’s which was marked by gradual liberalisation, then from 60’s to 70’s which was
characterized by a mere selective stances, followed by the 80's which heralded a liberal policy. During the 'Nineties' the liberalisation process was carried forward with the sweeping structural reforms. Throughout the 70's attention of the government was focused on the enforcement of Foreign Exchange Regulation Act (FERA) and towards its end, the failure to step up volume and proportion of manufactured exports in the context of second oil crisis began to worry policy makers. It was realized that international competitiveness of Indian goods was poor due to inferior quality and technology obsolescence, limited range and the high cost.

Another factor was that marketing channels were dominated by the MNC's in the industrialized countries. The government tried to deal with the situation by emphasizing modernization of plant and equipment through liberalized imports of capital goods and technology, exposing Indian industry to competition by reducing imports restriction and tariffs and assignment of greater role to MNCs on the promotion of manufactured exports by encouraging them to set up Export Oriented Units (EOUs). All the measures were reflected in the Industrial Policy Statement of 1980.

The policy statement throughout the 80's covered liberalisation initiatives of the government. Liberalisation in the licensing rules,
exemption from foreign equity restrictions under Foreign Exchange Regulation Act (FERA) to 100 per cent for export-oriented units were the remarkable features of the statement. In 1984 a major amendment in Monopolies and Restrictive Trade Practices (MRTP) Act severely curtailed its scope. In 1985, twenty five industries were delicensed and the government decided to set up four more Export Processing Zones (EPZs) in addition to the existing two, at Kandla (1965) and Santacruz (1972) to attract multinational enterprises to start export oriented units.\textsuperscript{11}

The Export-Import (EXIM) policies were liberalized in these years for the import of raw materials and capital goods by expanding the list of items on the Open General License (OGL). In 1984, nearly 200 capital goods were slashed and in 1985 restrictions on import of designs and drawings were removed.

In November 1980, the process of streamlining foreign collaboration got under way with the delegation of power to administrative ministries for approvals involving an outflow of more than Rs. 5 million in foreign exchange without any foreign equity participation, which was raised to Rs. 10 million. Tax rates on payment of royalties were also reduced from 40 per cent to 30 per cent. The policy towards foreign equity participation was also made flexible and except the general ceiling of 40 per cent on foreign equity cases were taken up
on merit of individual proposals. Foreign equity participation was also allowed in existing companies with a view to facilitate the transfer of superior technology by the Cabinet Committee on Economic Affairs (CCEA) in 1986. The procedures for employment of foreign nationals were also eased. Custom tariffs on general projects, machinery and components were reduced to 10 per cent, and concession in tariffs in the electronic sector were extended to 35 more types of equipments in 1989 budget. The aluminium and cement industries were decontrolled and broad-banding in respect of industrial licensing was extended to production of white goods.

The Technical Development Fund (TDF) scheme was liberalized in 1988-89 to allow import of technology and capital goods upto the foreign exchange equivalent of Rs. 30 million. Approvals for opening up of liaison offices by foreign firms were liberalized and the procedures for outward remittances of royalties, technical fees and dividends were streamlined. As a result of streamlining, the rejection rate, in foreign collaborations, came down from 30 per cent to between 5 and 8 per cent.

In December 1989 a new government come to power which vowed to carry forward the process of liberalisation and streamline the process of foreign investment. Government showed its willingness to grant approvals to Foreign Direct Investment (FDI) proposals involving 40 per
cent foreign equity in new import policy of 1990, eighty two more capital
goods were brought under Open General License (OGL) taking its
number to 1343 items. Under Technical Development Fund, the limit for
import of design and drawings were raised to Rs. 10 million with an
overall ceiling of Rs. 30 million from Rs. 3 million. The government took
further measures for de-bureaucratization and greater transparency of
foreign investment approvals, which were announced in the Parliament in
May 1990.

The aforementioned approvals included abolition of licensing for
new units for fixed investment upto Rs. 250 millions (Rs. 750 million for
EOU’s and units located in specified backward areas). No clearance
would be needed for foreign collaboration agreement provided the royalty
payment was restricted to 5 per cent on domestic sales and 8 per cent on
exports.

For proposals involving lump sum payment, requiring the
government clearance would be communicated within a month. The
government also proposed to issue a positive list of industries where
foreign investment would be welcome. But all these measures could not
be implemented because government was facing severe crisis and
ultimately it fell and the next government, which was minority
government, could not have the courage to implement these liberalisation
measures. Subsequent failures lead the Indian economy to its worst financial crisis with the deficit in the Balance of Payment (BOP) and rising trade imbalance.

Second Phase of Economic Liberalisation (1991-2001):

The year 1991 marks an important watershed in the post-independence economic history of the country. The approach to and content of economic policy underwent an important change. The balance of payment crisis of 1991 was converted into an occasion to introduce certain fundamental economic reforms, for both growth and stability. These were undertaken mainly 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 came out with a host of reforms packages right from July 1991 which were undertaken in almost all the areas of economic activity which are discussed briefly in the following paragraphs.

Foreign Direct Investment (FDI) - After Liberalisation:

India initiated economic policy reforms in 1991 and since then these reforms have played a critical role in the overall economic
development of the Indian economy. The reforms have involved opening the economy, making it more competitive, getting the government out of huge morass of regulation, empowering the States to take more responsibility for economic management and creating a kind of competition between the States for foreign investors. The gross domestic product (GDP) growth rate which had collapsed to 0.8 per cent in 1991-92 rebounded to a near normal 5.3 per cent in 1992-93, and then accelerated to 6.2 per cent in 1993-94. Subsequently, the GDP grew at an average rate of 7.5 per cent in three years. 1994-95 to 1996-97, before slowing down to 5.1 per cent in 1997-98. It is important to note that despite the slow down, the average growth rate during the four years in 1994-95 to 1997-98 was 6.9 per cent, significantly higher than the growth rate of 5.6 per cent achieved during the 1980’s. However, the average growth rate of GDP in the five years from 1998-99 to 2002-03 remained significantly lower (5.42) than that of 1980s as well as for the first 8 years of 1990s (6.0 per cent).  

All over the world Foreign Direct Investment (FDI) is now recognized as an important source of non-debt financing. It is sought as a means of technology inflow and of establishing inter-firm connections in a world of Multinational Companies (MNCs) operating primarily on the basis of network of global inter connections. In the present global
scenario, it is possible for India, to achieve dynamic growth based upon labour intensive manufacturing, that combines the vast supply of Indian labour, including skilled, managerial and engineering labour, with the foreign capital, technology and markets. The FDI has proved to be resilient during financial crisis. For instance, in East Asian countries such investment was remarkably stable during the global financial crisis of 1997-98.\textsuperscript{15}

Table 2.1

Foreign Direct Inflow to India: Approvals vs. Actual Inflows

<table>
<thead>
<tr>
<th>Year</th>
<th>Approvals</th>
<th>Actual Inflows</th>
<th>Realization rate ( per cent)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1991</td>
<td>5.3</td>
<td>3.5</td>
<td>66.04</td>
</tr>
<tr>
<td>1992</td>
<td>38.9</td>
<td>6.8</td>
<td>17.48</td>
</tr>
<tr>
<td>1993</td>
<td>88.6</td>
<td>17.9</td>
<td>20.20</td>
</tr>
<tr>
<td>1994</td>
<td>141.9</td>
<td>32.9</td>
<td>23.19</td>
</tr>
<tr>
<td>1995</td>
<td>320.7</td>
<td>68.2</td>
<td>21.27</td>
</tr>
<tr>
<td>1996</td>
<td>361.5</td>
<td>84.4</td>
<td>23.35</td>
</tr>
<tr>
<td>1997</td>
<td>548.9</td>
<td>120.4</td>
<td>21.93</td>
</tr>
<tr>
<td>1998</td>
<td>308.1</td>
<td>92.1</td>
<td>29.89</td>
</tr>
<tr>
<td>1999</td>
<td>283.7</td>
<td>73.0</td>
<td>25.73</td>
</tr>
<tr>
<td>2000</td>
<td>370.4</td>
<td>83.9</td>
<td>22.65</td>
</tr>
<tr>
<td>2001</td>
<td>268.7</td>
<td>13.0</td>
<td>48.75</td>
</tr>
<tr>
<td>2002</td>
<td>108.9</td>
<td>68.7</td>
<td>63.00</td>
</tr>
<tr>
<td>Total</td>
<td>2845.6</td>
<td>782.8</td>
<td>27.5</td>
</tr>
</tbody>
</table>

Source: Compiled from data in SIA newsletter (Ministry of Commerce and Industry), April 2002.
Table 2.1 shows the trend of FDI approvals in India, along with actual realization rate, since 1991. The table points out clearly that FDI approvals as well as actual flows have continuously been showing upward trend from 1991 to 1997. Actual inflows, which were merely Rs. 3.5 billion in 1991, reached Rs. 120.4 billion in 1997. But during 1998 and 1999 the FDI flow declined considerably. Besides the Asian crisis and sanctions imposed on India as a consequence of nuclear explosion test cast their shadow on FDI flows in India. But the FDI flow again showed increasing trend both in 2000 and 2001. It is noteworthy that the position of FDI actual flow, as a per centage of approvals, has remained very dismal in almost each year since 1997. Actual FDI as a proportion of FDI approved works out only 27.5 per cent for the last 12 years.

Table 2.2
Sector-wise break-up of FDI approved (Aug. 1991 to May 02)

<table>
<thead>
<tr>
<th>Sector</th>
<th>Per centage of total FDI approved</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fuels</td>
<td>32.11</td>
</tr>
<tr>
<td>Telecommunications</td>
<td>17.83</td>
</tr>
<tr>
<td>Transportation</td>
<td>6.83</td>
</tr>
<tr>
<td>Service sector (Financial and Non-Financial)</td>
<td>6.32</td>
</tr>
<tr>
<td>Metallurgical</td>
<td>6.00</td>
</tr>
<tr>
<td>Electrical equipment, computer, software,</td>
<td>5.14</td>
</tr>
<tr>
<td>hardware and electronics</td>
<td></td>
</tr>
<tr>
<td>Food processing</td>
<td>4.49</td>
</tr>
<tr>
<td>Hotel &amp; tourism</td>
<td>1.89</td>
</tr>
<tr>
<td>Consultancy</td>
<td>-</td>
</tr>
<tr>
<td>Others</td>
<td>19.27</td>
</tr>
</tbody>
</table>

Source: Compiled from data in SIA Newsletter (Ministry of Commerce and Industry), June 2002.
Sector-wise break-up of FDI and technical collaboration approved after globalization is presented in Table 2.2. It is evident from the table that the engineering sector received the largest (32.11 per cent) share of total FDI. While, telecommunication sector is at the second position by receiving the 17.83 per cent share of total FDI, the transport sector stood occupies third position by receiving 6.8 per cent share of total FDI “between August 1991 to January 1999”. The position of various other sectors concerning per centage share in total FDI approvals from August 1991 to May 2002 is not very much different except for electrical equipment, computer and electronic industry.

The facts and figures regarding country-wise break-up of FDI flow after the initiation of financial sector reforms are exhibited in Table 2.3.

**Table 2.3**
Country-wise break-up of FDI approvals

<table>
<thead>
<tr>
<th>Country</th>
<th>Country-wise break-up of FDI approvals (Rs. million)</th>
<th>per cent share in total</th>
</tr>
</thead>
<tbody>
<tr>
<td>USA</td>
<td>461844.82</td>
<td>41949.58</td>
</tr>
<tr>
<td>Mauritius</td>
<td>221983.34</td>
<td>72339.82</td>
</tr>
<tr>
<td>UK</td>
<td>159767.18</td>
<td>4112.29</td>
</tr>
<tr>
<td>Japan</td>
<td>91076.81</td>
<td>8275.44</td>
</tr>
<tr>
<td>South Korea</td>
<td>96901.01</td>
<td>410.79</td>
</tr>
<tr>
<td>-----------------</td>
<td>------</td>
<td>------</td>
</tr>
<tr>
<td>Germany</td>
<td>790325.60</td>
<td>5937.64</td>
</tr>
<tr>
<td>Netherlands</td>
<td>46955.07</td>
<td>44.55</td>
</tr>
<tr>
<td>Australia</td>
<td>65552.46</td>
<td>616.95</td>
</tr>
<tr>
<td>France</td>
<td>50354.30</td>
<td>2020.74</td>
</tr>
<tr>
<td>Malaysia</td>
<td>55606.20</td>
<td>158.83</td>
</tr>
<tr>
<td>Singapore</td>
<td>41597.66</td>
<td>3232.44</td>
</tr>
<tr>
<td>Italy</td>
<td>4447.50</td>
<td>1073.12</td>
</tr>
<tr>
<td>Israel</td>
<td>42347.48</td>
<td>9.90</td>
</tr>
<tr>
<td>Cayman Island</td>
<td>36327.10</td>
<td>998.31</td>
</tr>
<tr>
<td>Switzerland</td>
<td>27395.18</td>
<td>716.58</td>
</tr>
<tr>
<td>Canada</td>
<td>23818.87</td>
<td>1544.00</td>
</tr>
<tr>
<td>Thailand</td>
<td>24588.21</td>
<td>3.75</td>
</tr>
<tr>
<td>Hong Kong</td>
<td>17867.42</td>
<td>4221.33</td>
</tr>
<tr>
<td>Sweden</td>
<td>17012.77</td>
<td>1011.83</td>
</tr>
<tr>
<td>South Africa</td>
<td>18881.63</td>
<td>59.70</td>
</tr>
<tr>
<td>UAE</td>
<td>6494.00</td>
<td>500.90</td>
</tr>
<tr>
<td>China</td>
<td>7129.38</td>
<td>0.00</td>
</tr>
<tr>
<td>West Indies</td>
<td>6474.30</td>
<td>0.00</td>
</tr>
<tr>
<td>Panama</td>
<td>6405.45</td>
<td>1.30</td>
</tr>
<tr>
<td>Denmark</td>
<td>5294.84</td>
<td>263.41</td>
</tr>
<tr>
<td>Bermuda</td>
<td>6322.00</td>
<td>88.25</td>
</tr>
<tr>
<td>Oman</td>
<td>5787.14</td>
<td>37.64</td>
</tr>
<tr>
<td>Kuwait</td>
<td>5842.60</td>
<td>7.33</td>
</tr>
<tr>
<td>Indonesia</td>
<td>3929.80</td>
<td>1.02</td>
</tr>
<tr>
<td>Taiwan</td>
<td>2327.49</td>
<td>51.52</td>
</tr>
<tr>
<td>Qatar</td>
<td>315.30</td>
<td>4300.00</td>
</tr>
<tr>
<td>New Zealand</td>
<td>2787.68</td>
<td>2.76</td>
</tr>
<tr>
<td>Philippines</td>
<td>8383.76</td>
<td>6.58</td>
</tr>
</tbody>
</table>
Table given above shows that although the US still remains India’s major investment partner, its share in India’s aggregate foreign direct investment inflow has shrunk subsequently of late. The US share in India’s aggregate FDI approval has declined from 26.15 per cent during 1991-99 to 23.91 per cent during 2000-2003 (upto April 2003). Much of this fall in the share of the US in the new millennium was accounted for by its poor performance in 2002 following economic downturn in the previous year. Its share in India’s aggregate FDI approvals fell by more than five per cent from about 24 per cent in 2001 to 18.8 per cent in 2002.

In actual terms, the FDI approvals of the US declined by a hefty 58.3 per cent from Rs. 4,921.53 crores in 2001 to Rs. 2051.12 crore in 2002. Interestingly, while the share of the US in India’s aggregate FDI approval declined, that of Mauritius increased dramatically.

Infact, Mauritius has become India’s largest investment partner in the new millennium. Its share in our total FDI approvals has increased dramatically from 12.5 per cent during 1991-1999 to 25.67 per cent during 2002-2003. And in 2002, when the share of the US fell by as much
as five per cent over the previous year, that of Mauritius increased by 3 per cent from 14 per cent in 2001 to 17 per cent in 2002.

Unlike the past, when India had to depend largely on the US for capital inflow, the new millennium has witnessed a drastic change in the source of foreign fund. In fact, a number of developed western nations have substantially increased their stake in India in recent years. UK’s share in India’s total FDI approvals, for example, has increased sharply from about 9 per cent during 1991-1999 to 15.29 per cent during 2000-2003.

India’s FDI approvals, in fact, fell drastically in 2002 following declaration in FDI inflow world over. The liberalisation has improved India’s rating abroad and the investors all over the world are now keen to invest in India.

ENVIRONMENT FRIENDLY REFORMS FOR FOREIGN INVESTORS:

Economic liberalisation brought a large number of reforms in different areas of the economy to create congenial environment for foreign investors: The present study proceeds to sort out the major aspects of economic reforms that relate to the following aspect of foreign investment in India.
Financial Sector Reforms:

The object of financial sector reforms is stated to improve profitability of the state-owned commercial banking system and better functioning of the domestic capital market. The architects of liberalisation in India seem to be working on the simple presumption that the discipline of market forces will make both the banking system and the capital market more efficient. The reforms in the context of commercial banks seek to improve profitability and restore financial health. The actual and the intended reduction in the statutory liquidity ratio (the minimum percentage of deposits that banks must hold in government securities) and the cash reserve ratio (the minimum proportion of deposits that banks must hold in cash) are meant to ensure that resources made available in the form of bank deposits are not pre-empted by the government but released for the private sector. The government has also introduced new guidelines for income recognition, asset classification, provisioning requirements and capital adequacy in the commercial banking system\textsuperscript{16}.

Keeping this in view a number of committees were appointed to recommended as to what important measures could be taken to prop up the banking sector to be globally competitive. Among these, the most significant committee was Narasimha's committee appointed by the
Reserve Bank of India (RBI) in 1991 which recommended the following measures.

- The branch licensing system for opening new branches should be abolished.
- A liberalized view should be adopted for allowing foreign banks in the country and both foreign and domestic banks should be treated at par.
- Statutory Liquidity Ratio (SLR) for banks should be curtailed to the level of 25 per cent within next five years. Cash Reserve Ratio (CRR) should also be curtailed in various phases.
- There should be abolition of dual control of RBI and Finance Ministry on Banks. RBI should only functions as a regulatory authority of banking system in the economy.
- Augmentation of capital base of commercial banks to the international norm of 8 per cent deposit through public issue of shares.
- Phased deregulation of administered interest rates on bank deposits and advances and lending of term lending institutions.

Since 1991, reforms in the banking sector undertaken are stated briefly as follows:
• Statutory Liquidity Ratio (SLR) on incremental net domestic demand and time liabilities declined from 38.5 per cent to 25 per cent.

• Interest rates on deposits and advances of cooperative banks completely deregulated subject to a minimum lending rate of 12 per cent.

• Average CRR on NDTL reduced gradually from 15 per cent to 10.5 per cent and is further brought down to 10 per cent in March 1998.

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

• Thirteen public sector banks have attained a capital to risk weighted assets ratio of 8 per cent. Full capital adequacy norms obtained by all foreign banks and may Indian banks.

• New private banks were given licenses to operate and about 10 banks have come up since 1991.

• CRR on non-resident Indian were first rationalized and then finally removed with effect from 1996 and interest rates on these term deposits were completely deregulated.
Capital Market Reforms:

Some major steps were undertaken in the reforms package of 1991 regarding capital market to facilitate a rapid and sustained improvement in the overall functioning of the capital market.

The reforms in the capital market seek to finance investment in the private sector and attract foreign portfolio capital. Interest rates in the domestic capital market have been deregulated and the need for prior government approval of the size and price of equity issues in the primary capital market have been dispensed with. It is believed that the capital market will now be disciplined by market forces, while the newly constituted Securities and Exchange Board of India (SEBI) will establish rules and regulations to govern the stock market and its intermediaries.

Foreign Institutional Investors were granted permission to operate in the capital market by registering themselves with SEBI. To encourage non-resident investment, transactions in shares and debentures can now be undertaken with prior permission of Reserve Bank of India (RBI). Indian companies now permitted to operate in international capital market with the use of American Depository Receipts (ADRs) and Global Depository Receipts (GDRs). SEBI was entrusted with the power of issuing regulations and file suits without prior permission of the
government. Over the Counter Exchange of India (OTCEI) and National Stock Exchange of India (NSE) started functioning with stock trading and electronic display, clearing and settlement of facilities.

Economic liberalisation is about bringing market prices closure to efficiency prices and allowing individuals, households or firms more freedom to make economic decisions. This means a reduced role for the state. More concretely, it means moving away from political or bureaucratic discretion towards market-based uniform rules guided by the price mechanism. But a well-functioning price mechanism requires the institution of a well-functioning market. Markets do not suddenly materialize, but are deliberate acts of the state.

**Information Technology Reforms:**

India’s Information Technology sector has exhibited tremendous growth. From a fledging level of US$43.5 million in 1990, the sector notched revenues of US$11bn in 2000-01, representing nearly 5 per cent of India’s GDP, of which exports accounted for US$5.8 billion.

A separate Ministry of Information Technology has been established by the Government on October 15, 1999. The IT Ministry will be primarily responsible for all policy legislation relating to information technology, knowledge based industries, internet, e-commerce and IT
education and IT–based education and development of electronics, computers and creation of Silicon valleys in India. Information Technology Act, 2000 has been enacted. To deals with cyber security, cyber crime and other information security related legal aspects. The Act paves the way for electronic documentation and payments through certification of public keys by the certifying authorities and maintaining database of certifying authorities and a national repository artifacts and other technical infrastructure and a constant vigil on primary a consumer rights.

According to a recent World Bank study, India is the preferred location for software vendors for its quality and cost. Recognizing the special advantages and opportunities in India, many leading IT multinationals have set up operations in India. India has a strong Unix base which provides opportunities for the development of products for Internet - based applications. Further, India has global connectivity with international dialing facility from over 13,220 locations. Leased/switched high-speed data links from major centers through Software Technology Parks (STPs) and Videsh Sanchar Nigam Ltd. (VSNL) for point-to-point communication are also available. Internet connectivity is provided through several networks. Market openings have emerged across four business sectors – IT services, Software products, IT enabled services and
E-business. By March, 2001 end the combined turnover of the IT and software services companies in India would have touched almost US$ 10 billion with exports touching US $ 6.24 billion and profits expected to continue and also to increase by more than 30 per cent year an year. The software exports are expected to grow to US$ 500 billion by 2008.

- Automatic route for foreign equity upto 100 per cent in software and electronics, except aerospace and defence.
- 100 per cent foreign investment permitted in units set up exclusively for exports. Such units can be set up under any one of the following schemes, namely, Electronic Hardware Technology Parks (EHTPs), Software Technology Parks (STPs), Free-Trade Zones (FTZs) Export Processing Zones (EPZs) and 100 per cent Export Oriented Units (EOUs).
- A number of States have developed their own IT policy to promote the development of software sector. Tax holiday upto 2010 for IT units to be set up in Software Technology Parks.
- Tax holiday to R&D for upto 10 years with 12 per cent tax concession.
- IT venture capital fund set up.
- Simplification and liberalisation of Export & Import Policy.
Telecommunication Reforms:

India’s 23 million-line telephone network is one of the largest in the world and the third largest among emerging economies (after China and Republic of Korea). Given the low telephone penetration rate – 2.2 per 100 people of population, which is much below the global average, India offers vast scope for growth. It is, therefore, not surprising that India has one of the fastest growing telecommunication system in the world with system size (total connections) growing at an average of more than 20 per cent over the last 4 years.

The industry is considered as having the highest potential for investment in India. The growth in demand for telecom services in India is not limited to basic telephone services. India has witnessed rapid growth in Cellular, Radio Paging, Value-added services, Internet and Global Mobile Personal Communication by Satellite (GMPCS) services. This is expected to soar in the next few years.

Recognizing that the telecom sector is one of the prime movers of the economy, Government’s regulatory and policy initiatives have also been directed towards establishing a world class telecommunications infrastructure in India. The telecom sector in India, therefore, offers an ideal environment for investment.
Foreign collaboration coupled with an attractive trade and investment policy, have made India an attractive market for telecom equipments described as follows:

- No industrial license required for setting up manufacturing units for telecom equipment.
- In basic cellular, value added services and global mobile personal communications by satellite, FDI is limited to 49 per cent subject to licensing and security requirements and adherence by the companies (which are investing and the companies in which the investment is being made) to the license conditions for foreign equity cap and lock-in period for transfer and addition of equity and other license provisions.
- Internet Service Providers (ISPs) with gateways, radio-paging and end-to-end bandwidth, FDI is permitted upto 74 per cent with FDI beyond 49 per cent requiring Government Approval.
- No equity cap is applicable to manufacturing activities.
- FDI upto 100 per cent is allowed for the following activities in the telecom sector\(^{23}\).

**Infrastructure Sector Reforms:**

The infrastructure also got its share from subsequent policy changes. For rapid development of any economy adequate investment
should be made in its infrastructure and key to this is the imposition of appropriate user changes, which provide adequate return on the investment.

- The Indian Electricity Act (1910) and the Electricity Supply Act (1948) were amended to make inroads for the entry of private investments in power transmission. There were various enactments, the Central Electricity Commission (CEC) was set up in which provisions for States were made to establish their own independent regulatory commissions.

- In February 2000, a conference of Power Ministers of all States was held, which took some important decisions like, the hundred per cent metering by December 2001, audit of energy at all levels, total elimination of power theft and restructuring of all State Electricity Boards (SEBs).

- To demonstrate its commitment and to accelerate power sector reforms, the central government raised the plant outlay from 9,194 crores to 10030 crores which is a substantial hike.

- In national integrated highway project merging the golden quadrilateral connecting Delhi, Mumbai, Chennai and Kolkata with the east-west (Silchar to Sourashtra) and North-South (Kashmir to Kanniya Kumari) was launched.
• To increase the density of internet, a policy framework has been designed to issue licenses to provide Internet Service Providers (ISPs). There will be no license for the first five years and after that a nominal license fee of Rs. 1 will be charged. Government is also planning to introduce the conveyance bill to cover telecommunication, information technology and information and broadcasting sectors is an integrated manner\textsuperscript{25}.

**Foreign Trade Policy:**

Foreign trade policy has been drastically changed in the Eighties; it incorporated a large number of provisions for controlling import and export. It was the result of protectionist trade policy, which was implemented through strict controls and licensing in relation to foreign trade. The object of foreign trade policy reforms implemented so far India has been to eliminate discretionary bureaucratic controls mostly on imports, to reduce the protection available to domestic industry, and to bring domestic prices closer to world prices. In conformity with these objectives, their has been a rapid dismantling of quantitative restrictions (quotas) on imports and exports, a substantial reduction in tariffs on imports combined with an abolition of subsidies on exports, and several downward adjustment in the exchange rates which have lead to a sizeable depreciation of rupees. The presumption is that this process (by making
exports more attractive and imports more expensive) will shift resources from the production of known traded goods to the production of traded goods, while exposure to international competition will force domestic firms to become more efficient\textsuperscript{26}.

Since 1991, lacunae in exim policy have been plugged off by removing quantitative controls on export and import as a result of which, foreign trade can flourish in an atmosphere of freedom from the state controls. The process of economic reforms is seeking to increase the degree of openness of the economy to integrate it as soon as possible with the global economic system. The endeavour is, therefore, not confined to trade flows, it extends to capital flows also.

**Foreign Trade Policy in India - Some Highlights:**

Following are the some highlights of Foreign Trade Policy:\textsuperscript{27}

- Big push to exports to garner 1.5 per cent of the world share by 2009.
- Foreign Direct Investment (FDI) permitted upto 100 per cent to establish and develop free trade and warehousing zones.
- New schemes to boost exports of fruits, vegetables, flowers and minor forest produce.
- Duty-free import of capital goods under Export Promotion Capital Goods (EPCG) scheme for agriculture sector.
• Import of seats, bulbs and tubers liberalized.
• “Target Plus” scheme to accelerate growth of exports.
• Export Oriented Units (EOU’s) exempted from service tax.
• EOU’s permitted to retain 100 per cent export earnings.
• Duty Entitlement Passbook (DEBP) scheme retained till replaced by a new one.
• Restrictions on importing second-hand capital goods lifted.
• Validity of license of various schemes increased to uniform 24 months.
• Import of gold of 18 carrots and above allowed under replenishment scheme.

**Foreign Exchange Management Act (FEMA):**

Foreign Exchange Management Bill was introduced in parliament in August 1998. It was adopted by the parliament in 1999 with an aim to consolidate and amend the law relating to foreign exchange with the objective of facilitating external trade and payment and for orderly development and maintenance of foreign exchange market in India. This new Act replaced Foreign Exchange Regulation Act (FERA), which was enacted in 1973 and emphasized on exchange regulation or exchange control. It was directly referred to the objective of Multinational Corporations (MNCs) in India and it was necessary to obtain Reserve
Bank's permission either in general or special, in most cases. FEMA brought drastic changes. Now, except for section 3, no other section of FEMA has provisions that stipulate obtaining RBI's permission^28.

FEMA represents a major departure from the past policies in two respects; first it can be seen as a step towards capital account convertibility other, by removing FERA, the government seems to have finally decided to give up regulations on foreign capital in the country. Therefore, the absence of FERA will pose serious difficulties in regulating foreign investments. This also curtails the process of RBI that put restrictions on the drawl of foreign exchange for payment due on account of amortization of loans or for depreciation of direct investment in ordinary course of business. These relaxations on regulation of foreign exchange and movement towards convertibility will improve the external sector. But these relaxations and openness of economy will also push the current account deficit and create foreign exchange difficulties as the recent turmoils in global financial market have shown. Therefore, the government, which was advocating the relaxation, has started taking steps once again to impose some kind of restrictions.

Public Sector Reforms:

It would seem that the main objectives of the government are to reduce the activities of public sector, to facilitate the closure of loss-
making units in the public sector, and to ease the burden on the exchequer on account of the public sector. It has been emphasized that the public sector should focus only on those sectors which are strategic and high technology based or constitute an integral part of the essential infrastructures. It has been stated that public sector enterprises which are chronically sick will be referred to the Board of Industrial and Financial Reconstruction (BIFR), which would decide whether these units can be effectively reconstituted or whether they should simply be closed down. The centrepiece of public sector reforms, however, has been disinvestment of government equity upto 20 per cent, subsequently extended to 49 per cent, in selected public sector enterprise\textsuperscript{30}.

Reforms in the public sector in India are large on words but short on substance. The articulated objectives are limited and inappropriate while their pursuit is half-hearted. The number of industries reserved for the public sector stands reduced but there has been no systematic review of the portfolio of public investment that might lead to restructuring or rationalization. There are some hesitant steps, in terms of legislative amendments and administrative arrangements, that may make it possible to close units in the public sector and retrench workers with suitable compensation. Much of this, however, remains in the sphere of intentions, for the political constituencies for such changes have not yet been
created. However, the aim of reducing the burden imposed by the political sector on the exchequer is being advertised with zest. Notwithstanding the rhetoric of restructuring, the dominant motive underlying the sale of government equity in the public sector has been the desire to mobilize resources for the exchequer. This is born out by facts.

The capital receipts from the sale of such assets, in the range of Rs. 25-30 billion per annum, have been digested quietly by the union budgets to reduce the borrowing needs of the government. Thus, the fiscal deficit of the central government has been reduced temporarily. However, one-shot assets sales cannot provide a sustainable solution to narrowing the fiscal deficit. This approach to public sector reforms characterized by asset sales and closures constitute the most unimaginative, perhaps opportunistic, form of privatization without any attempt at genuine restructuring. It is neither adjustment nor reform. It may imply selling the flag-ships and keeping the tramp-ships, or sending white elephants to the slaughter house, but there is no systematic attempt to address problems of efficiency and productivity in the public sector. The reason for this is not simply the lack of economic imagination on the part of our reformers. Many public sector enterprises serve as the cows that are to be milked by the politicians and bureaucrats, including some of the enthusiasts for liberalisation.
Industrial Policy Reforms:

Industrial policy reforms has removed barriers to entry for new firms and limits on growth in the size of existing firms. Investment decisions are no longer dependent upon government approval or constrained by state intervention.

Industrial licensing has been abolished for all industries, accept those specified, and irrespective of levels of investment, and the exceptions are few. The law regulating monopolies has been amended to remove the threshold limit of one billion rupees on the assets of large business houses and to eliminate the need for prior approval from the government for capacity expansion, capacity creation, amalgamation, mergers or takeovers on the part of such companies. In simple terms, it means a quest on the part of economic actors to appropriate potential economic gains arising from securities created by the government and controls or opportunities created by the government policies. Some recent developments in India suggested that acquisitions, mergers or takeovers by firms in the industrial sector have enabled the enlarged corporate entity to capture a preponderant market share. It is possible to cite several examples. There are some that are significant and worth noting: the acquisition of Tomco by Hindustan Lever, the takeover of Godrej and
Boyce by Procter and Gamble, the merger of Parle and Coca Cola; and the tie up between Malhotras and Gillette.

In all these cases, the dominant market share so attained in a particular product range has tended to eliminate established competition or pre-empt potential competition. This would simply not be permissible under anti-trust laws in most countries. Given the importance of scale economies in manufacturing, concern about the concentration of economic power should not become a constraint in growth. But in such situations, the market must be governed either by calibrating competition or by suitable anti-trust legislation in India, the law on monopolies has been diluted to abolish limits on the growth of firms through mergers, or acquisitions but laws needed to regulate monopolistic, restrictive or unfair trade practice have not been strengthened.

The new industrial policy of India 1991 gives a clear cut approval for foreign direct investment upto 51 per cent, foreign equity in the case of high priority industries and this obviously extends a cordial invitation to multinationals in a big way.

The foreign direct investment with infact, the course of new technology and marketing into the economy expertise and provide for interaction with some of the largest international manufacturing houses and marketing firms. From which the country will seek a lot of
advantages. The market friendly approach of the scheme of globalization is expected to create suitable environment for the free entry of foreign capital on a very large scale and also facilities for smooth movement of goods through substantial reduction of tariffs and, thus, pave the way for further integrating the Indian economy. According to the budget speech 1992-93 of the Finance Minister of India, “the new system is designed to provide a powerful boost to our exports as well as to efficient import substitutions”.

The system provides adequate incentive to earn foreign exchange and thereby promotes exports. In the beginning several constraints prevented the easy gains of this process of globalization of the Indian economy and at the present moment its prospects are not bright as some critics put forward their views. According to them, globalization which implies consumerism of the western style, has actually resulted in a higher priority for luxury cars over mass transport and five star hotels over the low cost indigenous housing. So, globalization is the harbinger of western culture of life for a few sections of people. Better to say, only a microscopic percentage of the people of India, will be benefited through the process of globalization. Of course, the findings of several studies relating to this issue reveal the fact that the strategies that public copied so far have never contained any inbuilt mechanism that can offer
the benefits of growth for the poor masses. The policy of liberalisation has been adopted in a manner, which contains a basket of welfare measures for the vast population but in effect promotes poverty and stagnation.

**Disinvestment Policy:**

Disinvestment policy is an integral part of economic liberalisation that visualizes an end to State Monopoly. The Indian government had virtually embraced bankruptcy during the period 1981-91. Its coffers were empty by the end of this period. The financial condition of the States of the Indian Union was also very critical. This funds crunch forced the government to incorporate disinvestment on an important element of the New Economic Policy (NEP) announced in July 1991. The Central and the State governments had become weak in terms of political stability by mid 1991. Though sufficient money could have been mopped up through effective mobilization of excise duties, income tax, sales tax, custom duty, cooperative dues, neither the Central government nor the State governments were prepared to opt for this hard measure.

There was no preparedness on the part of either the Central government or the State governments to prune public expenditure. They preferred to approach the international leading agencies or sell government assets. It was realized that dependence on external resources
as well as disinvestment had to be resorted to as measure of political balancing. The political system in India has all through been dominated by the rich and powerful sections of the society, which do not pay the legitimate taxes and continue who have their strong hold on different institutions of the society. Thus, it was found politically expedient to go in for disinvestment as most of government assets since independence, and prior to that period, were built up largely from contributions coming in from the poor sections of society.

The government appointed the Krishnamurthy Committee in 1991 and the Rangarajan Committee 1992. Both committees recommended disinvestment to fulfill the objective of modernization of the public sector through strengthening R&D, initiating diversification expansion programmes, retraining and reemployment of employees, funding the genuine needs of expansion, widening the capital market base, and mitigating fiscal deficits of the government.

These committees distinguished between the short-term and the long-term goals of disinvestment and advised the government not to sacrifice the long-term goals for the sake of fulfilling the short term objectives. The first disinvestment took place in 1991. Trenches of selected Public Sector Undertakings (PSU) shares were offered to banks and financial institutions. It has been entrusted to Disinvestment
Commission, which is statutory body to fix the price, timing and composition of the trenches. It is free option of NRIs, PIOs, GDRs, FIIs and domestic investors to subscribe to the trenches offered by the Disinvestment Commission subject to the approval of the government.

**Disinvestment in Public Sector Undertakings (PSUs):**

India’s Disinvestment programme has moved so far and the plethora of issues that have been raised in the public domain relating to most Public Sector Undertakings (PSUs). The disinvestment process in relation to PSUs involves two distinct phases: (a) preparation and (b) execution.

Preparation entails a detailed review of the PSUs covering operational, financial and legal issues in order to determine their current condition, their strengths, weaknesses, potential and financial restructuring requirements.

As per the Economic Survey, 2001 the government has set out the following policies towards PSUs:\(^{39}\)

- Bring down government equity in all non-strategic PSUs to 26 per cent or lower, if necessary.
- Restructure and revive potentially viable PSUs.
- Close down PSUs that cannot be revived, and
• Fully protect the interests of workers.

The following table depicts the targets and achievements of disinvestment programme during 1991-92 to 1999-2000.

Table 2.4
Disinvestments in Public Sector Undertakings (PSUs)
(Rs. in crores)

<table>
<thead>
<tr>
<th>Year</th>
<th>Target</th>
<th>Achievements</th>
</tr>
</thead>
<tbody>
<tr>
<td>1991-92</td>
<td>2500</td>
<td>(3038)</td>
</tr>
<tr>
<td>1992-93</td>
<td>2500</td>
<td>(1913)</td>
</tr>
<tr>
<td>1993-94</td>
<td>3000</td>
<td>(Nil)</td>
</tr>
<tr>
<td>1994-95</td>
<td>4000</td>
<td>(4843)</td>
</tr>
<tr>
<td>1995-96</td>
<td>7000</td>
<td>(362)</td>
</tr>
<tr>
<td>1996-97</td>
<td>5000</td>
<td>(902)</td>
</tr>
<tr>
<td>1997-98</td>
<td>4000</td>
<td>(5371)</td>
</tr>
<tr>
<td>1998-99</td>
<td>5000</td>
<td>(902)</td>
</tr>
<tr>
<td>1999-2000</td>
<td>10000</td>
<td>(1829)</td>
</tr>
</tbody>
</table>

Note: Figures within brackets indicate percentage of achievements to target.
Sources: Compiled from the Chartered Accountant, the Institute Chartered Accountants of India, New Delhi, June 2001, p.16.

Table 2.4 reveals the year-wise disinvestment of Public Sector Undertakings (PSUs). It shows that in majority of the year-wise achievements the results have fallen below the targeted levels in the years 1992-93, 1995-96, 1996-97, 1998-99 and 1999-2000. The achievements are below figure-wise (given in column 3 in crores) whereas in the year 1991-92, 1994-95 and 1997-98 the achievements in disinvestment were over reached as shown in column 3. The figure for the year 1993-94 are
not available. Therefore, nothing can be explained about it. The overall mission of disinvestment appears to be accomplished and achieved during the period shown in the abovementioned table.

**Insurance Sector Reforms:**

The insurance sector was also under the purview of the liberalisation process. A committee was constituted way back in April 1993 under the chairmanship of Dr. R.N. Malhotra, Ex-Governor of RBI. This committee submitted its recommendations to the Finance Minister. The committee stressed on the liberalisation of insurance industry in terms of deregulation and restructuring of insurance industry. Some of the important points of the recommendations are as follows:

- The private participation be permitted in insurance sector but the same company should not be permitted to perform both life and general insurance business.
- The minimum paid up capital for new company should be Rs. 100 crores including minimum subscription of 26 per cent now exceeding to 49 per cent and maximum of 40 per cent from the promoters.
- No other equity holders, excluding the promoters of private insurance company, should be granted equity share exceeding one per cent of the total equity.
• Foreign insurance companies should be permitted to operate in India on selective basis and only if they perform business by establishing a joint enterprise with Indian promoters.41

• All the associate companies of GIC should be granted permission to perform business independently and GIC should work only as Re-insurance Company.

• The share capital of GIC to be increased from Rs. 107.5 crores to Rs. 200 crores, which include 50 per cent share of the government, the rest should be opened for the general public and a certain percentage should be reserved for employees of the corporation.

• The paid up capital for all associate companies of the GIC, presently Rs. 40 crores, should be raised to Rs. 100 crores.

• The committee also recommended increasing the paid up capital of the LIC from Rs. 5 crores to Rs. 100 crores of which 50 per cent should be reserved for the government and rest for the public.

• All the old and new insurance companies should be regulated under similar rules.

• Controller of insurance should be given all the responsibility under the Insurance Act.
• Insurance Regulatory Authority (IRA) has been established in insurance sector on the lines of SEBI and IRA has been granted complete functional authority.

• IRA has a permanent source for financing its activities and for this IRA should be permitted to charge a levy of 0.5 per cent on the annual income of the insurance companies.

• New insurance companies entering into insurance industry should perform a minimum pre-determined insurance in rural sector and to promote life insurance in rural areas, postal life insurance should be used.

• Abolition of license system for insurance surveyors and company should be free to recruit the surveyors of their own.

• Insurance companies should be permitted to settle the claim upto Rs. one lakh on primary survey basis.

• All the insurance companies have to deposit Rs. 10 crores as security deposit before starting business.

• Failure to fulfill social obligations would attract a fine of Rs. 25 lacs, in case the obligation is not fulfilled, license would be cancelled.

• The Indian promoters can hold more than 28 per cent of the total equity for a period of 10 years from the date of commencement of
business, and the rest by non-promoter Indian share holders, which will not include equity of foreign promoters and share holding of FII, NRIs and CCBs.

Economic liberalisation is the firm policy of the State to ameliorate operational environment for foreign investors in the country. The new economic policy has removed unnecessary restrictions on operation of large houses and flow of foreign investments. As a result of procedural and structural reforms, the country is heading towards strong economy. It includes streamlining of procedures, raising of permissible equity limits, wider scope for investments in sectors of their choice. Further, the value of currency has been hooked to current market level. In foreign trade, import licensing has been abolished and tariff rates reduced. It is a positive step to deregulate exports by dismantling regulatory framework for exports. Steps have been taken to liberalize domestic market. However, trade regulatory authority of India has been established to monitor compliance, with existing rules and regulations.

It is a welcome step to remove controls by discarding industrial licensing policy in respect of a large number of products. It is supported by deregulation of financial sector. It is easier to raise capital in domestic and foreign markets. Investors have strong incentive for portfolio investments. It would have favourable impact on return with lower and
flatter rate of direct and indirect taxes. There is considerable progress in respect of price liberalisation for the products that were subject to administered pricing. It would lead to virtual abolition of State monopoly with steps to expedite disinvestment policy of public enterprises. In short, the country is smoothly progressing in its way to an open economy.
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