CHAPTER - 3

ECONOMIC LIBERALIZATION AND ITS IMPACT ON TRANSNATIONAL CORPORATIONS (TNCS) IN INDIA

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3.1 Introduction:

The preceding chapter presented a detailed outlines with regard to the statement of the problems followed by an extensive review of literature. Logical and cogent description as regards the need for the study scope, objectives of the study, research hypotheses and research methodology have also been made alongwith of course, the limitations of the study.

In this chapter, the Research Scholar has made an attempt to make an incisive and critical study with regard to economic liberalization and its impact on the business activities of Transnational Corporations (TNCs) in India. The study highlights all the important liberalization packages and measures for financial sector reforms including banking sector reforms, capital market reforms, fiscal and monetary reforms, trade and investment reforms, and public sector reforms in a bid to globalize the Indian economy for substantial growth and development with social justice and equity.

International business in today’s world is regarded as the major driving force of economic activity. It not only enables the economy to flourish, but also serves as the bedrock for the increasingly interdependent global network of technology, investment, trade and production.

From the beginning of British rule itself, the industrial changes had started taking place. During the Second World War, the British government became acutely conscious of the need for industrial expansion, research and training and established the Board of Scientific and Industrial Research in the year 1940. This was followed by the creation of a Department of Planning and Reconstruction at
the centre. The Industrial Policy of independent India was first announced in 1948. This was the first concerted attempt to enunciate a comprehensive industrial policy for the country which served as the kingpin of the country's industrial development planning.

This policy emphasized the need for securing the participation of foreign capital and enterprise particularly as regards industrial techniques and knowledge so as to boost up the pace of industrialization. The participation of foreign capital should be carefully regulated in national interest. The resolution made it amply clear that as per rule the major interest in ownership and effective control should always be in Indian hands. Thus, while recognizing the need for foreign capital in the industrialization of the economy, the government insisted upon the progressive Indianization of foreign concerns.

The aim of the Industrial Policy Resolution of 1948 was to clear the hurdles and help in progressive move of the economy. It also purported to help the process of investment (both domestic and foreign) and to lessen industrial conflict, and to help both the private as well as public enterprises to march hand in hand to accelerate the pace of industrial development.

The planning era started with the adoption of socialistic pattern of society for national objectives. It necessitated formulation of industrial policy in relation to planned economic development. So in the context of this bold industrial programme, the need therefore arose for reformulation and re-orientation of 1948 Industrial Policy Resolution. As a result, the new Industrial Policy Resolution of 1956 came into being. Important provisions of the 1956 Resolution were
new classification of industries into three categories, which bore a close resemblance to the earlier classification, but were more sharply defined and were broader in coverage as to the role of the state. They are divided into three schedule, these were (a) Schedule A: those which were to be an exclusive responsibility of the state, (b) Schedule B: those which were partially state owned and partially private owned, but in which private enterprises would be expected only to supplement the effort of the state, and (c) Schedule C: all the other remaining industries would be in general, left to the initiative and enterprise of the private sector.3

The Governments attitude to foreign capital was the same as was annunciated in Industrial Policy resolution of 1948.4 The redeeming feature of the 1956 policy gave expressions to mixed economy of industrial development.5

The Industrial Policy of 1973 was viewed as a supplement to the Industrial Licensing Policy of 1970.6 It has paid greater attention to defining the role of private sector with particular reference to the large industrial houses, but failed to identify the joint sector with a view to making use of private expertise and resources in line with the governments socio-economic objectives.7

The growth of industrial output during the period 1967-1977, except for the year 1976 had been not more than 3 to 4 per cent per annum on an average. Lots of industries suffered financial crisis, as well as many of them were in the clutch of strikes and lockouts. “The incidence of industrial sickness was found to be wide-spread and some of the major industries were worst affected. Unemployment had increased, rural urban disparities had widened and the rate of real
investment got stagnated. The industrial policy, announced in December 1977, was, therefore primarily directed towards removing these distortions of the past so that the goal of faster economic development could be achieved within a time bound programme.\textsuperscript{8}

The 1977 Industrial policy was framed with the idea that it would help in the balance development of economy, in which all the people should share benefits of industrial development. The policy was somewhat harsh to the large units in the private sector, when it stipulated that they would have to rely on internally generated resources for financing new projects or expanding existing projects. Government determination to run public sector in profitable basis in order to ensure that investment in these industries pays an adequate return to society.\textsuperscript{9}

The government announced Industrial Policy, of 1980 making provisions for major relaxation and concessions benefiting the small, medium as well as large-scale with the triple object of modernization, expansion and development of backward areas.\textsuperscript{10}

The thrust of the concessions was in doubling the investment limit of tiny, small and ancillary sectors, regularization of the excess capacity and permitting automatic expansion facility for large units in the priority sector and setting up new industries in industrially backward areas. "Broadly speaking this new policy offered a new deal to the private sector, promise to improve the efficiency of the public sector and re-affirmed its faith in MRTP Act and the FERA."\textsuperscript{11}

Realizing the key role of exports in development, the new policy provides for sympathetic consideration of request for setting up 100% export oriented units, or for the expansion of existing units
exclusively for purposes of export and for allowing fully the export opportunities. On January 2, 1986, the government notified reduction in export obligation for setting up industries in backward areas by MRTP and FERA companies.\textsuperscript{12}

3.2 Economic Liberalization Regime of 1991:

The New Economic Policy regime of 1991 came to the fore at the juncture when India was facing with the serious problems of (i) A huge fiscal deficit due to unproductive expenditure outpacing revenue leading to continuous deficit financing. (ii) A heavy foreign debt with a high debt service ratio. (iii) Adverse BoP leading to sharp decline in the external value of money. (iv) Low level of efficiency economy with huge wastage of resources. (v) Excess of supply of labour over its demand resulting in rise in unemployment. (vi) Stagnancy in agricultural output; poor growth performance in the economy as a whole in addition to a serious inflationary problem, contributing towards fiscal imbalance, external imbalance, sharp rise in prices, stagnant rate of savings and reduction in employment opportunities.\textsuperscript{13}

Under these circumstances, reforms were badly needed to provide a springboard for the economy to take off for a self-sustaining growth. The following are the significant features of the New Economic Policy (NEP):

\textit{Public Sector Policy:}

It was a ripe time therefore that the government adopted a new approach to public enterprises. There must be a greater commitment to the support of public enterprises, which are essential for the
operation of the industrial economy. The priority areas for growth of public enterprises were demarked:\textsuperscript{14}

(i) Essential infrastructure goods and services.

(ii) Exploration and exploitation of oil and mineral resources.

(iii) Technological advancement in the areas which are crucial in long-term development of the economy.

(iv) Manufacture of products where strategic considerations predominate such as defence equipment.

(v) At the same time the public sector will not be barred from entering areas not specifically reserved for it.

By this provision, the spirit of competition was to be induced in the public enterprises by inviting private sector participation. In the case of selected enterprises, part of government holdings in the equity share capital of these enterprises was to be disinvested in order to provide further market discipline to the performance of public enterprises.

\textit{Privatization Episode:}

In the first stage of reform process, the disinvestment of PSU shares was done. It has been realized that the PSUs are the best places for redtapism and corruption. Further, inefficient management in the hands of political leaders and bureaucrats lead them to incur heavy losses. So by disinvesting the shares, it was tried to create some sense of responsibility in the public sector. Further, in this episode most of the government owned sectors except postal, railways, and defence are being partly privatized. Private entrepreneurs were allowed to those arenas, where only the PSUs
could play. The airlines, banks and some utility services were also left in the hands of the private people.

### 3.3 Trade Reforms:

Reform in trade policy purported to be directed to create an environment, which would provide a stimulus to export. While at the same time, reduce the degree of regulation and licensing control on foreign trade, such as, full convertibility of money, import for exports simplification of procedures, allowance to foreign investors for equity participation in export trading houses. Moreover, there should be no discrimination for Indian and foreign goods. These reforms have reduced the degree of licensing in import trade, to broaden, to enhance and harmonize export incentive and to introduce a self-balancing mechanism where imports would be automatically regulated by the availability of EXIM scrips through export earnings.\textsuperscript{15}

The following are the highlights of external sector reforms in the financial year 2000-2001:

- Removal of quantitative restrictions. Import of 894 items made license free and another 414 items permitted to be imported against SIL in EXIM policy changes announced on March 31, 1999. The government has further decided to phase out all QRs maintained on BoP grounds by April 1, 2001.

- Incorporation of a new chapter in EXIM policy to boost export of services.

- Free Trade Zones (FTZ) to replace Export Processing Zones and these are to be treated as outside the country's customs territory.

- Except for a negative list, sectoral limit, and a few explicitly defined constraints, all other FDI will now be under the RBI automatic system. NRIs / OCBs have been permitted to invest under the automatic route in all items, barring a few.
Indian companies free to access the ADR / GDR markets through an automatic route subject to the specified norms and post-issue reporting requirements. Such issues would, however, need to conform to the existing FDI policy.

3.4 Reforms in Industrial Sector:

As regards the industrial sector reforms, measures to delicensing has been directed so as to promote the growth of a more efficient and competitive industrial economy, such as reducing the controlled or licensed sector to minimum amendments. In controlling rules and legislation's – Companies Act, MRTP Act, Sales of Goods Act, Partnership Act, FERA etc., to let the industrialists to go by themselves but a vigil on them should be kept so that they don't take undue advantage of the freedom. Some of the reform initiatives taken in the sphere of industrial sector are briefly outlined as follows:

- Industrial licensing for almost all-bulk drugs abolished.
- Automatic approvals of foreign investment upto 51 per cent and foreign technology agreements permitted for all bulk drugs and formulations, barring only a few.
- Basic telecommunication services opened to private participation, including foreign investments.
- Minimum lending rates for amounts over Rs. 2 lakh abolished. The rate for advances between Rs. 25,000 and Rs. 2 lakh reduced to 13.5 per cent.
- SLR reduced to 31.5 per cent to make more credit available for the commercial sector.
- Import duties on capital goods reduced to 15 per cent on export related capital goods, 25 per cent for project imports and most capital goods, and continuation of concessional duties at 20 per cent for power projects and nil for fertilizer projects.
- MODVAT extended to capital goods and petroleum products.
Corporate tax reduced from 45 per cent for widely held companies and 50 per cent for closely held companies to 40 per cent for domestic companies and from 65 per cent to 55 per cent for foreign companies.

Five-year tax holidays to new industrial undertakings initially allowed for industrially backward state.

**Industrial Licensing Policy:**

Industrial licensing is governed by the Industries Act, 1951. Over the years, keeping in view the changing industrial scene in the country, the policy has undergone modifications. "In order to achieve the objectives of the strategy for the industrial sector for the 1990s and beyond it is necessary to make a number of changes in the system of industrial approvals." Major policy initiatives and procedural reforms are called so that the Indian industrialist should understand the importance of their in the growth of an economy and they can easily meet and compete with the emerging changes in domestic and global opportunities and realization of industrial potential of the country.

Industrial licensing henceforth is abolished for all industries, except those specified irrespective of level of investment. "These specified industries, continue to be subject to compulsory licensing for reasons related to security and strategic concerns, social reasons, problems related to safety and overriding environmental issues, manufacture of products of hazardous nature and articles of elitist consumption." The exemption from licensing is particularly helpful to many dynamic small and medium entrepreneurs who have been unnecessarily hampered by the licensing system. As a whole, the Indian economy will hopefully be benefited by becoming more
competitive, more efficient and modern and will take its rightful place in the world of industrial progress.

**Monopolies And Restrictive Trade Practices Act (MRTP Act):**

The pre-entry scrutiny of investment decisions by so-called MRTP companies will no longer be required. Instead, emphasis is accorded on controlling and regulating monopolistic, restrictive and unfair trade practices rather than making it necessary for the monopoly houses to obtain prior approval of the Central Government for expansion, establishment of new undertakings, merger, amalgamation, and takeover and appointment of certain directors. Similarly, the provisions regarding restrictions on acquisition of and transfer of shares have been appropriately incorporated in the Companies Act.\(^\text{18}\)

Simultaneously, provisions of the MRTP Act have been strengthened in order to enable the MRTP Commission to take appropriate action in respect of the monopolistic, restrictive and unfair trade practices. The newly empowered MRTP Commission will be encouraged to require investigation on complaints received from individual consumers or classes of consumers.

**3.5 Foreign Exchange Regulation Act (FERA) To Foreign Exchange Management Act (FEMA):**

Under the liberalization regime the Foreign Exchange Regulation Act (1973) has diluted the regulatory provisions paving way for accelerated foreign trade and investment.\(^\text{19}\) “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 new ordinances under liberalization regime have removed a large number of restrictions on companies, which are as follows: \(^{21}\)

- Permission for Indian firms to set up joint ventures abroad.
- FERA companies allowed appointing technical and management advisors.
- Permission to FERA companies to open up branches.
- Acquisition of immovable property by FERA companies in India, borrowing of money or acceptance of deposits by them etc.
- Non-Resident Indians (NRIs) companies and residents permitted to open up foreign currency accounts in India in the wake of partial convertibility on the current account.
- The NRIs are exempted from making declarations of their assets abroad.

The changes brought about in the FERA Act would hopefully open vistas of investment opportunities for foreign investors on the one hand and the Indian firms on the other in terms of facilitation of rules for opening up joint ventures abroad. With these changes, the Indian exports would receive much-needed boost in terms of competitiveness. \(^{22}\)

The government welcome step to replace FERA with FEMA in 1999 in the wake of rupee being fully convertible on current account and partial convertible on capital account will bring about overall efficiency in the foreign exchange management.
3.6 Current And Capital Account Convertibility:

The liberalization and the globalization programme initiated since July 1991 has changed the basic characteristics of the Indian economy in general and the external sector in particular. The domestic economy is now substantially integrated to the global economy. The foreign trade is almost fully deregulated, control remains only on consumer goods. Imports of gold and silver are now permitted legally, albeit with duties. Tariffs on most capital and intermediate goods range between 0 and 25 per cent, with an average of about 10 per cent. The maximum tariff is now 50 per cent. The average tariff on all imports, including, consumer goods, has come down to about 25 per cent.

There is now a unified market determined exchange rate for all external transactions. The current account is virtually deregulated, except consumer goods imports and some minor restrictions on repatriation of dividend, etc. The capital account is also substantially deregulated. NRI deposits and investments require no permission. FDI is now almost automatic. Portfolio investment flows through various forms. The Indian companies can also raise capital abroad through GDR and maintain offshore funds. The only restrictions are on domestic resident Indians.

The government has also begun to explore the feasibility of Capital Account Convertibility (CAC). It seems to have been inspired by the burgeoning foreign exchange reserves and the relative stability of the exchange value of rupee after the reform on the one hand and the better performance of the economy in the recent years (6/7 per cent growth) on the other. While presenting the Union Budget for
1997-98 the then Finance Minister Mr. Chidambaram announced a Committee under the Chairmanship of Mr. Tarapore, former Deputy Governor of the RBI, to examine the feasibility of CAC for India.\textsuperscript{23}

The committee submitted its report in mid 1997 before the currency turmoil in the East and South East Asia. While accepting the principle of CAC for India it has set some conditionalities for introducing it.

**Tarapore Committee Recommendations:**\textsuperscript{24}

The Tarapore Committee recommended that CAC should be introduced in phases over a period of three years. But the committee recommended that CAC should be introduced only after the economy satisfies the following conditionalities:

a) The gross fiscal deficit of the Centre as a ratio to GDP should be brought down from 5 per cent to 3.5 per cent in the year 2000.

b) The annual inflation rate during the period 1997-2000 should be maintained at an average of about 3 percent.

c) Between 1997 and 2000 the Cash Reserve Ratio (CRR) of banks should be reduced from 10 per cent to 3 per cent, and the Non-Performing Assets (NPA) ratio of banks should be brought down to 5 per cent (which according to RBI Annual Report 1996-97 is 17.7 per cent).

The Committee felt that the economy is capable of attaining all these and accordingly recommended CAC by the year 2000. Accordingly, the Committee prepared the road map for implementing CAC by the year 2000.\textsuperscript{25}

**3.7 Infrastructure Sector Reforms:**\textsuperscript{26}

A brief account of infrastructural reforms is presented as under:
General Measures:

- Uniform tax holiday of 15 years for all infrastructure sector projects.
- Creation of Foreign Investment Implementation authority to smoothen flow of FDI into the infrastructure sector.
- The import duty structure for project imports rationalized.

Power:

- Mega Power Project policy announced.
- Restructuring of SEBs to be encouraged, new transmission and distribution systems to get fiscal benefits given to infrastructure sector.

Telecom:

- New telecom policy announced
  - Domestic long distance calls to be opened up.
  - Department of Telecom Services (DTS) to be corporatized by 2001.
  - DTS / MTNL to enter as third cellular operators.
- TRAI reconstituted through an ordinance
  - Clear distinction between the recommendatory and regulatory function of the Authority.
  - Mandatory for government to seek recommendations of TRAI in respect of matters dealing with need and timing for introduction of new service providers and the terms and conditions of license to a service provider.
  - Composition of Authority i.e. TRAI has been changed.
  - Separate disputes redressal body known as “Telecom Disputes Settlement and Appellate Tribunal” has been set up.
- Specific Targets for Telecom
  - Make available phone on demand by 2002.
Encourage development of telecom in rural areas and increase rural tele-density from the current level of 0.4 to 4.0 by the 2010.

Achieve telecom coverage of all villages in the country by 2002.

Provide Internet access to all district headquarters by 2002.

Resources for meeting the Universal Service Obligation (USO) would be raised through a universal access levy, which would be a percentage of revenue, earned by all operators under various licenses.

Existing license holders of basic and value added services allowed switching over to a revenue sharing agreement.

Provide high-speed data and multi-media capability(using ISDN) to all towns with a population greater than 2 lakh by 2002.

**Roads:**

- A new case of Re 1 per liter on HSD imposed to generate funds, which will be transferred to Central Road Fund. Most of it will be used for development and maintenance of State Roads and National Highway etc.

- Model Concession Agreement for BOT road project more than Rs. 100 crore and less than Rs. 100 crore finalized.

**Railways:**

- Indian Railway Catering & Tourism Corporation (IRTC) Ltd. incorporated as a Government Company with the objective of upgrading and managing rail catering and hospitality.

- Indian Railways have issued Letters of Intent for ownership, operation and management of two luxury trains in private sector.

**Civil Aviation:**

- Restructuring of airports of Air Authority of India (AAI) through long-term leasing route.
**Urban Infrastructure:**

- Special Package for Housing construction and Services which will facilitate development of urban infrastructure.

### 3.8 Foreign Investment Policy:

Different countries are at different stages of economic development. From the viewpoint of our country, in a developing economy, investment from abroad is essential if works like a means of bridging the two crucial gaps; the savings gap and the foreign exchange gap. Besides, it serves as a vehicle for the transfer of modern technology.

In order to invite foreign investment in high priority industries, there requires large investment and advanced technology, it has been decided to provide approval for direct foreign investment upto 51% foreign equity in such industries. “There shall be no bottlenecks of any kind in this process. This group of industries has generally be known as the ‘Appendix Industries’ and are areas in which FERA companies have already been allowed to invest on a discretionary basis”. 27

Promotion of exports of Indian product calls for a systematic exploration of world markets possible only through intensive and highly professional marketing activities. The government will appoint a special board to negotiate with such firm so that we can engage in purposive negotiation with such large firms, and provide the avenues for large investments in the development of industries and technology in the national interest. (A detailed study with regard to foreign investment policy is critically examined in Chapter-4).
3.9 Tax Reforms:

Finance ministry announced wide-ranging concessions in excise and customs through rationalization and restructuring of duties. The standard deduction for salaried class of men and women were raised. Tax rebates and exemptions were also made. The wealth and gift taxes were also reduced. A ten-year tax holiday for new industries set up in specified area; new power generation and distribution companies and electronics, hardware and software technology parks, were allowed. The excise duty on various items like coffee, tea, vanaspati, electronics items, etc. was reduced. Customs duty rates have also been reduced through which capital goods could be imported at lower cost for faster growth of economy. Some of the recent tax reform measures are outlined as follows:

- Major Reforms of Central Excise. Eleven major advalorem rates of excise duty reduced to 3 per cent, namely, a central rate of 16 per cent, a merit rate of 6 per cent and a demerit rate of 24 per cent.
- The cap on MODVAT credit of 95 per cent of the admissible amount was lifted and restored to 100 per cent.
- Reduction in peak protective customs tariff from 45 per cent to 40 per cent.
- Seven major advalorem rates of customs duty, namely 5 per cent, 10 per cent, 20 per cent, 25 per cent, 30 per cent, 35 per cent and 40 per cent were rationalized to 5 advalorem rates, namely, 5 per cent, 15 per cent, 25 per cent, 35 per cent and 40 per cent.
- The provisions relating to amalgamation of companies were rationalized by relaxing the existing conditions for carry forward and set off of accumulated losses and unabsorbed depreciation. In addition new provisions making demerger of companies tax-neutral have been provided.
With a view to expand the tax base, “One-by-Six” criteria introduced in the 1998-99 budget for identifying potential tax assesses was extended to 19 more cities (from 35) having population of more than 5 lakh.

Tax holiday benefit extended for cold chains and storage facilities to promote agro-processing.

Export entertainment industry products given facilities and tax benefits similar to those for export of goods and merchandise under Section 80HHC.

Historic decision taken to implement domestic trade tax reforms. All States and UTs to implement uniform floor rates of Sales tax by January 1, 2000 and VAT by April 1, 2001. Sales tax incentives to be phased out by January 1, 2000.

3.10 SEBI And The Globalization of Capital Market:

Securities and Exchange Board of India (SEBI) was constituted with the objective of promoting orderly and healthy development of the securities market and to provide adequate investor protection. It aims to remove the unhealthy practices prevalent in Indian capital market and create an environment to facilitate mobilization of resources through the securities market. Thus, the Board plays a dual role by adapting regulatory functions as well as playing an important development role.

The main function of the SEBI is to deal with all the matters relating to development and regulation of securities market and investor protection and to advise the government on all these matters. SEBI was given statutory status and powers through an Ordinance promulgated on January 30th 1992. The Ordinance was replaced by an Act of Parliament on 4 April 1992. Under the Act, SEBI has been assigned the following main functions:
a) regulating the business in stock exchange and other securities markets;

b) registering and regulating the working of stock brokers, sub-brokers, share transfer agents, bankers to an issue, trustees of trust deeds, registrars, merchant bankers, underwriters, portfolio managers and other intermediaries associated with the securities markets;

c) registering and regulating the working of collective investment schemes including mutual funds;

d) promoting and regulating the self-regulatory organization;

e) prohibiting fraudulent and unfair trade practices relating to securities markets;

f) promoting investors education and training of intermediaries of securities market;

g) prohibiting insider trading in securities and

h) regulating substantial acquisition of share and takeover of companies.

The Indian capital market witnessed substantial development as a sequel to the liberalization of Indian economy. The total number of stock exchanges increased from 9 to 22. The major developments in the capital market are:

(a) the setting up of OCTCEI and National Stock Exchange,

(b) the entry of many public sector corporations into the market for raising debt and equity,

(c) the entry of several mutual funds including some in the private sectors and the development of strong investor preference in their favour,

(d) the growth of intermediaries, such as, Merchant Bankers, and Underwriters,

(e) the establishment of Rating Agencies,
(f) the repeal of Capital Issues Control Act, and

- CIS Regulations were notified in October 1999.
- Announcement of calendar for issue of Treasury Bills and reintroduction of 182-day Treasury Bills.
- Rolling Settlement has been introduced in 10 select scrips.
- Companies given freedom to determine par value of shares issued by them.

3.11 Banking Sector Reform - Agenda And Progress:

Since 1991 the Government of India has been witnessing the behavior of the Indian financial system and recommended reform measures. The most important of these is the Narasimham Committee (RBI: 1991), which recommended drastic changes in the behavior of both commercial and development banks. Briefly stated, the Committee felt that the efficiency in the real sector of the economy can not be improved without an efficient and healthy financial sector, and the efficiency of the financial system can be improved only through competition, both domestic and international, operational flexibility and functional autonomy.

Accordingly, the Committee put forward a set of recommendations dealing with various aspects of the functioning of the financial system and especially the banking system. In a nutshell, the major recommendations of the Committee were as follows:

1. Reduction in Statutory Liquidity Ratio (SLR) from 38.5 per cent of demand and time liabilities of commercial banks in 1991 to 25 per cent;
b) reduction in Cash Reserve Ratio (CRR) of commercial banks from 15 per cent of demand and time liabilities to 5 per cent;
c) phased deregulation of administered interest rates on bank deposits and advances and lending of term lending institutions;
d) phasing out the directed credit and differential interest rates to priority and other sectors;
e) augmentation of capital base of commercial banks to the international norm of 8 per cent of deposits though public issue of shares; and
f) prudential classification of assets and liabilities of commercial banks.

The Committee also recommended consolidation of rural branches, revamping of cooperative and regional rural banking, closure of unviable branches of commercial banks, opening up of banking to the private sector in general and international competition in particular, greater autonomy to the managers of the state owned financial institutions to make profit from banking business, introduction of competition among banks, including state owned banks, and better monitoring of financial system through new regulatory agencies. Finally, the Committee had recommended a gradual reduction in staff and unviable branches. However, the Committee has not recommended any wholesale privatization of commercial or development banks. It only recommended partial divestment of equity to private shareholders.  

3.12 Insurance Sector And Private Participation:  

The Government’s efforts at introducing the IRA Bill in Parliament to give it a legal shape and also open the sector for public participation received simultaneously criticism as well as
appreciation. For a measure to draw this sort of response, which to an ordinary mind appears inexplicable. The step taken should really be a major one. Criticism was on the ground that the Government thoughtlessly entered into an area where no progressive steps were considered necessary. The persons against the opening up say that all that was required to be done for the healthy existence and growth of insurance companies in India had already been done and no further progress would be needed. The appreciation of Government’s efforts comes from a section of the society which said that at last the Government decided to end the monopoly of the State’s insurers, recognize and enhance the importance of the insurance sector in garnering the scarce long term resources for purposes of investment and consequently for the development of economy. The committees including the Rakesh Mohan Committee which looked into infrastructure development plan for our country had emphasized the need to have long term resources to be ploughed into the basic infrastructures like roads, ports, airports, communication, transport etc. and such long term resources would become available only by developing a vibrant insurance market. This view is based on the fact that it is only from the insurance market particularly the life and the pension segments that long-term resources are generated – looking for an equally long-term media for investments. The recognition of this is accentuated by the fact that such long term resources have necessarily to be generated within the country and any borrowings made from outside or even within India would not make the proposition viable.
The insurance market is only a part of the overall financial sector which has in the recent past gone through a transformation, a change which had taken its place from a position of assumed complacency to vibrancy and vitality which it lacked earlier. It is in this background that one has to view the changes that have been taking place in the area of capital market reforms and banking sector reforms.

Some of the salient features of the Insurance Regulatory and Development Authority Act (IRDA), 1999 are as follows:

- The insurance sector in India has been thrown open to the private sector. The second and third schedules of the Act provide for removal of exclusive privilege of existing corporations/companies to do life and general insurance businesses.

- An Indian insurance company is a company registered under the Companies Act, 1956 in which foreign equity does not exceed 26 per cent of the total equity shareholding, including the equity shareholding of Non-Resident Indians (NRIs), Foreign Institutional Investors (FIIs) and Overseas Corporate Bodies (OCBs).

- After the commencement of an insurance company, the Indian promoters can hold more than 26 per cent of the total equity holding for a period of ten years, the balance shares being held by non-promoter Indian share holders which will not include equity of the foreign promoters, and share holding of FIIs, NRIs and OCBs.

- After the permissible period of ten years, excess equity above the prescribed level of 26 per cent will be disinvested as per a phased programme to be indicated by IRDA. The Central Government is empowered to extend the period of ten years in individual cases and also to provide for higher ceiling on share holding of Indian promoters in excess of which disinvestment will be required.
On foreign promoters, the maximum of 26 per cent will always be operational. They will, thus, be unable to hold any equity beyond this ceiling at any stage.

The Act gives statutory status for the Interim Insurance regulatory Authority (IRA) set up by the Central Government through Resolution in January 1996.

All the powers presently being exercised under the Insurance Act, 1938 by the Controller of Insurance (COI) will be transferred to the Insurance Regulatory and Development Authority (IRDA).

The IRDA Act also provides for the appointment of COI by the Central Government when the Regulatory Authority is superseded.

The minimum amount of paid-up equity capital is Rs. 100 crore in case of life insurance as well as general insurance and Rs. 200 crore in case of re-insurance.

Solvency margin (excess of assets over-liabilities) is fixed at not less than Rs. 50 crore for life as well as general insurers; for reinsurance solvency margin stipulated at not less than Rs. 100 crore in each case.

Insurance companies will deposit Rs. 10 crore as security deposit before starting their business.

In the non-life sector, IRDA would give preference to companies providing health insurance.

Safeguards for policy holders' funds include specific provision prohibiting investment of policy holders funds' outside India and provision for investment of funds in accordance with policy directions of the IRDA, including social and infrastructure investments.

Every insurer shall provide life insurance or general insurance policies (including insurance for crops) to the persons residing in the rural sector, workers in the unorganized or informal sector or for economically vulnerable or backward classes of the society and other categories of persons as may be specified by regulations made by IRDA.
Failure to fulfill the social obligations would attract a fine of Rs. 25 lakh, in case the obligations are still not fulfilled, license would be cancelled.

3.13 Fiscal Reforms:

Economic reforms in India, which were initiated in 1991, had two objectives: stabilization and structural adjustment. Stabilization was necessary to correct the macro economic imbalances, which periodically destabilize the Indian economy, such as, high inflation, unsustainable fiscal deficit and current account deficit, acute foreign exchange shortage and balance of payments problem. Although the need for a reform in India was felt for quite some time the actual reform measures began only after an acute foreign exchange crisis in early 1990s.

The Structural Adjustment Programme (SAP), that followed was initiated with the twin objectives of preventing recurring macro economic imbalances on the one hand, and acceleration of long-run growth of income and standard of living on the other. Both stabilization and structural adjustment programmes emphasized liberalization and globalization as principal instruments of achieving these goals.

The economic reform in India, as in most developing countries, began with a financial support from the International Monetary Fund (IMF) and the World Bank. The broad framework of the reform is therefore the IMF-World Bank sponsored Structural Adjustment Programme (SAP). The design and sequencing of the reform however needed some adjustments to suit the Indian economic conditions, including political economy.
In a nutshell, the Government has so far deregulated private investment in all but a few sensitive sectors (defence, natural resources and environment), withdrawn restrictions on monopoly and big business houses. It restricted the scope of new public enterprises only in the core sectors, open the scope of private investment in many sectors hitherto reserved to only public sectors – such as power, telecommunications and other infrastructures – divested shares of some public enterprises, lowered personal tax rates and abolished tax on dividend income, reduced excise and import duties, delicensed imports of most capital and intermediate goods, and liberalised inflows of foreign capital, not only foreign direct investment (FDI) but also portfolio capital.

Financial sector reform is very intricately related to the fiscal reform. In a controlled economy the budget constraint forces the government to retain the hold over the financial system. Without an easy accessibility of funds from the financial system the government cannot satisfy diversified political and economic interests. High fiscal therefore often becomes a major obstacle to financial reform.

When economic reforms were initiated in India in 1991, fiscal deficit was quite high. It was felt that without a fiscal correction the economy could neither stabilize nor accelerate. Fiscal imbalance can be corrected by either raising tax and non-tax resources or by reducing expenditures. The Structural Adjustment Programme (SAP) emphasized mainly on the reduction of government expenditure, particularly, subsidies and bureaucratic expenditure. The SAP also disfavored public investment. It was implicitly assumed that public investment ‘crowds out’ private investment.
The actual implementation of SAP varied between the Centre and the States and also among states. The pace of fiscal reform also slackened over the years. At the state levels, the constraints of fiscal reform have become sharper, particularly for the poorer states. This is resulting in a vicious circle: lack of reform leads to lower investment and this in turn leads to poor infrastructure.

3.14 Impact of Liberalization on TNCs In Indian Economy:

The results of reform process were seen in many faces. First the control over inflation achieved because of good agricultural results and reduction in balance of payment due to excess of export over import. The inflation rate brought down from almost 18 per cent to the range of 5 to 6 per cent. Foreign exchange reserves are now beyond 25 billion dollars against 2 billion in 1991. The foreign loans are being repaid before scheduled time. Though the scam damaged the liquidity and temporarily raised the question of confidence, the controlled measures of reform process brought back the confidence of general public in capital market and economy. GDP has risen almost from nil to 5 per cent. Though reduction in tax rates and excise/customs duties have taken place, there is an increase in revenue collections, which is the sign of improved industrial activity. A very good environment of competition has also been established with the large number of transnational corporations operating in Indian economy.

Through the process of joint ventures and subsidiaries the TNCs bring in technology besides capital and also create market for their products. The flurry of Ms&As by TNCs with Indian corporates is yet
another post-NEP period phenomenon. The TNCs are also showing a good deal of interest in marketing of financial services.

In fine the economic liberalization of July 1991 is to facilitate the Indian economy in general and industry in particular to achieve international competitiveness led to the implementation of radical changes in India's foreign investment policy. The policy has duly recognized the role and importance of foreign capital and technology through TNCs in the industrial development of India.

The economic reform processes albeit have resulted in considerable amount of creditable things, yet there are certain pitfalls. The major discreditable thing happened due to disinvestment of PSU shares. The PSU shares were disinvested at a cheaper rate than the market price, which led to heavy loss to the government. The stock market crash through bank fraud scam and disinvestment has proved as a curse to small and inexperienced investors, sending wrong signals to the foreign investors.

3.15 Conclusion:

It may be concluded that the reform process is benefiting the economy in a better way and augurs well for future. The whole economic scene has undergone drastic changes. The major achievement of the economic reforms can be reckoned with in terms of the control of inflation, growth for corporate sector, introduction of capital intensive technology for global competitiveness and modernization. However, there are certain neglected areas of economic reform, such as, agriculture, social security and health security etc.
The government has yet to initiate many vital reform measures. For instance, it has not privatized any public enterprise, including those, which grossly violated the criteria of either public goods or 'core' industry concept. Many of them are loss making enterprises. Nor has the government closed any 'sick' or unviable public enterprises. The government has referred many of them to the BIFR but has yet to take any concrete step towards either privatization or closure. The basic problem in many of these enterprises is over employment. Pending either privatization or closure, the government could have at least taken steps to improve efficiency and productivity of labour and management. But even in this respect, actions initiated are grossly inadequate. The divestment programme is also lopsided. Instead of selling shares of unwarranted enterprises the government has sold shares in profit making enterprises, including natural monopolies and core enterprises.

Infrastructure is now open to the private – both domestic and foreign – investment in this sector during the reform period is abysmally poor. The anarchic pricing and subsidy policies together with institutional failure discourage private investment in infrastructure.

Employment and wage policy in the public sector is another area where the reform has failed to make any dent. The exit policy – with respect to both labour and industry – is to be debated at length, but as of now could not be implemented in either public or private sector. Despite deregulation, bureaucratic controls continue to thwart economic activities, particularly at the state and the local levels. As a result corruption and inefficiency continue unabated and have
probably increased, as would be evident from various financial ‘scams’ unearthed during the 1990s. Many of these ‘scams’ have occurred before initiated of the reform but were unearthed during the reform years due to public interest litigations. However due to lack of transparency in the government functioning and the lethargic pace of investigation by the official investigation agencies these scams have often dragged for an indefinite period. Since many of these scams were related to deregulations and divestment of shares in public enterprises they have given wrong signals to the genuine investors, both domestic and foreign. Whether because of this or not India is now branded as one of the most corrupt countries in the world by some international rating agencies. This image has to be changed to a country with full of promises of galore, opportunities for trade and investment to attain cherished target of 7 to 8 per cent of GDP.

3.16 References:

2. Ibid.
3. Ibid., p. 61.
5. Ibid., p.291.
7. Ibid.
8. Ibid.
10. Ibid., p. 97.
11. Ibid., p. 103.
12. Ibid., p. 104.
13. Ibid., p. 105.
14. Ibid.
15. Ibid.
17. Ibid., p. 71.
18. Ibid., p. 72.
20. Ibid., p. 123.
22. Ibid., p. 125.
24. Ibid., p. 103.