CHAPTER-III

PRIVATIZATION: THEORETICAL REFLECTIONS

India's tryst with economic reforms began immediately after independence in 1947. Political disputes about the role of the state in the development of Indian industry and agriculture began with the debates about the nature of Indian socialism and its economic planning. On one side were the landlords and Indian industrialists who emphasized productivity and growth. And on the other were those who wished greater redistribution through the direct intervention of the state. The extent of political power wielded by these groups had a substantial impact on policy. Technical assessments about the results of the planning experience along with exogenous shocks such as wars and balance of payments crises also influenced policy outcomes. In this story of the relative importance of the state and the market, one could divide the Indian experience into three broad phases. The first period from independence till 1968 witnessed political battles which produced a compromise that gave birth to a large public sector, trade protection, and incentives for Indian industry to operate within a protected Indian market. Capital had some room for maneuver even though it substantially depended on the state. Indian agriculture suffered during this period. The second phase between 1969 and 1974 witnessed an intensification of state intervention in economic activity.
saw the evolution of a model that increasingly began to rely on price incentives and efficiency. The third phase was a slow and evolutionary process. The shift away from import substitution towards trade promotion and efficiency occurred slowly, and, unlike in the case of China, it was Indian industry and its interests that drove the reforms process rather than the interests of foreign capital. In the post 1975 period, the phase of economic reforms beyond 1991 marked the most radical departure from the past. The post 1991 period has witnessed institutional or structural changes favoring competition and private investment in areas such as telecommunications and capital markets. Economic policies have shifted from emphasizing import substitution to vigorously promoting exports, driven by shifts in industrial and trade policy.

Reforms have given a distinct meaning to Indian federalism. Regional inequalities, slow rates of growth in the agrarian sector, and challenges to redistribution and the provision of physical and human infrastructure pose challenges for the story of India’s development. During this period, the politics of economic policy occurred largely within the Congress party. Right-wing parties like the Swatantra party and the Jan Sangh could pose the threat of weaning people away from the Congress party if a radical version of social and economic transformation were imposed on those who had favored private property and price incentives.
The socialists within the Congress, who favored radical redistribution and abolition of private property, had the sympathy of Prime Minister Nehru.\(^1\) One the other hand, Sardar patel and many state level party leaders, who were a powerful political force to reckon with, were uneasy with the idea of radical redistribution.\(^2\) The compromise that emerged between the radical version and the status quo lasted till about 1968\(^3\). Prime Minister Indira Gandhi pursued economic reforms for brief period at the time of a balance of payments crisis in 1966. Sardar Patel’s influence between 1947 and 1950 set the stage for a compromise that would give private industry some room for manoeuvre in India. He enjoyed enormous powers, which were deployed for deciding the composition of the Congress Working Committee. Patel facilitated the formation of a Socialist Party outside the Congress Party, which was a major loss for Nehru and the Congress socialists.\(^4\)

Patel and the doyen of Indian nationalist business G.JD. Birla had shared a common vision. Birla played an important role in working out a mechanism that would determine the transfer of assets between India and Pakistan in the aftermath of partition. He had helped Patel’s candidate purshottamdas Tandon get elected as the Congress President in 1950, against the wishes of Nehru.\(^5\) He was relied upon to brief Patel about the state of industrial sectors like jute and cotton and, as Patel’s emissary in the late 1940s, made high profile visits to the US and the UK\(^6\).
The compromise was most clearly evident in industrial policy. The report of the Economic Programme Committee of the congress Party in January 1948 was very different from the Industrial Policy Resolution (IPR) of April 1948.

The report had suggested nationalization of public utilities and key industries, public ownership of monopolies, and the abolition of the managing agency system. Homi Modi and Birla had criticized the report on behalf of the Federation of Indian Chambers of Commerce and Industry (FICCI). They were satisfied that the water-down IPR of April 1948 had allowed public ownership of assets in only three sectors of the economy. In the six other sectors, the government had the right to begin new enterprises while the old privately owned enterprises could continue. The rest of the sectors were open for private investment. The late 1940s had witnessed the removal of price controls on sugar, cotton, and food grains. The Company Law enacted in 1956 gave a new lease to the managing agency system, which had been criticized in the Report of the Economic Programme Committee in 1948. Withdrawal of this provision would have created a disruption in the managerial environment of private companies. Indian industry had opposed the Industrial Development and Control Bill introduced in parliament in 1949.
The final compromise was the Industrial Development and Regulation Act of 1951. Arguments against production controls and investment pessimism were made on behalf of Indian industry by the FICCI. Patel had even urged Birla to mobilize opposition to the bill. The proponents of government regulation were empowered by the rising inflation in the aftermath of the deregulation of prices in 1948. The Industrial Development and Regulation Act 1951 was a compromise between those who wanted extensive controls and those who wished the self-regulation of industry. A number of sectors were brought under licensing but development councils were also established to give industry a voice in sectoral policies. These development councils and the Central Advisory Council on Industry with representatives from Indian industry would work closely with the government on licensing issues. While Indian industry wished greater room for manoeuvre within India, it sought help from the state to protect it from foreign competition. The Planning Commission came into existence in March 1950, as a compromise between those who wanted the commission to enjoy powers of policy implementation, and those who wished that it remain just an advisory body.

Strong proponents of planning like Nehru and Gulzarilal Nanda desired a powerful Planning Commission. Industry needed the state for finance but was opposed to directions from the state with respect to the modalities of doing business. Patel was opposed to a powerful Planning Commission.
Several ministers were also opposed to a Planning Commission with powers of implementation, as this would rob them of their executive power. Matters came to a head when Finance Minister John Mathai tendered his letter of resignation, owing largely to the proposal of setting up the Planning Commission as a super cabinet. The Planning commission was to be an arm of the government with powers to decide the size and allocation of resources but devoid of substantial powers to interfere with the work of other ministries.

Indian industry had worried about direction from the Planning Commission. G.D. Birla lost no time in organizing FICCI into a cohesive organization. FICCI conducted an extensive orientation programme for Members of Parliament (MPs). The Hindustan Times and the Eastern Economist, both of which were owned by Birla, argued the perspective of Indian industry. The First Five-Year Plan was sympathetic to the concerns of Indian industrialists in the private sector. The final draft of the Plan, which was approved in December 1952, allocated Rs. 15 billion out of a total of Rs. 35 billion for the private sector. Financial organizations such as the Industrial Finance Corporation of India (IFCI), the National Industrial Development Corporation (INDC), and the Industrial Credit and Investment Corporation of India (ICICI) were born between 1950 and 1955.
The First Five Year Plan allocations emphasized a more prominent role for Indian private industry and agriculture than would be the case with the Second Plan, which began in 1956. The politics of the Second Five Year Plan was quite different from that of the First Five year plan. This period witnessed the ascendance of heavy capital intensive industrialization, largely within the public sector. The death of Patel enabled Nehru to garner greater authority within the Congress Party after assuming the Presidency of the Congress party. By the mid-1950s at the height of Nehru’s power, the Planning Commission had assumed over reaching importance. Nehru could now obtain approvals from the Cabinet, the All-India Congress Committee and the National Development council. The Planning Commission was manned typically by about five respected technocrats as full members; the prime minister was chairman and the deputy chairman enjoyed the rank of a cabinet minister. The Cabinet Secretary the first among the secretaries in the Indian administrative service was a secretary of the Planning commission; and the Finance Ministry’s Chief Economic Advisor was an advisor to the Planning Commission. I.G. patel, the Deputy Economic Advisor of the Ministry of Finance had played an important role in coordinating the work between the Planning Commission and the Ministry of Finance on the eve of the Second Plan. The rise of Nehru and the Planning Commission gave birth to a certain Kind of technocratic thinking. Voices favoring the importance of consumer
goods and light industrial projects did not gain much ground in the policy debates\textsuperscript{21}. Foreign advisors from the US, USSR, and China were consulted\textsuperscript{22}.

Finally, it was the Nehru Mahalanobis model of heavy industrialization that won the day. Capital intensive industrialization was considered a necessary investment for the long term development of the country. This was supposed to promote the goal of economic self sufficiency. To a great extent, this strategy of modernization drew inspiration from the Soviet success with centralized planning\textsuperscript{23}. The allocations for organized industry and minerals grew from 7 per cent in the First Plan to about 20 per cent in the Second Plan\textsuperscript{24}. The emphasis on heavy industry in the public sector was a distinct characteristic of the Second plan. Lobbying by Indian industry was less effective in the mid 1950s\textsuperscript{25}. The Industrial Policy Resolution of 1956 brought more area of industrial activity under regulation. Private investment in organized industry in the First Plan was about twice the level of public investment.

This sequence stood reversed, and there was much greater investment in large scale public sector industries than in industries in the private sector in the Second Plan. Even though private capital had some room for manoeuvre, the state's powers over private capital through licensing and financial controls, rendered the private sector in a position of dependence with respect to the
The emphasis shifted to heavy industrialization, with reduced resources for the development of Indian agriculture. The reduction in the outlay on agriculture and irrigation was to the tune of 20 per cent of the Plan expenditure from the earlier 33 per cent. Despite reduced outlays in agriculture, Indian faced its first balance of payments crisis in 1956-57. Short of resources to fund both industry and agriculture, India's agricultural strategy during the Second Plan emphasized institutional changes such as land reforms, cooperatives, and economies of scale using abundant manpower to boost productivity without having to make substantial investment. State trading was pursued with the aim of containing the price level.

It was believed that the availability of abundant manpower, coupled with redistribution via land reforms and economies of scale to be realized through the cooperative farming effort, would enhance agricultural productivity without having to invest much in agriculture.

The Congress party at the local level could neither sustain the radical redistribution programme, nor could it enthuse a substantial number of unemployed people towards the cooperative movement. Agriculture ministers at the Centre like A.P. Jain and S.K. Patil were critical of the approach of the Planning commission towards Indian agriculture. They argued for price incentives and subsidies rather than price controls through state trading.
The surplus labour failed to respond to the call of the cooperative movement, while the landed elite suspected cooperatives in agriculture as an attempt to introduce community collectivization. The cooperative effort did not take into account the crop specificity of regions. It lumped all regions as equally suited for all kinds of agricultural activities, creating a paucity of resources for all the districts. Political opposition against the Congress Party was brewing. By the late 1950s, the Swatantra party posed a threat to the Congress party's claim to represent the landed and the propertied classes. The Chinese invasion of Tibet in 1959 and the war in 1962 were dampeners for the lesions in collectivization that India had wished to learn from China.

In the parliamentary bye-elections of 1963, Rammanohar Lohia (Socialist party), J.B. Kripalani (independent) and Minoo Masani (Swatantra party) won seats against the Congress party candidates. This called for self reflection within the Congress party. Nehru felt the challenge and requested Kamraj and a few others to step down from political positions, urging them to devote themselves to the cause of the Congress party. The Kamraj Plan especially picked right-wing Congress party functionaries in high political positions and entrusted them the task of party reorganizations. Nehru's attempt to put some weight being the redistributive ideal failed to take shape after the war with China in 1962. The war had taken a serious toll on his
health. The economic scenario was gloomy towards the end of Nehru's tenure. The agriculture sector, which is the base for industrial expansion, was in shambles by the late 1950s and the early 1960s.

Land reforms had failed miserably. Whereas in 1953-54 three fourths of the agricultural households owned 16 per cent of the land, in 1961-2 the same proportion of households owned 20 per cent of the land. In June 1966 60 per cent of all agricultural families remained outside the cooperative movement. The rural elite was averse to redistribution of resources. Food grain production in 1962-3 declined below the levels of 1961-2 While industry was growing, even if at a lower than targeted rate of growth of 8 per cent, the economy was in dire need of agricultural growth. The period between 1964 and 1968, beginning with the prime minister ship of Lal Bahadur Shastri and lasting till the early years of Mrs Gandhi's tenure, witnessed greater attention to India's agriculture.

The power of the Planning commission, which was a firm supporter of capital intensive industrialization, was reduced. Members of the planning commission now had fixed tenures, and the Cabinet Secretary would no longer be the secretary of the Planning commission. Finance Minster T.T. Krishnamachari, who felt the need for heavy industrialization rather than price and technological incentives, had to resign. Sachin Choudhury and Morarji
Desai, the two finance ministers who succeeded Krishnamachari, were not in favor of sacrificing agriculture for industry. Shastri's secretariat had more cordial relations with the Federation of Indian Chambers of Commerce and Industry than was the case during the Nehru period. Shastri increased the powers of the Prime Minister's Office (PMO). His secretary L.K.Jha, who was more inclined towards viewing government as regulator rather than an entrepreneur, became influential.

Shastri's office systematically engineered a reduction in the important of the Planning commission and tried to change the mindset of the Ministry of Finance. He brought in the technocratic minister of Steel and Heavy Industries, C.Subramaniam, as minister of Food and Agriculture. Subramaniam advanced arguments to justify the need for better seeds, pesticides, irrigation, and price incentives for ensuring agrarian development and food self-sufficiency that were reminiscent of the reasons advanced for increasing self-sufficiency in iron and steel as the engine of India's industrial growth during the Second Five-Year Plan. The reduced power of the Planning Commission and the increased role of the National Development council, composed of state chief ministers who favored a pro-agriculture policy, aided subramaniam's designs of boosting Indian agriculture.
The period between 1969 and 1973 saw conflicts emerge between the old guard of the congress Party called the ‘Syndicate’, and Prime Minister Mrs Indira Gandhi, whose support base was the Left oriented members of the Congress party in the Congress Forum for Socialist Action, and the Communist party of India. The conflict became Full blown in the Faridabad session of the congress party in April 1969, when Mrs. Gandhi directly attacked Congress president Nijalinappa. When the Congress president proposed the name of Neelam Sanjeeva Reddy for presidency of the country, Mrs Gandhi opposed this move by proposing the name of the trade union leader V.V.Giri. Mrs. Gandhi was worried that a president elected by the Syndicate would try to dislodge here from power. V.V.Giri won the election to presidency only by a narrow margin.

A majority of the Congress members of parliament and the state level members of legislative assemblies had voted for Neelam Sanjeeva Reddy. Giri could not have won the election without support from the left within the Congress and from the Communist party of India. Mrs Gandhi’s policies subsequently needed to follow the course of satisfying the left. The traditional Congress support base was not likely to be of much help under these circumstances. The state very quickly came to acquire the commanding heights of the economy in a manner that surpassed Nehru’s record of
encouraging public ownership of assets. All the major banks were nationalized, covering over 85 per cent of the bank deposits in 1969.

In the same year, the Monopolies and Restrictive Trade practice Act barred all commercial enterprises valued at greater than Rs. 200 million from expansion or diversification. The industrial licensing policy was made more stringent in 1970. Between 1969 and 1971 the government nationalized the coal, copper, general insurance and significant parts of the steel industry. The wheat trade was nationalized in 1973. The Foreign Exchange Regulation Act (1974) brought down the permissible level of foreign equity in Indian firms from 51 per cent to 40 per cent. Indian company law requires 51 per cent of the votes for the passage of ordinary resolutions dealing with the closure of business and the appointment and removal of directors. The radical economic stance favoring state control and inward oriented industrialization began to change slowly but perceptibly after 1974. This was a response to the continuing crisis of public policy in dealing with social mobilizations.

It is plausible to argue that the politics of command directed from the state now turned into a politics of aggressive demands made on the state by social actors seeking a better quality of life. The deprivations that the people were willing to bear when the prices of essential commodities rose in the mid 1960s now produced violent unrest, which could not be brought under control.
by the regular coercive machinery of the state. Jayaprakash narayan was the charismatic leader who brought the social forces together in the mid 1970s. Mrs Gandhi failed to contain student unrest in Gujarat and Bihar, which was fuelled by inflation. She gave up the idea of nationalizing the food grain trade in 1974.

The deflationary macroeconomic policy introduced to curb inflation resulted in worker unrest. In May 1974, 1.7 million railway workers went on strike. Mrs Gandhi’s position became politically weak after the Allahabad High Court found in June 1975 that she had committed corrupt practice under the Representations of People’s Act. Her inability to deal with the protest led to the proclamation of Emergency in June 1975. The period between June 1975 and the elections in March 1977 produced the only period of authoritarian rule in India’s post colonial political history. Mrs. Gandhi initiated a policy change that would seek to promote exports and interfere less with the activities of private capital. The pro business tilt in India’s economic policy began in 1975.

These policies began having a cumulative effect on growth rates after 1980, which was a major break from growth rates of the past. The growth in India’s per capita income, which was 1.4 per cent per annum between 1950 and 1980, accelerated to 3.6 per cent per annum between 1980 and 2004.
This policy shift, even though it was not very significant compared to developments in other parts of East and Southeast Asia, was significant in relations to policies pursued in India between 1969 and 1974. Moreover, these shifts reflected India's won learning with previous experiences in policy making.

The steady devolution of the rupee, deflationary economic policy, and the decision not to take over wheat trade in 1974 signalled a quiet departure from previous practices. The new Economic Programme of 1975-6 gradually liberalized the procedure for increasing production capacity beyond what was stipulated in the license. It made it easier for private industry to conduct research and development; procure license for production, imports and exports; and encouraged foreign collaborations.\textsuperscript{40} The Janata party government that came to power in 1977 pursued private sector enabling politics. Its electoral victory had resulted from the movement spearheaded by Jayaprakash Naraya.

The new dispensation emphasized agriculture over industry. It tried to promote small scale industries. The government was averse to public sector undertakings and removed the 10 per cent price preference for these enterprises. It abolished price controls on sugar and the food zoning system. The government eased procedures for private sector credit and imports\textsuperscript{41}. 

78
These measures may have aided the realization of 8 per cent growth in Indian industry in 1980.42

Several reports and policy documents critical of government policy came to characterize the Janata government (1977-9) and the Congress governments of Indira Gandhi (1980-3) and Rajiv Gandhi (1984-9).

Various reports of the Government of India beginning from the late 1970s began arguing the case for increasing export orientation for financing India’s development.43 The influential report of Vadilal Dagli demonstrated the adverse consequence of the system of controls, which resulted in delays and corruption. Narasimham (1985) argued against controls and in favour of exposing the Indian economy to the winds of competition. Abid Hussain argued for making trade an integral part of India’s development strategy.44

Mrs Gandhi was surrounded by liberal minded technocrats like Late P.C. Alexander, L.K.Jha and Manmohan Singh in the early 1980s, who thought differently from earlier economic policy influential like D.P.Dhar and P.N.Haksar. It is not a coincidence that L.K.Jha, who was influential during the mid 1960s when liberalization had been attempted, was to become an important player again in the early 1980s. The idea of homegrown conditionality was emphasized when India successfully sought a large IMF drawing of SDR
5 billion in the aftermath of the second oil shock in 1979. India pre-empted IMF conditionalities by embedding reforms relating to macroeconomic adjustment within the Sixth Five-year Plan (1980-5). 53 per cent of the loan was for public sector investments. Export promotion and import liberalization were emphasized, along with import substitution in power, fertilizer, and insecticides. While the Indian state did not work out a pro-market compromise with the IMF, it moved towards pro-business deregulation against opposition from the Left in India. The US, UK, and Australia had opposed this loan within the IMF but did not use the veto. Rajiv Gandhi's tenure was unabashedly more tilted towards promoting Indian business for engendering efficiency and growth than any regime in the past. Big business was redefined: the Monopoly and Restrictive Trade Practices (MRTP) Act would now regulate businesses worth more than Rs. 1 billion as compared with the earlier size limit of Rs. 200 million.

Fewer firms would now come under MRTP's regulatory sway. Eighty-two intermediate industries, such as electronic machinery and machine and drug-related industries were delicensed, and it became easier to obtain a license in others. Broad banding permitted entrepreneurs greater freedom to choose between product types without seeking permission is for production. Capacity expansion became much easier. Physical infrastructure was viewed as a critical component of private sector-oriented growth. The National
Thermal Power Corporation funded by the World Bank became one of the largest power producers in the world using coal.

The Mahanagar Telephone Nigam Limited (MTNL) providing telecom services in the metropolitan area of Delhi and Mumbai, was made autonomous of the Department Telecommunications and corporatized against the wishes of the majority of the telecom unions. Corporatization or creating government owned entities autonomous from their respective ministries was designed to make the government owned telecom service provider more efficient. Private production of telecommunications equipment was also allowed in the mid to late 1980s. Rajiv Gandhi’s pro-business budget of 1985 was criticized at the Congress Party’s session in 1985 for not having involved socialism as an explicit goal.

Organized labour opposed the corporatization or privatization of public assets wherever it was attempted. The opposition to economic liberalization was further complicated by the allegation that Rajiv Gandhi was involved with the Bofors scandal concerning financial kickbacks due to the acquisition of a Swedish gun for the Indian Army.

The state began to retreat from the liberal agenda from 1986 onwards. In 1986 the customs duty on some capital goods and machine tools was raised.
In 1987 customs duty on imports of all machinery, except those for power and fertilizers, was raised to 85 per cent. Direct taxes were not raised but indirect taxes were raised to shore up revenue. Anti poverty programmes were initiated in 1987 to garner a pro poor image. The 1988 budget aided the large farmers by increasing outlays in agriculture, irrigation, fertilizer, and pesticides. Protection for capital goods industries was increased.

In the face of impending elections the 1989 budget was designed as a pro-poor budget. The jawahar Rojgar Yojana was to uplift 44 million rural people out of poverty. The retreat of the state from the agenda of promoting India’s competitiveness could be viewed as reflecting the increasing power of both the rich agrarian and indigenous business communities in economic policy. The rich and middle farmer agrarian community got mobilized in the 1980s and demanded investments and subsidies. It would not tolerate the discrimination against rural India by urban India, which became famously dubbed as ‘Bharat versus India’.

A state inclined towards protecting indigenous business could not discipline capital by accepting external competition. The traditional industrial houses maintained their clout in the context of a protected economy Reliance was perhaps the only major new corporate players to emerge during this
regime. Its growth was premised on excellent relations with the state, which enabled the company to obtain the permissions it needed. Economic liberalization promoting competition would therefore not be easy, even though there was a considerable consensus within the government to pursue it.

During the last decade there has been a burst of interest in the idea of privatization. It has been praised by some who call the idea that privatization can make a useful contribution to economic prosperity or maintain that the subject is still surrounded by intellectual confusion. The broad reason for this burst of interest in privatization is that most governments are searching for new ways to mobilize resources and for ways to use more effectively the resources they have. The privatization response can be considered as a reaction to the worldwide growth of government. Data available with the international monetary Fund (IMF) reveals that public expenditures in most countries rose in real terms, by 2 to 3 per cent annually, registering particularly high rates between 1960-1975, while in the early 1970s, only 13 countries monitored by the IMF were spending 30 per cent of the gross domestic product (GDP) in the public sector, by the end of the decade about 40 countries were spending more than one third of their GDP in the public sector.

In effect, a quite revolution had occurred in the shifting of resources into the public sector in the decade of the 1970s. in the less developed
countries (LDC), this was characterized by the growth of state owned enterprises (SOE). To cite a few instances, in Mexico at the beginning of the 1960s there were about 150 SOEs, by now they have risen to 600. In Brazil, there were 150 SOEs at the beginning of the 1960s by the beginning of the 1980s they had increased to 600 or 700.

Generally the governments in all countries have gone beyond the provision of public goods and services such as national defence, law and order or street lighting. They have invested in and promoted the production and distribution of a variety of private goods through the allocation of public resources and the creation of public organizations. Private goods are items such as food, clothing or medical care whose consumption by one person denies its consumption by another. When such goods are supplied by the state it is based on the belief that their quality or quantity of supply would be inadequate if left to the private sector. Some of the reasons for this belief are the rudimentary state of the private sector, small number of entrepreneurs, small size of businesses, inability of the private sector to raise resources and a wish to promote a particular distribution of income. Sometimes the public sector has been bloated by politicians and bureaucrats in search of power and prestige. Disillusionment with the performance of SOEs is common in developed as well as developing countries. The general impression seems to be that they have failed in their objectives. They are viewed as being more of a drain on the
nations budget than as generator of new resources. In most countries unbridled state expansion has led to economic inefficiency in the productive activities of the public sector with high costs of production, inability to innovate and costly delays in the delivery of the goods produced. It has also caused ineffectiveness in the provision of goods and services including the failure to meet intended objectives, diversion of benefits to elite groups and political interference in the management of enterprises as well as rapid expansion of the bureaucracy, straining the budget, furthering labour problems within the public sector, inefficiency in the economy and adverse effects on the whole economy. Far from removing market distortions, they have given rise to new ones. They have given employment, but many of them suffer from being overmanned. When measured from indices like capacity utilization or profitability ratios, they fall far behind their counterparts, if any, in the private sector.

A reaction against state owned industries and state provided services have been predominant in England since the late 1970s. The 1979 Conservative election manifesto claimed “The balance of our society has been increasingly tilted in favour of the state at the expense of individual freedom. This election may be the last chance we have to reverse this process.
Economic Reforms in India

The impact of these views has been most obviously felt in England's privatization programme for state owned industries and state provided services. In the United States placing a greater reliance on the private sector had been the centerpiece of the Reagan Administration's programme of accelerated and sustained growth through market-oriented economic policies. India was a latecomer to economic reforms, embarking on the process in earnest only in 1991, in the wake of an exceptionally severe balance of payments crisis. The need for a policy shift had become evident much earlier, as many countries in East Asia achieved high growth and poverty reduction through policies that emphasized greater export orientation and encouragement of the private sector.

Indian took some steps in this direction in the 1980s, but it was not until 1991 that the government signaled a systemic shift to a more open economy with greater reliance upon market forces, a larger role for the private sector including foreign investment, and a restructuring of the role of government.

India's economic performance in the post reform period has many positive features. The average growth rate in the 10 year period from 1992-1993 to 2001-2002 was around 6.0 per cent, as shown in Table which puts India among the fastest growing development countries in the 1990s. This
growth record s only slightly better than the annual average of 5.7 per cent in
the 1980s, but it can be argued that the 1980s growth was unsustainable,
fuelled by a build up of external debt that culminated in the crisis of 1991. in
Sharp contrast, growth in the 1990s was accompanied by remarkable external
stability despite the East Asian crisis. Poverty also declined significantly in the
Post reform period and at a faster rate than in the 1980s, according to some
studies.

### India’s Growth Performance

<table>
<thead>
<tr>
<th></th>
<th>Total Growth</th>
<th>Sectoral Growth of GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Growth</td>
<td>Agriculture</td>
</tr>
<tr>
<td>1970-2 to 1980-1 (average)</td>
<td>3.2</td>
<td>2.0</td>
</tr>
<tr>
<td>1981-2 to 1990-1 (average)</td>
<td>5.7</td>
<td>3.8</td>
</tr>
<tr>
<td>1991-2</td>
<td>1.3</td>
<td>-1.1</td>
</tr>
<tr>
<td>1992-3</td>
<td>5.1</td>
<td>5.4</td>
</tr>
<tr>
<td>1993-4</td>
<td>5.9</td>
<td>3.9</td>
</tr>
<tr>
<td>1994-5</td>
<td>7.3</td>
<td>5.3</td>
</tr>
<tr>
<td>1995-6</td>
<td>7.3</td>
<td>-0.3</td>
</tr>
<tr>
<td>1996-7</td>
<td>7.8</td>
<td>8.8</td>
</tr>
<tr>
<td>1997-8</td>
<td>4.8</td>
<td>-1.5</td>
</tr>
<tr>
<td>1998-9</td>
<td>6.5</td>
<td>5.9</td>
</tr>
<tr>
<td>1999-2000</td>
<td>6.1</td>
<td>1.4</td>
</tr>
<tr>
<td>2000-1</td>
<td>4.0</td>
<td>0.1</td>
</tr>
<tr>
<td>2001-2</td>
<td>5.4</td>
<td>5.7</td>
</tr>
<tr>
<td>1992-3 to 1996-7 (average)</td>
<td>6.7</td>
<td>4.6</td>
</tr>
<tr>
<td>1997-8 to 2001-2 (average)</td>
<td>5.4</td>
<td>2.3</td>
</tr>
</tbody>
</table>

However, the 10 year average growth performance hides the fact that while the economy grew at an impressive 6.7 per cent in the first five years after the reforms, it slowed down to 5.4 per cent in the next five years. India remained among the fastest growing developing countries in the second sub-period because other developing countries also slowed down after the East Asian crisis, but the annual growth of 5.4 per cent was much below the target of 7.5 per cent that the government had set for the period. Inevitably, this has led to some questioning about the effectiveness of the reforms.

Opinions on the causes of India’s growth deceleration vary. World economic growth was slower in the second half of the 1990s, and that would have had some dampening effect, but India’s dependence on the world economy is not large enough for this to account for the slowdown. Critics of liberalization have blamed the slowdown on the effect of trade policy reforms on domestic industry. However, the opposite view is that the slowdown is due not to the effects of reforms, but rather to the failure to implement the reforms effectively. This in turn is often attributed to India’s gradualist approach to reform, which has meant frustratingly slow pace of implementation. Policy changes in several major areas, covered by the reform programme: fiscal deficit reduction, industrial and trade policy, agricultural policy, infrastructure
development, financial development, privatization, and social sector development. Based on this review, we consider the cumulative outcome of 10 years of gradualism to assess whether the reforms have created an environment that can support 8 per cent GDP growth, which is now the government target. Fiscal profligacy was seen to have caused India’s balance of payments crisis in 1991, and a reduction in the fiscal deficit was therefore an urgent priority at the start of the reforms. The combined fiscal deficit of the central and state governments was successfully reduced from 9.4 per cent of GDP in 1990-1 to 7 percent in both 1991-2 and 1992-3, and the balance of payments crisis was over by 1993. However, the reforms also had a medium term fiscal objective of improving public savings so that essential public investment could be financed with a smaller fiscal deficit to avoid ‘crowding out’ private investment. This part of the reform strategy was unfortunately never implemented. As shown in Table, public savings deteriorated steadily from +1.7 per cent of GDP in 1996-7 to 1.7 per cent in 200-1. This was reflected in a comparable deterioration in the fiscal deficit, taking it to 9.6 per cent of GDP in 200-1. Not only is this among the highest in the developing world, it is particularly worrisome because India’s public debt to GDP ratio is also very high, at around 80 per cent of GDP, the fiscal deficit effectively preempts about 90 per cent of household financial savings for the government. What is worse, the rising fiscal deficit in the second half of the 1990s was not
financing higher levels of public investment, which were more or less constant in this period.

These trends cast serious doubts on India's ability to achieve higher rates of growth in future. The growth rate of 6 per cent per year in the post reform period was

**Major macroeconomic indicators**

<table>
<thead>
<tr>
<th></th>
<th>Combined Fiscal Deficit of Central and State Governments</th>
<th>Gross Savings</th>
<th>Gross Capital Formation</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Private Sector</td>
<td>Public Sector</td>
<td>Private Sector</td>
</tr>
<tr>
<td>1990-1</td>
<td>19.4</td>
<td>22.0</td>
<td>1.1</td>
</tr>
<tr>
<td>1991-2</td>
<td>7.0</td>
<td>20.1</td>
<td>2.0</td>
</tr>
<tr>
<td>1992-3</td>
<td>7.0</td>
<td>20.2</td>
<td>1.6</td>
</tr>
<tr>
<td>1993-4</td>
<td>8.3</td>
<td>21.9</td>
<td>0.6</td>
</tr>
<tr>
<td>1994-5</td>
<td>7.1</td>
<td>23.2</td>
<td>1.7</td>
</tr>
<tr>
<td>1995-6</td>
<td>6.5</td>
<td>23.1</td>
<td>2.0</td>
</tr>
<tr>
<td>1996-7</td>
<td>6.4</td>
<td>21.5</td>
<td>1.7</td>
</tr>
<tr>
<td>1997-8</td>
<td>7.3</td>
<td>21.8</td>
<td>1.31</td>
</tr>
<tr>
<td>1998-9</td>
<td>8.9</td>
<td>22.6</td>
<td>-1.01</td>
</tr>
<tr>
<td>1999-2000</td>
<td>9.4</td>
<td>24.0</td>
<td>-0.9</td>
</tr>
<tr>
<td>2000-1</td>
<td>9.6</td>
<td>25.1</td>
<td>-1.7</td>
</tr>
</tbody>
</table>

Achieved with an average investment rate of around 23 per cent of GDP. Accelerating to 8 per cent growth will require a commensurate increase
in investment rates ranging from 36 to 38 per cent of GDP. While it can be argued that there was over investment in East Asia, especially in recent years, it is unlikely that India can accelerate to 8 per cent of GDP. Part of the increase can be financed by increasing foreign direct investment, but even if foreign direct investment increases from the present level of 0.5 per cent of GDP to 2.0 per cent an optimistic but not impossible target domestic savings would still have to increase by at least 5 percentage points of GDP.

The view can also be taken that any process which reduces the involvement of the state or public sector in the nation’s economic activities is privatization. In such a case much of the discussion on privatization will boil down to a discussion on divestiture. Divestiture generally refers to the sale by the State of the whole or part of its own holdings of equity shares in a company to private shareholders. Selling or denationalizing SOEs is another way of easing their financial burden on the State. Of course if the economy is really to be saved from the burden of nonviable enterprises, liquidation acts as a major force for efficiency. Governments, fearing the financial and social consequences, are reluctant to let big companies close, whether in the private or public sector. The case of the government takeover in India of Empress Mills which is making a loss of lakhs of repees daily reveals some aspect of this problem. The same can be said about moves to nationalize a large number of closed but privately owned textile mills in Bombay. A number of processes
of divestiture can be suggested. It is not necessary to sell the whole or a majority of shares of SOEs. Many countries have sold or planned to sell minority shares. This will also include the sale of all or some of the assets of public enterprises or other public entities.

The mode of divesting may differ. The most common methods include a public offering of shares. Between 1977 and 1987, as many as 21 public issues were made through the privatization of public enterprises. In India where a number of private enterprises have a significant institutional holding the situation described above may readily appeal to the government. Profit making units could be considered for a partial sale of assets that would let the government have the controlling interest. The resultant revenue will give budgetary support. Moreover the government will continue to be able to use the internal resources generated for plan investment. However the “dominance” of the public sector may well be reduced by this process. Government may also sell shares initially to a Development Financial Institution with the specific understanding that the latter will later sell the holding to private investors. Such a transaction of course becomes the first phase of a divestiture and whether the Financial Institution is in the public or private sector makes no real difference.
Thee is much more to privatization than divestiture. Governments may also contract out services they have planned and specified to other organizations that produce and deliver them. Franchising authorizing the delivery of certain services in designated geographical areas is common in utilities and urban transport. The action taken by the government in breaking the strike of the workers of the Delhi Transport Corporation was indicative of its future privatization plans. The case for subcontracting of urban transport is quite strong. Contracting is also common in public works, defence, road construction and maintenance in India. An innovation is the giving of vouchers to subsidize consumers for items like food, health care and education.

Government could also withdraw from the provision of many goods and services and leave them wholly or partly to the private sector. Often the introduction of competition brings about efficiency and innovation. For instance, there is no need for the government to run hotels or be in the business of bread making. Such activities could well be leased out to the private sector generating profit for the government rather than making continuous losses. Most significant here is the recent announcement that the government owned Hotel Corporation of India would be privatized.
If a plea for privatization of some public enterprises is made in India as a means of recouping a part of the invested resources, very basic questions arise. Why invest resources and then start recouping a part of those resources.

Thus there would be a one time inflow of capital at the cost of sacrificing the future recurring flow of profits. It seems hardly like that any significant quantum of resources by partial or complete privatization of enterprises making losses. Various state governments have offered to sell losing units but no private entrepreneur has come up to purchase them.

The central government's effort must be directed primarily toward improving revenues, because performance in this area has deteriorated significantly in the post reform period. Total tax revenues of the centre were 9.7 percent of GDP in 1990-1. They declined to only 8.8 percent in 2000-1, whereas they should have increased by at least two percentage points. Tax reforms involving lowering of tax rates, broadening the base and reducing loopholes were expected to raise the tax ratio, and they did succeed in the case of personal and corporate income taxation, but indirect taxes have fallen as a percentage of GDP. This was expected in the case of customs duties, which were deliberately reduced as part of trade reforms, but this decline should have been offset by improving collections from domestic indirect taxes on goods and by extending indirect taxation to services.
This part of the revenue strategy has not worked as expected. The Advisory Group on Tax Policy for the Tenth Plan recently made a number of proposals for modernizing tax administration, including especially computerization, reducing the degree of exemption for small scale units and integration of services taxation with taxation of goods. These recommendations need to be implemented urgently. There is also room to reduce central government subsidies, which are known to be highly discretionary and poorly targeted (for example, subsidies on food and fertilizers), and to introduce rational user charges for services such as passenger traffic on the railways, the postal system and university education. Overstaffing was recently estimated at 30 per cent, and downsizing would help reduce expenditure. State governments also need to take corrective steps. Sales tax systems need to be modernized in most states. Agricultural income tax is constitutionally as signed to the states, but no state has attempted to tax agricultural income.

Land revenue is a traditional tax based on landholding, but it has been generally neglected and abolished in many states. Urban property taxation could yield much larger resources for municipal governments if suitably modernized, but this tax base has also been generally neglected. State governments suffer from very large losses in state electricity boards (about 1
per cent of GDP) and experience substantial losses in urban water supply, state road transport corporation is, and in managing irrigation systems. Overstaffing is greater in the states that at the centre. The fiscal failures of both the central and the state governments have squeezed the capacity of both the centre and the states to undertake essential public investment.

High levels of government borrowing have also crowded out private investment. Unless this problem is addressed, the potential benefits from reforms in other areas will be eroded, and it may be difficult even to maintain the average growth rate of 6 per cent experienced in the first ten years after the reforms, let alone accelerate to 8 per cent.

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

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

The main area where action has been inadequate relates to the long standing policy of reserving production of certain items for the small scale sector. About 800 items were covered by this policy since the late 1970s, which meant that investment in plant and machinery in any individual unit
producing these items could not exceed $250,000. Many of the reserved items, such as garments, shoes, and toys, had high export potential, and the failure to permit development of production units with more modern equipment and a larger scale of production severely restricted India's export competitiveness. The Report of the Committee on Small Scale Enterprises (1997) and the Report of the Prime Minister's Economic Advisory Council (New Delhi, 2001) had both pointed to the remarkable success of China in penetrating world markets in these areas and stimulating rapid growth of employment in manufacturing. Both reports recommended that the policy of reservation should be abolished and other measures adopted to help small scale industry. While such a radical change in policy was unacceptable, some policy changes have been made very recently: 14 items were removed from the reserved list in 2001, and another 50 in 2002. The removed items include garments, shoes, toys, and auto components, all of which are potentially important for exports. In addition, the investment ceiling for certain items was increased to $1 million. However, these changes are very recent, and it will take some years before they are reflected in economic performance.

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

A recently completed joint study by the World Bank and the Confederation of Indian Industry found that the investment climate varies widely across states, and these differences are reflected in a disproportional share of investment, especially foreign investment, being concentrated in what are seen as the more investor friendly states (Maharashtra, Gujarat, Karnataka, Adhara Pradesh, and Tamil Nadu) to the disadvantage of other states (like Uttar Pradesh, Bihar, and West Bengal). Investors perceived a 30 per cent cost advantage in some states over others, on account of the availability of infrastructure and the quality of governance. These differences across states have led to an increase in the variation in state growth rates, with some of the less favored states actually decelerating compared with the 1980s. Because liberalization has created a more competitive environment, the payoff from pursuing good policies has increased, thereby increasing the importance of state level action. Infrastructure deficiencies will take time and resources to remove, but deficiencies in governance could be handled more quickly with sufficient political will.
Trade policy reform has also made progress, though the pace has been slower than in the case of industrial liberalization. Before the reforms, trade policy was characterized by high tariffs and pervasive import restrictions. Imports of manufactured consumer goods were completely banned. For capital goods, raw materials and intermediates, certain lists of goods were freely importable, but for most items where domestic substitute were being produced, imports were only possible with import licenses. The criteria for issue of licenses were non-transparent, delays were endemic, and corruption unavoidable. The economic reforms sought to phase out import licensing and also to reduce import duties.

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

Progress in reducing tariff protection, the second element in the trade strategy, has been even slower and not always steady. As shown in Table. The weighted average import duty rate declined from the very high level of 72.5 per cent in 1991-2 to 24.5 per cent in 1996-7. However, the average tariff rate then increased by more than 10 percentage points in the next four years. In February 2002, the government signaled a return to reducing tariff protection. The peak duty rate was reduced to 30 per cent, a number of duty rates at the higher end of the existing structure were lowered, while many low end duties were raised to 5 per cent. The net result is that the weighted average duty rate is 29 per cent in 2002-3.
Weighted average import duty rates in India

<table>
<thead>
<tr>
<th></th>
<th>All commodities</th>
<th>Peak Duty</th>
<th>Customs Duty</th>
<th>No. of Basic Duty</th>
</tr>
</thead>
<tbody>
<tr>
<td>1991-2</td>
<td>72.5</td>
<td>150</td>
<td></td>
<td>22</td>
</tr>
<tr>
<td>1992-3</td>
<td>60.6</td>
<td>110</td>
<td></td>
<td>20</td>
</tr>
<tr>
<td>1993-4</td>
<td>46.8</td>
<td>85</td>
<td></td>
<td>16</td>
</tr>
<tr>
<td>1994-5</td>
<td>38.2</td>
<td>65</td>
<td></td>
<td>16</td>
</tr>
<tr>
<td>1995-6</td>
<td>25.9</td>
<td>50</td>
<td></td>
<td>12</td>
</tr>
<tr>
<td>1996-7</td>
<td>24.6</td>
<td>52*</td>
<td></td>
<td>9</td>
</tr>
<tr>
<td>1997-8</td>
<td>25.4</td>
<td>45*</td>
<td></td>
<td>8</td>
</tr>
<tr>
<td>1998-9</td>
<td>29.2</td>
<td>45*</td>
<td></td>
<td>7</td>
</tr>
<tr>
<td>1999-2000</td>
<td>31.4</td>
<td>40</td>
<td></td>
<td>7</td>
</tr>
<tr>
<td>2000-1</td>
<td>35.7</td>
<td>38.5</td>
<td></td>
<td>5</td>
</tr>
<tr>
<td>2001-2</td>
<td>35.1</td>
<td>35.8</td>
<td></td>
<td>4</td>
</tr>
<tr>
<td>2002-3</td>
<td>29.0</td>
<td>30.8</td>
<td></td>
<td>4</td>
</tr>
</tbody>
</table>


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

Liberalizing foreign direct investment was another important part of India's reforms, driven by the belief that this would increase the total volume of investment in the economy, improve production technology, and increase access to world markets. The policy now allows 100 per cent foreign ownership in a large number of industries and majority ownership in all except banks, insurance companies, telecommunications, and airlines. Procedures for obtaining permission were greatly simplified by listing industries that are eligible for automatic approval up to specified levels of foreign equity (100 per cent, 74 per cent and 51 per cent). Potential foreign investors investing within these limits only need to register with the Reserve Bank of India. For investments in other industries, or for a higher share of equity than is automatically permitted in listed industries, applications are considered by a Foreign Investment Promotion Board that has established a track record of speedy decisions. In 1993, foreign institutional investors were allowed to purchase shares of listed Indian companies in the stock market, opening a window for portfolio investment in existing companies.

These reforms have created a very different competitive environment for India's industry than existed in 1991, which has led to significant changes.
Indian companies have upgraded their technology and through mergers and acquisitions and refocused their activities to concentrate on areas of competence. New dynamic firms have displaced older and less dynamic ones: of the top 100 companies ranked by market capitalization in 1991, about half are no longer in this group. Foreign investment inflows increased from virtually nothing in 1991 to about 9.5 per cent of GDP. Although this figure remains much below the levels of foreign direct investment in many emerging market countries (not to mention the 4 per cent of GDP level in China), the change from the pre-reform situation is impressive. The presence of foreign owned firms and their products in the domestic market is evident and has added greatly to the pressure to improve quality.

These policy changes were expected to generate faster industrial growth and greater penetration of world markets in industrial products, but performance in this respect has been disappointing. As shown in table, industrial growth increased sharply in the first five years after the reforms, but then slowed to an annual rate of 4.5 per cent in the next five years. Export performance has improved, but modestly. The share of exports of goods in GDP increased from 5.7 per cent in 1990-1 to 9.7 per cent, but this reflects in part an exchange rate depreciation. India’s share in world exports, which had declined steadily since 1960, increased slightly from around 0.5 per cent in 1990-1 to 0.6 per cent in 1999-2000, but much of the increase in world market
share is due to agricultural exports. India’s manufactured exports had a 0.5 per cent share in world markets for those items in 1990s, and this rose to only 0.55 per cent by 1999. Unlike the case in China and South East Asia, foreign direct investment in India did not play an important role in export penetration and was instead oriented mainly toward the domestic market.

One reason why export performance has been modest is the slow progress in lowering import duties that make India a high cost producer and therefore less attractive as a base for export production. Exporters have long been able to import inputs needed for exports at zero duty, but the complex procedure for obtaining the necessary duty free import licenses typically involves high transactions cost and delays. High levels of protection compared with other countries also explain why foreign direct investment in India has been much more oriented to the protected domestic market, rather than using India as a base for exports. However, high tariffs are only part of the explanation for poor exports performance. The reservation of many potentially exportable items for production in the small scale sector (which has only recently been relaxed) was also a relevant factor.

Privatization, a recently coined term is very often pronounced by the propagandists of liberal economy when a public enterprise (PE) fails to meet the expectation of the nation. Public sector, of late, has been subjected to
severe criticism not only in India but all over the world. But in India, it is recently that the attack has gathered momentum both in official and unofficial levels resulting in a concerned move for privatization which is too serious a matter to be ignored. However, no one will deny the fact that the performance of may public sector units in India have been deteriorating very fast affecting the whole economy. Particularly, the performance of the PEs in core sector has seriously disturbed the economy in the shape of inadequate power supply, inefficient railway transport, inadequate supply of fertilizers and so on. This has created an abyss of despair in the minds of the people of this country to such an extent that privatization of PEs is being discussed in different circles and projected as a panacea for revitalizing the loss making PEs. The question of privatization, therefore, deserves proper attention from all concerns including academic world.

A common criticism of India’s economic reforms is that they have been excessively focused on industrial and trade policy, neglecting agriculture that provides the livelihood of 60 per cent of the population. Critics point to the deceleration in agricultural growth in the second half of the 1990s (shown in table) as proof of this neglect. However, the notion that trade policy changes have not helped agriculture is clearly a misconception. The reduction of protection to industry, and the accompanying depreciation in the exchange rate, has tilted relative prices in favor of agriculture and helped agricultural
exports. The index of agricultural prices relative to manufactured products has increased by almost 30 per cent in the past ten years. The share of India's agricultural exports in world exports of the same commodities increased from 1.1 per cent in 1990 to 1.9 per cent in 1999, whereas it has declined in the ten years before the reforms.

But while agriculture has benefited from trade policy changes, it has suffered in other respects, most notably from the decline in public investment in areas critical for agricultural growth, such as irrigation and drainage, soil conservation and water management system, and rural roads as pointed out by Gulati and Bathla (2001), this decline began much before the reforms and was actually sharper in the 1980s than it 1990s. They also point out that while public investment declined, this was more than offset by a rise in private investment in agriculture, which accelerated after the reforms. However, there is no doubt that investment in agriculture related infrastructure is critical for achieving higher productivity, and this investment is only likely to come from the public sector. Indeed, the rising trend in private investment in agriculture could easily be dampened if public investment in these critical areas is not increased.

The main reason why public investment in rural infrastructure has declined is the deterioration in the fiscal position of the state governments and
the tendency for politically popular but inefficient and even inequitable subsidies to crowd out more productive investment. For example, the direct benefit of subsizing fertilizer and underpricing water and power goes mainly to fertilizer producers and high income farmers, while having negative effects on the environment and production, and even on the income of small farmers. A phased increase in fertilizer prices and imposition of economically rational user charges for irrigation and electricity could raise resources to finance investment in rural infrastructure, benefiting both growth and equity. Competitive populism makes it politically difficult to restructure subsidies in this way, but there is also no alternative solution in sight.

Some of the policies that were crucial in promoting food grain production in earlier years, when this was the prime objective, are now hindering agricultural diversification. Government price support levels for food grains, such as wheat, are supposed to be set on the basis of the recommendations of the Commission on Agricultural Costs and Prices, a technical body that is expected to calibrate price support to reasonable levels. In recent years, support prices have been fixed at much higher levels, encouraging over production. Indeed, public food grain stocks reached 58 million tons on 1 January 2002, against a norm of around 17 million tons! The support price system clearly needs to be better aligned to market demand if
farmers are to be encouraged to shift from food grain production towards other products.

Agricultural diversification also calls for radical changes in some outdated laws. The Essential commodities Act, which empowers state governments to impose restrictions on movement of agricultural products across state and sometimes even district boundaries and to limit the maximum stocks who lessees and retailers can carry for certain commodities, was designed to prevent exploitive traders from diverting local supplies to other areas of scarcity or from hoarding.

The report of the Task Force on Employment has made comprehensive proposals for review of several other outdated agricultural laws. For example, laws designed to protect land tenants, undoubtedly an important objectives, end up discouraging marginal farmers from leasing out non viable holdings to larger farmers for fear of being unable to reclaim the land from the tenant. The Agricultural produce Marketing Acts in various states compel traders to buy agricultural produce only in regulated markets, making it difficult for commercial traders to enter into contractual relationships with farmers. Development of a modern food processing sector, which is essential to the next stage of agricultural development, is also hampered by outdated and often
contradictory laws and regulations. These and other outdated laws need to be changed if the logic of liberalization is to be extended to agriculture.

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

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

Because of these difficulties, the expansion of generation capacity by the utilities in the 1990s has been only about half of what was targeted, and the quality of power remained poor, with large voltage fluctuations and frequent interruptions. The flaws in the policy have now been recognized, and a more comprehensive reform is being attempted by several state governments. Independent statutory regulators have been established to set tariffs in a manner that would be perceived to be fair to both consumers and producers. Several state are trying to privatize distribution in the hope that this will overcome the corruption that leads to the enormous distribution losses. However, these reforms are not easy to implement. Rationalization of power
tariffs is likely to be resisted by consumers long used to subsidized power, even though the quality of the power provided in the pre-reform situation was very poor. The establishment of competent and credible regulatory authorities takes time, private investors may not be able to enforce collections of amounts due nor to disconnect supply for non payment without adequate backing by the policy. For all these reasons, private investors perceive high risks in the early stages and therefore demand terms that imply very high rates of return. Finally, labour unions are opposed to privatization of distribution.

These problems are formidable, and many state governments now realize that a great deal of preliminary work is needed before privatization can be successfully implemented. Some of the initial steps, like tariff rationalization and enforcing penalties for non payment of dues and for theft of power, are perhaps best implemented with the existing public sector framework, so that these features, which are essential for viability of the power sector, are not attributed solely to privatization. If the efforts now being made in half a dozen states succeed, it could lead to a visible improvement within a few years.

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

India's banking reforms differ from those in other developing countries in one important respect, and that is the policy toward public sector banks that dominate the banking system. The government has announced its intention to reduce its equity share to 33.3 per cent, but this is to be done while retaining government control. Improvements in the efficiency of the banking system will therefore depend on the ability to increase the efficiency of public sector banks.
Sceptics doubt whether government control can be made consistent with efficient commercial banking because bank managers are bound to respond to political directions if their career advancement depends upon the government. Even if the government does not interfere directly in credit decisions, government ownership means that managers of public sector banks are held to standards of accountability asking to civil servants, which tend to emphasize compliance with rules and procedures and therefore discourage innovative decision making. Regulatory control is also difficult to exercise. The unstated presumption that public sector banks cannot be shut down means that public sector banks that perform poorly are regularly re-capitalized rather than wedded out. This obviously weakens market discipline, since more efficient banks are not able to expand market share.

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

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

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

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

The term 'public enterprise' is sometimes used to mean any economic activity of the government as distinguished from private economic activity. It is generally conceived as an economic undertaking which is owned and
controlled by public authorities. According to Dr. V. K. R. V. Rao, 'A public sector enterprise is by definition an enterprise where there is no private ownership, where its functions are not merely confined to the maximization of profit or promotion of private interest of the enterprise but are governed by the public and social interest and where management is responsible to the government either directly or indirectly as departmental undertakings or indirectly as in government companies and corporations. The feature of PE envisaged in the above definition is the government ownership which distinguishes the PEs, from private enterprises. Another important aspect of PEs highlighted in the definition is that the aim of PEs is not merely to make profit maximization or promotion of private interest of the enterprises while these two are articulated as the basic objectives of private enterprises. If the views of Dr. Rao is accepted, the question of privatization of PEs seems to be basically retrograde to the concept of PEs. Seems to be basically retrograde to the concept of PEs. In fact, PE is not a mere replace of private capitalism. PEs in India is based on a distinct philosophy and envisaged a definite outlook. PE, in a sense, is a commitment of the government and a prelude to government ideology.

Unfortunately, state involvement in economic activities of this country has not been well thought out and properly planned. Some of the PEs were inherited and others were consciously set up, while some other were acquired
because of the failure of the private sector to run them profitably. Therefore, different forms of PEs have emerged and their nature of operation is also different. PEs which were originally nationalized have still limited private ownership. There is also joint sector, where government jointly with the private entrepreneurs set up some enterprises which, as such remain outside the preview of PEs. However, the present policy and practice of the government system that common people by and large think PEs as the part and parcel of the government. Therefore, privatization not only appears contradictory to the basic concept of PE but also will affect the public faith and believe in the ideology so long pursued by the Government.

**Privatization**

Privatization may be conceived as a process which allows private enterprises either to set up new units in an industry which hitherto was absolutely reserved for PEs or to acquire partly or wholly ownership of PEs with the ultimate object of transforming the PEs to private entrepreneurs. However, privatization in a narrow sense implies enationalisation. It may be in the form of ‘divestiture’ which means the sale of the whole or part of holding of equity shares owned by the state to the private shareholders of a government owned enterprise; as a result there sector to private sector. In other words it turns the
social ownership to individual private ownership. Thus it may be described as the process of decimalization of enterprises.

However, privatization in a broad sense means the liberal industrial policy of government, in the sense having fewer controls and regulations of the government on the economic activities of private entrepreneurs.

While broad definition of privatization according to Sarker and Das includes (a) Divesture (b) Denationalization (c) Liquidation (both formal and informal) (d) privatization of management viz. lease and management agreement (e) abandoning or canceling proposals either to start a new state owned enterprise, or to expand and/or diversify activities of any existing one (f) farming out to private contractors or agencies the functions of supplying various goods and services needed by the public enterprises instead of these being provided or produced by the PEs themselves.

While William Glade perceived four dimensions of privatization of PEs e.g. (1) Privatization of financing, (2) privatization of production, (3) privatization by denationalization and (4) privatization by liberalization of trade and business. Privatization of financing entails the utilization of private funds to relieve the state enterprise from temporary budgetary problems. Privatization of production includes the introduction of contract labour instead
of directly employing labour force. Decentionalisation, perhaps is the most important and undisputed form of privatization which involves the selling of shares of PEs partly or wholly to the private inventors. Liberalization, in fact, is the disguised form of privatization which may be in the form of relaxing or removing statutory constraints on competition or prices etc. all the four dimensions of privatization described by Glade are quite visible in the Indian panaram. In this sense privatization has started in India.

The public sector accounts for about 35 per cent of industrial value added in India, but although privatization has been a prominent component of economic reforms in many countries, India has been ambivalent on the subject until very recently. Initially, the government adopted a limited approach of selling a minority stake in public sector enterprises while retaining management control with the government, a policy described as 'disinvestment' to distinguish it from privatization. The principal motivation was to mobilize revenue for the budget, though there was some expectation that private shareholders would increase the commercial orientation of public sector enterprises. This policy had very limited success. Disinvestment receipts were consistently below budget expectations, and the average realization in the first five years was less than 0.25 per cent of GDP compared with an average of 1.7 per cent in 17 countries reported in a recent study.
There was clearly limited appetite for purchasing shares in public sector companies in which government remained in control of management.

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

The privatization of Modern Foods and BALCO generated some control very, not so much on the principle of privatization but on the transparency of the bidding process and the fairness of the price realized.
Subsequent sales have been much less problematic, and although the policy continues to be criticized by the unions, it appears to have been accepted by the public, especially for public sector enterprises that are making losses or not doing well. However, there is little public support for selling public sector enterprises that are making large profits, such as those in the petroleum and domestic telecommunications sectors, although these are precisely the companies where privatization can generate large revenues. These companies are unlikely to be privatized in the near future, but even so there are several companies in the pipeline for privatization that are likely to be sold, and this will reduce resistance to privatizing profit making companies.

An important recent innovation, which may increase public acceptance of privatization, is the decision to earmark the proceeds of privatization to finance additional expenditure on social sector development and for retirement of public debt. Privatization is clearly not a permanent source of revenue, but it can help fill critical gaps in the next five to ten years while longer term solutions to the fiscal problem are attempted. Many states have also started privatizing state level public sector enterprises. These are mostly loss making enterprises and are unlikely to yield significant receipts, but privatization will at least eliminate the recurring burden of financing losses.
<table>
<thead>
<tr>
<th>Year</th>
<th>Central Government</th>
<th>State Government</th>
</tr>
</thead>
<tbody>
<tr>
<td>1990-1</td>
<td>1.42</td>
<td>5.98</td>
</tr>
<tr>
<td>1991-2</td>
<td>1.25</td>
<td>5.85</td>
</tr>
<tr>
<td>1992-3</td>
<td>1.29</td>
<td>6.72</td>
</tr>
<tr>
<td>1993-4</td>
<td>1.49</td>
<td>5.57</td>
</tr>
<tr>
<td>1994-5</td>
<td>1.49</td>
<td>6.27</td>
</tr>
<tr>
<td>1995-6</td>
<td>1.54</td>
<td>5.33</td>
</tr>
<tr>
<td>1996-7</td>
<td>1.56</td>
<td>5.13</td>
</tr>
<tr>
<td>1997-8</td>
<td>1.60</td>
<td>5.18</td>
</tr>
<tr>
<td>1998-9</td>
<td>1.67</td>
<td>5.41</td>
</tr>
<tr>
<td>1999-2000</td>
<td>1.59</td>
<td>6.60</td>
</tr>
<tr>
<td>2000-1</td>
<td>1.58</td>
<td>5.46</td>
</tr>
</tbody>
</table>


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

Much of the debate in this area has focused on what has happened to expenditure on social sector development in the post reform period. Dev and Mooij find that central government expenditure towards social service and rural development increased from 7.6 per cent of total expenditure in 1990-1 to 10.2 percent in 2000-1. As shown in table as a percentage of GDP, these expenditures show a dip in the first two years of the reforms, when fiscal stabilization compulsions were dominant, but there is a modest increase thereafter. However, expenditure trends in the states, which account for 80 per cent of total expenditures in this area, show a definite decline as a percentage of GDP in the post reform period. Taking central and state expenditures together, social sector expenditure has remained more or less constant as percentage of GDP.

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

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

While the challenges in this area are enormous, it is worth noting that social sector indicators have continued to improve during the reforms. The literacy rate increased from 52 per cent in 1991 to 65 per cent in 2001, a faster increase in the 1990s that in the previous decade, and the increase has been particularly high in some of the low literacy states such as Bihar Madhya Pradesh, Uttar Pradesh, and Rajasthan. But in the recent past Bihar seems to be getting out of this ‘backward’ tag.
However, the intention of the government's liberal policy is to open the door for the entry of private enterprises into the areas so long preserved for public sector. It is claimed that the liberal trade policy has helped to increase exports but simultaneously imports have progressively gone up as a result trade deficits have further been enlarged. However, the exponents of privatization advise the government to lift all sorts of controls and restrictions on private enterprises.

This policy of liberalization will ultimately lead the country towards capitalistic system. In the name of 'pragmatism' the critics of PEs pleased for adopting a conscious policy of 'disinvestment' in public sector which is euphemism for privatization. India being a developing country therefore have to make the choice whether they will adopt the capitalistic path of development or opt for planned development of the socialistic model for self reliant growth based primarily on its own resource endowment and necessary foreign help. India has accepted the second choice. It has committed the economic growth with social justice.

Thus, the state intervention in the economic activities of this country is not just an ideological choice. It was almost a compulsion born out of certain objective factors that prevailed at the time of independence of this country. Therefore one must understand that 'privatization' is not the panacea. Moreover, the performance of private enterprises from social point of view is
quite derogatory to the basic goals and objectives of the constitution. Privatization contradict the state policy of socialistic pattern of society and the basic objectives of the industrial policies of this country. Privatization seems to be inconsistent with planned economy which, this country, adopted long ago as an instrument for socio-economic development. Under the circumstances it is important know how this venture of privatization of public services has performed.

*****
End Notes:


2. Sardar Patel was not only India's first Home Minister and Deputy Prime Minister; he wielded enormous power within the Congress party and the government.

3. This broad characterization holds true when compared with the period 1969-74. The period between 1954-64, which saw the rise of Nehru and the Second Five Year Plan, saw a greater role of the state in the economy compared with the sub periods 1947-54 and 1964-8. This section will explain why this was the case.


5. Nehru's candidate was J.B.Kripalani, See also Frankel, India's Political Economy, pp. 88-90.


11. Ibid., pp. 146-52.


14. Indias First Five Year Plan began in 1951, even though the final plan document was ready only in 1952.


17. Frankel, India’s Political Economy,


23. Ibid.,

25. Ibid.,


27. Dhar, The Evolution of Economic Policy in India 9new Delhi, Oxford University press, 2003,


37. Ibid., pp. 58-63
38. Assema Sinha, The Regional Roots of Developmental Politics in India

   in India, in Anne Krueger (ed.) Economic Policy Reforms and the Indian
   Economy, New Delhi, Oxford University press, 2002.


43. R.G.Nambiar, B.L. Mumgekar and G.A. Tadas, Import Liberalization
   Hurting Domestic Industry and Employment, Economic and Political

44. Ministry of Finance, Economic Survey 2001-02, New Delhi, Ministry of
   Finance, 2002.


46. Ibid.,

47. Jean Dreze and Amartya Sen, Economic Development and Social
   Opportunities, New Delhi, Oxford University press, 1995.