Chapter 1

Introduction:

This subject of financial sector liberalization has assumed importance because sound financial systems serve as an important channel for achieving economic growth. Most of the developing and underdeveloped countries adopt this route for the development of their economic system. But the relationship between liberalization and development of various sectors of economy has been a subject of investigation and analysis. It has been observed that higher levels of financial development are positively associated with economic development (King and Levin 1993 *1; Rajan and Zingales 1998 *2; Demirgüç-Kunt, Asli and Maksimovic 1998 *3; Jayaratne and Strahan 1996 *4). Many countries adopted a series of financial sector liberalization measures in the late 1980s and early 1990s that included interest rate liberalization, entry deregulations, reduction of reserve requirements and removal of credit allocation. Strengthening of financial system, expanding economic opportunity has greatest potential to create value for business and society. This business opportunity can create job, enable technology transfer, build human capital and physical infrastructure, generate public revenue for government and offer a variety of products and services to consumers and other business including those operating at what has been termed the “Base of the economic pyramid”. Each of these impacts has multiplier effects on social and economic development. With its varied geographical and ethnic diversity, India provides a classical example of a developing country which has adopted a pattern of socialistic economy getting transformed to market oriented economy. If supported by responsible business practices, and more inclusive business models and financial,
technical, institutional or policy innovations, they can make major contribution to the poverty reduction and serve core business interest at the same time.

India started into a developing and an open-market economy, yet traces of its past autarkic policies remain. Economic liberalization, including industrial deregulation, privatization of state-owned enterprises, and reduced controls on foreign trade and investment, began in the early 1990s which was also called LPG (Liberalisation, Privatisation and Globalisation) era. It has served to accelerate the country's growth, which has averaged more than 7% per year since 1997. India's diverse economy encompasses traditional village farming, modern agriculture, handicrafts, a wide range of modern industries, and a multitude of services. Slightly more than half of the work force is in agriculture, but services are the major source of economic growth, accounting for nearly two-thirds of India's output, with less than one-third of its labor force. In 2010, the Indian economy rebounded robustly from the global financial crisis - in large part because of strong domestic demand - and growth exceeded 8% year-on-year in real terms. However, India's economic growth began slowing in 2011 probably because of a tight monetary policy, intended to address persistent inflation, and a decline in investment, caused by investor pessimism about domestic economic reforms and about the global situation. The growth story which was being scripted with the liberalization changed its character and got into the reverse trend. Some school of thought came with the own criticism/ explanation about such unsustainable growth.

**Meaning and back drop of LPG:**

India was underdeveloped economy reeling under the severe balance of payment crisis along with the low economic growth. Since independence India wanted the
economic development to take place in a planned manner and at a higher momentum. So, it adopted the path of planned economy through 5 years planning guided and strategized by the planning commission and now Niti Ayog. Indian planners have given five industrial policies

industrial policy 1948, 1956, 1977, 1980 and 1991 and twelve five year plans. It was observed after the analysis of achievements of these plans that there has been wide gap between the objectives of the plans and the achievements under the same.

The new approach in the economic policy of 1991 aimed at reducing the extent of government controls over various aspects of the domestic economy, increasing the role of the private sector, redirecting scarce public sector resources to areas where the private sector was unlikely to enter, and opening up the economy to trade and foreign investment like changes that were blind implemented in other developing countries. The adoption of New Economic Policy “NEP” was a great milestone in the history of Indian Economy. The concept of NEP was based on ‘L.P.G.’ model meaning Liberalization, Privatization and globalization. It was beginning of a new era.

**Definition of the term “Liberalisation” and “Economic Liberalisation.”:** The term “Liberalisation” stands for “the act of making less strict.” Liberalization refers to relaxation of government restrictions usually in areas of control in running trade and commercial activity with less interference of government department in day to day working. Liberalization may also be defined as a sub process of removing the legal bottle necks as a part of the process of reallocation, restructuring and out sourcing of productive economic activity*6. It is characterized by more and more free movements of factors of production, knowledge, technology and services as per the market and consumer requirements. It relates to higher and more autonomy. It also means
removal or reduction of the tariff and other restrictions on the flow of goods and services between countries. It is a kind of empathetic behavior towards trade and commerce. Liberalization refers to further Opening up of their respective economies to foreign capital and investments.

**Definition of term “Privatisation” and Economic Privatisation:** The term “Privatisation” refers to the transfer of ownership of property or business from a government to a private owned entity. Privatization refers to the transfer of assets service functions from public to private ownership or control and the opening of the neither to closed areas to private sector entry. Privatization can be achieved in many ways franchising, leasing, contracting and divesture. The transition from a publicly traded and owned company to a company which is privately owned and no longer trades publicly on a stock exchange. When a publicly traded company becomes private investors can no longer purchase a stake in that company.

**Definition of term “Globalisation” and Economic globalisation:** The term globalization can be used in different contexts. The general usages of the term Globalization can be as follows:

a/ Interactions and interdependence among countries.

b/ Integration of world economy.

c/ Deteritorisation.

Globalisation means integration the domestic economy with the world economy. It is a process which draws countries out of their insulation and makes them join rest of the world in its march towards a new world economic order. It involves increasing interaction among national economic system, more integrated financial markets, economies of trade, higher factor mobility, free flow of technology and spread of
knowledge throughout the world. According to Deepak Nayyar6, “Globalisation can be defined, simply as the expansion of economic activities across political boundaries of nation states. More importantly perhaps it refers economic interdependence between countries in the world economy.”

**Reasons and background of liberalisation:**

The new policies in India was also aimed at reducing the extent of Government controls over various aspects of the domestic economy, increasing the role of the private sector, redirecting scarce public sector resources to areas where the private sector is unlikely to enter, and opening up the economy to trade and foreign investment like changes that were blind implemented in other developing countries. But an important feature of India’s reform programme, when compared with reforms underway in many other countries, is that it has emphasised gradualism and evolutionary transition rather than rapid restructuring or "shock therapy". These changes have been accompanied by a lively debate in India and have also attracted interest abroad. International opinion has typically welcomed the reforms and generally urged a much faster pace of implementation, especially in view of changes taking place in other countries.

The reform programme initiated in June 1991 was nevertheless very different from the incremental approach to reforms of the 1980s. As far as objectives are concerned, the later reforms were based on a much clearer recognition of the need to integrate with the global economy through trade, investment and technology flows and for this purpose to create conditions which would give Indian entrepreneurs an environment broadly comparable to that in other developing countries, and to do this within the space of four to five years. As far as instruments are concerned, there is clear recognition that the reforms cannot be limited to piecemeal adjustments in one or other aspect of policy but must bring about system changes affecting several sectors
of the economy. The comprehensiveness of the reforms was not perhaps fully evident at the very beginning, when the primary focus was on restoring macro-economic stability, but as the reforms proceeded the scope and coverage of the reform effort was more clearly outlined.

The main elements of the background are as below:

1. **Fiscal Stabilisation**: The central government fiscal deficit had expanded steadily during the 80s and had reached a peak level of 8.4% of GDP in 1990-91. Allowing for deficits of the state governments, this meant an overall Government fiscal deficit of around 10% which was high by any standard. A reduction in the central government's fiscal deficit was therefore critical for the reforms to take off. The first year of the reforms saw a substantial reduction in the central government fiscal deficit from 8.4% of the GDP in 1990-91 to 5.9% in 1991-92 and further to 5.7% in 1992-93. Some of the reduction in the fiscal deficit in the first two years was achieved by systemic improvements which permanently strengthened the fiscal situation, such as for example the abolition of export subsidies in 1991-92 and the partial restructuring of fertiliser subsidy in 1992-93.

2. **Industrial Policy and Foreign Investment**: The most radical changes implemented in the reform package have been in the area of Industrial Policy removing several barriers to entry in the earlier environment. The system of industrial licensing, which required government permission for new investments as well as for substantial expansion of existing capacity was virtually abolished. Licensing needed only for a small list of industries, most of which remain subject to licensing primarily because of environmental and pollution considerations. The parallel but separate controls over investment and expansion by large industrial houses through the Monopolies and Restrictive Trade Practices (MRTP) Act have also been eliminated. The many inefficiencies of this system - carefully
documented by Bhagwati and Desai as early as 1970 - are now truly a part of history as far as the central government is concerned. A comprehensive restructuring of the Companies Act was also decided. This process of revision of the companies act is now passed by parliament in 2013 which aims at simplifying and modernizing this aspect of the legal framework governing the corporate sector.

The liberalization of controls over domestic investors was accompanied by a radical restructuring of the policy towards foreign investment. Earlier, India's policy towards foreign investment was selective and was widely perceived by foreign investors as being unfriendly. The percentage of equity allowed to foreign investors was generally restricted to a maximum of 40%, except in certain high technology areas. Foreign investment was generally discouraged in the consumer goods sector unless accompanied by strong export commitments. The new policy was much more actively supportive of foreign investment in a wide range of activities. Permission started getting automatically granted for foreign equity investment up to 51% in a large list of 34 industries. For proposals involving foreign equity beyond 51%, or for investments in industries outside the list, applications are processed by a high level Foreign Investment Promotion Board. Various restrictions earlier applied on the operation of companies with foreign equity of 40% or more have been eliminated by amendment of the Foreign Exchange Regulation Act and all companies incorporated in India are now treated alike, irrespective of the level of foreign equity.

3. **Trade and Exchange Rate Policy**: In keeping with the objective of greater openness and outward orientation, trade policy was very substantially liberalized. The complex import control regime earlier applicable to imports of raw materials, other inputs into production and capital goods has been virtually dismantled. Today, all raw materials, other inputs and capital goods, can be freely imported.
except for a relatively small negative list. Imports of consumer goods remain restricted except for the limited windows of permissible imports of such items by returning Indians and a limited facility for imports of some consumer goods allowed. The removal of quantitative restrictions on imports has been accompanied by a gradual lowering of customs duties. India's customs duties before the reforms were very high, with the average rate of duty being as high as 100% and very substantial variations around this average. The Government made a series of downward adjustments in customs duties in each of the four Budgets since 1991. Exchange rate policy has gone through a series of transitional regimes since 1991, leading to a total transformation at the end of three years. The reforms began with a devaluation of about 24% in July 1991 in a situation in which extensive trade restrictions were still in place. The devaluation was accompanied by an abolition of export subsidies to help the fiscal position, and an offsetting increase in export incentives in the form of special incentive licenses (Exim scrips) given to exporters which could be used to import items which were otherwise restricted. These licenses were freely tradable and commanded a premium in the market depending upon the excess demand for restricted imports. The system was modified in March 1992 by the introduction of an explicit dual exchange rate system simultaneously with the dismantling of licensing restrictions on import of raw materials, other inputs into production and capital goods. These items were made freely importable against foreign exchange obtained from the market at a market determined floating exchange rate. Imports of certain critical item's such as petroleum, essential drugs, fertilizer and defense related imports were paid for by foreign exchange made available at the fixed official rate, and the demand for foreign exchange at the official rate to pay for these imports was met by requiring exporters to surrender 40% of their export earnings at the official rate.
The remaining 60% of export earnings was available to finance all other imports, all other current transactions and debt service payments, at the market rate. This dual exchange rate system was again a short lived transitional arrangement to a unified floating rate which was announced in March 1993. After a year's experience with the unified rate the Government, in March 1994, announced further liberalization of payment restrictions on current transactions and stated its intention of moving to current account convertibility. Capital controls however remain in place. Thus in the short space of two and a half years the trade and payments system moved from a fixed and typically overvalued, exchange rate operating in a framework of substantial trade restrictions and export subsidies, to a market determined exchange rate within a framework of considerable liberalization on the trade account and the elimination of current restrictions.

4. **Tax Reform**: Reform of the tax system has been an important element in the Government's reform programme with major changes contemplated in both direct and indirect taxes. The broad directions of tax reform have been spelt out in the Report of the Taxation Reforms Committee (Chelliah Committee). The Committee recommended a move towards a simpler system of direct taxation with moderate rates and fewer exemptions, a progressive reduction in the level as well as the range of variation of customs duties and a rationalisation of the domestic excise taxes on industrial production with a switch from specific to ad valorem rates, fewer duty rates and a drastic reduction if not elimination of exemptions. Substantial progress has been made in these directions in the four budgets that have been presented since the reforms began and this is best seen by considering the cumulative changes that have taken place in each of the major areas of taxation:
• The maximum marginal rate of personal income tax was 56% in June 1991. This has now been reduced to 40% and again reduced to 30%.

• The incentive structure for savings in the form of financial assets has been strengthened. The Wealth Tax, which was earlier applicable to all personal assets, has been modified to exempt all productive assets including financial assets such as bank deposits, shares and other securities.

• The rates of corporate income tax, which were 51.75% for a publicly listed company and 57.5% for a closely held company have been unified and reduced to 46%. All these rates are inclusive of a 15% surcharge. Without the 15% surcharge the rate of corporate tax would be 40% which is the same as the maximum marginal rate on personal taxation.

• Customs duties, as noted above, have been significantly reduced over the past three years and the Government has indicated that further reductions are expected to be implemented in phases to bring the rates in line with those prevailing in other developing countries.

• Excise duties on domestic manufactured goods were charged at varying rates on different commodities, with most of the duties being specific rather than ad valorem. There were also a large number of exemptions. A system of tax credit for taxes paid on inputs called Modified Value Added Tax or MODVAT was in force but excluded important sectors such as textiles and petroleum. Duty credit was also not available on excise duty paid on capital goods at the time of investment. The Budget presented in February 1994 has greatly simplified the system, with the bulk of the taxes shifted to an ad valorem basis and the number of exemptions greatly reduced. The coverage of the tax credit for taxes paid on inputs has been
extended to include petroleum and capital goods. The number of excise duty rates has been reduced from 21 to 10. A start has also been made in extending indirect taxation to a few services by imposing a 5% tax on telephone bills, premium payments for general insurance and stock brokers' commissions. The list of items under service tax went on increasing in every budget due to the success in implementation and the amount of resource generation. It is now a very broad based.

These reforms in the tax system go a long way towards the objective of creating a system which avoids economic distortions, and ensures adequate buoyancy of revenues to support the task of fiscal consolidation.

5. **Public Sector Policy**: Reform of the public sector is a critical element in structural adjustment programmes all over the world and is also included on India's reform agenda. However, this is an area where changes are being implemented slowly. Unlike the case in many other countries, where public sector reform has involved explicit programmes of outright privatisation of public sector units combined with closures of unviable units, the approach adopted in the Indian reform programme is more limited.

Instead of outright privatization the Government initiated a limited process of disinvestment of Government equity in public sector companies, with Government retaining 51% of the equity and also management control. The disinvestment helps provide non-inflationary resources for the Government Budget, without adding to the fiscal deficit. However this is not the only objective. The emergence of private shareholders in public sector units and trading of public sector shares in the stock markets are both expected to make public sector managements more sensitive to
commercial profitability. This is especially so since the Government has decided not to use budgetary resources to finance public sector investment in industry. Public sector companies have been given a clear signal that in future their investment plans must be financed either by internal resource generation or by resources raised from the capital markets - both alternatives being bound to encourage and reward efficiency and commercial orientation. A number of public sector units have resorted to the capital markets to raise resources to finance their investment plans and this trend is certain to accelerate in future.

The policy towards loss making public sector units is also cautious. The government announced phase out of the budgetary support to finance losses over three years and this has had a salutary effect in confronting public sector units with a hard budget constraint. This needs to be supplemented with a policy for active restructuring of these units wherever it is possible to make them economically viable, and with closure combined with adequate compensation for labour where it is not. The Government did not order any closures on its own initiative, but an objective process for determining whether a unit should be closed or not has been initiated by amending the Sick Industrial Companies Act (SICA) to bring sick public sector companies under the purview of the Board for Industrial and Financial Reconstruction (BIFR) in the same way as private sector companies are covered. Sick public sector companies (defined under the law as companies which have completely eroded their net worth) are now automatically referred to the BIFR which will then consider whether a consensus can be evolved among the existing management (i.e. Government, creditors and labour) for a viable restructuring package which may involve some voluntary burden sharing by all parties - banks may offer to reschedule loans, workers to accept partial retrenchment or wage freezes, Government may have to give up taxes due etc. The Board can also consider revival packages involving induction of new managers, with a
fresh injection of capital. If no consensus can be evolved for a revival package the BIFR is authorised to order closure of the unit and liquidation of its assets. This is a lengthy process but it does provide an objective means of exploring ways of reviving sick public sector units, with closure as a credible ultimate threat in extreme cases.

6. **Labour Market Reforms**: Markets are unduly rigid. Indian labour laws provide a high degree of protection to labour with retrenchment of labour and closure of an unviable unit requiring prior permission of the State Government for units employing more than 100 workers. These were a few words with which India was known and addressed. It is also important to recognise that reform of labour laws is a politically sensitive issue. Any weakening of the labour laws was likely to evoke fears of widespread unemployment. The reform of labour laws must come after the creation of credible safety nets to deal with the problems of displaced labour. Thus, a National Renewal Fund was created which financed compensation payments to labour rendered redundant in the course of public sector restructuring and closure of unviable units. It also helped in redeployment of the labour force by retaining and reorientation.

7. **Financial Sector Reform**: The reforms in the real sector aim at creating a new set of incentives which will encourage reallocation of resources towards more efficient uses. This process needs to be underpinned by a parallel process of financial sector reform which will enable the financial sector to mobilise savings and allocate them in a manner which supports the process of restructuring in the real economy. Several initiatives have been taken in these areas.

**Indian Insurance Industry**

The Insurance in India started without any regulation in the Nineteenth Century. It was a typical story of a colonial era: a few British insurance companies dominating the
market serving mostly large urban centers. After the independence, it took a dramatic
turn. Insurance was nationalized. First, the life insurance companies were
nationalized in 1956, and then the general insurance business was nationalized in
1972. Only in 1999 private insurance companies have been allowed back into the
business of insurance with a maximum of 26% of foreign holding. The nationalization
of life insurance was justified mainly on three counts. (1) It was perceived that private
companies would not promote insurance in rural areas. (2) The Government would be
in a better position to channel resources for saving and investment by taking over the
business of life insurance. (3) Bankruptcies of life insurance companies had become
a big problem (at the time of takeover, 25 insurance companies were already
bankrupt and another 25 were on the verge of bankruptcy).

**Life Insurance industry**: The life insurance industry was nationalized under the Life
Insurance Corporation (LIC) Act of India. In some ways, the LIC has become very
successful. Despite being a monopoly, it has some 60-70 million policyholders. Given
that the Indian middle-class is around 250-300 million, the LIC has managed to
capture some 30 odd percent of it. The level of customer satisfaction for LIC was high
as given in reports of Mehlotra Committee and is still high.\(^{7}\) Table 1 given below.
This is somewhat surprising given the frequent delays in claim settlement. Market
penetration in the rural areas has grown substantially. Around 48% of the customers
of the LIC are from rural and semi-urban areas. This probably would not have
happened had the charter of the LIC not specifically set out the goal of serving the
rural areas. One *exogenous* factor has helped the LIC to grow rapidly in recent years:
a high saving rate in India. Even though the saving rate is high in India (compared
with other countries with a similar level of development), Indians exhibit high degree
of risk aversion. Thus, nearly half of the investments are in physical assets (like
property and gold). Around twenty three percent are in (low yielding but safe) bank deposits. In addition, some 1.3- percent of the GDP are in life insurance related savings vehicles. This figure has doubled between 1985 and 1995.

The General Insurance Corporation:

Although efforts were made to maintain an open market for the general insurance industry by amending the Insurance Act of 1938 from time to time, malpractice escalated beyond control. Thus, the general insurance industry was nationalized in 1972. The General Insurance Corporation (GIC) was set up as a holding company. It had four subsidiaries: New India, Oriental, United India and the National Insurance companies (collectively known as the NOUN). It was understood that these companies would compete with one another in the market. It did not happen. They were supposed to set up their own investment portfolios. That did not happen either. It began to happen after 29 years. The NOUN has kicked off an internal exercise to segregate the entire investment portfolio of the GIC (in 2001). The GIC has a quarter of a million agents. It has more than 2,500 branches, 30 million individual and group insurance policies and assets of about USD 1,800 million at market value (at the end of 1999). It has been suggested that the GIC should close 20- 25% of its nonviable
branches (Patel, 2001). The GIC has so far been the holding company and re-insurer for the state-run insurers. It reinsured about 20% of their business.

**Process of Opening of Insurance Market:** Although Indian markets were privatized and opened up to foreign companies in a number of sectors in 1991, insurance remained out of bounds on both counts. The government wanted to proceed with caution. With pressure from the opposition, the government (at the time, dominated by the Congress Party) decided to set up a committee headed by Mr. R. N. Malhotra (the then Governor of the Reserve Bank of India).

According to the Insurance Regulatory and Development Authority (IRDA), the insurance industry in India at present consists of 24 general insurance companies including specialized insurers such as Export Credit Guarantee Corporation of India and the Agricultural Insurance Corporation of India, and 23 life insurance companies. Of the 22 insurers who set up operations in life insurance after the industry was opened up for the private sector, 20 are joint ventures with foreign companies. Similarly, of the 17 non-life insurers, including health insurers operating in the private sector, 16 are in collaboration with foreign partners. Thus, 36 insurance companies in the private sector are operating in collaboration with well-established foreign companies.

**Indian Banking Industry:**

Since 1991, India has been engaged in banking sector reforms aimed at increasing the profitability and efficiency of the then 27 public-sector banks that controlled about 90 per cent of all deposits, assets and credit. The reforms were initiated in the middle of a “current account” crisis that occurred in early 1991. The crisis was preceded by massive, unhedged, short-term capital inflows, which then aggravated double
mismatches (a currency mismatch coupled with a maturity mismatch) and undermined the soundness of the domestic financial sector. A maturity mismatch is generally inherent in the banking sector since commercial banks accept short-term deposits and convert them into relatively longer-term, often illiquid, assets.

Nevertheless, massive, predominantly short-term capital inflows – largely in the form of inter-bank loans – shortened banks’ liabilities, thus expanding the maturity mismatch. The crisis was caused by poor macroeconomic performance, characterized by a public deficit of 10 per cent of GDP, a current account deficit of 3 per cent of GDP, an inflation rate of 10 per cent, and growing domestic and foreign debt, and was triggered by a temporary oil price boom following the Iraqi invasion of Kuwait in 1990. Prior to the reforms, India’s financial sector had long been characterized as highly regulated and financially repressed. The prevalence of reserve requirements, interest rate controls, and allocation of financial resources to priority sectors increased the degree of financial repression and adversely affected the country’s financial resource mobilization and allocation. After Independence in 1947, the government took the view that loans extended by colonial banks were biased toward working capital for trade and large firms (Joshi and Little 1996). Moreover, it was perceived that banks should be utilized to assist India’s planned development strategy by mobilizing financial resources to strategically important sectors. Reflecting these views, all large private banks were nationalized in two stages: the first in 1969 and the second in 1980. Subsequently, quantitative loan targets were imposed on these banks to expand their networks in rural areas and they were directed to extend credit to priority sectors. These nationalized banks were then increasingly used to finance fiscal deficits. Although non-nationalized private banks and foreign banks were allowed to coexist with public-sector banks at that time, their activities were highly restricted through entry regulations and strict branch licensing
policies. Thus, their activities remained negligible. Reflecting these views, all large private banks were nationalized in two stages: the first in 1969 and the second in 1980. Subsequently, quantitative loan targets were imposed on these banks to expand their networks in rural areas and they were directed to extend credit to priority sectors. These nationalized banks were then increasingly used to finance fiscal deficits. Although non-nationalized private banks and foreign banks were allowed to coexist with public-sector banks at that time, their activities were highly restricted through entry regulations and strict branch licensing policies. Thus, their activities remained negligible. In the period 1969-1991, the number of banks increased slightly, but savings were successfully mobilized in part because relatively low inflation kept negative real interest rates at a mild level and in part because the number of branches was encouraged to expand rapidly. Nevertheless, many banks remained unprofitable, inefficient, and unsound owing to their poor lending strategy and lack of internal risk management under government ownership. Joshi and Little (1996) have reported that the average return on assets in the second half of the 1980s was only about 0.15 per cent, while capital and reserves averaged about 1.5 per cent of assets. Given that global accounting standards were not applied, even these indicators are likely to have exaggerated the banks’ true performance. Further, in 1992/93, non-performing assets (NPAs) of 27 public-sector banks amounted to 24 per cent of total credit, only 15 public-sector banks achieved a net profit, and half of the public-sector banks faced negative net worth. Following the 1991 report of the Narasimham Committee, more comprehensive reforms took place that same year.

Indian Mutual Fund Industry:

In India, the need for the establishment of mutual funds was felt in 1931 and the concept of mutual fund was coined in 1964, by the farsighted vision of Sri
T.T.Krishnamachari, the then finance minister. Taking into consideration the recommendations of the Central Banking Enquiry Committee and Shroff Committee, the Central Government established Unit Trust of India in 1964 through an Act of Parliament, to operate as a financial institution as well as an investment trust by way of launching UTI Unit Scheme 64. The overwhelming response and the vast popularity of UTI Unit Scheme 64 and the Mastershare Scheme in 1986 attracted the attention of banks and other financial institutions to this industry and paved the way for the entry of public sector banks. By the end of 1986-87, UTI had launched 20 schemes mobilizing funds amounting to Rs.4,56,500 crores and are now an integral part of the Indian financial system.

The SEBI formulated the Mutual Fund Regulations in 1993, establishing a comprehensive regulatory framework for the first time, while the Indian Mutual Fund Industry (IMFI) had already passed through two phases of developments. The first phase was between 1964 and 1987 when the UTI was the only player, managing total assets of Rs.4,564 crores by the end of March 1987. In 1987, the public sector banks and insurance companies were permitted to set up mutual funds. Accordingly, the LIC and GIC and six public sector banks initiated the setting up of mutual funds, bringing out a new era in the mutual fund industry. Based on the recommendations of the Dave panel report in 1991, the Government of India issued new guidelines for setting up mutual funds in public sector, private sector as well as in joint sector on February 14, 1992. The mutual fund industry has gained momentum in 1993 with the entry of private sector in the wake of liberalization and globalization. Further, the industry has gained a coveted status after the implementation of the SEBI (Mutual Funds) Regulations 1996.
Over the years, the financial services in India have undergone revolutionary changes and had become more sophisticated, in response to the varied needs of the economy. The process of financial sector reforms, economic liberalization and globalization of Indian Capital Market had generated and augmented the interest of the investors in various instruments.

Relevance of the current study:

The research paper has a relevance due to the fact that Indian Economy which grew at an average growth rate of 9 Percent in the five year period from 2003 – 2008, but it was thrown out of the track by the global financial crisis of 2008, which virtually engulfed every county in the world. The earlier adverse economic crisis namely Asian Crisis of 1997-1998 and US recession of 2001 did not come anywhere close to the magnitude of the impact that the financial crisis of 2008 had on the either the Global or Indian Economy. We recovered from the crisis sooner than the other countries but the growth rate has yet to reach the pre crisis level. There is a wide spread anxiety whether the growth drivers that worked our way during 2003 to 2008, still intact? When it will reach the double digit growth? What indeed should we be doing to achieve that? *9

India is integrating with the world, more extensively, more deeply and faster than we tend to acknowledge. India’s remarkable growth acceleration in the period 2003 – 2008 is a demonstration of the positive side of the globalization. We benefitted from the steady growth and stability around the world. But the flip side of this globalization is the increasing affect of the global upheaval with a higher degree of impact. So the liberalization coupled with globalization takes the economy of the country in a direction guided by the market forces with the strings of the control not remaining within the country or in the hands of one person or some persons. This liberalization
had several impact of the Indian finance industry popularly known as BFSI. The study acquired a special significance due to the liberalization of the Indian insurance industry in 2001 and ending the state monopoly. This was not just one industry but the ramification of the liberalization reached to the whole of financial market due to change in the control of the funds available. So the first decade viz 2001 to 2010 of the liberalization was taken as the period relevant for the study.

**Objective of study:**

Indian economy has undergone through a strong phase of liberalization coupled with Privatization and Globalization. The Indian economy has embraced 2nd generation reforms.*10 The year 2000 marked an new era in the finance industry with the amendment in the insurance act and passage of IRDA act.

The present study will be taking up the various effect of first generation reforms (Pre 2001) which was also called LPG (Liberalization, Privatization and Globalization) and the second generation reforms (2001 – 2011), on the Indian economy. It will also analyse the results and effect on the Indian Economy through the first generation reforms, which necessitated different agencies including Govt. of India to undertake the second generation reforms. All the reforms leading to the liberalization and its effect will be studied and analyzed. However the scope of this thesis is limited to the liberalization in Financial sector i.e Banking, Insurance and Mutual funds.

The Objective of the study is as following:

**To understand the effect of the various reforms in financial sector**

The effect will be confined to the period 2001 to 2011 and the study will be limited to BFSI sector.
Scope and limitations of the study:

This study researches only the effects on the Indian economy for the period 2001-2011 and will be limited to Banking, Insurance and mutual funds. This segment is popularly called BFSI (Banking, Financial services and Insurance). It will be confined to examine the effects on the intermediate level not the upper level of reinsurance and the global and complex actuarial and valuations systems and its effects. It will be considered that these macro environment is stable and is utilized by the companies and organizations to the optimum level. It should also be noted that the life and general insurance will not be dealt separately in any of the study. Insurance is examined here as a social-economic mechanism, without distinguishing between the insurance lines (life, non-life, casualty and property insurance), although there are significant differences between them. Furthermore, the research focuses only on commercial insurance (contrary to public social securities and insurance programs) for private consumers (contrary to the business insured). Similarly, while examining the mutual fund industry and Banking industry, the scope of the study will remain confined to the intermediate level.

Research Questions:

The study aims at answering the following research questions at the completion of the research:

1. Is there any change in the indices of Indian Economy due to liberalization?
2. Is there generation of new employment opportunities as a result of liberalization?
Hypothesis of the Study:
The study will be done on the following hypothesis. It has been hypothesized that

1. There is a significant change in revenue and its pattern of transaction as an outcome of liberalization
2. There is a significant change in ratio of various products sold by financial sectors, due to liberalization.
3. There is a significant change in the cost efficiency, earning efficiency and the profitability in the organization who got transformed during the liberalization period.

Methodology:
This study follows exploratory investigation method in which theoretical as well as empirical exploration has been conducted to reach to some significant results. The study aims to evaluate the various aspects on the liberalization. The standard nomenclature and definitions of Indian insurance industry, banking industry and mutual fund industry has been used in the study and reporting of the same. There has been separate set of reason for the nationalization of the banks and amalgamation of the various private insurance players to get them converted in one name in the form of large monolithic LIC of India. There after there has been 360Degree turn in the gap 44 yrs for life insurance and 28 yrs of general insurance industry. The mutual fund industry has also undergone regular and rapid change in past two and half decades.

Data:
The research is fully based on the published data or in other words only on the secondary data. Most of the data are time series data. The scholar has attempted to
analyse the various primary data available with IRDA, RBI and SEBI internet sites with the help of the various publications of Ministry of Finance and other ministries of various state governments.

**Data Sources:**

The following sources constitute the major sources of data for this very research:

(a) The Census of India official website: www.censusindia.gov.in

(b) The official publications of Reserve Bank of India on its website: www.rbi.org.in

(c) The official publication of IRDA on its website: www.irda.gov.in

(d) The official publications of SEBI on its website: www.sebi.gov.in

(e) Association of Mutual Funds of India. Website: www.amfiindia.com

(f) Life insurance council reports and data. website: www.lifeinscouncil.org

(g) Various research papers and thesis published on Shodhganga. Website: shodhganga.inflibnet.ac.in

(h) Data published on CRISIL (A Standard and Poor's company) website: www.crisil.com

(i) Indian mutual fund industry Distribution continuum: Key to success. A study in collaboration with Indian Chamber of Commerce. Website: www.kpmg.com

(j) The official website of Govt. of India. Website: www.india.gov.in


**Sample period:**

The research has been confined to the period 2001 to 2011 but the data of the period prior to 2001 has also been taken to make the conclusion and interpretation more accurate. The process of liberalization is a continuous process. There has been some landmark initiatives having far reaching consequences by the new government. A discussion on the same has been taken to make the thesis more updated.
Limitation of data:
The data warehousing of various government institutions and regulators is very erratic. Various data has not been put on the public domain. The time series data has many gaps at various periods.

Chapter scheme:
The thesis has been divided into following chapters:

1. Introduction
2. Review of Literature
3. New Economic Policy
4. India and Liberalization
5. Financial sector reforms
7. Conclusion & Suggestion.
Books and References:


*5 Paper Published by Prof. K. Aravindakashan, Kochi, at UGC sponsored National Seminar on " A decade of economic reforms in India : Retrospect and prospect "; Nagarjuna University, Guntur, AP; Jan 2003.

*6 Mr. Subir Gokhran, Dy. Governor, RBI. Lecture delivered at the 45th A D Shroff Memorial Lecture at Indian Merchants’ Chamber, Mumbai on 2nd Nov. 2011.


*9 Mr. D Subbarao , Governor , RBI at Haskar memorial Lecture delivered at the Centre of Research in Rural and industrial Development , Chandigarh on 25th Nov. 2012

*10 Extracted from the speech of Mr. Yashwant Sinha, Finance minister, in the budget speech of 2000- 2001
Chapter – 2

Review of Literature :

This chapter provides for the comprehensive review of the studies and literatures available on the various parameter of the financial market and its status. While the focus will be on the Indian scenario but the international scenario will also be given due importance. The Uruguay Round of GATT (now WTO) advocated the removal of restrictions and non-tariff trade barriers to free flow of international services across countries so that domestic market of LDCs (Low developed countries) improve its efficiency and competitiveness and eventually improve economic growth. It is important to note that there are very few studies done on such "Behavioural Finance" and connecting the same with the Indian Economy. However, it is important to note that the availability of data on various topics of financial industry is of a very low quality. There has not been any standardised method of presentation of data. Every year the contents and the presentation changes its formats. There has been very few research initiated by IRDA either on its own or thru its any sponsored agency or atleast the research work has not been published. The mutual fund industry has also been suffering from the same syndrome. There is very less attention given by the SEBI on the study of mutual fund market. As a result of all these things, the research work done by the research scholar had to depend on the available research publications, which are very few in no and mostly very remotely connected to the subject.

Vijay Joshi and I. M. D Little, India's Economic Reforms, 1991-2001. Here the focus is on the economic reforms introduced after the financial crisis of 1991. The
authors examine the different areas of the economy and outline the successes and 
effects of reform measures. They utilize economic theory and knowledge to suggest 
ways to liberalize the economy and open up the market to revitalize the Indian 
economy alongside those reforms already implemented. They end with predictions of 
the future of economic reforms and what sectors should be seen as priorities for 
prospective development.

N. Vaghul (1994), Liberalization of financial markets in India emphasised the 
importance of liberalization in the financial market.

Aghion et al. (2006) emphasis of the importance of higher saving. It increases funds 
available for investment projects, leading to capital accumulation and economic 
growth. In order to encourage saving, financial sector policies should be geared to 
providing more incentives to save. One important debate about the role of finance in 
promoting saving has been about the implications of financial liberalization on the 
saving rate. Proponents of financial liberalization such as McKinnon (1973) and 
Shaw (1973) have argued that the process of eliminating or significantly alleviating 
financial system distortions can encourage savers by increasing their net real returns.

Bayoumi (1993; Jappelli and Pagano (1994) lays the importance of financial 
market. The studies of Outreville (1990 b), Catalan et. al. (2000) and Ward and 
Zurbruegg (2002) highlights the importance of insurance industry that it can provide 
the economic growth through financial intermediation, risk aversion and generate 
employment. Ahuja (2004) points out that for the continued development of the 
insurance industry, there is a need to review the 26 per cent limit on foreign equity 
ownership. In insurance, the extent of insurance business that an insurance company 
can underwrite depends on the amount of capital available with it. This is because it 
has to follow the solvency norms defined by the regulator. Underwriting higher risk 
thus calls for having a higher capital. Given the limited ability of the Indian partners to
garner additional capital, there is a strong case for raising the FDI limit so that the competition in insurance can blossom fully. The implication of liberalization vary with the country. Skipper Herold D, Jr. C.V. Starrr and J Mack Robinson (2000) in their study gave in depth knowledge on the issue of liberalization of the insurance market. Many countries have liberalized their financial market with a view to reap the benefits of liberalization.

Henneberger and Ziegler, (2006) in a paper analyzed the employment effects of FDI in the service sector. It was shown that positive employment effects of FDI in services which have been taken for granted in the literature are likely only for a very limited subset of services, namely services that require physical proximity and whose users have high mobility costs. For all other services, negative effects of FDI on domestic employment are possible, and in some cases even likely.

AK Sukla (2006) reviewed that the euphoria is well earned as well look at the economic measures of liberalization initiated in insurance sector. Six years into competitive market, the Indian insurance industry exhibited a healthy growth trend of new business and market share. From total premium underwritten of Rs.34, 898 crore in the year 2000-01 to Rs.66, 287.93 crore in 2003-04, followed by the aggressive achievement posted at Rs.81301.40 crore in 2004-05, the life insurance industry saw the new players stabilize their operations keenly matched by LIC and the premium numbers bring out the fact that the size of the insurance market grew over the six years of liberalization. CS Rao (2007) reported that “Insurance is a vital economic activity and there is an excellent scope for its growth in the emerging markets. The opening up of the insurance sector has raised high hopes among people both in India and abroad. The recent detarrification in the non-life domain has provided a great deal of operational freedom to the players.”
Rastogi and Shankar (2007) claims that insurance industry contributes to the financial sector of an economy and also provides an important social security net in developing countries. This study identifies the causes and the objectives with which the sector was reformed in 2000 to conclude that only in the last decade, the hybrid model of privatization with regulation adopted by the Government has yielded positive results and the sector has started to look up. The sector in its present form looks promising for the consumers, the insurers and the nation as a whole.

Dr Milind Sathye (2002) has worked on “Efficiency of Banks in a Developing Economy: The Case of India”. He studied the productive efficiency of banks in developing country, that is, India. The measurement of efficiency is done using Data Envelopment Analysis (DEA). Two models have been constructed to show how efficiency scores vary with 32 change in inputs and outputs. The efficiency scores, for three groups of banks, that are, publicly owned, privately owned and foreign owned, are measured. He examines that the mean efficiency score of Indian banks compares well with the world mean efficiency score and the efficiency of private sector commercial banks as a group is, paradoxically lower than that of public sector banks and foreign banks in India. He also recommends that the existing policy of reducing non performing assets and rationalization of staff and branches may be continued to obtain efficiency gains and make the Indian banks internationally competitive which is a declared objective of the Government of India.

A. Amarendra Reddy (2003) studied “banking sector deregulation and productivity change decomposition of Indian banks”. He measured productivity growth of the banking industry in India during 1996 to 2002. The competition in the Indian banking industry has intensified since the financial liberalization, which started in the early nineties.
Debendra Kumar Mahalik and Sreekumar (2005) worked on “Performance Measurement of Indian Banks: An Alternative Approach”. According to their study banking sector plays a considerable role in the economic development and business improvement, in this aspect ranking of banks is vital. This ranking of banks helps in their performance improvement with respect to self and others; this in fact created a need for measurement of performance of banks. In their study they made an attempt to rank some of the Indian Banks using AHP, TOPSIS and DEA, which take care of the qualitative and quantitative factors taken together. This in fact has resulted an alternative ranking of banks. The data used in this case are from the published data of various banks. They also discussed the results with other standard methodology for ranking methods.

Mr. R. N. Malhotra (the then Governor of the Reserve Bank of India, former finance secretary), report published in 1994. It was formed to evaluate the Indian insurance industry and recommend its future direction. The Malhotra committee was set up with the objective of complementing the reforms initiated in the financial sector. The reforms were aimed at creating a more efficient and competitive financial system suitable for the requirements of the economy keeping in mind the structural changes currently underway and recognising that insurance is an important part of the overall financial system where it was necessary to address the need for similar reforms. The report was the basis of privatization and it took 6 long years for government to implement the same.

Nalini Prana Tripathi (1996) examined the importance and growth of mutual funds and evaluated their operations in order to suggest some measures for the success of mutual funds in India. She pointed out that with progressive liberalization of economics policies,
there has been a rapid growth of Capital Market, Money Market and financial services industry including mutual funds along with others. This paper suggests that mutual fund organizations are required to upgrade their skills and technology.

**Bijan Roy and Saikat Sonan Dep (2004)** in their study conducted the fact related to the evidence of persistence in the performance of the Indian Mutual Funds. Further analyzes how Mutual Fund performance relates to past performance. Three categories of funds are examined: Equity, debt and balanced scheme.


**S. Mohannan (2006)** in his article put emphasis over the Indian mutual fund industry which is one of the fastest growing sectors in the Indian capital and financial markets. Stating that the mutual fund industry has been dramatic improvements in quantity as well as quality of product and service offerings. Results founded that mutual funds assets under management grew by 96% between the end of 1997 and June 2003 and as a result it rose from 8% of GDP to 15%.

**Khare, Kant Sanjay, (2007)** in his article he emphasis over the mutual funds, stating it is a way (source) of saving and earning better return for small investors. As, one doesn’t have to figure out which stocks or bonds to buy.

**Rao Hanumantha P and Mishra Vijay Kumar (2007)** In their case study they sim ply but emphasis over the SWOT of Mutual Fund Industry in India as with the Indian Mutual Fund Industry standing on the verge of a massive growth. The comprehensive SWOT analysis of the MF Industry suggests that the prospects for the industry in
future are significant. Undoubtedly the initial phase of the MF Industry in India was slow but steady. But after a slow start, the industry has picked up and is presently going through a growth phase. Globally, MFs have become very popular avenue of investment.

Raw Hanumantha P. and Mishra Vijay Kr., (2007) in their article stating Mutual Funds Investment as a saving vehicle and interrelating it with the financial mark ets who gave an opportunity to serve as a saving vehicle. The booming Indian financial market has a lot to do with the booming Indian Economy. One of the important functions of the financial market is to turn the savings of the people into the investments in corporate.

R K Gupta (2009) in his book “global financial crisis”, an attempt has been made to provide a holistic view of the global financial turmoil. Some Indian policymakers argued that India would be relatively immune to this crisis because of the strong fundamentals of its economy and a well regulated banking system. However, the crash in the Indian stock market, triggered by a pull out of Foreign Institutional Investors (FIIs) funds, October 2008 onwards, is indicative of the integration of Indian economy with the world economy despite claims of decoupling.

Journal of the Asia Pacific Economy Vol. 16, No. 1, February 2011, 71–80 ; Impact of financial development on economic growth: empirical evidence from Pakistan Abdul Jalila and Mete Feridunb∗ aSchool of Economics, Quaid-i-Azam University, Islamabad, Pakistan; Department of Banking and Finance, Faculty of Business and Economics, Eastern Mediterranean University, Famagusta, Mersin, Turkey. It investigates the effects of financial sector development on economic growth in the case of Pakistan from 1975 to 2008. The results suggest the presence of a positive and significant relationship between financial development and economic growth.
Understanding China’s Growth: Past, Present, and Future, Xiaodong Zhu is Professor of Economics, University of Toronto, Toronto, Ontario, Canada. Journal of Economic Perspectives—Volume 26, Number 4—Fall 2012—Pages 103–124 has described the growth of China, specially in comparison to the European economic growth. It begins by discussing briefly China’s historical growth performance: that is, how China went from the world’s leading economic power about 900 years ago to a situation in which it essentially missed the Industrial Revolution and had close-to-zero growth in per capita GDP from 1800 to 1950. For the period from 1952 to 1978, when growth was less than 3% and the period since 1978 changed the scenario.
Chapter 3

New Economic Policy

At the dawn of independence from British Colonial rule, Indian economy was in shattering state and mass population of poor, illiterate and unemployed sections of the society was looking towards the national leaders of that period for building a new India, which could provide positive hopes to them in a 'real promising' way. The first prime minister of India envisaged an economic model which was very much influenced by the soviet. This era is marked by the emergence and growth of popular 'Nehru Model' of development. His doctrine of 'Democratic Socialism' formed the base of new model of development he envisaged for India. "Inevitably, there was a reaction against the laissez-faire policies that the colonial government had followed for most of its life, and great caution at first about continued contact with foreign governments and business interests." *11.
The mode of 'Democratic Socialism', was a combination of the popular Soviet Russia's 'Socialist Model' and the other equally popular Capitalist Model being followed by a number of developed western countries including USA. As it was also true that the private sector in India was limited to very few hands and it was incapable handling big affairs. The long term gestation period investment policies could be implemented only by booking the public. The National Planning Committee (NPC) towards the end of 1938, which opined that 'State should own or control all key industries and services, mineral resources and railways, waterways,
shipping and other public utilities and in fact all those large-scale industries which were likely to become monopolistic in character*. Along with material and capital resources addition for development, social justice was equally needed as per the philosophy of 'Democratic Socialisation'. Some of its peculiar features can be summed up as under:

a) Strong faith in democratic values for individual good,
b) Removal of poverty at mass level,
c) State’s role in providing minimum basic facilities for all.
d) State's prominent role in reduction of economic embalances,
e) State's constructive role in providing equal opportunities for all and especially for the underprivileged,
f) Big faith in mixed economy,
g) State’s prominent role in checking the monopolistic tendencies in society,
h) Economic gains not for the sake of profits but for social justice,
i) Planned economic development with strategies focused on 'total development of total society' by adopting democratic means.

Such vision became the guiding spirit for the development planning in India and thereby clearing the way for creation of a mass structure of public sector in the nation. In order to give a boost to public sector, the Government of India passed an Act in Parliament in May 1955 and the Imperial Bank of India was taken over by the state and State Bank of India was constituted in July, 1955. "Later the State Bank of India (Subsidiary Banks) Act was passed in 1959 enabling the State Bank of India to take over eight former State associated bank as its subsidiaries" *13. President of India promulgated Life Insurance (Emergency Provisions )
Ordinance, 1956 on Jan 19, 1956 to bring the management and control of the life insurance business in India including the foreign business of Indian insurers and the Indian business of foreign insurers, under the control of Central government. So a new Act was passed in Parliament and Life Insurance Corporation of India came into existence on September 1, 1956. Again in 1969 nationalization of 14 major scheduled commercial banks took place. Further in 1980, 6 more commercial banks were nationalised. The general insurance business was nationalized from January 1, 1973 through the General Insurance Business (Nationalization) Act 1972. The General Insurance Company (GIC) was formed as a holding company in November 1972. It had four companies under its control viz. National Insurance Company Limited, The New India Assurance Company Limited, the Oriental Insurance Company Limited and the United India Insurance Company Limited.

Through planning Indian economy made considerable achievements in the half century since independence. The population has more than doubled, agricultural production has tripled and this prevented the occurrence of large-scale famines. The industrial base became much more diversified than what it was in 1951. While the volume of industrial production increased more than 15 times. And the per-capita income of Indians has increased more than twice ever since 1950-51. Life expectancy rate has almost tripled as a consequence of the substantial fall in the Death Rate and improvements in the standard of living of the people. However a realistic assessment of the result of planning calls for a rigorous comparison of what was promised and what has been delivered through the plans. Statistics show that the promises were largely belied. As per official statistics in 1993-94, almost 320 million Indians were deemed to be living in poverty. This is not much less than the entire Indian population of 360 millions in 1950-51.
### Table 3.1 Health Indicators

<table>
<thead>
<tr>
<th>Year</th>
<th>Life expectancy at birth (Years)</th>
<th>Infant mortality rate (Death per 000 live births)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1951</td>
<td>32.1</td>
<td>146</td>
</tr>
<tr>
<td>1971</td>
<td>45.6</td>
<td>129</td>
</tr>
<tr>
<td>1981</td>
<td>54.4</td>
<td>114</td>
</tr>
<tr>
<td>1991</td>
<td>55.9</td>
<td>80</td>
</tr>
<tr>
<td>1997</td>
<td>62.4</td>
<td>71</td>
</tr>
</tbody>
</table>

### Table 3.2 Estimates of poverty

<table>
<thead>
<tr>
<th>Year</th>
<th>All india</th>
<th>Rural</th>
<th>Urban</th>
<th>All india</th>
<th>Rural</th>
<th>Urban</th>
</tr>
</thead>
<tbody>
<tr>
<td>1973</td>
<td>54.9</td>
<td>56.4</td>
<td>49.0</td>
<td>3.6</td>
<td>3.3</td>
<td>3.8</td>
</tr>
<tr>
<td>1977</td>
<td>51.3</td>
<td>53.1</td>
<td>45.2</td>
<td>6.8</td>
<td>7.4</td>
<td>4.4</td>
</tr>
<tr>
<td>1983</td>
<td>44.5</td>
<td>45.7</td>
<td>40.8</td>
<td>5.6</td>
<td>6.6</td>
<td>2.6</td>
</tr>
<tr>
<td>1993</td>
<td>36.0</td>
<td>37.3</td>
<td>32.4</td>
<td>2.9</td>
<td>1.8</td>
<td>5.8</td>
</tr>
</tbody>
</table>

Source: Data sourced from Economic Survey 2000-2001
Background of the NEW ECONOMIC POLICY, 1991:

There has been hardly any development on the different sectors of economy and GDP in the Nehruvian model of economic planning which was also called “Mahalnobis Model”. It was felt that the economic policy and the thrust area requires a change. The data given below is the testimony to this statement.

<table>
<thead>
<tr>
<th>Year</th>
<th>Agriculture</th>
<th>Industry</th>
<th>Services</th>
<th>GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>1951-79</td>
<td>2.24</td>
<td>5.18</td>
<td>4.15</td>
<td>3.50</td>
</tr>
<tr>
<td>1980-91</td>
<td>3.42</td>
<td>5.32</td>
<td>6.18</td>
<td>5.04</td>
</tr>
</tbody>
</table>

The First Plan (1951-56) projected a doubling of the per capita income. But it was realised almost just before 1990-91 (See Table 3.4). Four decades later, that the target was achieved. So the target which was set out for 5 years took forty years to achieve. It has also to be mentioned that though there was no external aggression or war but the internal conflicts and princely states consumed a lot of energy and time. A major turning point in the post-independence development of the economy was marked by the drought and stagnation of the mid-Sixties. Public investment declined (partly on account of the higher defence spending following the 1962 and 1965 wars with China and Pakistan) and industrial growth stagnated. This was to some extent
compensated by the Green revolution, but there was all round recognition that the economy was in trouble.

Another addition to the woes of Indian economy was the industrial policy given by Late Morarji Desai Government in 1977. It was yet another departure from the practicing trend. The main features of the economic policy given by him is as under:

The Janta Party framed its new policy in December 1977 with following important provisions:

a) Developing small scale sector

b) Classification of small sector as cottage and household industries, Tiny sector (with an investment in machinery and equipment up to Rs. 1 lakh) and Small Scale industries with investment up to Rs. 10 lakh and in case of ancillaries up to Rs. 15 lakh.

c) Areas for Large-scale Sector:

i) basic industries, essential for providing infrastructure and developing small scale and village industries, such as steel; nonferrous metals, cement, oil refineries.

<table>
<thead>
<tr>
<th>Year</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1950-51</td>
<td>5708</td>
</tr>
<tr>
<td>1990-91</td>
<td>11535</td>
</tr>
<tr>
<td>2010-11</td>
<td>35993</td>
</tr>
</tbody>
</table>

Table 3.4 Per Capita NNP at Constant Prices

Source: Economic Survey 2010-11
ii) Capital goods industries for meeting the machinery requirements of basic industries as well as small scale industries

iii) high technology industries which required large scale production and which were related to agricultural and small scale industries development such as fertilizers, pesticides and petrochemicals etc.

iv) Other industries which were outside the list of reserved items for the small scale sector and which were essential for development of the economy like machine tools, organic and inorganic chemicals etc.

In nutshell, the Industrial Policy of 1977 specified that public sector would not only be the producer of very important and strategic goods of basic nature but it would also work for maximising essential supplies for consumers and it would work for the development of small scale sector and ancillary units. This policy increased the number of reserved items (which need government license) from 180 to 807 by May 1978. It revamped the Khadi and Village Industries Commission. As far as approach towards foreign collaboration was concerned it stated that in areas where foreign technological know how is not needed, existing collaborations will not be renewed. It argued that majority interact in ownership and control should be in India hands. It was a little bit sceptical in taking over such industrial units as it had been adding to the tones of public sector.

The period of Janta Party govt was over and Rajiv Gandhi came to power. Growth did accelerate in the Eighties, a decade which saw the first string of liberalization. Though he tried to make changes and bring the old Nehruvian and Mahalnobis industrial policy back with some modification. The industrial policy statement, 23rd July 1980 had tried to instil confidence. The public sector inefficiency was noticed. The Rajiv Gandhi Government (October 1984 to December 1989) felt concerned for the heavy losses of public sector in financial terms and had a marked thrust towards
liberalization, inter alias, through large scale relicensing, broad banding of industries which remained within the ambit of licensing and the higher endorsement of capacity. The large areas which were exclusively reserved for public sector like telecommunication, oil exploration, oil refineries and civil aviation was thrown open to private sector also. Though Rajiv Gandhi never came up with a formal industrial policy statement. On one hand Rajiv Gandhi in his speech at Lok Sabha (1985) showed faith in public sector by stating that public sector would continue to be the "key to our development and a pathfinder to take the country to the 21st century."(Rajiv Gandhi's speech in Lok Sabha dated December 18th 1985.) He opened the doors to private sector in many reserved areas for public sector in order to lessen the burden on the government and also to give chance to private sector to explore new dimensions in Indian economy.(Seventh Five Year Plan Document, Government of India Publication, New Delhi, 1987)

**Deficit budget, External and Internal borrowing**:

There was revenue surplus before 1970-71 but by 1980-81 there was a revenue deficit of Rs 2037 crores. The revenue deficit shot up to Rs 18,562 crores in 1990-91 on account of rising non-developmental expenditure which rose from Rs 9867 crores in 1980-81 to Rs 49,349 crores in 1990-91 or a five-fold increase within a decade. Non-developmental expenditure also witnessed a more than four-fold increase during the nineties. During 1980-81 to 2000-2001 while developmental expenditure increased ten-fold, non-developmental expenditure increased more than twenty one times. This forced the government to more borrowings. Market borrowings net of repayment were only Rs 238 crores in 1970-71; these increased to Rs 2679 crores in 1980-81 and further to Rs 8001 crores in 1990-91. Economic reforms have only accentuated the intensity of the borrowings. Fiscal deficit has been constantly increasing. Between 1980-81 to 1990-91 it rose five fold and in the nineties it has
risen about three fold. But the faster growth in the second half of the Eighties under the stewardship of Rajiv Gandhi was fed by reckless external borrowing and irresponsible fiscal expansion at home. India’s external debt which was little less than $20 billion in 1980 reached $40 billion in 1985 and shot up to $82 billion in 1990, giving the country the dubious distinction of being one of the top debtor nations in the world. It also meant that about 40 percent of export earnings had to be devoted entirely to the servicing of the debt. In order to meet international commitments short-term loans had to be frequently resorted to between 1987 and 1990. This sent a crisis signal to lenders and depositors. "Depleted official reserves, large deficits in balance of payments, and sharp decline in GDP growth which was reflected in similar declines in almost all sectors of the economy demanded urgent attention. **14 It was at this time that the World Bank's Report of October 1990 advocated a 20 per cent devaluation of the rupee to correct the balance of payments problem. There is not enough evidence to suggest that it was meant as a warning to depositors. A massive flight of capital, specially from the Foreign Currency Non-Resident accounts started immediately thereafter. The flight, which amounted to a little over $ 100 million on October 1990, slowed down in the next few months, but was $ 370 million in April 1991, $230 million in May and 9; 330 million in June 1991.".

The period of Seventh Five Year Plan ended in 1990 which virtually marked the end of an era lasting more than forty years in India and popular for following Nehru Model of Development based on Democratic Socialism.

Fiscal mismanagement had to be paid in the early Nineties, when the balance of payments crises of 1991 became the occasion to make sweeping changes in economic policy.
The beginning of 1990's was a 'new paradigm shift' in Indian economy with the emergence of new generation policies of Liberalization, Globalization and Privatization (LPG). This change was not only due to internal pressure of heavy losses to public sector but was due to the global changes as well. Changes were observed on the international front also. The adoption of soft and liberal policies by Margret Thatcher in UK and many South American nations during 1980's were the new trends in world economy. The disintegration of U.S.S.R. after Gorbachov regime marked the end of bipolar world and beginning of a unipolar world led by the Capitalist state USA were the biggest events of historical significance. The impact of such events forced the Indian government to think beyond the lines of 'public sector dominance'. The economical logic and rationale to check the heavy loss making public sector undertakings made the government to think with different approach. Thus in an endeavour to rejuvenate the nation facing heavy fiscal defect, the Narasimha Government came up with 'New Economic Policy of 1991' which was total reversal of public sector policy followed till that period. This new policy statement of 1991 did not close the gates for public sector but brought drastic and radical changes in the earlier policy. “Each country may have its own rationale behind adopting privatization as a national goal. The privatization actually originated in the U.K in 1979 and spread to other developed and developing economies during 1980s while declining growth rates, raising unemployment, increasing inflation and decline in investments lead to privatization in most of the industrial countries, the acute debt crisis in most of the developing countries forced them to resort to the structural adjustment programme including privatization”

**15

**New Economic Policy, 1991**

The New Economic Policy, claimed to be an attempt to alter the basic parameters of economic policies since Independence and to restructure the economy drastically. It
was an effort not only for the remedial measure of balance of payments but it was an attempt to do many more. It was launched a few days (24th July 1991) after the formation of the Government subsequent to the general elections of 1991. The then Finance Minister Man Mohan Singh claimed many other advantages and objectives of the NEP.

**First**, the new NEP will meet the crisis of balance of payments and fiscal deficits.

**Second**, it will release industries from the shackles of unnecessary controls and regulations which have become hurdles in the way of industrial growth.

**Third**, in the light of the general trend towards globalisation, the Indian economy cannot remain isolated and therefore has to be globalised to take advantage of global finances and technology.

**Fourth**, the Indian industries will be subjected to market discipline both internally and externally.

**Fifth**, it will encourage large scale private foreign investment through incentives provided by budgetary and non-budgetary policies.

**Sixth**, Indian industries instead of remaining isolated, artificially protected and divided will now be obliged to become more competitive, cost conscious and efficient. The public sector which has proved to be a drain on the national resources as it has been incurring massive losses will get rationalised either through internal efficiency or by semi-privatisation, i.e. participation of the private sector in its equities and management.

**Seventh**, India will be able to get long term and short term loans from the World Bank and the IMF to meet the balance of payment deficits and thus save itself from the humiliation of default.

**Eighth**, it shall be possible to mobilise large sums of money held by the NRIs and thus avoid dependence on the international financial system.
Ninth, a lot of black money can be mopped up through India Investment Bonds and investment in housing without any questions being asked about the sources of money. Later on a package for the Small and Tiny sectors of industry was announced separately in August 1991.

**Action and initiatives under NEW ECONOMIC POLICY**

i) **Fiscal Discipline**

Fiscal stability and firm discipline is a prerequisite for the success of economic reforms. It was given the highest priority, especially in the initial phase of crisis management when the current account deficit was high and inflation in double digits. The Central Government fiscal deficit had expanded steadily during the eighties and had reached a peak level of 8.4% of GDP in 1990-91. The reduction in the fiscal deficit in the first two years was achieved by systemic improvements which permanently strengthened the fiscal situation, such as for example the abolition of export subsidies in 1991-92 and the partial restructuring of fertiliser subsidy in 1992-93. Another important systems change was the announcement that budget support to loss making public sector units in the form of Government loans to cover their losses would be progressively phased out. However part of the fiscal adjustment in the first two years was also achieved by restricting development expenditure, including expenditure on social and economic infrastructure. An important new initiative in the 1994-95 Budget was the announcement that there will be a pre-determined cap on the extent of monetisation of the Government deficit which did not exist earlier since the Government could borrow from the Reserve Bank without limit. It was proposed to operate a ceiling on Government borrowing from the Reserve Bank by authorising the Reserve Bank to auction Treasury Bills at market rates whenever the predetermined ceiling is breached for more than a specified period.
2. **Industrial Policy and Foreign Investment**

Perhaps the most radical changes implemented in the reform package have been in the area of Industrial Policy removing several barriers to entry in the earlier environment. The system of pervasive industrial licensing prevalent earlier, which required Government permission for new investments as well as for substantial expansion of existing capacity, has been virtually abolished. Licensing is now needed only for a small list of industries, most of which remain subject to licensing primarily because of environmental and pollution considerations. The parallel but separate controls over investment and expansion by large industrial houses through the Monopolies and Restrictive Trade Practices (MRTP) Act have also been eliminated. The many inefficiencies of this system - carefully documented by Bhagwati and Desai as early as 1970 - are now truly a part of history as far as the Central Government is concerned. A comprehensive restructuring of the Companies Act was also underway, has been passed by parliament in 2013, which aims at simplifying and modernising this aspect of the legal framework governing the corporate sector. One area where licensing controls remain in place relates to the list of industries reserved for the small scale sector. Doubts are often expressed on whether reservation, which prevents larger units from entering the reserved areas to compete with small scale industries, is a desirable instrument for promoting the small scale sector. However the Government has indicated that the general policy of reserving certain items for the small scale sector will continue for social reasons. This restriction may not be very significant in practice since the areas reserved in this way are actually quite small. The major problem really arises in certain product areas which are reserved for the small scale sector but which also have a substantial export potential such as for example toys and "garments. In order to introduce a measure of flexibility in such cases, the Government has modified policy to allow medium scale units to enter such
areas provided they export at least 50% of production. The list of industries reserved for the public sector has been drastically pruned and many critical areas have been opened up to private sector participation. Electric power generation has been opened up for private investment, including foreign investment, and several State Governments are actively negotiating with various foreign investors for establishing private sector power plants. The hydrocarbon sector, covering petroleum exploration, production and refining has also been opened up to the private sector including foreign investment and has attracted significant investor interest. Air transport, which until recently was a public sector monopoly, has been opened up to the private sector and some new entrants have begun operations. The Telecommunication sector has also been opened up for certain services such as cellular telephones, though the modalities for inducting private sector participants have yet to be worked out. The liberalisation of controls over domestic investors has been accompanied by a radical restructuring of the policy towards foreign investment. Earlier, India's policy towards foreign investment was selective and was widely perceived by foreign investors as being unfriendly. The percentage of equity allowed to foreign investors was generally restricted to a maximum of 40%, except in certain high technology areas, and foreign investment was generally discouraged in the consumer goods sector unless accompanied by strong export commitments. The new policy is much more actively supportive of foreign investment in a wide range of activities. Permission is automatically granted for foreign equity investment upto 51% in a large list of 34 industries. For proposals involving foreign equity beyond 51%, or for investments in industries outside the list, applications are processed by a high level Foreign Investment Promotion Board. The Board has established a record of speedy clearance of applications and the total volume of foreign equity approved in the first 24 months amounts to $3 billion. This compares with annual levels of approvals of
only about $150 million only a few years earlier. Various restrictions earlier applied on
the operation of companies with foreign equity of 40% or more have been eliminated
by amendment of the Foreign Exchange Regulation Act and all companies
incorporated in India are now treated alike, irrespective of the level of foreign equity.
India has joined the Multilateral Investment Guarantee Agency (MIGA) and has
recently concluded a bilateral Investment Protection Agreement with the United
Kingdom. Similar bilateral agreements are being negotiated with other major investing
countries.

3. **Trade and Exchange Rate Policy:**

   With the ethos of liberalization, trade policy has been very substantially liberalised for
all except final consumer goods. The complexity in the process for imports of raw
materials, other inputs into production and capital goods has been virtually
dismantled. Today, all raw materials, other inputs and capital goods, can be freely
imported except for a relatively small negative list. Imports of consumer goods remain
restricted except for the limited windows of permissible imports of such items by
returning Indians and a limited facility for imports of some consumer goods allowed
against special import licenses which are given to certain categories of exporters as
an incentive. The exclusion of consumer goods from trade liberalisation is an
important restrictive element in trade policy - and the Government has indicated that
this too will be gradually liberalised - but for all other sectors quantitative restrictions
on imports have been largely eliminated. It is accompanied with a gradual lowering of
customs duties. India's customs duties before the reforms were very high, with the
average rate of duty being as high as 100% and very substantial variations around
this average. The Government has made a series of downward adjustments in
customs duties in each of the four Budgets since 1991. The peak rate of customs duty
applicable to several items was over 200% in 1991. It has been lowered to 65% in
1994. Other customs duty rates below the peak have also been lowered, especially the duties on capital goods. The rate of customs duty on capital goods used to be as high as 90-100% in 1991 with concessional duty imports of capital goods available only to 100% export oriented units. The duties on capital goods have now been lowered to a range from 20% to 40%. Exchange rate policy had phased transformation since 1991, leading to a total transformation at the end of three years. The reforms began with a devaluation of about 24% in July 1991 in a situation in which extensive trade restrictions were still in place. The devaluation was accompanied by an abolition of export subsidies to help the fiscal position, and an offsetting increase in export incentives in the form of special incentive licenses (Eximscrips) given to exporters which could be used to import items which were otherwise restricted. These licenses were freely tradable and commanded a premium in the market depending upon the excess demand for restricted imports. The system was modified in March 1992 by the introduction of an explicit dual exchange rate system simultaneously with the dismantling of licensing restrictions on import of raw materials, other inputs into production and capital goods. These items were made freely importable against foreign exchange obtained from the market at a market determined floating exchange rate. Imports of certain critical item's such as petroleum, essential drugs, fertiliser and defence related imports were paid for by foreign exchange made available at the fixed official rate, and the demand for foreign exchange at the official rate to pay for these imports was met by requiring exporters to surrender 40% of their export earnings at the official rate. The remaining 60% of export earnings was available to finance all other imports, all other current transactions and debt service payments, at the market rate. This dual exchange rate system was again a short lived transitional arrangement to a unified floating rate which was announced in March 1993. After a year's experience with the unified rate
the Government, in March 1994, announced further liberalisation of payment restrictions on current transactions and stated its intention of moving to current account convertibility. Capital controls however remain in place. Thus in the short period of two and a half years the trade and payments system has moved from a fixed and typically overvalued, exchange rate operating in a framework of substantial trade restrictions and export subsidies, to a market determined exchange rate within a framework of considerable liberalisation on the trade account and the elimination of current restrictions.

4. Tax Reform :
This was a major element of the Reform programme. Chelliah Committee had also recommended the simplification of the of the direct taxes with moderate rates and fewer exemptions. The committee also recommended progressive reduction in variations in customs duty as well as rationalization of domestic excise duty.

- Following recommendations, the maximum marginal rate of personal income tax which was 56% in June 1991 is now been reduced to 34.61%.
- The incentive structure for savings in the form of financial assets has been strengthened.
- The Wealth Tax, which was earlier applicable to all personal assets, has been modified to exempt all productive assets including financial assets such as bank deposits, shares and other securities. (Now removed completely; Finance bill 2015)
- The rates of corporate income tax, which were 51.75% for a publicly listed company and 57.5% for a closely held company have been unified and reduced to 46%. Now, it is at 25% with additional 15 & surcharge.
- Customs duties, as noted above, have been significantly reduced over the past three years and the Government has indicated that further reductions are
expected to be implemented in phases to bring the rates in line with those prevailing in other developing countries.

- Excise duties on domestic manufactured goods were charged at varying rates on different commodities, with most of the duties being specific rather than ad valorem. There were also a large number of exemptions. A system of tax credit for taxes paid on inputs called Modified Value Added Tax or MODVAT was in force but excluded important sectors such as textiles and petroleum. Duty credit was also not available on excise duty paid on capital goods at the time of investment. The Budget presented in February 1994 has greatly simplified the system, with the bulk of the taxes shifted to an ad valorem basis and the number of exemptions greatly reduced. The coverage of the tax credit for taxes paid on inputs has been extended to include petroleum and capital goods. The number of excise duty rates has been reduced from 21 to 10. A start has also been made in extending indirect taxation to a few services by imposing a 5% tax on telephone bills, premium payments for general insurance and stock brokers’ commissions. The longer term objective of the Government is to move to a Value Added Tax, but this is still a distant prospect since it involves integration of the taxes on production, which under the Constitution are levied by the Central Government, with taxes on sales which are levied by State Governments. These reforms in the tax system go a long way towards the objective of creating a system which avoids economic distortions, and ensures adequate buoyancy of revenues to support the task of fiscal consolidation. The changes in tax structure will have to be accompanied by major improvements in tax administration to realise the full potential of reforms in this sector. The Government has indicated that this is high on its agenda.
5. **Public Sector Policy**

Reform of the public sector is a critical element in structural adjustment programmes all over the world and is also included on India's reform agenda. However, this is an area where changes are being implemented slowly. India has adopted go slow and cautious approach towards this sector. It is true that the reforms started with the main aliment in the public sector but at the same time there are so many public sectors which has been categorised as Maharatns, Navaratnas and Mini Navratnas on the basis of excellence of their performance and higher turnover. The closure of terminally ill public sector was the last resort. Outright privatisation the Government has initiated a limited process of disinvestment of Government equity in public sector companies, with Government retaining 51% of the equity and also management control. Govt has set out a target of Rs. 56,000 crore in this budget* (Finance bill 2014) which will be fetched thru the disinvestment in Public sector. The disinvestment helps provide noninflationary resources for the Government Budget, without adding to the fiscal deficit. This is reverse flow of money or unlocking of the funds. There was a time when govt was providing budgetary support to the public sector and now it is other was round.
Table 3.5 Year wise Receipts from Disinvestments of PSU

<table>
<thead>
<tr>
<th>Year</th>
<th>Disinvestment receipts</th>
</tr>
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<tbody>
<tr>
<td></td>
<td>Budgeted estimate</td>
</tr>
<tr>
<td>1991-92</td>
<td>2500</td>
</tr>
<tr>
<td>1992-93</td>
<td>2500</td>
</tr>
<tr>
<td>1994-95</td>
<td>3500</td>
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<td>1995-96</td>
<td>4000</td>
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<td>1996-97</td>
<td>5001</td>
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<tr>
<td>1997-98</td>
<td>4800</td>
</tr>
<tr>
<td>1998-99</td>
<td>9600</td>
</tr>
</tbody>
</table>

6. Financial Sector Reform:

Any reform process could not be complete without the perfect symphony of the financial system. There was a need of a financial sector reform which will enable the financial sector to mobilise savings and allocate them in a manner which supports the process of restructuring in the real economy. Several initiatives have been taken in these areas covering both the banking system and the capital markets. As far as banking system reform is concerned, the Government has announced a package of reforms to be implemented over a three year period based on the report of the Committee on the Financial System*16. The high reserve requirements applicable to banks in the form of the statutory liquidity ratio (SLR) and the cash reserve ratio
(CRR) were essentially designed to support Government borrowing at below market rates of interest and constituted a hidden tax on financial intermediation. The Government announced that these high reserve requirements will be progressively reduced. Parallel with the reduction in the requirements for compulsory investments by banks in Government securities, the interest rates on Government securities are increasingly market determined. Interest rate regulation in the banking system is also being reduced and rationalised. Earlier the Reserve Bank of India prescribed a number of different interest rates on deposits of different maturities and also a large number of prescribed lending rates for different sectors and classes of borrowers. Deposit rates for different maturities have now been freed subject only to a single ceiling. The proportion of deposits which banks can accept in the form of Certificates of Deposits, which are completely free from interest rate regulation, has been increased. On the lending side the number of prescribed interest rates for different types of borrowers has been reduced from six to three and it is proposed to move to an even simpler system with only one concessional rate and a single floor rate for all other loans. Prudential norms relating to income recognition, provisioning and capital adequacy applicable to banks, have been brought in line with Basle Committee standards. Combined with improved accounting practices and management information systems in the banks, this is expected to yield a much better picture of the true financial condition of the banks. This in turn will improve the quality of lending and generate pressures for greater efficiency among borrowing units. The absence of such pressures from the banking system in the past has been one of the reasons for pervasive inefficiency in many sectors of the economy. The new norms reveal that the nationalised banks, which account for about 90% of total deposits, have a much higher proportion of non-performing assets than was earlier supposed. Full provisioning for these assets will inevitably lead to substantial impairment of capital
and this means the nationalised banks will require extensive injection of fresh capital to meet the new capital adequacy norms. The Government has announced a programme of contributing fresh capital to the nationalised banks which involves a substantial burden on the Budget. This is unavoidable, reflecting the real cost of past banking inadequacies. However, in order to mitigate the impact on the Budget it is envisaged that the relatively stronger nationalised banks with good balance sheets will mobilise additional capital from the market by issuing new equity to the public. This will dilute the present 100% Government ownership of these banks by bringing in new private shareholders though Government equity will remain at least 51%. It is expected that the induction of private shareholders will create an environment in which these banks will pay much greater attention to the commercial viability of their operations. The banking system is also being opened up to competition from new private banks and several new banking licenses have been granted. Branches of foreign banks have also been expanded to increase competition. All these policy changes will be supported by improved supervision by the Reserve Bank of India and strengthening of the management systems within the nationalised banks. The Government has also set up special Debt Recovery Tribunal to help facilitate recovery by banks from defaulting borrowers. The end result of these initiatives should be a much more efficient banking system which would support greater efficiency in the real sector. Parallel with efforts to reform the banking system the Government has also embarked on a major reform of the capital market. During the eighties the capital market grew remarkably in size, with a sharp increase in the volume of resources being raised by the corporate sector in the form of corporate debt and new equity. The size of the investing public also expanded considerably especially in the form of subscribers to mutual funds. This quantitative expansion was not however matched by necessary qualitative improvements. India’s stock exchanges have shown
considerable dynamism, but they remained inadequately regulated and suffered from lack of transparency in trading practices. Supervision was not up to the level required to ensure investor protection. Several important initiatives have been taken in the past two years to remedy these deficiencies and raise standards to those prevailing in countries with well functioning efficient capital markets. The requirement of Government permission for companies issuing capital, as well as the system of Government control over the pricing of new issues of equity by private companies, has been abolished with the repeal of the Capital Issues Control Act in May 1992. Firms are now free to issue capital and price new issues according to market conditions subject only to guidelines. The Securities and Exchange Board of India (SEBI) has been established as an independent statutory authority for regulating the stock exchanges and supervising the major players in the capital markets (brokers, underwriters, merchant bankers, mutual funds, etc). The focus is not on control and Government intervention but on establishing a framework of regulation to ensure transparency of trading practices, speedy settlement procedures, enforcement of prudential norms and full disclosure for investor protection. An important initiative taken as part of the reforms is the opening up of the capital market for portfolio investments. Indian companies have been allowed to access international capital markets by issuing equity abroad through the mechanism of Global Depository Receipts. Foreign institutional investors managing pension funds or other broad based institutional funds have been allowed to invest directly in the Indian capital markets. Favourable tax treatment has been granted to such investments to encourage capital inflows through these routes. These initiatives have come at a time when international fund managers are diversifying their portfolios by investing in "emerging capital markets" and India has benefited from this trend along with other developing countries. So gradually the control aspect in the Indian economy was
made thru appointment of different regulators not the micromanagement of the affairs by govt them self.

7. Reforms and the Agricultural Sector:

The real taste of reforms could down only with the appropriate reform in the agriculture sector, which could directly affect the 70% of our population living in rural areas. This calls for substantial investments in land and water management, supply of improved seeds, an effective system for delivery of rural credit and of course security of tenure. Many of these elements fall within the area of responsibility of State Governments. A disturbing feature of recent trends in the agricultural sector is that real investment in agriculture, both public and private, has been stagnant. There is need for substantial increase in public investment in agriculture and irrigation but this can only happen if resources available for investment with the State Governments can be increased. Unfortunately, investible resources with State Governments have been seriously eroded because of large increases in unproductive current expenditure and the heavy burden of losses on the provision of basic economic services in rural areas such as electric power and irrigation. The new fiscal regime not only makes agricultural exports more competitive at the new exchange rate, it also stimulates the growth of the agro-processing industry, with strong backward linkage to agriculture. Unrestricted movement of agricultural commodities both domestically (across States) and also for exports were allowed. All Central Government restrictions on domestic trade have been removed though some State Governments restrictions remain. Restrictions on agricultural exports have also been reduced significantly though not as yet fully eliminated. Some of the remaining restrictions, such as for example the restriction on exports of pulses and coarse grains are not really binding in practice but have been continued with an eye to avoiding any psychological pressure on prices.
The benefit of better banking system, improved insurance of crops will help this sectors to improve. Especially laxness regarding loan recovery, has greatly weakened the cooperative credit system and has also weakened rural lending by the commercial banking system. The financial sector reforms currently underway will address this problem through a combination of rationalisation of interest rates to reduce the disincentive of unviable lending rates which discourage rural lending, recapitalisation of banks and restructuring of cooperative credit institutions.

8. **Labour Market Reforms**: A commonly heard complaint from domestic as well as foreign investors is that labour markets are unduly rigid. Indian labour laws provide a high degree of protection to labour with retrenchment of labour and closure of an unviable unit requiring prior permission of the State Government for units employing more than 100 workers. But reforms of various such labour acts demanded by the industries to grow, would have taken the country by storms due to its political sensitivity. Under the existing law, such permission is not always granted and this leads to the complaint that Indian firms lack the flexibility they need to adapt to changed economic circumstances. This requirement of retrenchments of labour and permission to close down the business was not only required by the new entrants but also by the existing players to remain competitive. A first step in this direction has been taken by the creation of a National Renewal Fund which will finance compensation payments to labour rendered redundant in the course of public sector restructuring and closure of unviable units. It will also finance retraining programmes to help redeploy such labour. Financing for the fund is being provided from the Central Budget and resources have been obtained from multilateral and bilateral aid donors in support of this activity.
India’s heterogeneity and unity in diversity through a stable democratic system must be appreciated. It should be noted that India neither have full federal structure nor a unified monolithic political structure. In a country like India, with more than one billion people, some 16 officially recognized major languages, and vast ethnic and religious diversities, poses major governance challenges. India has achieved remarkable success in holding the country together. India had governed its economy through a policy regime of centralized planning accompanied by an extensive regulatory framework for more than forty years before it launched economic reforms in 1991. In addition to the above it must be simultaneously extended from central to state governments and below to the third tier of local governments. It has, therefore, not been easy to change the mindsets of policy makers (especially at the lower levels of bureaucracy) and of other beneficiaries of the entrenched regime and such a three tier spread. Building a political consensus on economic reforms across the various political parties with their vastly different ideologies has been a very difficult process. This has been especially true under coalition governments but also even when a single party has held a majority. Consensus building and reform implementation is complicated further when the central government and the states are in the hands of different parties (or coalitions). The rapidly increasing frequency of elections at the central and state levels during the post-1990 period of economic reforms has led the incumbent governments and the contesting opposition parties to resort to ‘vote-bank’ politics or ‘competitive populism’. The vested interests of groups such as trade unions, producers with licenses and holding monopoly interests, and bureaucrats have often scuttled or delayed further market-based economic reforms. These factors explain well India’s ‘stalled’ reforms in certain areas directly hurting vested interests of selected lobby groups. The growth of regional parties and their assumption of
power in many Indian states has further delayed the percolation of central-level economic reforms down to the state level.

**Economic scenario - Post New Economic policy ‘1991**:

The gradual implementation of reforms and balancing twin tough challenge of making the “Balance of payment” favourable and controlling socially and politically intolerable high level of inflation. Still India’s performance in the post economic reforms were simply great. It was caught the attention of the worldwide community for the gradualist approach against the external liberalization yet reaching to affirm level of getting economic growth.

Through prudent macro-economic stabilization policies including devolution of the rupee and other structural economic reforms the balance of payments crisis was clearly over by the end of March 1994. Foreign exchange reserves had risen to the more than adequate level of US $15.07 billion and the current account deficit as a percentage of GDP was nearly eliminated. Export growth rate at 20.0 percent in 1993-94 over the previous year was quite encouraging. Macro-economic stability has endured in the ten years of economic reforms to 2003. Foreign-exchange reserves peaked at US$70 billion at the end of March 2003 (and touched US$80 billion in June 2003) The current account ‘recorded a surplus—equivalent to 0.3 percent of GDP—in 200102’ *18. The cumulative FDI inflows from 1991 to September 2006 were Rs.1, 81,566 crores (US $ 43.29 billion). The sectors attracting highest FDI inflows are electrical equipments including computer software and electronics (18 per cent), service sector (13 per cent), telecommunications (10 per cent), transportation industry (nine per cent), etc. In the inflow of FDI, India had surpassed South Korea to become the fourth largest recipient. India controls at the present 45 per cent of the global outsourcing market with an estimated income of $ 50 billion. In respect of market capitalization (which takes into account the market value of a quoted company by
multiplying its current share price by the number of shares in issue), India is in the fourth position with $894 billion after the US ($17,000 billion), Japan ($4800 billion) and China ($1000). India is expected to soon cross the trillion dollar mark. As per the Forbes list for 2007, the number of billionaires of India has risen to 40 (from 36 last year) more than those of Japan (24), China (17), France (14) and Italy (14) this year. The wealth research firm report, there are 14800 multi billionairs in India as on 31st Dec. 2014 compared to 11,700 of Russia, 10,300 of Brazil, 9,800 of Canada, 8200 of France. The highest no in the world is for US with 1,83,500 and followed by China 26,600, Germany 25,400 and UK 21,700. *19.

The economy responded very well to the reforms in the first half of the 1990s. In fact, India’s growth performance in the first three years after the start of reform programme was better than almost all developing countries that have gone through such a reform process. The economy was inching towards the attainment of a 7 per cent growth path in the mid 1990s, significantly higher than the 5.5 per cent achieved in the 1980s and the 3 to 3.5 per cent in the previous three decades along with the favorable balance of payments and the sustained reduction in inflation; the significant reduction in poverty to 23-26 percent; the substantial expansion of trade from about 12 to 13 per cent of GDP in the late 1980s to 22 to 23 per cent.

The concern area and the darker side of the economy was just not over. It was noticed that there was revenue surplus before 1970-71 but by 1980-81 there occurred a revenue deficit of Rs 2037 crores. The revenue deficit shot up to Rs18,562 crores in 1990-91 on account of rising non-developmental expenditure which rose from Rs 9867 crores in 1980-81 to Rs 49,349 crores in 1990-91 or a five-fold increase within a decade. Economic reforms have not reserved the process. On the other hand, revenue deficit in 2000-2001 is estimated at Rs. 77,369 crores or a more than four-fold increase in a decade. Non-developmental expenditure also witnessed a more
than four-fold increase during the nineties. During 1980-81 to 2000-2001 while developmental expenditure increased ten-fold, non-developmental expenditure increased more than twenty one times. This forced the government to more borrowings. Market borrowings net of repayment mere only Rs 238 crores in 1970-71; these increased to Rs 2679 crores in 1980-81 and further to Rs8001crores in 1990-91. The figure was Rs76,521 crores in 2000-2001 registering a nearly ten-fold increase in a decade. Higher borrowings led to higher interest payment which registered an eight-fold increase during the eighties and nearly five-fold increase in the nineties. Interest payment at Rs112,300 crores now takes away 69 per cent of the Centre's tax revenue. It is more than the total annual Plan expenditure of the Government. An idea of the debt and interest burden of the government can be had from the fact that during 2001-2002, while revenue receipts of the Central Government are slated at Rs 231,745 crores, interest and debt repayment is slated at Rs 238,272 crores. It is trumpeted that economic reforms have resulted in a decline in fiscal deficit from 6.6 per cent of GDP in 1990-91 to 4.7 per cent in 2001-2002 (BE). This has been achieved by non progressive approach with a percentage decline in the capital expenditure from 4.7 per cent of the GDP in 1991-92 to 2.6 per cent in 2001-2002. As capital expenditure also includes repayment of loans, so what is significant is only that part of the capital expenditure which goes to improve the productive base which is known as capital outlay. Capital outlay in 1999-2000 was Rs 24,400 crores out of a total expenditure of Rs283,882 crores. The decline in aggregate public investment from eight per cent in the early nineties to less than seven per cent in the later period has impacted on the growth rate of GDP which has marginally declined in recent years. The overall growth rate of GDP declined from 7.3 per cent in the 1995-96 to 5.3 per cent in 2000-01. What is more disconcerting is the decline in agriculture and allied sectors where the growth rate has declined from seven per cent
in 1998-99 to 0.9 per cent in 2000-2001 despite normal monsoon. Food grains production is stationary around 200 million tonnes which has resulted in declining per capita production. Per capita per day availability of foodgrains was lower by 40 grains in 2000-2001 than what it was in 1990-91.

Table 3.6 Selected Macroeconomic Indicators 1989-2003

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<tbody>
<tr>
<td><strong>A. Growth of GDP (%)</strong></td>
<td>5.6</td>
<td>6.3</td>
<td>6.1</td>
<td>4.4</td>
<td>5.6</td>
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<td><strong>B. GDP Growth by Sectors (%)</strong></td>
<td></td>
<td></td>
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<tr>
<td>i. Agriculture &amp; Allied</td>
<td>2.7</td>
<td>4.9</td>
<td>0.3</td>
<td>-0.4</td>
<td>5.7</td>
<td>-3.1</td>
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<td>ii. Industry, of Which Manufacturing</td>
<td>6.7</td>
<td>8.3</td>
<td>4.0</td>
<td>7.3</td>
<td>3.4</td>
<td>6.1</td>
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<tr>
<td>iii. Services</td>
<td>6.7</td>
<td>6.0</td>
<td>10.1</td>
<td>5.6</td>
<td>6.8</td>
<td>7.1</td>
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<tr>
<td><strong>C. Inflation Rate (WPI Index (%))</strong></td>
<td>9.1</td>
<td>10.4</td>
<td>4.8</td>
<td>2.5</td>
<td>5.2</td>
<td>3.2</td>
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<td><strong>D. Current Account Balance as % of GDP</strong></td>
<td>-3.1</td>
<td>-1.1</td>
<td>-0.5</td>
<td>-0.5</td>
<td>na</td>
<td>na</td>
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<td><strong>E. Foreign Exchange Reserves (US $ Bn.)</strong></td>
<td>3.37</td>
<td>19.65</td>
<td>35.06</td>
<td>39.55</td>
<td>51.05</td>
<td>69.89</td>
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<td><strong>F. Exchange Rates (Rs/US $)</strong></td>
<td>10.6</td>
<td>31.4</td>
<td>43.33</td>
<td>45.51</td>
<td>47.69</td>
<td>48.44</td>
</tr>
<tr>
<td><strong>G. Rate of Growth of</strong></td>
<td></td>
<td></td>
<td></td>
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<td></td>
<td></td>
</tr>
<tr>
<td>i. Exports (%)</td>
<td>18.9</td>
<td>18.4</td>
<td>10.8</td>
<td>21.0</td>
<td>-1.6</td>
<td>26.4</td>
</tr>
<tr>
<td>ii. Imports (%)</td>
<td>8.8</td>
<td>22.9</td>
<td>17.2</td>
<td>1.7</td>
<td>1.7</td>
<td>14.5</td>
</tr>
<tr>
<td>iii. Exports as % of GDP</td>
<td>6.4</td>
<td>9.6</td>
<td>9.1</td>
<td>10.4</td>
<td>9.9</td>
<td>na</td>
</tr>
<tr>
<td>iv. Imports as % of GDP</td>
<td>9.3</td>
<td>10.5</td>
<td>12.4</td>
<td>11.8</td>
<td>11.6</td>
<td>na</td>
</tr>
<tr>
<td><strong>H. Fiscal Deficit as % of GDP</strong></td>
<td>7.9</td>
<td>4.7</td>
<td>5.4</td>
<td>5.6</td>
<td>5.9</td>
<td>5.5</td>
</tr>
<tr>
<td><strong>I. Revenue Deficit as % of GDP</strong></td>
<td>2.6</td>
<td>3.1</td>
<td>3.5</td>
<td>4.1</td>
<td>4.2</td>
<td>3.9</td>
</tr>
<tr>
<td><strong>J. Saving Ratio as % of GDP</strong></td>
<td>22.3</td>
<td>24.9</td>
<td>24.1</td>
<td>23.4</td>
<td>24.0</td>
<td>na</td>
</tr>
<tr>
<td><strong>K. Investment as % of GDP</strong></td>
<td>24.9</td>
<td>25.4</td>
<td>25.2</td>
<td>24.0</td>
<td>23.7</td>
<td>na</td>
</tr>
</tbody>
</table>


**Foreign Trade and International scenario:**

Foreign exchange reserves had risen to the more than adequate level of USFood stocks with the Food Corporation of India, held to ensure national food security, peaked at sixty million tons (compared to the required twenty million tons). It took longer to control inflation but this led to relatively more enduring results (excluding the impact of externally determined fuel prices). Since 2002, the country has enjoyed a low interest-rate regime. The Rupee had started appreciating against US$ after April 2003. These Performance indicators have helped to provide an ‘enabling environment
India has also increasingly integrated its economy with the global economy. Along with its fairly good growth rate (which, however, is far below the potential growth rate of eight percent targeted by India’s Tenth Five-Year Plan), India has been successful in reducing poverty. The poverty ratio (that is, people below the poverty line as a percentage of the population) as estimated by the Planning Commission at the national level came down from 36 percent in 1993-94 to 26.1 percent in 1999-2000. The poverty ratio during this period declined both in rural areas and in urban areas. There is little doubt that poverty in India has been reduced during the last decade. The Planning Commission has set a poverty ratio target of 19.3 percent by the end of the Tenth Plan period (to March 2007). An important indicator of gains from economic reforms, reflecting the attractiveness of India as an investment destination, is shown by the increasing inflows of both FDI and Foreign Institutional Investment (FII) into India. Inflows of both FDI and FII into India has increased in the decade to 2002. On average, according to the Ministry of Finance’s Economic Survey, India has

**ECONOMIC INDICATORS of REFORM**

After half a century of inward-orientation, the share of India’s trade as a proportion of GDP rose from 13.1 percent in 1990 to 20.3 percent in 2000. By Indian standards this is an impressive performance. India’s economy has also successfully moved into a higher trajectory of growth and displayed strong dynamism in selected sectors. This encouraging performance brightens the prospects for stepping up India’s growth rate and improving the competitive edge in the years to come through further appropriate economic reforms. The average annual growth rate of 5.8 percent achieved by the
Indian economy during the years of economic reforms since 1992 is encouraging. Currently, after China, India is among the fastest-growing countries in Asia. Since the annual rate of population growth has slowed significantly to nearly 1.8 percent during the 1990s, per capita income has been growing at a healthier real rate of four percent per annum. India’s growing middle class of more than 350 million people, with a reasonably affluent standard of living, provides a huge market for foreign corporations, especially since April 2003, when all quantitative restrictions on imports were lifted. The ratio of trade to GDP increased from 13.1 percent in 1990 to 20.3 percent in 2000. The proportion of Gross Capital Inflows to GDP during the same period increased from 0.8 percent to 3.0 percent. Gross Foreign Direct Investment as a percentage of GDP (which was zero in 1990) rose to 0.6 percent in 2000. India has been attracting US$2.5 billion to US$3 billion and nearly US$4 billion in 200102 in FDI per annum mostly in various infrastructural sectors such as large power and telecommunication projects. India’s economy under the reforms has made rapid strides in selected industrial areas and knowledge- and skill-intensive services. These specific growth areas have experienced significant restructuring under more competitive conditions in the marketplace through mergers and acquisitions and technological and managerial innovations. This has led to the achievement of recognizable increases in international competitiveness in a number of sectors including auto components, telecommunications, software, pharmaceuticals, biotechnology, research and development, and professional services provided by scientists, technologists, doctors, nurses, teachers, management professionals and similar professions. The spillover effects of India’s increasing international competitiveness have helped in improving the rate of growth of export earnings. They have also directly benefited Indian consumers by making better quality, lower-priced goods available.
Areas of weakness:

The most notable weakness of the reform process has been in fiscal consolidation. Indian governments at both the central and state levels have failed miserably to reign in growing revenue deficits and reduce the overall fiscal deficit. The foundations for a sustainable high growth rate in any economy lie in maintaining fiscal discipline. This has not been adequately achieved by Indian policymakers. Excessive use of market borrowing to cover budget deficits has often put upward pressure on interest rates and pre-empted ('crowded out') borrowings by the private sector. The structure of revenue expenditure and political obstacles to any reduction of subsidies and downsizing the government at all levels have been primarily responsible for the lack of progress on fiscal reforms. The real issue in restructuring government finances is ‘right-sizing’ the government by adequately increasing government expenditure on infrastructure of both the hard and soft varieties, based upon growing resources. India’s record on social development expenditure has been poor considering Indian requirements and poor also in relation to many developing countries, including some of the least developed countries in Sub-Saharan Africa. The abysmally low ranking of India on the Human Development Indices computed by the United Nations bears testimony to this assertion.*20 .Dreze and Sen*21 remarked in 1995 that India’s social development indicators in 1991 (when reforms were launched) were lower than in several East and Southeast Asian countries three decades ago.35 India must bridge this social development gap by significantly increasing its public expenditure on social services if it wishes to achieve the targeted annual growth rate of eight percent set by the country’s Tenth Plan. As Ahluwalia has remarked, larger investment in the social sectors is ‘necessary not only because social development is an end in itself, but also as a precondition of accelerating growth’.22 The massive shift required in the pattern of government expenditure in India in favour of social sectors and infrastructure can
only be carried out through structural fiscal reforms. The Fiscal Responsibility and Budget Management (FRBM) Act (2003) provides for complete elimination of the revenue deficit by 31 March 2008. This Act is, therefore, a step in the right direction. Despite ‘dilution’ of the original draft bill, it is important legislation because it sets the condition that the government can run a fiscal deficit only if borrowings are made to finance investments which will enhance productive capacity’. Another major weakness of the Indian economic reforms is the economy’s experience with ‘jobless growth’ in the post-1990 period. Rigid labour laws relating to retrenchments have constricted growth in the organized manufacturing sector. As a labour surplus country, there already exists a huge backlog of both ‘open’ and ‘disguised’ unemployment. With a growing population, every year adds to the labour force. Economic reforms have accelerated growth but failed to generate adequate employment. For example, the rural unemployment rate, after declining to 5.61 percent in 1993-94, rose to 7.21 percent in 1999-2000 as did the All-India (urban plus rural) rate of unemployment. If this disturbing trend is allowed to continue, it will breed social unrest and add to the ranks of terrorists and other anti-social elements in the country. Last but not least, the reforms have led to growing disparities between richer and poorer states (more and less developed, especially in terms of infrastructure) within India. Although the all-India average annual growth rate in the reform era has been on the order of 5.8 percent.

**Sectoral Distribution of Indian Economy**

India’s economy has been traditionally agriculture dependent. But with the ongoing liberalization the dependence of population on the agriculture has declined very low in comparison to the share of primary sector i.e. agriculture to the GDP. Currently 59% of the population is engaged in the primary sector and contributing just 22% of GDP.
This shows the reduction in the rural earning and increased chances to rural indebtedness.

![Chart 3/7](image)

But there has been hardly any change in the pattern in the year 2001 to 2010. The effect of the liberalization got faded away.

![Chart 3/8](image)

With the change in the govt at centre there was no formal announcement on the new economic policy, but there are already major shift in the economic policy visible. Some of the major initiative is Pradhanmantri Jan Dhan Yojna, Expenditure...
Management Commission, “Make in India”, Scrapping of Planning commission and installation of NITI AYOG, Increase in the share holding of the foreign participant in Insurance sector, Opening of licencing process to new banks, Clean Ganga project, Direct benefit transfer scheme etc.

**Expenditure Management Commission:**

The constitution of Expenditure Management Commission was announced in the Budget Speech of 2014 – 15 by Finance Minister of India Shri Arun Jaitley. The Commission will be a recommendation body with the primary responsibility of suggesting major expenditure reforms that will enable the government to reduce and manage its fiscal deficit at more sustainable levels. It will be a five-member body composed of the former Reserve Bank Of India Governor Bimal Jalan who has been appointed to Head the Commission, former Finance Secretary Sumit Bose, former RBI Governor Dr. Subir Gokarn and two other members. It has been observed that despite the legal mandate intended to lower the Fiscal Deficit to 3% within the stipulated time (Fiscal Responsibility and Budgetary Management Act, 2003), India has witnessed a high fiscal deficit year after year. Subsidies, public services under pricing and arbitrary allocation of scarce natural resources are a few examples of government activities that have led to high expenditures, with no revenue to fund them. Sluggish growth in the Indian economy during the recent past years has not helped the situation. All of the above have led to the creation of the Expenditure Management Commission that is needed to look into the various aspects of expenditure reforms to be undertaken by the Government. The newly constituted commission is mandated to recommend the overhaul to reduce the three major subsidies (i.e. Food, Fertilizer and Oil). It will examine the expenditure reforms in detail and recommend that they be undertaken by the government to bring down the
fiscal deficit. Once the fiscal deficit is under control, it is predicted that the Indian economy with strengthen at the macro level and that persistent inflation will ease.

Make in India:

It is a major initiative by the government. The future lies in manufacturing.

Domestic manufacturing is the central tenet for achieving faster, more inclusive and sustainable growth. Manufacturing has large stakes involved, not just because the sector employs 30% of the non-agricultural workforce in India, but also because of its contribution to the overall economy. Only a sharp increase in the Indian manufacturing sector workforce will increase overall income levels of the country which in turn will ensure inclusive and sustainable growth. If India is to regain and sustain overall GDP growth of 9% per annum, it is essential that manufacturing sector should grow at more than 12%. But 75% of India’s working population is educated only to middle school or below. This staggering figure of approximately 600 million people is not even equipped to benefit from the opportunities in the flourishing service sector. It is only the labour intensive manufacturing sector that has the potential to generate employment in adequate numbers to absorb the larger labour pool. Indian manufacturing sector currently contributes close to 15% of GDP which is almost half when compared to “factory of the world” China, whereas service sector contributes almost 60% to GDP. This huge mismatch in terms of contribution to GDP makes it
imperative for India to focus on manufacturing and bring it close to 25% over next decade.

<table>
<thead>
<tr>
<th>Contribution to GDP (%)</th>
<th>2008-09</th>
<th>2009-10</th>
<th>2010-11</th>
<th>2011-12</th>
<th>2012-13</th>
<th>2013-14</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture, forestry &amp; fishing</td>
<td>15.77%</td>
<td>14.64%</td>
<td>14.59%</td>
<td>14.37%</td>
<td>13.95%</td>
<td>13.94%</td>
</tr>
</tbody>
</table>

**Industry**

<table>
<thead>
<tr>
<th>Mining &amp; quarrying</th>
<th>2.36%</th>
<th>2.3%</th>
<th>2.25%</th>
<th>2.11%</th>
<th>1.98%</th>
<th>1.86%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Manufacturing</td>
<td>15.78%</td>
<td>16.17%</td>
<td>16.17%</td>
<td>16.28%</td>
<td>15.76%</td>
<td>14.94%</td>
</tr>
</tbody>
</table>


But Indian economy cannot generate such huge financial resource either thru the private sector or thru the govt sector. The Challenge is to keep the capital expenditure low and at the same time ensure the growth in the Indian economy. The programme “Make In India” is one of the answer to this.

**Prdhan Mantri Jan Dhan Yojna:**

The scheme has been started with a target to provide 'universal access to banking facilities' starting with "Basic Banking Accounts" with overdraft facility of Rs.5000 after six months and RuPay Debit card with inbuilt accident insurance cover of Rs. 1 lakh and RuPay Kisan Card. In next phase, micro insurance & pension etc. will also be added.
Provisions of the scheme:

1. Account holders will be provided zero-balance bank account with RuPay debit card, in addition to accidental insurance cover of Rs 1 lakh.

2. Those who open accounts by January 26, 2015 over and above the 1 lakh accident, they will be given life insurance cover of Rs 30,000.

3. After Six months of opening of the bank account, holders can avail 5,000 ₹ overdraft from the bank.

4. With the introduction of new technology introduced by National Payments Corporation of India (NPCI), a person can transfer funds, check balance through a normal phone which was earlier limited only to smart phones so far.

5. Mobile banking for the poor would be available through National Unified USSD Platform (NUUP) for which all banks and mobile companies have come together.

<table>
<thead>
<tr>
<th>S.N.</th>
<th>Public Sector Bank</th>
<th>Regional Rural Bank</th>
<th>Private Bank</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Rural (in lakhs)</td>
<td>Urban (in lakhs)</td>
<td>Total (in lakhs)</td>
</tr>
<tr>
<td>1</td>
<td>479.5</td>
<td>405.1</td>
<td>884.76</td>
</tr>
<tr>
<td>2</td>
<td>167.0</td>
<td>29.56</td>
<td>196.58</td>
</tr>
<tr>
<td>3</td>
<td>18.66</td>
<td>16.42</td>
<td>38.08</td>
</tr>
<tr>
<td></td>
<td>665.2</td>
<td>451.1</td>
<td>1119.4</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>No of accounts (in lakhs)</th>
<th>No of RuPay Debit card (in lakhs)</th>
<th>Balance in accounts (in lakhs)</th>
<th>No of accounts with zero balance (in lakhs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>479.5</td>
<td>801.9</td>
<td>687477.33</td>
<td>635.9</td>
</tr>
<tr>
<td>2</td>
<td>167.0</td>
<td>111.97</td>
<td>137598.95</td>
<td>147.95</td>
</tr>
<tr>
<td>3</td>
<td>18.66</td>
<td>26.88</td>
<td>50932.99</td>
<td>23.12</td>
</tr>
</tbody>
</table>

Chart 3/9

**NITI Aayog:**

India has undergone a paradigm shift over the past six decades - politically, economically, socially, technologically as well as demographically. The role of Government in national development has seen a parallel evolution. Keeping with
these changing times, the Government of India has decided to set up **NITI Aayog** *(National Institution for Transforming India)*, in place of the erstwhile Planning Commission, as a means to better serve the needs and aspirations of the people of India.

This changing reality and growing mismatch has been recognized for years now; with experts, including many from within the erstwhile Planning Commission, recommending appropriate changes: The 8th Five Year Plan document - the very first after the liberalisation of 1991 - itself categorically stated that, as the role of Government was reviewed and restructured, the role and functions of the Planning Commission too needed to be rethought. The Planning Commission needed to be reformed to keep up with changing trends; letting go of old practices and beliefs whose relevance had been lost, and adopting new ones based on the past experiences of India as well as other nations.

The Standing Committee on Finance of the 15th Lok Sabha observed in its 35th Report on Demand for Grants (2011-12) that the Planning Commission "has to come to grips with the emerging social realities to re-invent itself to make itself more relevant and effective for aligning the planning process with economic reforms and its consequences, particularly for the poor".

Former Prime Minister and noted economist, **Dr. Manmohan Singh** - in his farewell address to the Commission in April 2014 - also urged reflection on "what the role of the Planning Commission needs to be in this new world. Are we still using tools and approaches which were designed for a different era? What additional roles should the Planning Commission play and what capacities does it need to build to ensure that it continues to be relevant to the growth process?"

The new institution will be a catalyst to the developmental process; nurturing an overall enabling environment, through a holistic approach to development going
beyond the limited sphere of the Public Sector and Government of India. This will be built on the foundations of:

An **empowered** role of States as equal partners in national development; operationalizing the principle of Cooperative Federalism.

A **knowledge hub** of internal as well as external resources; serving as a repository of good governance best practices, and a Think Tank offering domain knowledge as well as strategic expertise to all levels of government.

A **collaborative** platform facilitating Implementation; by monitoring progress, plugging gaps and bringing together the various Ministries at the Centre and in States, in the joint pursuit of developmental goals.

**Direct Benefit Transfer Scheme**:

This scheme is a preemptive exercise to passing on the benefit of subsidy directly to the end user without involving any intermediaries. The DBTL or PAHAL is the first step in that direction. This scheme has already added more than 10 crore beneficiary and it is largest scheme of the world for such a huge transfer of funds. This was first launched on 1st Jan 2013 covering 20 district for a trial. The talk is already on to transfer the benefit of fertilizer, food and all such welfare scheme directly to the accounts of the beneficiaries.

Thus the process of Liberalization, Privitization and Globalization which came into the full steam with the launch of New Economic Policy 1991 is picking up the pace even after change in guards at the centre. The compulsive privatization has taken a new avatar and the new schemes are being launched without announcement of yet another NEW Economic Policy by the govt of different political party at the centre. The schemes announced in recent past and the Budget 2015 is an extension to the same philosophy of growth.
Books and References:


*12. Ruddar Dut, K.P.M. Sundharam, n.1 , p.172


*15 Samuel Masilamani, Economic Reforms and Trade Unions in India, Friedrich Ebert Stiftung, 1995, p.49

*16 Narasimham Committee report on banking reforms


*19 The Times of India, dated 2nd April 2015


*22 M S Ahluwalia, op.cit., p.74.

*23C Rangarajan, ‘Focus on Revenue Deficit’, Business Line (New Delhi), June 10, 2003, p.4
Chapter – 4

India and Liberalization

Liberalisation of the financial sector has been at the forefront of development policy as the influence of the groundbreaking studies by *24* McKinnon (1973) and Shaw (1973) has spread. However the results for the countries have been mixed. In a country like India the rapid economic development is the need and it may be achieved only with the meaningful contribution of financial sector. According to *25* Fanelli and Medhora (1998):

i) although there is an increase in the credit supply after liberalization, the result of financial deepening is rather modest

ii) there have been open financial crises a few years after financial liberalisation was adopted

iii) some interventionist countries like Korea have achieved impressive levels of financial deepening without significant liberalisation.

In view of these points, it is interesting to make a study of the Indian financial sector comparing Indian performance with other developing countries which have adopted financial liberalisation policy. In India, like in many other economies, there is a wide network of institutions, instruments and markets indicating widening and deepening of the Indian financial system and we have already noted some of the major developments in the financial sector.
First we examine the current Indian scenario on different parameters and compare the same with other developed, developing and less developed countries. Each of the parameter has a bearing on the growth and vice versa.

Chart 4 / 1

*India’s share in World GDP in purchasing power parity (PPP) terms*

Source: IMF, World Economic Outlook

Chart 4 / 2: Percentage of people above 15 years of age operating a Saving/Checking account at a formal institution

Source: Demirguc-Kunt & Klapper, 2012
It is very important to understand the international dynamics and growth parameters. The scholar would be focusing on the comparison of economy of BRICS countries and the immediate neighbourhood Pakistan to understand the pace and the direction of our economy. While the focus will on the performance of the three key sectors viz. Banks, Insurance and Mutual fund but the other economic indicators which has a bearing to financial sector will also be examined to the extend as required for the current study. There are two important economic forum where India has taken a lead role. These forum are SAARC and BRICS. The SAARC forum has more of a political overtone as the other member country except Pakistan has very small economy has no significance in international scenario. On the other hand BRICS is an Important economic forum which is getting stronger after every meet. Recent announcement of establishment of BRICS bank could be a first step towards opening a million avenues for the growth of all members countries.

BRICS is the acronym for an association of five major emerging national economies: Brazil, Russia, India, China and South Africa. The grouping was originally known as "BRIC" before the inclusion of South Africa in 2010. The BRICS members are all developing or newly industrialised countries, but they are
distinguished by their large, fast-growing economies and significant influence on regional and global affairs; all five are G-20 members. Since 2010, the BRICS nations have met annually at formal summits. Russia currently holds the chair of the BRICS group, and will host the group's seventh summit in July 2015.

As of 2014, the five BRICS countries represent almost 3 billion people, or approximately 40% of the world population. The five nations have a combined nominal GDP of US$16.039 trillion, equivalent to approximately 20% of the gross world product, and an estimated US$4 trillion in combined foreign reserves.

**Comparing China and Indian economy and liberalization:**

There are some striking similarities in the economic history of the two giant Asian economies both in the more distant and recent past. Both countries were marked at "independence" in the 1940s by centuries of cultural stability and economic stagnation -- the subtitle of my Hindu Equilibrium (on China see Elvin). The stagnation was in per capita income, so that with the relatively modest population growth of the past there was extensive growth (in Lloyd Reynolds felicitous phrase) but no obvious signs of intensive growth -- which leads to a secular increase in per capita income. The planning process of China started in 1953 with first five year plan 1953-1957, modelled after the planning system of Soviet Union, but later point of time in 1978 they ended the 5 years plan concept where as in India the planning process of 5 year started in 1950 and it continued till now until the formation of NITI AYOG (The outcome of NITI AYOG is in hypothetical state as of now) except for the two gaps of yearly plans. In 1978 China adopted to market oriented economy, after the end of Cultural Revolution of 1966-1976 which ended with a scarcity economy. Chinese mass, in general was very dissatisfied with the long que of essential commodities. There were four basic reasons which forced China to migrate to the market based
economy. The first reason of change was the end of Cultural revolution and death of it propagate. The second reason of the change was the believe that many economic planners had learned from experience that a planning system was difficult to manage and economically inefficient. There could be difference in scale of inefficiency as believed by diff officials but the fact remained same. Third, rapid economic growth and development that took place in the more market-oriented neighbouring economies served as examples that a market economy can perform better. The neighbouring economies included Hong Kong, Taiwan, South Korea and Singapore. The contrasts in the economic performance between North and South Korea, between East and West Germany, and between Eastern and Western Europe reinforced this point. Fourth, for the reasons stated above the Chinese people desired a market oriented reform and would support it. The Chinese people had also suffered through the economic consequences of central planning, including the shortage of consumer goods, the limited variety and the lack of improved quality. There was a similar compulsive situation before India also in 1991 when there was crisis on balance of payment and the inflation was going through the roof. But the planners in India, again took the gradualist approach and the outcome of the same is visible in terms of the difference in GDP growth between India and China (See Chart)

There is vast difference in the ethnic compositions of the two countries. Whereas India has been a multi-ethnic society par excellence for millennia, China has been ethnically homogenous to a remarkable degree. Secondly, whereas political instability has been the norm in India, China has shown a remarkable political unity under centralized imperial rule for millennia. The main cultural and political differences were: the decentralized form of social control as embodied in the Indian caste system and regionally fragmentation. It can be compared with the more centralized social control in an absolutist state -- in a relatively integrated national market of China which has
remained united politically from Sung to modern times with only relatively brief periods of disruption between regimes.

A comparison of the relative performance of the two giant Asian economies is beset by statistical problems relating to estimates of Chinese GDP and population. By contrast Indian national income figures and population data are much more secure. The problems with the Chinese data which have sadly been used even by reputable international organizations like the World Bank -- can be readily highlighted by looking at the implications of the World Bank estimates of per capita GNP and its growth rate between 1965-1990 in India and China. According to the World Bank (1992, World Development Indicators, Table 1) the average rate of growth of per capita income was 5.8% for China and 1.9% for India over this period. The level of per capita income in 1990 was $370 for China and $350 for India. These figures imply that per capita incomes in China in 1965 could only have been 41% of India's. As Srinivasan*26 rightly comments:

No knowledgeable analyst of the two countries would subscribe to this relative value of China's GNP per capita in 1965! A plausible explanation for these paradoxical figures is that the figure of $370 in 1990 as China's per capita GNP reflects the consideration that a more realistic figure might soon make China ineligible for loans from IDA, the soft loan affiliate of the World Bank. Nor has the scholarly discussion reached any measure of agreement (see *Rawski, Ma and Garnaut, Kumar)*27 For the base period, 1950, the most plausible inference is Kumar's: "The per capita income of both India and China was very low in 1949 and given the margin of error, it is not worth arguing about which country was the poorer. There were similarly many anomalies in the whole econometric and demographic reporting or at least the data which the outside world has. There is serious misreporting in the administrative pricing structure, population, growth of population due to various social
problems also. The figures given in the census were misreported due to the ‘govt one child policy’ and may be for the reason of taking soft loan from the international institutions.

The theory of financial development and economic growth states that financial development, which is reflected by changes in the scale and structure of financial agencies and financial markets, can accelerate the liquidity of financial resources among various sectors of social production and subsequently promote economic growth through specific financial mechanisms and functions. China’s financial system is also in the process of reform. The main financial reforms and developments lie in three aspects: (1) improving the ownership structure of commercial banks and
broadening the scope of credit; (2) gradually establishing and improving the capital market to meet demands for financing and transactions; (3) establishing and developing the insurance market and enhancing its supporting function for economic growth. With the deepening of economic transformation and financial reform, China’s economy has achieved rapid growth. China’s financial markets have also developed very quickly. It is reported that from 1998 to 2010, the growth rate of outputs of China’s primary, secondary, and tertiary industries were 274 percent, 486 percent, and 663 percent, respectively. Meanwhile, the growth rates of the total balance of bank loans, the total market value of listed companies, and total premium income were 612 percent, 1,234 percent, and 1,093 percent, respectively. Does financial development promote the growth of three industries in China? Knowing the answer to this question will be theoretically and realistically important for China’s government to guide the adjustments of industrial structure and then achieve balanced and sustainable economic or industrial growth. Before economic reform, the People’s Bank was a mono-bank that had branches to accept deposits from the public. Its other functions were to issue currency and to extend loans to state enterprises according to the need specified and approved by the planning authority. It had no authority to decide on these loans. Commercial banks did not exist in the sense of being able to extend credits to enterprises according to the criterion of profitability. In 1983 the People’s Bank was nominally transformed into a central bank. Specialized banks, including the Industrial and Commercial Bank of China, Agricultural Bank of China and the People’s Construction Bank of China, were established and given some autonomy in the extension of credits in the early 1980’s in the same way that state industrial enterprises were given autonomy to make production decisions. This led to the rapid increase in the supply of currency (since the central bank had to honour the loans extended by the specialized banks) in 1984 by 50% and an inflation
rate of 8.8% by the overall retail price index in 1985. Reforms of the banking system to serve a market economy (as the Central Committee of the Chinese Communist Party declared China’s economy to be a socialist market economy in October 1992) progressed gradually in the late 1980’s and early 1990’s. Banking reform is one important example to demonstrate the rule that institutions cannot be changed by legislation alone. Besides the banking system, other financial institutions were changed. In 1981 the government formed the China International Trust and Investment Corporation (CITIC) to attract foreign capital. Similar investment trusts under the sponsorship of provincial governments followed. Stock markets in Shanghai and Shenzhen were established in the early 1990s. As pensions will be provided under a new social security system, pension funds will become an important source for savings and investment. The domestic insurance business, after being suspended for over twenty years, was reopened. Foreign insurance companies have been allowed to operate in China. The financial sector can be expected to expand further as foreign companies enter under the provisions of the WTO.
Per Capita GDP for China and India

Source: Earth Policy Institute

Life insurance penetration, 2010
% of total premium to GDP

Drivers of China’s life market:
- Emerging mass affluent segment
- Urbanization
- Aging population
- Rising awareness of protection and long-term saving

Source: Swiss Re Sigma World Insurance Report, 2011
A population of more than 1.3 billion, and a GDP growth rate of 8%, China’s insurance industry represents a huge market. American insurance companies have spent millions of dollars over several decades lobbying the U. S. government for licenses in China. As one part of China’s economic reforms, China’s government started permitting limited foreign access to the emerging insurance market in 1992 with AIG’s entry into Shanghai. However, various criteria required for approval to operate within China, special requirements for a business license from local governments, the slow pace of comprehensive insurance legislation, and incidences of protectionism, all hampered the pace of entry of foreign insurance companies. Even for those fortunate entrants, strict restrictions on the geographic scope of operations, the insurance products that could be issued, and the selection of partners all slowed their further development. The combination of three factors, the vast market potential, the strict limitations on entry, and slow approval of permission to
operate, led to insurance becoming one of the most heated points of contention during China’s WTO entrance negotiations. In the negotiations leading to the U.S.-China Bilateral WTO Agreement of November, 1999, insurance played an important role. The specific agreements regarding insurance were signed. The important points were (+ Briefing on the Clinton Administration Agenda for the WTO) Investment: China agreed to allow 50 percent ownership for life insurance. Life insurers may now choose their own joint venture partners. For non-life, China will allow branching or 51% ownership on accession and form wholly owned subsidiaries in 2 years. Reinsurance is completely open upon accession (100 percent, no restrictions). While the United States agreed to China’s request to limit foreign equity participation in life insurance to 50%, China agreed to significantly accelerate the elimination of geographic restrictions the percentage of equity participation in the first few years. This increased the pace of Chinese insurance industry it continued till 2008 when the growth in the insurance market became flat. As of Indian context the cap on the foreign shareholding which was 26% in 2001 was relaxed to 49% in 2015 and this ceiling is applicable in all the insurance formats. The result and outcome of the same is yet to be visible.

Comparison Pakistan and Indian economy and liberalization:

There are a number of examples in history where two countries that share the same fate and trajectory for a while suddenly start to diverge in their economic fortunes. A persistent difference in the growth rates of the two countries – i.e. a difference in long-run growth – translates into a huge difference in GDP per capita within a generation or two. Berkeley’s Brad Delong provides a number of such historical comparisons: North vs South Korea, China vs Taiwan (until the 80s), Cambodia vs Thailand,
Georgia vs Turkey, Cuba vs Mexico, and so on. Each pair of countries had similar “initial conditions” and yet something clicked in one country but not the other. The result was that within a few decades, the successful high-growth country was on average *eight times* richer than its twin counter-part! This is how important long-run growth is. A country that fails to trigger what is necessary for long-run growth traps itself in the cycle of poverty.

India and Pakistan are a natural pair for long-run comparison. The two countries share a common colonial history and started off with a largely similar nature of economic activity. How does the long run trajectory of these two countries compare? Pakistan has maintained a respectable annual average growth rate of GDP over 5% during 1950-51 to 2004-05. However there has been violent fluctuation in the pattern in the various intervening years. The growth in manufacturing sector has shown a respectable figure (Table 4/10) but the growth in the service sector has been far from encouraging.
We use real exports per capita as our metric of comparison because exports are much better measured than other components of GDP in India and Pakistan. Exports

<table>
<thead>
<tr>
<th>Year</th>
<th>Overall</th>
<th>Transport, Storage &amp; Communication</th>
<th>Wholesale and Retail</th>
<th>Finance and Insurance</th>
<th>Ownership of Dwelling</th>
<th>Public administration and Defence</th>
<th>Services *</th>
</tr>
</thead>
<tbody>
<tr>
<td>1960-61 to 1969-70</td>
<td>8</td>
<td>9.11</td>
<td>8.69</td>
<td>13.79</td>
<td>3.74</td>
<td>8.36</td>
<td>5.23</td>
</tr>
<tr>
<td>1970-71 to 1979-80</td>
<td>6.32</td>
<td>5.78</td>
<td>5.63</td>
<td>8.88</td>
<td>3.86</td>
<td>6.99</td>
<td>6.6</td>
</tr>
<tr>
<td>1980-61 to 1989-90</td>
<td>6.65</td>
<td>7.5</td>
<td>6.9</td>
<td>7.61</td>
<td>9.72</td>
<td>8.04</td>
<td>4.91</td>
</tr>
<tr>
<td>1990-91 to 1999-00</td>
<td>4.73</td>
<td>8.38</td>
<td>4.95</td>
<td>7.74</td>
<td>1.27</td>
<td>0.77</td>
<td>6.48</td>
</tr>
<tr>
<td>2001-02 to 2004-05</td>
<td>4.64</td>
<td>10.73</td>
<td>5.54</td>
<td>4.17</td>
<td>1.94</td>
<td>2.44</td>
<td>0.96</td>
</tr>
<tr>
<td>1960-61 to 2004-05</td>
<td>6.23</td>
<td>8.03</td>
<td>6.43</td>
<td>8.91</td>
<td>4.35</td>
<td>5.64</td>
<td>5.26</td>
</tr>
</tbody>
</table>
also provide a reflection of a country’s global interconnectedness. The graph below plots real exports per capita for India and Pakistan starting in 1980. We index the two lines to 100 in 1992 for ease of comparison.

Comparison of Exports of India and Pakistan.

Up until 1992, both India and Pakistan were on a similar trajectory with low growth in their exports per capita. However, the trajectories diverge strongly in 1992 with India’s export growth taking off while Pakistan continued to trudge along at mediocre pace. One can see the power of compounding when growth rates persistently differ. Within a span of just two decades, Indian exports per capita have grown to be almost six times those of Pakistan. What explains the persistent divergence between India and Pakistan since 1992? A natural candidate would be India’s economic liberalization that kicked off in 1992. However, an oft-overlooked fact is that Pakistan initiated economic liberalization earlier and with greater gusto than India. So something else
must be at work. The divergence between India and Pakistan has more to do with Pakistan’s failure to keep up with its peers as opposed to the growth being unique to India.

**Chart 4 / 11**  Growth Rates of GDP and Value Added in Major Sectors of the Economy (Decadal Averages)

<table>
<thead>
<tr>
<th>Period</th>
<th>GDP</th>
<th>Agriculture</th>
<th>Manufacturing</th>
<th>Services Sector</th>
</tr>
</thead>
<tbody>
<tr>
<td>1950s</td>
<td>3.11</td>
<td>1.76</td>
<td>7.73</td>
<td>3.61</td>
</tr>
<tr>
<td>1960s</td>
<td>6.80</td>
<td>5.10</td>
<td>9.90</td>
<td>6.70</td>
</tr>
<tr>
<td>1970s</td>
<td>4.80</td>
<td>2.40</td>
<td>5.50</td>
<td>6.30</td>
</tr>
<tr>
<td>1980s</td>
<td>6.50</td>
<td>5.40</td>
<td>8.20</td>
<td>6.70</td>
</tr>
<tr>
<td>1990s</td>
<td>4.60</td>
<td>4.40</td>
<td>4.80</td>
<td>4.60</td>
</tr>
<tr>
<td>2001-2005</td>
<td>5.00</td>
<td>3.38</td>
<td>7.03</td>
<td>5.74</td>
</tr>
</tbody>
</table>

Source: Pakistan (various issues) and Pakistan (1999).
Financial Sector Reforms in Pakistan:

The post nationalization phase of Indian banks before implementation of Narsimhan committee - I was almost similar to what Pakistan faced after the nationalization of banks in 1974 with much higher magnitude. Under this structure, the performance of banks is affected due to a variety of factors including political and bureaucratic interventions, excessive influence of trade unions in banking affairs, etc. Similarly, the imposition of restrictions on entry of private banks is considered to be the harshest type of controls on banking operations and supposed to be contributing more towards creation of an uncompetitive environment in banking industry. The empirical evidence also reveals that strict entry restrictions for new banks effectively shield the banks from competition [Deolalkar (1999); Joshi and Little (1997)]. High statutory requirements for banks, regulated interest rates, and directed credit programmes are also important restrictions/controls which can impact the efficiency of banks. Realising the inherent weaknesses in Pakistan’s financial system, a broad based programme of reforms was framed for the financial sector in early 1990s. The reform agenda included, among others, financial liberalisation and deregulation measures which are as follows: privatisation of NCBs, removal of restrictions on opening-up of private banks, phasing out of subsidised and mandatory credit schemes, removal of caps on deposit and lending rates of banks, abolishment of the system of credit ceiling, switching towards market based approach of credit distribution, lowering of statutory requirement for banks, etc. These measures were not implemented at any specific date or point of time. Rather, it took almost two decades on their full/partial implementation, depending upon the nature of reform. To facilitate the process of participation, Banks (Nationalisation) Act, 1974 was amended in 1990, which enabled the Government to sell all or any part of the share capital of the nationalised banks. In a subsequent amendment, the government was allowed to suspend the provisions of
the Banks (Nationalisation) Act, in cases where 26 percent shares of any nationalised bank were sold to the private sector. Furthermore, a bank would fall outside the ambit of the Banks (Nationalisation) Act, 1974 when 51 percent of the share capital was taken up by the private sector. There were five nationalised commercial banks which included National Bank of Pakistan (NBP), Muslim Commercial Bank (MCB), Allied Bank Limited (ABL), United Bank Limited (UBL), and Habib Bank Limited (HBL). Out of these banks, the shares of Muslim Commercial Bank were sold to the private sector in 1991. The shares of Allied Bank Limited were also disinvested and the management and control of the bank was handed over to the Employee Management Group. Despite the privatisation of MCB and ABL, the dominance of nationalised commercial banks (NCBs) continued by the end of 2000. The MCB was completely privatised in October 2002. The bidding for disinvestment of 51 percent share of HBL was held on 29th December 2003 and the management of the bank was transferred to Agha Khan Fund for Economic Development (AKFED) on 26th February, 2004. The bidding for disinvestment of 51 percent share of UBL was held on 5th September, 2003 and the management of the bank was transferred to consortium of Abu Dhabi Group and Bestway Group on 19th October, 2003. The National Bank of Pakistan has off loaded 23.2 percent shares through local stock exchanges. The remaining shares of NBP would be off-loaded after changes in the NBP Act. Despite the Privatisation Commission efforts, the remaining 49 percent* shares of UBL have not yet been sold.

With regard to removal of restriction on opening up of banks, the Banks (Nationalisation) Act of 1974 was amended in 1991, which allowed private sector to operate banking companies. In August 1991, ten new private banks were allowed to start their operations. Out of these, two banks did not begin their business activity. Subsequently, eleven new banks were sanctioned. As regards approval of licensing of banks, the Government had de facto right to approve the licensing of banks,
therefore, the Section 27 of the Banking Companies Ordinance was amended in 1997 to take the government out of the process of licensing of banks and make the Central Board of the SBP as the final decision-making authority in the matter.*28 The Bank of Punjab and the Bank of Khyber were owned by Punjab and NWFP provinces respectively and were scheduled with the SBP in September 1994 and became subject to the regulatory framework of the SBP. The financial liberalisation during 1990s resulted in mushroom growth of financial banks, thereby threatening not only the financial stability but also their very existence. As a consequence, the SBP initiated the process of consolidation of banks. Since 2000, the merger and acquisition of several banks have been completed while some other banks are going under the consolidation process. To give operational autonomy to the SBP, the State Bank of Pakistan Act 1956 and the Banking Companies Ordinance (BCO) were amended in 1991. Following the grant of autonomy in 1993, the SBP initiated a comprehensive plan for introduction of a market-based monetary policy. In this regard, various monetary management measures were initiated. The system of credit ceilings was abolished and replaced with credit-deposit ratio, which was also removed in 1994. The caps on banks’ lending rates were eliminated to pave the way for implementation of monetary policy indirectly through signals of liquidity and short-term interest rate changes. In line with market-based policy, various steps were taken which includes reduction in Government borrowing from the banking system, elimination of subsidised credit schemes, introduction of improved technology for market intervention, and further deepening and widening of the financial market. Further amendments in the Ordinances were approved in May 1997 which also converted into permanent law. Exchange and payments reforms were initiated in early 1990s to promote the bank intermediation, encouraging the foreign investment, facilitating the forex transactions and enhancing foreign trade. Major structural change
came with the introduction of multiple exchange rate system in July 1998, which was gradually unified and transformed to a free-floating exchange rate regime in July 2000. Restructuring of banking system was a difficult task. A number of state owned banks were downsized and restructured through golden handshake and branch closure programmes in later half of 1990s. To strengthen the capital base of some of the weak nationalised banks, the SBP provided equity for their respective rehabilitation plans that included reduction in workforce, rationalisation of branches, controls on expenditures, transparent lending policies, and intensification of loan recovery effort. Banking supervision was suffering from various problems before the introduction of banking sector reforms of 1990s. The role of SBP, which had the main responsibility to supervise the banking system, was marginalised as it faced inadequacy of banking supervision capacity. With the grant of autonomy to the SBP in 1993, abolition of the PBC, and changes in the BCO, the SBP devised a strategy to consolidate banking supervisory functions. It also issued separate Prudential Regulations for commercial banks, SMEs, agriculture, microfinance, and infrastructure. Further, loan recovery process was further streamlined by issuing clear guidelines for loan classification and requiring banks to submit regular reports on recoveries. The Insurance industry in Pakistan is in very nascent stage. In 2013, 7 life insurance members including State Life posted growth of almost 15% and reached Rs 101 billion worth of premium income in 2013. Between the 7 life insurers, the IAP represents almost 100% of life premium generated in Pakistan. On the other-hand, 28 Non-life member companies grew by a sedate 9% and achieved premium income of Rs 49 billion representing almost 86% market share. PRCL the only reinsurer amongst our members grew by 10%. The insurance penetration just reached 0.88% as on the close od 2013 FY. *(The Insurance Association of Pakistan
(IAP), annual report, 2014). The below mentioned table show the status of insurance in 2000 and even in 3013 there is no substantial improvement in the status.

<table>
<thead>
<tr>
<th>Countries</th>
<th>Total</th>
<th>Non-Life</th>
<th>Life</th>
</tr>
</thead>
<tbody>
<tr>
<td>USA</td>
<td>8.8</td>
<td>4.3</td>
<td>4.5</td>
</tr>
<tr>
<td>Brazil</td>
<td>2.1</td>
<td>1.8</td>
<td>0.4</td>
</tr>
<tr>
<td>Mexico</td>
<td>1.7</td>
<td>0.9</td>
<td>0.9</td>
</tr>
<tr>
<td>UK</td>
<td>15.8</td>
<td>3.1</td>
<td>12.7</td>
</tr>
<tr>
<td>China</td>
<td>1.8</td>
<td>0.7</td>
<td>1.1</td>
</tr>
<tr>
<td>India</td>
<td>2.3</td>
<td>0.6</td>
<td>1.8</td>
</tr>
<tr>
<td>Malaysia</td>
<td>3.7</td>
<td>1.6</td>
<td>2.1</td>
</tr>
<tr>
<td>Indonesia</td>
<td>1.2</td>
<td>0.6</td>
<td>0.5</td>
</tr>
<tr>
<td>Nigeria</td>
<td>0.7</td>
<td>0.5</td>
<td>0.1</td>
</tr>
<tr>
<td>Kenya</td>
<td>2.6</td>
<td>1.9</td>
<td>0.7</td>
</tr>
<tr>
<td>Pakistan*</td>
<td>0.5</td>
<td>0.3</td>
<td>0.2</td>
</tr>
</tbody>
</table>

Source: IRDA India Year Book 2001  
* - Life insurance data from balance sheets of life insurance companies. Non life data from Insurance Association of Pakistan

Comparison Brazilian and Indian economy and liberalization:

The Brazilian economy has gone through a significant transformation during the past decade. Following nearly a quarter-century with very little growth in per capita GDP, there was a major change beginning in 2004. GDP per person (adjusted for inflation) grew at a rate of 2.5 percent annually from 2003-2014, more than three times faster than the 0.8 percent annual growth of the prior government (1995-2002). This growth rate was achieved in spite of the 2008-09 global financial crisis, which pushed Brazil into recession in 2009; and this comparison includes the slowdown of the past few years.
During the “lost decade” of the 1980s and through 1994, Brazil experienced an unenviable combination of near-stagnation in real income per capita, very high inflation (peaking in 1993 at an annual rate close to 2,500 percent) fed by pervasive indexation, and recurring balance of payments crises. The poverty rate hovered above 40 percent and the inequality (Gini) coefficient around 60 during most of that period (Table 4 / 14). A series of attempts at macroeconomic stabilization faltered because of poor design (heavy reliance on heterodox price controls) and/or weak implementation. Political instability also characterized most of the early years following the end of the military dictatorship in 1985.
### Brazil: Main Economic and Social Indicator

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Real GDP growth rate</td>
<td>1.9</td>
<td>1.3</td>
<td>2.5</td>
<td>2.1</td>
<td>4.2</td>
<td>-0.3</td>
<td>7.5</td>
<td>2.7</td>
</tr>
<tr>
<td>Real GDP per capita growth rate</td>
<td>0.9</td>
<td>-0.2</td>
<td>0.7</td>
<td>0.4</td>
<td>3.0</td>
<td>-2.0</td>
<td>6.0</td>
<td>na</td>
</tr>
<tr>
<td>Consumer price inflation</td>
<td>431.7</td>
<td>1321.3</td>
<td>9.7</td>
<td>8.8</td>
<td>6.1</td>
<td>4.3</td>
<td>5.9</td>
<td>6.5</td>
</tr>
<tr>
<td>Unemployment rate</td>
<td>na</td>
<td>7.0</td>
<td>8.1</td>
<td>10.1</td>
<td>9.4</td>
<td>9.1</td>
<td>6.7</td>
<td>6.0</td>
</tr>
<tr>
<td>Current account balance (as percentage of GDP)</td>
<td>-2.0</td>
<td>0.0</td>
<td>-2.7</td>
<td>-3.5</td>
<td>0.6</td>
<td>-1.5</td>
<td>-2.2</td>
<td>-2.1</td>
</tr>
<tr>
<td>International reserves (e.o.p., US $ billion)</td>
<td>9.7</td>
<td>38.8</td>
<td>44.6</td>
<td>37.8</td>
<td>19.8</td>
<td>238</td>
<td>352</td>
<td>1</td>
</tr>
<tr>
<td>External debt (e.o.p., as percentage of GDP)</td>
<td>27.8</td>
<td>26.3</td>
<td>26.5</td>
<td>41.8</td>
<td>12.1</td>
<td>12.6</td>
<td>12.3</td>
<td>11.9</td>
</tr>
<tr>
<td>Poverty rate</td>
<td>41.2</td>
<td>42.3</td>
<td>34.8</td>
<td>34.9</td>
<td>29.0</td>
<td>22.6</td>
<td>21.4</td>
<td>na</td>
</tr>
<tr>
<td>Gini's coefficient</td>
<td>0.6</td>
<td>0.6</td>
<td>0.6</td>
<td>0.6</td>
<td>0.6</td>
<td>0.6</td>
<td>0.5</td>
<td></td>
</tr>
</tbody>
</table>

**Source:** Database of the Central Bank (www.beb.gov.br) and IPEA (www.ipea.gov.br)

Brazil emerged quickly and strongly from the 2008-09 crises, with the economy growing by some 7.5 percent in 2010; inflation, albeit above target, remains manageable and has started to decelerate. The traditionally tight external constraints seem to have all but disappeared: the current account deficit, at the equivalent of about 2 percent of GDP, is moderate; foreign direct investment (FDI) has soared in the last couple of years, more than covering the current account deficit; and international reserves are at an all-time high. The discovery of large deep-sea oil reserves holds the promise of turning this historically oil-importing country into a large net energy exporter. On the social front, poverty has been substantially reduced from the high levels of the early 1990s, and the distribution of income has improved significantly; a whole new lower-middle class is enjoying unprecedented access to consumer durables and credit. Access to basic education and health services is now nearly universal, and crime rates are falling. Not surprisingly, Brazil is
an increasingly assertive and influential voice in international political and economic fora.

**Financial sector reforms in Brazil:**

Brazil has a dynamic banking sector that represents about 8% of GDP (insurance services included). Following the trend dating to the second half of 2004, banking institutions have continued targeting their investments to credit operations. The volume of financial system credit increased from 24% of GDP in 2004 to 48% in December 2011. By 2011, there were about 21,278 branches, representing an increase of 15% versus the position of 2007. This was an expected outcome in view of the technological advancements introduced by the need felt by institutions to cut costs, what triggered a deep rationalization of operating procedures by financial institutions. Another explanation for the lower pace of growth experienced by bank branches is the reorganization processes implemented by large network banks in the wake of acquisitions that took place in recent years. The high and volatile inflation of the 1980s and early 1990s constituted a major obstacle to the development of deep financial markets in Brazil. Domestic banks, sheltered from competition by restrictions on foreign banks’ entry, concentrated their activities on short-term lending and purchases of Treasury bills at high real interest rates. The large public sector banks (federal and some state-owned ones) were the sole providers of limited longer-term financing for investments. The successful disinflation brought about by the Plano Real, while creating the necessary preconditions for an eventual development of more modern and sound financial markets, also deprived the banks of a source of easy profits and exposed underlying weaknesses in many of them. As a result, the mid-1990s saw a number of actual or threatened bank failures, which required decisive government intervention. This centred on two programs (McQuerry, 2011):
• A program for private banks (PROER), involving: i) liquidity provision for banks in difficulty but assessed to be ultimately solvent; ii) financial support for the acquisition of failing but salvageable banks by stronger ones, and for an orderly unwinding of clearly insolvent ones; iii) the creation of a deposit guarantee fund; and iv) a strengthening of the Central Bank’s powers of supervision and bank resolution; and •

A program for state-owned banks (PROES), many of which were in serious financial difficulties, having been used by the states to finance their own ballooning deficits and politically sensitive private sector projects. The PROES mainly focused on closing or privatizing these banks, with a view to hardening the budget constraint on the states, following the comprehensive restructuring of their debt mentioned above.

These programs entailed a substantial fiscal cost, estimated at several percentages points of GDP (Fishlow, 2011), but they set the foundations for a sounder development of the financial system in their wake. Other reforms also contributed importantly over the last decade or so:

• Liberalizing restrictions to entry by foreign banks;

• Further strengthening bank regulation and supervision by the Central Bank, ensuring compliance with high prudenti

al requirements;

• Strengthening the regulation of non-bank financial intermediaries and of the stock exchanges;

• Modernizing the financing of housing; and

• Improving the legislation regulating the realization of collateral for nonperforming loans and bankruptcy procedures.

These reforms undoubtedly contributed to a significant deepening of financial intermediation (without bubbles) during most of the past decade. The financial system proved very resilient to the shock of the global crisis of 2008-09. Nevertheless, the system remains dominated by relatively few large private and public banks; directed
credits continue to play a large role, especially in the longer-term segment of the market; and borrowing costs for both the public and the private sector, especially small and medium enterprises remain quite high in real terms, pointing to the need for further reforms in this area.

Brazil is the largest insurance market in Latin America and ranks 15th globally, according to the latest information from the Swiss Re survey. The Brazilian private insurance market remains proportionally small, despite the potential that exists for growth given the country’s large population and stable economy. Premiums were equivalent to a modest 3.1% of GDP in 2010. There is a considerable degree of vertical integration between insurers and banks, with many of the larger banks – for example, Banco Bradesco, Banco Itaú-Unibanco and Banco Santander – offering a full line of insurance services. Large, stand-alone insurers include Porto Seguro, Sul América and Brasilprev.

The poor development of the sector stems from the high inflation and chronic macroeconomic instability that characterized Brazil until the mid-1990s. Such conditions made it impossible for individuals to make long-term financial decisions or to have any confidence in those who might promise to provide for them. As inflation expectations have eased over the past several years, the insurance market has started to respond. Insurance premiums amounted to R$90.1 bn in 2010, almost 17.6% above the figure for the previous year, according to the regulatory agency for the sector, the Superintendency of Private Insurance (SUSEP). Life insurance (including health insurance plans) amounted to 58% of total insurance premiums in 2010. Automotive insurance amounted to 23%, and property insurance amounted to 9%.

Source: Deloitte Brazil Research (based on Central Bank of Brazil data) Banks in 2011 % of total assets 5 largest conglomerates 10 largest conglomerates 15 largest conglomerates 20 largest conglomerates Total (US$ 5.1 trillion)
The insurance industry has performed well since pension reform in 2004, primarily in the life and pension sectors and with products aimed at small companies and individuals. Notably, the sector has benefited from the continued growth of a new life insurance plan, known as VGBL (Vida Gerador de Benefício Livre). VGBL is a long-term savings product, similar to a 401(k) plan, but created for individual employees rather than employers. A VGBL pays out funds to policyholders while they are still alive and includes several incentives, such as annual dividend payments and the ability to direct how a policyholder’s funds should be invested.

Compared with regular pension plans, VGBL has a lower limit for monthly or annual contributions, and income tax is due only on capital gains at the time of withdrawal. The plan is attractive to taxpayers who already use their 12% deduction for social security payments on other types of social-security programmes and are not able to benefit from the tax discount provided for regular pension-plan contributions. VGBL premiums reached R$36.7 bn in 2010, a sharp increase from R$30.2 bn in 2009. VGBL policies amounted to 40.7% of total premiums in the insurance industry in 2010, according to SUSEP. According to the Organization for Economic Cooperation and Development (OECD), Brazil has the eighth largest pension fund system in the world, considering the total funds managed. The pension system has 337 closed supplementary pension fund entities, 2,815 pension plans, 3.2 million participants and beneficiaries and assets of approximately R$602.6 billion, according to the latest data consolidation made by PREVIC in December 2011.

Foreign participation – The few remaining restrictions on the entry of foreign companies to the insurance and reinsurance market are slowly being eliminated. Companies are free to enter the market in association with a Brazilian company already operating in the area, but to operate independently they need authorization from the government.
The government sold the state owned reinsurance company IRB-Brasil Resseguros and attracted the interest of major foreign companies, including Swiss Re, Munich Re, Transatlantic Re and Cologne Re. In addition to being a monopoly reinsurer, the company was also the reinsurance regulator. In a bid to open the sector to new companies, the government approved Supplementary Law nº 126/2007 in January 2007, which hands reinsurance regulation over to the National Council of Private Insurance (CNSP). SUSEP is responsible for sectoral supervision.

The new legislation allows three types of companies to begin operating in the reinsurance market in Brazil. “Local” reinsurers have registered offices in Brazil and are incorporated with the sole purpose of conducting reinsurance transactions. “Admitted” reinsurers have registered offices abroad and a registered representative office in Brazil. “Eventual” reinsurers are foreign reinsurance companies with registered offices abroad but without a representative office in Brazil. These firms must be registered with SUSEP to conduct reinsurance transactions in Brazil.
The growth of GDP of Bricks countries is a always a comparative analysis and measure of the liberalization of the participating countries. The chart shown below is a clear depiction of the same.
But the above comparison is not enough unless we compare the figures in absolute terms which is given below:
Conclusion: When we compare the three major developing economies which is Chinese, Brazilian and Indian we find three different scenario. In 1990 Brazilian economy was in better GDP per capita compared to India and China. Though like several economist the Chinese figure is a bit less thrust worthy. But still the fact remained the process of reforms has put all the three economy in three different level, While China adopted the process of manufacturing as vehicle of economic development and invited foreign participants to setup the manufacturing base, India adopted the development of service sector, mainly export of IT and soft skill. This is very much evident from the graph 4.2 which reflects the sectoral distribution of the income. Brazilian economy which was virtually in a severe debt trap could come out
of the and show the growth is commendable but the discovery of petrochemical has also paid a lucky role. A country which as importer of petroleum product became exporter. But at the same time the economy was also managed well. The sky rocketing inflation was brought to control without compromising the growth. The external debts was also managed well. This has happened with the massive liberalization of the financial industry whether it is China or Brazil. The whole of banking and insurance sector has been opened for the foreign participation without any cap on the equity share holding. Except the country’s central bank like Reserve Bank of India, the domestic government banks were largely privatised or management were handed over to private hands. The regulators of all the sectors in these countries were strengthened. Prudential norms were introduced and the BASEL II and BASEL III is getting introduced in phased manner. If we compare it with India we find that the insurance is yet to come out of the shackles. We are treating Life, non Life and Re insurance similarly. There is no social security compulsory contribution plan which should have been applicable on all. So basically there is not enough avenues for mobilisation of saving which could have done miracles which has been done in China who propelled the growth with 40% savings contribution and like Brazil which has world’s 8 rank pension fund market. India has high insurance penetration and low Insurance density which shows our ability to penetrate more as it shows the acceptability of saving but it has to given direction. If this happens then all the monies which was goings to the scams of hundreds and thousand of crores of Chit Fund would have not happened.
Books and References:

*24 McKinnon (1973) and Shaw (1973)

* 25 Fanelli and Medhora (1998):

Srinivasan*26


*28 Banking System Review, State Bank of Pakistan, 2006
Chapter 5

Financial Sector Reforms

India's financial sector is diversified and expanding rapidly. It comprises commercial banks, insurance companies, non-banking financial companies, cooperatives, pensions funds, mutual funds and other smaller financial entities. This subject of financial sector reforms has assumed added importance in view of the recent global financial crisis of unprecedented dimensions. In this context it is worth recalling as to what happened when East Asia faced a major financial crisis. Each major global financial crisis has its own initial triggering causes, but they all have similar underlying problems of economic greed and reckless risk-taking behaviour of major financial sector players. Therefore, questions remain as to whether our strategy for financial sector reforms needs to be reviewed in the light of what has happened in the major developed countries, which were all along being considered as role models for our financial sector reforms.*29

In this context it is significant to note that India has managed to escape with relatively small damage from the devastating impact these two financial crises have had on the rest of the world. It is widely accepted in India that economic development is facilitated by the growth and diversification of financial institutions and products. After the launch of reforms in the early 1990s, there have been significant changes in the landscape of our financial sector. The need for regulation in financial markets began to be emphasized in part as a reaction against the problems experienced in the Southern Cone countries of Latin America as a result of excessively enthusiastic financial liberalization in the late 1970s (Diaz-Alejandro, 1985). To this extent the liberalizing, and regulatory thrusts described above are somewhat contradictory, but
the apparent contradiction is easily reconciled. Proponents of greater regulation do not necessarily endorse all the direct controls criticized by adherents of the financial repression school. Their main point is that financial liberalization by itself will not achieve the desired results in the financial sector. It may be necessary to remove direct controls in many areas to achieve greater efficiency in financial intermediation but this must be accompanied by stronger regulation aimed at strengthening prudential norms, transparency, and supervision. This has been broadly the approach to financial reforms adopted in India and progress can therefore be evaluated in terms of progress achieved on each of these fronts. The need for stronger regulation is also required due to the perception that financial markets are different from goods markets in important respects and liberalization of such markets aimed at allowing market forces free play can lead to inferior outcomes. *30

**As per the views expressed by Mr. Montek S Ahulwalia “LIBERALIZATION AND REGULATION is PARALLEL NOT CONTRADICTORY THRUSTS ”**

Before examining the specific achievements of financial sector reforms in India, it is useful to reflect on the principles underlying these reforms and their congruence with international practice. Financial sector reforms all over the world have been driven by two apparently contradictory forces. The first is a thrust towards liberalization, which seeks to reduce, if not eliminate a number of direct controls over banks and other financial market participants. The second is a thrust in favour of stronger regulation of the financial sector. This dual approach is also evident in the reforms attempted in India and the background and rationale for it need to be well understood.
**Liberalization and reforms in insurance sector:**

Liberalization of the domestic financial market has been a common characteristic of a number of economies since late 60’s. This was particularly true in case of industrially advanced countries like Australia, Japan, UK, and France. However, this was not been confined to these industrially developed countries only. In recent years, many LDCs have taken macroeconomic reforms, which involve structural adjustment programme. Main concentration was towards the financial system, especially banking and insurance sectors, which typically either owned or controlled by the state itself. The developing country like India along with other semi-industrialized countries has opened up their financial sector *31.

The New Economic Policy (NEP) introduced in India in June 1991 by the then newly elected government and the process of liberalization of Indian financial sector is part of that new policy. The main thrust of reforms in the financial sector was the creation of efficient and stable financial institutions and markets. Reforms in the banking and non-banking sectors focused on creating a deregulated environment, strengthening the prudential norms and the supervisory system, changing the ownership pattern, and increasing competition. The main idea is globalization, privatization, deregulation and liberalization.*32

With the paradigm shift in the development strategy, the economy is increasingly opening up and there is a step forward towards market orientation. Consequently, some financial markets such as capital market, forex market and banking sector have reformed subject to various degrees of level. The insurance sector yet to receive the reform initiatives to get the benefit out of the global changes that occurred in the recent past. The Uruguay Round of GATT (now WTO) also advocated the removal of restrictions and non-tariff trade barriers to free flow of international services across
countries so that domestic market of LDCs (Less developed countries) improve its efficiency and competitiveness. It is against this backdrop that many countries have deregulated its insurance sector and countries, which already allowed private insurance business further deregulated their reinsurance business such as Brazil (1991) and Peru (1991).*33

**Need for reforms in insurance sectors required:**

No review of financial sector reforms in India can be complete without reference to the need for reforms in the insurance sector. India is one of only four countries — the other three being Cuba, North Korea, and Myanmar — where insurance till recently was a public sector monopoly. The rationale of liberalizing the banking system and encouraging competition among the three major participants viz. public sector banks, Indian private sector banks, and foreign banks, applies equally to insurance. There is a strong case for ending the public sector monopoly in insurance and opening it up to private sector participants subject to suitable prudential regulation. Cross-country evidence suggests that contractual savings institutions are an extremely important determinant of the aggregate rate of savings. Insurance and pension schemes are the most important form of contractual savings in this context. Their importance will increase in the years ahead as household savings capacity increases with rising per capita incomes, life expectancy increases, and as traditional family support systems, which are a substitute for insurance and pensions, are eroded. A competitive insurance industry providing a diversified set of insurance products to meet differing customer needs, can help increase savings in this situation and allocate them efficiently. The insurance and pensions industry typically has long-term liabilities which it seeks to match by investing in long-term secure assets. A healthy insurance is therefore an important source of long-term capital in domestic
currency which is especially for infrastructure financing. reforms in insurance, will therefore strengthen the capital market at the long-term end by adding new players in this segment of the market, giving it greater depth or liquidity.

It is relevant to ask why these developments are less likely if insurance remains a public sector monopoly. One reason is that the industry suffers from a relatively high requirement for mandatory investment in government securities. However this implies that it is the mandatory requirement and not the public sector monopoly which is the real constraint. The fact is that the insurance industry does not fully utilize even the flexibility; available at present for investment in corporate securities. This is principally because lack of competition in the insurance sector means there is no pressure to improve the return offered to the investor. Competition will increase the pressure to improve returns and push insurance companies to move out of government securities to seek higher returns in high quality corporate debt. Needless to say, the process would be greatly expedited if fiscal deficit is also reduced resulting in a fall in the interest rate on government securities. Reforms in insurance are therefore more likely to create a flow of finance for the corporate sector if we can simultaneously make progress in reducing fiscal deficit.

**Process and studies initiated for the reform:**

In India, the reforms in the insurance sector (Life and General) commenced with the setting up of the **Committee on Reforms on Insurance Sector** under the chairmanship of Dr. R.N.Malhotra, the ex-governor of RBI, by the GOI in April 1993 for examining the structure of insurance industry. The recommendations of the Committee was submitted in 1994 which was accepted in principle by the government and started implementing the recommendations since December 1999, thus heralding
an era of liberalization in the country’s insurance sector\(^4\). The setting up of Insurance Regulatory and Development Authority (IRDA) and opening up of Insurance Business (life and general) to foreign capital up to 26 per cent were the initial steps in this direction. It is widely acknowledged that the opening up of the insurance sector has been aimed at ushering in greater efficiency in the insurance business by maximising productivity and minimising transaction cost. Competition is believed to bring a wider choice of products at lower prices to the consumers, larger coverage of population, better customer service, superior information technology, higher returns to the policyholders, and so on. The main recommendations of Malhotra Committee is as under:

(a) **Private sector should be allowed to enter the insurance business:** The Committee had deliberated on the subject and the following issues weighed in favour of opening the industry to competition: Competition would lead to better customer service. It would improve the quality and price of insurance products. The entry of new players would lead to better penetration of the market. When other wings of the financial sector like banking, mutual funds, merchant banking, and non-banking financial sectors were exposed to competition, there was no reason to keep insurance insulated. Public view was converging towards competition in the insurance sector. As public sector insurance institutions had created a good pool of professional talent and marketing network, there was no fear of them being incapable of facing competition.

(b) **No composite Insurance Companies:** The Committee recommended that no single company should be allowed to transact both life and general insurance business. The Committee had recommended as life and general insurance are two different lines of business, and prudence demands that there should not be any mixing up of funds.
(c) **Number of new entrants to be controlled**: The Committee felt that this step was necessary to control the cropping up of small private sector companies and their wilting away during a financial crisis.

(d) **Minimum paid-up capital**: With a view to ensure that only companies with a good track record in their line of business apply for licenses to act as insurance companies, the Committee recommended a paid-up capital of Rs.100 crore for the new entrants. At the same time, the Committee felt that this requirement could be lowered in cases where the promoters are state level co-operative institutions.

(e) **Obligation to do business in rural areas and for weaker sections of the community**: This stipulation was introduced to ensure a level-playing ground for all insurance companies. New entrants may tend to concentrate on more lucrative business to the neglect of the common people and the rural areas. To avoid this, the Committee had recommended that both life and non-life companies should procure a prescribed percentage of business from these segments. (f) Selective entry to foreign companies: The Committee felt that permitting foreign insurance companies would be in the interest of the Indian economy, particularly in the context of globalization. It recommended that entry to foreign companies should be on a selective basis. Foreign companies entering India should be required to float an Indian company, preferably as a joint venture.

(g) **Technology upgradation**: The insurance has become an information-driven industry all over the world. This, in effect, means heavy dependence on IT and development of computer support systems. The industry has to develop software to improve effective customer service and claim management.

(h) **Pension Sector**: To popularize the contribution to individual pension funds by self-employed professionals, traders and workers in the unorganized sectors, the Committee recommended income tax concessions up to a prescribed limit for
contribution to individual pension schemes floated and managed by insurance
companies. The Committee cited the nature of tax concessions available on individual
contributions to the pension funds and concessions available to pension funds in the
UK; it suggested that substantial concessions should also be available for
contributions to pension funds in India, and this should cover schemes managed by
all the insurance companies as well.

(i) Privatization of LIC and GIC: The Committee felt that as a State-owned entity,
LIC suffered many operational constraints, and its flexibility and ability to respond to
changing situations was limited. Many of the constraints are due to the reason that, in
the eyes of law, LIC falls within the definition of 'State'. To overcome this situation,
LIC should be taken out of the definition of 'State'. To achieve this, the share of the
Government in the equity of LIC should be reduced to 50% or to 49% as the
Government had decided in the case of certain PSUs. To enable LIC to run as a
board managed company with a dominant shareholding by the Government, the
shareholding pattern has to change, and LIC has to be registered as a company
under the Indian Companies Act. As far as GIC is concerned, it was recommended
that GIC should cease to be a holding company of four of its subsidiaries, and should
act as an Indian Reinsurer under the Indian Insurance Act. It was further
recommended that the share capital of GIC should be raised to Rs.200 crore from its
present level of Rs.107.50 crore. Out of this, 50% of the equity should be held by the
Government and the rest by the Public at large, including employees of GIC. As far as
the four subsidiary companies are concerned, it was suggested that they should
function as independent companies run by a board. It was further proposed that the
equity capital of each of these companies should be raised to Rs.100 crore with a
50% holding by the Government and the rest by the public and the employees of the
respective companies.
(j) Establishement of an Insurance Regulator: While considering the implications of opening up the industry to competition, the Committee also examined the role of the Controller of Insurance, and the need for a regulatory body for the insurance sector. The Controller of Insurance was vested with wide powers under the Indian Insurance Act, 1938. With the progressive nationalization of the life and general insurance sectors, the powers of the Controller of Insurance were reduced as many of the functions were transferred to the nationalised companies themselves or, wherever necessary, the Government itself started exercising the powers directly. The Committee felt that this dispensation was flawed even in the context of a State monopoly and would have to change in a competitive environment. The Committee suggested restoring the office of the Controller of Insurance to its full statutory powers and segregating it from the Ministry of Finance. The Committee had also suggested setting up an Insurance Regulatory Authority as a multi-member body and as a highly professional and compact organisation with adequate IT support, similar to the Securities and Exchange Board of India (SEBI). With this in view, the Committee proposed the establishment of a powerful and autonomous regulatory body on the lines of SEBI. The Committee also further stated that the regulatory authority should have full functional autonomy and operational flexibility to discharge its functions in a free and fair manner (Narayanan, 2006). *34

A new committee was setup immediately after the publication of the Malhotra Committee Report, (called the Mukherjee Committee) was set up to make concrete plans for the requirements of the newly formed insurance companies. Recommendations of the Mukherjee Committee were never made public. (Banga, 2007). *35
Finally, IRDA act was passed by parliament after a lot of deliberation and opposition from the various political parties in the year 2009 and it came in to enactment in 2000 after the consent from the president of India. The era of LPG which started in 1991 gave the out come after long 9 years of deliberation and systematic approach of opening of various opinion makers and decision makers.

One side of Coin was LIC of India which appointed an external consultant named Booz, Allen and Hamilton to study the effect of Mahlotra committee, liberalization and suggest the ways of strategic transformation. The committee gave its recommendation on the issues and it was not clearly spelled that how and when the recommendations were accepted and implemented. But the fact remained that both new life insurance and general insurance companies and those owned by government namely LIC of India and Gic of India with its four subsidiaries are operating side by side under the same umbrella of IRDA.

**Liberalization and reforms in Banking sector:**

Unlike insurance sector where the reforms came very late into being, the banking sector has seen reforms in a very regular phase. The banking industry has passed thru many turbulent phase. In order to understand the reforms and we must understand present make up of banking sector in India and its past progress with historical perspective. In over five decades since dependence, banking system in India has passed through five distinct phase, viz.

1. Evolutionary Phase (prior to 1950)
2. Foundation phase (1950-1968)
(3) Expansion phase (1968-1984)
(4) Consolidation phase (1984-1990)
(5) Reformatory phase (since 1990)

EVOLUTION PHASE: (PRIOR TO 1950)

Enactment of the RBI Act 1935 gave birth to scheduled banks in India but some of the banks had already been established. Prominent among the scheduled banks is the Allahabad Bank, which was set up in 1865 with European management. The first bank which was established with Indian ownership and management was the Oudh Commercial Bank formed in 1881, followed by the Ajodhya Bank in 1884, the Punjab National Bank in 1894 and Nedungadi Bank in 1899. Thus, there were five Banks in existence in the 19th century. During the period 1901-1914, twelve more banks were established, prominent among which were the Bank of Baroda (1906), the Canara Bank (1906), the Indian Bank (1907), the Bank of India (1908) and the Central Bank of India (1911). Thus, the five big banks of today had come into being prior to the commencement of the First World War. In 1913, An important point to be noted here is that no commercial bank was established during the First World War, while as many as twenty scheduled banks came into existence after independence -- two in the public sector and one in the private sector. The United Bank of India was formed in 1950 by the merger of four existing. The number of scheduled banks rose to 81. Out of 81 Indian scheduled banks, as many as 23 were either liquidated or merged into or amalgamated with other scheduled banks in 1968, leaving 58 Indian schedule banks. It may be emphasized at this stage that banking system in India came to be recognized in the beginning of 20 century as powerful instrument to influence the pace and pattern of economic development of the county. The role of commercial banks in India remained confined to providing vehicle for the community's savings and attending to the credit needs of only certain selected and limited segments of the
economy. Bank's operations were influenced primarily by commercial principle and not by developmental factor. Regulation was still only being introduced and unhealthy practices in the banks were then more rules than exceptions. Failure of banks was common as governance in privately owned joint stock banks left much to be desired.

**FOUNDATION PHASE: 1948-1968**

In those initial days, the need of the hour was to reorganize and to consolidate the prevailing banking network keeping in view the requirements of the economy. The first step taken to that end was the enactment of the Banking Companies Act, 1949 followed by rapid industrial finance. Role played by banks was instrumental behind industrialization with the impetus given to both heavy and Small Scale Industries. Subsequently after the adoption of social control, banks started taking steps in extending credit to agriculture and small borrowers. Finally, on July 1969, 14 banks were nationalised with a view to extending credit to all segments of the economy and also to mitigate regional imbalances. Thus, the period of regulated growth from 1950 till bank nationalization witnessed a number of far-reaching changes in the banking system. The banking scenario prevalent in the country during the period 1948 to 1968 presented a strong focus on class banking on security rather than on purpose. The emphasis of the banking system during this period was on laying the foundation for a sound banking system in the country. Banking Regulating Act was passed in 1949 to conduct and control operations of the commercial banks in India. The banking sector which was catering to the needs of Govt and rich individual and businessmen during pre independence era was made accountable and responsible for entire private economy. The government took the view that loans extended by colonial banks were biased toward working capital for trade and large firms *23 During this period number of commercial banks declined remarkably. There were 566 banks as on December, 1951; of this, number scheduled banks was 92 and the remaining 474 were non-
scheduled banks. This number went down considerably to the level of 281 at the
close of the year 1968. The sharp decline in the number of banks was due to heavy
fall in the number of non-scheduled banks which touched an all time low level of 210.

**EXPANSION PHASE (1968-1984)**

The motto of bank nationalization was to make banking services reach the masses
that can be attributed as "first- banking revolution". Commercial banks acted as vital
instruments for this purpose by way of rapid branch expansion, deposits mobilization
and credit creation. Penetrating into rural areas and agenda for geographical
expansion in the form of branch expansion continued. The second dose of
nationalization of 6 more commercial banks on April 15, 1980 further widened the
phase of the public sector banks and therefore banks were to implement all the
government sponsored programmes and change their attitude in favour of social
banking, which was given the highest priority. This phase witnessed socialization of
banking in 1968. Commercial banks were viewed as agents of change and social
control on banks. However, inadequacy of social control soon became apparent
because all banks except the SBI and its seven associate banks were in the private
sector and could not be influenced to serve social interests. Therefore, banks were
nationalized (14 banks in 1969 and 6 banks in 1980) in order to control the heights of
the economy in conformity with national policy and objectives. The banks were
expected to perform at the direction of government and implement the poverty
alleviation and employment generating scheme. The motto was more as social
banking than the commercial banking. This period also witnessed the birth of
Regional Rural Bank (RRBS) in 1975 and NABARAD in 1982 which had priority
sector as their focus of activity. Although number of commercial banks declined from
281 in 1968 to 268 in 1984, number of scheduled banks shot up from 71 to 264 during
the corresponding period, number of non-scheduled banks having registered
perceptible decline from 210 to 4 during the period under reference. The rise in the number of scheduled banks was, as stated above, due to the emergence of RRBS. During the next fifteen years of bank’s nationalisation the no of branches were opened at break neck speed and addition of 50000 banks branches were made with almost three fourth were opened in rural and semi urban area. Indian banking system was transformed from class banking to mass banking. But the speed of growth became difficult to manage and inefficiency creped up into the system. The more and more business became parameter of good performance and the quality of business, better service standards, better loans etc was on the backburner. Ultimately bank’s portfolio was filled with low and poor quality and risky lending.

<table>
<thead>
<tr>
<th>Year</th>
<th>Total No. of Branches</th>
<th>Rural Branches</th>
<th>Semi-urban Branches</th>
</tr>
</thead>
<tbody>
<tr>
<td>1969</td>
<td>8262</td>
<td>1833</td>
<td>3342</td>
</tr>
<tr>
<td>1980</td>
<td>32419</td>
<td>15105</td>
<td>8122</td>
</tr>
<tr>
<td>1991</td>
<td>60,220</td>
<td>35206</td>
<td>11,344</td>
</tr>
</tbody>
</table>


Table 5.1. BRANCH EXPANSION SINCE 1969 TO 1991

CONSOLIDATION PHASE; (1985-1990)

Although number of schedule banks increased from 264 in 1984 to 276 in 1990, branch expansion of the banks slowed down. Hardly 7000 branches were set up during this period. For the first time, serious attention was paid to improving housekeeping, customer services, credit management, staff productivity and profitability of the banks and concrete steps were taken during this period to rationalize the rates of bank deposits and lending. Measures were initiated to reduce the structural constraints and tight and tough control regime the development. By this time about 90% of commercial banks were in the public sector and were closely regulated in all its facets. The result was that during this period, the banks ended up
consolidating their losses rather than the gains. A very interesting development that had taken place during 1960s was the liquidation of many smaller banks by amalgamation with bigger and stronger banks.

Table 5.2
PROGRESS OF COMMERCIAL BANKING IN INDIA: 1951-91

<table>
<thead>
<tr>
<th>Indicator/Year</th>
<th>1951</th>
<th>1969</th>
<th>1987</th>
<th>1991</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Number Commercial Banks</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(including AABs):</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(a) Scheduled banks</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(b) Non-scheduled banks</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2. Number of offices</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3. Total deposits of Scheduled banks</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(As. Crores)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4. Total Credit of Scheduled banks</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(As. Crores)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>


**Reformatory Phase (since 1990):**

Unlike insurance industry, where the reforms and modification was very few and had happened after very long gap, banking sector was given structural and path correction on a regular intervals. We have discussed some of those measures in the different phases of banking sector. But some of the correction were not small but it had changed the course of the banking sectors. These were path breaking and creation of new era.

**Process and Studies Initiated for the Reform:**

**Reason & Backdrop of Reforms:** While acting as financial intermediaries between the savers and investors, commercial banks render a yeomen service to the development of an economy. Deposit expansion, which is one of the parameters indicating the development of banking, contributed to the growth of the economy.
Nationalization of major banks in 1969 accompanied by massive branch expansion gave fillip to deposit mobilization. The total deposits which stood at Rs. 908 crore in 1951 increased to Rs. 4646 crore by 1969—an increase of a little more than 5 times. In the subsequent eight years till 1987, the deposits increased by Rs. 1,02,699 crore. They stood at Rs. 2,01,199 crore in 1991. Correspondingly, bank credit had also increased from Rs. 547 crore in 1951 to Rs. 3599 crore in 1969 and to Rs. 1,21,865 crore in 1991.

**TABLE 5.3**

**NET PROFITS OF SCHEDULED COMMERCIAL BANKS**

(Rs. Crore)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>State Bank group (8)</td>
<td>244</td>
<td>280</td>
</tr>
<tr>
<td>Nationalized banks (19)</td>
<td>559</td>
<td>(-3648)</td>
</tr>
<tr>
<td>Private Sector banks (30)</td>
<td>77</td>
<td>60</td>
</tr>
<tr>
<td>Foreign banks (40)</td>
<td>320</td>
<td>(-842)</td>
</tr>
</tbody>
</table>

*Source: Govt. of India, Economic Survey, 2002-03, p. 59.*

(A) DECLINE IN PRODUCTIVITY AND PROFITABILITY: Despite this commendable progress serious problems have emerged reflected in a decline in productivity and efficiency and erosion of the profitability of the banking sector. The squeeze on profitability has emanated both from the factors operating on the side of income and on the side of expenditure. It may be seen from the Table 5.3 that in the case of nationalized banks, other than State bank group, profitability was quite low during 1991-92 over 1992-93. During 1992-93 they posted huge losses to the tune of Rs. 3648 crore. In case of private sector banks too the net profits have declined from Rs. 77 crore in 1991-92 to Rs. 60 crore. In 1992-93. The Foreign banks too have
sustained losses in 1992-93. These losses in 1992-93 may be attributed mainly to the securities scam engineered by Harshad Mehta and provisions made for non-performing assets. Joshi and Little (1996) have reported that the average return on assets in the second half of the 1980s was only about 0.15 per cent, while capital and reserves averaged about 1.5 per cent of assets. Given that global accounting standards were not applied, even these indicators are likely to have exaggerated the banks’ true performance.

High NPAs: Further, it may be noted that the average Return on Assets in the second half of 1980s was about 0.15 per cent, an extraordinarily low figure when compared to the international standards. Reflecting low capitalization of Indian banks, Return on Equity covered around 9.5 per cent and capital and reserves averaged about 1.05 per cent of assets in sharp contrast to 4 to 6 per cent in other Asian countries. The capital base defined as the ratio of paid-up capital and reserves to deposits of PSBs at a slightly over 2.85 per cent in 1990-91 compared very poorly with global standards. Thus by 1991, the country erected an unprofitable, inefficient and financially unsound banking sector. The operational efficiency of banking system had been unsatisfactory in terms of low profitability, growing incidence of NPAs and relatively low capital base. Consequently, the financial health of banks deteriorated. Further, the customer service was poor, their work technology was outdated and they were unable to meet the challenges of a competitive environment. These developments have necessitated devising a reform agenda for the banking sector.

**NARASIMHAM COMMITTEE – I (FIRST GENERATION REFORMS):** To restore the financial health of commercial banks and to make their functioning efficient and profitable, the Government of India appointed a committee called 'The Committee on Financed System' under the chairmanship of Sri M. Narasimham, ex-Governor of Reserve Bank of India which made recommendations in November 1991. The
Committee laid down a blueprint of financial sector reforms, recognized that a vibrant and competitive financial system was central to the wide ranging structural reforms. These recommendations are a landmark in the evolution of banking system from a highly regulated to more market-oriented system. The reforms introduced since 1992-93 breathed a fresh air in the banking sector. Deregulation and liberalization encouraged banks to go in for innovative measures, develop business and earn profits. These reforms, the Narasimham Committee-I felt, will improve the solvency, health and efficiency of institutions. The measures were aimed at

(i) ensuring a degree of operational flexibility,

(ii) internal 'autonomy for public sector banks in their decision-making process, and

(iii) greater degree of professionalism in banking operations

The Reserve Bank of India grouped the first phase of reform measures into three main areas: Enabling measures, Strengthening measures and Institutional measures. In other way, they can also be classified into five different groups

(a) Liberalization measures,

(b) Prudential norms,

(c) Competition directed measures,

(d) Supportive measures, and

(e) Other measures.

(A) LIBERALIZATION MEASURES

Statutory Liquidity Ratio (SLR) /Cash Reserve Ratio (CRR): The SLR and CRR measures were originally designed to give the RBI two additional measures of credit control, besides protecting the interests of depositors. Under the SLR, commercial banks are required to maintain with the RBI minimum 25 per cent of their total net demand and time liabilities in the form of cash, gold and unencumbered eligible
securities (under the Banking Regulation Act, 1949). The RBI is  capital adequacy which have all been implemented.

(B) PRUDENTIAL NORMS

In April 1992, the RBI issued detailed guidelines on a phased introduction of prudential norms to ensure safety and soundness of banks and impart greater transparency and accounting operations. The main objective of prudential norms is the strengthening financial stability of banks. Inadequacy of capital is a serious cause for concern. Hence, as per Basle Committee norms, the RBI introduced capital: adequacy norms. It was prescribed that banks should achieve a minimum of 4 per cent capital adequacy ratio in relation to risk weighted assets by March 1993, of which Tier I capital should not be less than 2 per cent. The BIS standard of 8 per cent should be achieved over a period of three years, that is, by March 1996, For banks with international presence, it is necessary to reach the figure even earlier. Before arriving at the capital adequacy ratio of each bank, it is necessary that assets of banks should be evaluated on the basis of their realizable value. Those banks whose operations are profitable and which enjoy reputation in the markets are all over to approach capital market for enhancement of capital. In respect of others, the Government should meet the shortfall by direct subscription to capital by providing loan. As per the recommendations of the Narasimham Committee banks cannot recognize income (interest income on advances) on assets where income is not received within two quarters after it is past due. The committee recommended international norm of 90 days in phased manner by 2002. The assets are now classified on the basis of their performance into 4 categories:

(a) standard,

(b) sub-standard,
(c) doubtful, and
(d) loss assets.

Adequate provision is required to be made for bad and doubtful debts (substandard assets). Detailed instructions for provisioning have been laid down. The Committee recommended provisioning norms for nonperforming assets.

(C) COMPETITION DIRECTED MEASURES

Since 1969 no bank was allowed to be opened in India. That policy changed in January 1, 1993 when the RBI announced guidelines for opening of private sector banks public limited companies. The criteria for setting up of new banks in private sector were defined. The guidelines were neither too stringent which could have made these banks to start not it was so easy that any body could have opened a shop. Consequently after the issue of guidelines in 1993, 9 new banks set up in the private sector. Foreign banks have also been permitted to set-up subsidiaries, joint ventures or branches, Their number increased from 24 in 1991 to 42 in 2000 and their branch network increased from 140 to 185. Over the same period Indian Banks were also been permitted to rationalize their existing branches, spinning off business at other centers, opening of specialized branches, convert the existing non-urban rural branches into satellite offices. Banks have also been permitted to close down branches other than in rural areas. Banks attaining capital adequacy norms and prudential accounting standards can set-up new branches without the prior approval of RBI. Two recommendation of the Narasimham Committee was to abolish the system of branch licensing and allow foreign banks free entry.

(D) SUPPORTIVE MEASURES
Revised format for balance sheet and profit and loss account reflecting and actual health of scheduled banks were introduced from the accounting year 1991-92. There have also been changes in the institutional framework. The RBI evolved a risk-based supervision methodology with international best practices. New Board of Financial Supervision was set-up in the RBI to tighten up the supervision of banks. The system of external supervision has been revamped with the establishment in November 1994 of the Board of Financial Supervision with the operational support of the Department of Banking. In tune with international practices of supervision, a three-tier supervisory model comprising outside inspection, off-site monitoring and periodical external auditing based on CAMELS (Capital Adequacy, Asset quality, Management, Earnings, Liquidity and System controls) had been put in place. Special Recovery Tribunals are set-up to expedite loan recovery process. The Securitization and Reconstruction of Financial Assets and Enforcement of Security Interests (SARFAESI) Act, 2002 enabled the regulation of securitization of and reconstruction of financial assets and enforcement of security interests by secured creditors.

(E) OTHER MEASURES

The Banking Companies (Acquisition and Transfer of Undertaking) Act was amended with effect from July 1994 permitting public sector banks to raise capital up to 49 per cent from the public. There are number of other recommendations of the Narasimham Committee such as

1. Reduction in priority sector lendings

2. Appointment of special tribunals for speeding up the process of loan recoveries, and

3. Reorganization of the rural credit structure,
But these recommendations needed detailed examination as these recommendations had far-reaching implications both in terms of the structure of the financial system and also the financing required to implement them.

RECOMMENDATIONS OF NARASIMHAM COMMITTEE – I

The main recommendations of the Committee were :-

1. Reduction of Statutory Liquidity Ratio (SLR) to 25 percent over a period of five years

2. Progressive reduction in Cash Reserve Ratio (CRR)

3. Phasing out of directed credit programmes and redefinition of the priority sector

4. Deregulation of interest rates so as to reflect emerging market conditions

5. Stipulation of minimum capital adequacy ratio of percent to risk weighted assets by March 1993

6. Adoption of uniform accounting practices in regard to income recognition, asset classification and provisioning against bad and doubtful debts

7. Imparting transparency to bank balance sheets and making more disclosures

8. Setting up of special tribunals to speed up the process of recovery of loans

9. Setting up of Asset Reconstruction Funds (ARFs) to take over from banks a portion of their bad and doubtful advances at a discount

10. Restructuring of the banking system, so as to have 3 or 4 large banks, which could become international in character, 8 to 10 national banks and local banks confined to specific regions. Rural banks, including Regional Rural Banks (R.RBs), confined to rural areas.

11. Setting up one or more rural banking subsidiaries by Public Sector Banks

12. Permitting RRBs to engage in all types of banking business

13. Abolition of branch licensing
14. Liberalizing the policy with regard to allowing foreign banks to open offices in India.

15. Rationalisation of foreign operations of Indian banks

16. Giving freedom to individual banks to recruit officers

17. Inspection by supervisory authorities based essentially on the internal audit and inspection reports.

18. Ending duality of control over banking system by Banking Division and RBI

19. A separate authority for supervision of banks and financial institutions which would be a semi-autonomous body under RBI

20. Revised procedure for selection of Chief Executives and Directors of Boards of public sector banks

21. Obtaining resources from the market on competitive terms by DFIs

22. Speedy liberalization of capital market

23. Supervision of merchant banks, mutual funds, leasing companies etc., by a separate agency to be set up by RBI and enactment of a separate legislation providing appropriate legal framework for mutual funds and laying down prudential norms for these institutions, etc.

Several recommendations have been accepted and are being implemented in a phased manner. Among these are the reductions SLR/CRR, adoption of prudential norms for asset classification and provisions, introduction of capital adequacy norms, and deregulation of most of the interest rates, allowing entry to new entrants in private sector banking sector etc.

**IMPACT OF FIRST GENERATION REFORMS**

The visible impact of first generation reforms may be summarized as follows:
(i) The banking system is well diversified with the establishment of new private banks and about 20 new foreign banks after 1993. The entry of modern, professional private sector banks and foreign banks has enhanced competition. With the deregulation of interest rates both for advances as well as deposits, competition between different bank groups and between banks in the same group has become intense. What is more important is that apart from growth of banks and commercial banking, various other financial intermediaries like mutual funds, equipment leasing and hire purchase companies, housing finance companies etc., which are sponsored by banks cropped up.

(ii) Finance regulation through statutory pre-emption has been lowered while stepping up of the prudential regulations.

(iii) Steps have been taken to strengthen PSBs through increasing their autonomy, recapitalization, etc. Based on specified criteria nationalized banks were given: autonomy in the matters of creation, abolition, up-gradation of posts for their administrative officers up to the level of Deputy General Manager. Rs. 10,987.12 crore for capitalization funds were pumped into banks during 1993-95. This indicates the extent of capital erosion faced by the nationalized banks.

(iv) A set of micro-prudential measures have been stipulated with regard to capital adequacy, asset classification, provisioning, accounting rules, valuation norms, etc. CRAR (Per cent to the risk weighted assets) of banks stood at 8 per cent. The percentage of Net NPAS to net advances of PSBs has declined from 14.4 per cent in 1993-94 to 8.5 per cent by 1997-98. The prudential norms have been significantly contributed towards improvement in pre-sanction appraisal and post-sanction appraisal and control, the impact of
which is clearly seen in the decrease in fresh addition of performing accounts into the NPA category. As per RBI Report on Currency and Finance consequent upon prudential norms, the most visible structural change has been improvement in asset quality.

(v) Measures have been taken to broaden the ownership base of PSBs by allowing them to approach the capital market. The Government of India, in a major policy announcement, decided to reduce its stake in PSBs from 100 per cent to 51 per cent retaining, however, the policy parameters of PSBs. The Government proposes to reduce further its stake to 33 per cent. Moreover, there is a provision for foreign investments to the extent of 20 per cent. The net result of the dilution in ownership of PSBs is that these banks are becoming slowly joint sector banks. A number of PSBs like State Bank of India, Andhra Bank, Bank of Baroda, Canara Bank, Punjab National Bank have gone up for public issue since 1994.

(vi) Mergers and acquisitions have been taking place in the banking sector. In the past, due to the existence of a large number of small non-viable banks, the RBI encouraged larger of small banks with big banks. Now, market driven mergers between private banks are taking place. So, the consolidation of banks are taking place.

(vii) These measures led to the intense competition among banks. This drove to better customer service, better quality of product added with innovation and process engineering for improved profitability and efficiency. The reduction in interest rates resulted in the fall of interest income on advances. So, the banks had to look for enhancing fee-based income, to fill the gap in interest income. A new era new fee based income added to the balance sheet of all the banks. The banks have now become financial supermart giving various
financial service under one roof ranging from Selling of mutual funds, life insurance, credit card, facilitation in the issue of shares etc. These services necessitated more and more of technological upgradation.

(viii) There has been considerable improvement in profitability of the banking system. There has been improvement in key financial indicators of all bank groups during the period 1992-98. For example, the net profits of the scheduled commercial banks as a percentage of the total assets has been turned around from a negative figure of 1.0 per cent on average during 1992-93 and 1993-94 to a positive of 0.5 per cent during 1994-95 to 1997-98. Simply, net profits as a percentage of working funds which was 0.39 per cent in 1991-92 and (-)1.08 per cent in 1992-93 turned positive in 1994-95 and reached 0.81 per cent by 1997-98. In case of most of the public sector banks business per employee and profit per employee have shown improvement in the recent period. For eg. in 1991-92 the average profit per employee of PSBs was Rs. 1.58 crore, it became positive in 1996-97 at Rs. 0.35 crore It further improved to Rs, 0.59 crore by 1999-2000 and Rs. 1.63 crore in 2002-03. By 1997, almost all public sector banks achieved the minimum capital adequacy norms of 8 per cent. The gross and net NPAs of banking system as a percentage of advances have declined to 16 per cent and 8.2 per cent respectively by March 1998, In terms of percentage of total assets, gross and net non performing assets have declined to 7.0 per cent and 3.3 per cent respectively by March 1998.

But still there was need for considerable improvement. Our banks and other financial institutions were far from international standards in terms of deliverables. The efficiency of the capital deployment and returns were low. It was considered that the
banking industry needs continuous improvement and modifications. So the 2\textsuperscript{nd} Narasimhan committee was established, what was called 2\textsuperscript{nd} generation reforms.

**NARASIMHAM COMMITTEE-II (1998)(SECOND GENERATION REFORMS)**

The phased implementation of major recommendations of Narasimham Committee-I (1991) provided base for first generation reforms of the financial sector. The period 1992-97 witnessed laying of the foundations for reforms of the banking system. In fact, India withstood the crisis of 1997 (South-East Asia crisis) indicates the stability of the banking system. Against such a backdrop, the Report of the Narasimham Committee-II in 1998 provided the road map for the second-generation reform process. Two points are worth noting at this juncture. First, the financial sector reforms were undertaken in the early reform cycle, and secondly, the reforms in the financial sector were initiated in well structured, sequenced and phased manner with cautious and proper sequencing, mutually reinforcing measures; complementarily between reforms in the banking sector and changes in the fiscal, external and monetary policies, developing financial infrastructure; and developing financial markets.

In the above stated backdrop, a second high-level Committee on Banking Sector Reforms under the chairmanship’ of Mr. Narasimham to "review the progress of banking sector reforms to date and chart a programme of financial sector reforms necessary to strengthen the Indian Financial System and make it internationally competitive. The Committee in its report (April 1998) made wide-ranging recommendations covering entire gamut of issues ranging from capital adequacy, asset quality, NPAs, prudential norms, asset-liability management, earnings and profits, mergers and acquisitions, reduction in government shareholdings to 33 per cent in public sector banks, the creation of global-sized banks,
recasting banks boards to revamping banking legislation. The second generation reforms could be conveniently looked at in terms of three broad inter-related issues:

(i) measures that need to be taken to strengthen the foundations of the banking system,

(ii) related to this, streamlining procedures, upgrading" technology and human resource development, and

(iii) structural changes in the system. These would cover aspects of banking policy, institutional, supervisory and legislative dimensions.

The important recommendation of the Committee may be stated as under:

A. MEASURES TO STRENGTHEN THE BANKING SYSTEM

(i) Capital Adequacy

The Committee set new an(t. Higher norms of capital adequacy. It recommended that the "minimum capital to risk assets ratio be increased to 10 per cent from its present level of 8 per cent in a phased manner -9 per cent to be achieved by the year 2000 and the ratio of 10 per cent by 2002. The RBI should have authority to rise further in respect of individual banks if in its judgment the situation warrants such increase.

(ii) Asset Quality NPAs and Directed Credit

The Committee recommended that and asset be classified as doubtful if it is in the substandard category for 18 months in the first instance and eventually 12 months and loss of it has been identified but not written off. Advances guaranteed by the government should also be treated as NPAs. Banks should avoid the practice of 'ever greening' by making fresh advance to the troubled parties with a view to settle interest dues and avoiding such loans treating as NPAs.

(iii) Prudential Norms and Disclosure Requirements
It recommended moving to international practice for income recognition and recommended 90 days norm in a phased manner by the year 2002. In future income recognition, asset classification and provisioning must apply even to government guaranteed advances. Banks should pay greater attention to asset liability management to avoid mismatches.

B. SYSTEMS AND METHODS IN BANKS

The internal control systems which are internal inspection and audit, including concurrent audit submission of controls returns by banks and controlling offices to higher level offices, risk management system, etc. should be strengthened. There are recommendations for inducting an additional whole time director on the board of the banks, recruitment of skilled manpower, revising remuneration to persons at managerial level, etc.

C. STRUCTURAL ISSUES

Banks were classified in different categories like strong banks, weak banks, narrow banks and new banks. Different norms were prescribed for merger of banks. It was cautioned that the merger of banks should not be used for the purpose of bailing out the weak and narrow banks but there should be mergers of strong banks for commercial and economic reasons and force multiplier effect.

(i) Need for Stronger Banks

The Committee made out a strong case for stronger banking system in the country, specially in the context of capital account convertibility, which would involve large inflows, and outflows of capital and consequent complications for exchange rate management and domestic stability. The Committee therefore recommended winding up of unhealthy banks and merger of strong and weak banks.

(ii) Banking Structure
The Committee has argued for the creation of 2 or 3 banks of international standard and 8 or 10 banks at the national level. It also suggested the setting up of small local banks, which would be confined to a limited area to serve local trade, small industry and agriculture at the same time these banks will have corresponding relationship with the large national and international banks.

(iii) Local Area Banks

In the 1996-97 budget, the Government of India announced the setting up of new Private Local Area Banks (LABs) with jurisdiction over three contiguous districts. This banker will help in mobilizing rural saving and in channeling them into investment in local areas. This was a major step in the liberalization of the banking industry. Accordingly, in 1996 five LABs licenses were issued which was located in Andhra Pradesh, Karnataka, Rajasthan, Punjab and Gujarat. These LABs have commenced business.

(iv) Public Ownership and Autonomy

The Committee argued that the government ownership and management of banks does not enhance autonomy and flexibility in the working of public sector banks. In this connection, the Committee recommended a review of functions of boards so that they remain responsible to the shareholders. The management boards are to be reorganized and they shall not be any government interference.

Review of Banking Laws

The Committee suggested the need to review and amend the provisions of RBI Act, SBI Act, Banking Regulation Act, and Banking Nationalization Act, etc. so as to bring them in line with the current needs of the industry. Other recommendations pertain to computerization process, permission to establish private sector banks, setting up of Board of Financial Regulation and Supervision and increasing the powers of debt recovery tribunals.
To summarize, the major recommendations were:

1. Capital adequacy requirements should take into account market risks also
2. In the next three years, entire portfolio of Govt. securities should be marked to market
3. Risk weight for a Govt. guaranteed account must be 100%
4. CAR to be raised to 10% from the present 8%; 9% by 2000 and 10% by 2002
5. An asset should be classified as doubtful if it is in the sub-standard category for 18 months instead of the present 24 months
6. Banks should avoid ever green of their advances.
7. There should be no further re-capitalization by the Govt.
8. NPA level should be brought down to 5% by 2000 and 3% by 2002
9. Banks having high NPA should transfer their doubtful and loss categories to Asset Reconstruction Company (ARC) which would issue Govt. bonds representing the realizable value of the assets.
10. We should move towards international practice of income recognition by introduction of the 90 day norm instead of the present 180 days.
11. A provision of 1% on standard assets is required.
12. Govt. guaranteed accounts must also be categorized as NPAs under the usual norms
13. Banks should update their operational manuals which should form the basic document of internal control systems.
14. There is need to institute an independent loan review mechanism especially for large borrower accounts to identify potential NPAs.
15. Recruitment of skilled manpower directly from the market be given urgent consideration.
16. To rationalize staff strengths, an appropriate VRS must be introduced.
17. A weak bank should be one whose accumulated losses and net NPAs exceed its net worth or one whose operating profits less its income on recap bonds is negative for 3 consecutive years.

The Narsimham Committee seeks to consolidate the gains made in the Indian financial sectors while improving the quality of portfolio, providing greater operational flexibility, autonomy in the internal operations of the banks and FIs so to nurture in, a healthy competitive and vibrant financial sector.

REVIEW OF BANKING SECTOR REFORMS:

In line with the recommendations of the second Narasimham Committee, the Mid-Term Review of the Monetary and Credit Policy of October 1999 announced a gamut of measures to strengthen the banking system.

(i) CAPITAL ADEQUACY AND RECAPITALISATION OF BANKS

Out of the 27 public sector banks (PSBs), 26 PSBs achieved the minimum capital to risk assets ratio (CRAR) of 9 per cent by March 2000. Of this, 22 PSBs had CRAR exceeding 10 per cent. To enable the PSBs to operate in a more competitive manner, the Government adopted a policy of providing autonomous status to these banks, subject to certain benchmarks. As at end—March 1999, 17 PSBs became eligible for autonomous status.

(ii) PRUDENTIAL ACCOUNTING NORMS FOR BANKS –

The Reserve Bank persevered with the on—going process of strengthening prudential accounting norms with the objective of improving the financial soundness of banks and to bring them at par with international standards.

(iii) ASSET LIABILITY MANAGEMENT (ALM) SYSTEM –

The Reserve Bank advised banks in February 1999 to put in place an ALM system, effective April 1, 1999 and set up internal asset liability management committees (ALCOs) at the top management level to oversee its implementation. The Reserve
Bank also released ALM system guidelines in January 2000 for all-India term-lending and refinancing institutions, effective April 1, 2000.

(iv) RISK MANAGEMENT GUIDELINES –

The Reserve Bank issued detailed guidelines for risk management systems in banks in October 1999, encompassing credit, market and operational risks. Banks would put in place loan policies, approved by their boards of directors, covering the methodologies for measurement, monitoring and control of credit risk. The guidelines also require banks to evaluate their portfolios on an on-going basis, rather than at a time close to the balance sheet date.

(v) DISCLOSURE NORMS –

As a move towards greater transparency, banks were directed to disclose the following additional information in the ‘Notes to accounts’ in the balance sheets from the accounting year ended March 31, 2000: (i) maturity pattern of loans and advances, investment securities, deposits and borrowings, (ii) foreign currency assets and liabilities, (iii) movements in NPAs and (iv) lending to sensitive sectors as defined by the Reserve Bank from time to time.

(vi) TECHNOLOGICAL DEVELOPMENTS IN BANKING –

The Indian banks entered a new era of Indian financial network (INFINET) . The real time based gross transfer (RTGS) was launched. IFINNET served as

4.4 CONCLUSION

There were many more recommendations of the Narsimhan committee relating to the operational efficiency and control on weak banks etc. Some recommendations are in the process of scrutiny by further deeper study by another committee. But the fact remains that banking sector reforms, which were implemented as a part of overall economic reforms, witnessed the most effective and impressive changes, resulting in
significant improvements within a short span. The distinctive features of the reform process may be stated thus:

(i) The entry of modern private banks and foreign banks enhanced competition. Deregulation of interest rates had also intensified competition.

(ii) Prudential norms relating to income recognition, asset classification, provisioning and capital adequacy have led to the improvement of financial health of banks. Consequent upon prudential norms the most visible structural change has been improvement in the quality of assets.

(iii) There has been considerable improvement in the profitability of banking system. The net profits of SCBs, which were negative in 1992-93, become positive in 1994-95 and stood at Rs. 17,077.07 Crore by March 2003. The profitability of the Indian Banking System was reasonably in line with International experience.

It may be pointed out that the banking sector reform is certainly not a one-time affair. It has evolutionary elements and follows a progression of being and becoming. From this point, Indian experience of restructuring banking sector has been reasonably a successful one. There was no major banking crisis and the reform measures were implemented successfully since 1992.

Criticism:

Some expressed the fear that the reforms will sound a blow to social banking. The Government did not accept the Narasimham Committee-I recommendation that advances to priority sector should be brought down from 40 per cent to 10 per cent. The Banks continued to be directed to lend a minimum of 18 per cent of total banks credit to agriculture sector.
Liberalization and reforms in Mutual Fund Industry

With the emergence of the capital market at the centre stage of the Indian financial system, the financial services industry nationally and internationally is growing leaps and bounds contributing significantly to the health of global economy as well as that of individual investors. Mutual funds offer good investment opportunities to the investors. At the start of the mutual fund industry in the early 1960's, there was one government owned firm, the Unit Trust of India (UTI). Along with several other sectors rest of the financial sector, this industry was liberalised in 1993, opening up to other asset management companies (AMC), resulting in a slew of choices in mutual fund products for the Indian investor. Today, the industry stands at 8252 billion INR in 2014 jumping from 470 billion INR in 1993 to 1396 billion INR in 2004.

Despite the growth as above Mutual fund penetration in India is low as compared to global and peer benchmarks. The AuM to GDP ratio stands at 7 to 8% as compared
to a global average of 37%. Even the SAAAME economy of Brazil, considered a peer emerging economy, is significantly ahead, with an AuM to GDP ratio of 45%.

**Chart 5/5: AUM/GDP Ratio**

Since the economic liberalisation of the early nineties, mutual funds have been regulated by the securities market regulator, Securities and Exchanges Board of India (SEBI), which was itself a very new regulator in the early nineties. At the time, like all the other parts of the financial sector, the industry was lightly regulated with low levels of transparency about the management of funds. It was only in 1998, after a spectacular episode of market misconduct by the CRB group of companies that there was a sea-change in the regulation and supervision of the mutual fund industry. The regulator focussed on the production end of the mutual fund industry. This resulted in very high disclosure and transparency of the assets under management and improving the governance of the AMCs, setting it apart from the rest of the fund management industry in India. This path towards greater transparency became the industry norm when UTI, the only AMC that was exempt from full transparency on
certain products, developed problems in fulfilling obligations to customers. As part of the government bailout package in 2001, the AMC was broken up into two funds. One had a fixed mandate of winding down upon completing the obligations of the original UTI schemes (primarily US-64) to existing customers. The other was a company where the government was one of other shareholders that would follow all the regulation of the other mutual fund companies. With this, the mutual fund industry became the only fund management industry in India with a minimal presence of public sector ownership.

Since then, there have continued to be changes in the regulation of mutual funds, but largely driven by developments in the broader securities markets. The rules-driven regulatory framework in India has meant that innovation in the securities markets often drives changes in the rules on how mutual funds can access these innovation in offering new products to their customers. However, regulations governing the fund management process has been more or less stable but conservative.

The Association of Mutual Funds in India (AMFI) has officially classified the four decades of mutual funds growth in India into six phases. First phases 1964-87 saw UTI consolidating its position by offering a variety of products and extending its reach throughout the country. The second phase (1987-93) marked the arrival of mutual funds sponsored by public sector banks and financial institutions. The third phase (1993-96) with the arrival of private sector players, both Indian and Foreign. The fourth phase (1996-99) started with SEBI regulations of 1996. The fifth phase (1999-2004) saw a significant growth in amounts mobilized and the emergence of uniformity in industry. In the sixth phase (2004- till date) the mutual fund industry is consolidating its growth.
Process of changes in Mutual Fund industry

The Securities and Exchange Board of India (SEBI) has brought out several regulations to improve the efficiency and quality of the capital market. The SEBI act promulgated in January 1992 encompasses the entire gamut of securities Industry in India. The other regulations are: SEBI (Stock Broken and Sub-Broken) Rules and Regulations, 1992; SEBI (Merchant Banker) Rules and Regulations, 1993; SEBI (Registrar to an Issue and Share Transfer Agents) Rules and Regulations, 1993; SEBI (Insider Trading) Regulations, 1993; SEBI (Mutual Funds) Regulations, 1993; SEBI (Prohibitron of Fraudulent and Unfair Trade Practices Relating to Securities Market) Regulations, 1995. The Malegam Committee report on disclosure norms aims at improving transparency, quality and competition in the capital market. Several steps have been initiated to improve the activities in the secondary markets. The removal of badla and introduction of revised carry forward, monitoring of price movement, introduction of capital adequacy norms for brokers, changes in listing rules, introduction of electronic trading, establishment of National Stock Exchange (NSE) and Over the Counter Exchange of India (OTCEI) etc., are all steps that have altered the market scenario in India. By end 1995, India was first in the world in terms of listed companies (7,985). However in terms of market capitalisation India ranked 21 (with a market capital of US $ 1,27,199 million) and its position in total value traded was 31 (with US $ 13,738).’ A number of steps were taken to liberalise and upgrade the capital market during 1998-2000. The securities laws (Amendment) ACT, 1999 passed by the parliament in December 1999 expands the definition of securities to include derivatives and units of collective investment schemes This will allow the ’ Bombay Stock Exchange, 1995-96 introduction of index features and other derivatives and strengthen the legal framework for regulating collective investment schemes. The securities laws (Second Amendment) Act, 1999 amends the SCRA,
1956, (The SEBI Act 1992 and the Depositories Act 1996 to empower the Securities Appellate Tribunal to dispose of Appeals under these Acts. The requirement of "actual payment" of dividends before an (IPO) initial Public offers was replaced by an "ability to pay" criterion The "Par Value" concept was abandoned so that companies can now issue shares of any value. Companies with demated shares can alter the par value indicated in the Memorandum and Articles of Association. Existing companies with shares of Rs. 10 or Rs 100 can avail of this facility by consolidating or splitting these shares. SEBI had issued guidelines for the credit rating agencies In this connection In addition to these measures due to external sector reforms undertaken in 1999-2000, the Indian capital market has witnessed an unprecedented upsurge To mention a few, the new Foreign Exchange Management Act, 1999 in place of FERA had all the provisions m conformity with a liberalised market for foreign exchange. Prevention of Money laundering bill has been introduced in parliament. Comprehensive automatic approval system for FDI, based on a negative list and transparent sector limits introduced. The Foreign equity limit for FDI through automatic route for drugs and pharmaceuticals raised to 74 per cent from the present 5 per cent. ' SEBL -, 2000 ' Economic Times bill Published by Economic Times Research Bureau .An automatic route was opened for the issue of ADR's ,GDR's ,by Indian companies under liberalised guidelines. Further the external Commercial borrowings (ECB) guidelines have been liberalised. India, thus, has. emerged as one of the important stock markets of the world. The opening up of the economy and the introduction of reforms as part of the structural adjustment programme have made the Indian capital market one of the most attractive emerging markets in the world, as evident from the flow of funds and entry of foreign brokers and financial institutions Into India.
THE PRIMARY MARKET (NEW ISSUES)

Changes in economic policy involving opening up of the Indian economy, freedom to corporate sector to approach capital markets to fix prices and premiums and public sector disinvestment programmes have given a much-needed boost to the primary market. The total amount of capital issues in the market went up from Rs 1,673.6 crore in 1992-93 to Rs 30,823.9 crore in 1994-95. The same, however, declined to Rs 22,918.5 crore in 1995-96. Capital issue (amount mobilised as a percentage of GDS) also decreased marginally, from 13.9 per cent in 1992-93 to 13 per cent in 1994-95, but drastically to 8.16 per cent in 1995-96. (Bombay Stock Exchange. Stock Market today. 1997)

There has been a steep fall in fresh public issues in the last two years (1996-98). While the fall is more prominent in the equity floatation, even debenture issues have dropped. The Indian stock market witnessed considerable changes in the last 5 yrs. The number of listed Companies has been rising continuously. Despite a fall in BSE sensex during 1997 as compared to 1994 the total volumes traded in during the same nearly doubled. However, the amount raised through primary capital issues continues to fall due to negative investor sentiment.

THE SECONDARY MARKET

The growth of the primary market in the post-reform period has also boosted the activities of the secondary market in terms of growth of stock exchange, listed capital, market capitalisation, etc. Stock market indices indicate the changing investors' sentiment and direction of economy. In the post-reform period, particularly 1992, the market witnessed a bullish phase and the 30-share sensex reached a peak of 4,467 on 22 April 1992 however the movement of indices was moderated subsequently in 1993-94. One of the significant happenings during this period was also a moderation in P/E ratios considered to be the most important determinant of Investment decision.
The P/E ratio which reached its peak in 1994 gradually came down and mid December 1996 it touched its lowest when sensex P/E was 16.57 and Natex PE 12.20. The lower P/E ratio was an attraction to foreign investors.

Apart from the legislative changes there has been many course correction steps that eas brought by SEBI realise the goal of Mutual fund industry and to make it more transparent and customer oriented.

**Major Changes in Mutual fund industry regulation :**

1. The securities and Exchange Board of India (mutual funds) Regulations, 1993, came into effect on 20 January, 1993 was the first attempt to bring mutual funds under a regulatory framework and to give direction to their functioning.

2. With a view towards investor protection and transparency of operation, two credit ratings, namely CRISIL and ICRA, were set up. Any borrower has to undergo credit rating before raising resources in the market. To provide an avenue for the smaller companies to raise resources,

3. Scraping of entry load in 2009 from mutual funds to reduce excessive churning – but this severely impacted earnings of all distributors. The down side of this amendment was reduction in number of active distributors from 70000 to less than 20000.

4. Earlier total expense ratio was 2.5% but after 1st Oct 2012 it can go up to 3%. Overall expense ratio may increase by 0.3% to 0.6% including 0.2% additional expense in lieu of exit loads, 0.3% incentive for reaching beyond 15 cities and 0.1% as service tax. SEBI named this “Steps to RE-ENERGISE Mutual Fund Industry”, so definitely someone will have to pay for this energy drink. This is bit surprising as across the globe financial products are shedding their expenses – making them more slim-trip & light on investors pocket.
5. Exit Loads are normally there in equity schemes viz. 1% for 1 year, so if someone redeems before 1 year, AMC will deduct 1% from redemption proceeds. The exit loads are added to schemes because if lot of investors keep buying & selling units it will impact performance of fund – fund managers always invest keeping in mind a long term period but their strategies are impacted if they are not sure of tenure of funds that they have. The surprising part was use of exit load funds. This amount goes, actually this amount is used to pay commissions to distributors – which defies the purpose of exit loads. **But from now onwards Exit loads will be added back to scheme which will also reduce some impact of increased expenses.**

6. **Product Labeling:** There are more than 300 equity scheme & this creates confusion in the mind of investor. Even if there selection criteria is just performance, is it wise to compare a large cap fund with mid cap fund? Now SEBI is making it mandatory that a fund should be classified by AMC according to his investment style & this should be mentioned in all marketing & client communication. This will simplify the choice for investors.*36

7. **Strict rules in case of Mis-selling:** Mis-selling is rampant in all personal finance products. Financial products are not durable products, where someone can see, feel & compare the things – it’s all about future promises, so mis-selling is very easy. New MF reform makes mis-selling a fraudulent and unfair trade practice – as penalties for frauds are far more serious than those for breach of code of conduct.

8. **More money for Investor Education:** Mutual Fund reform talks about assigning 0.02% from expense ratio for investor education that becomes decent money when we talk about Rs 7-8 lakh crores corpus managed by mutual fund industry.
9. New distributor class: As I mentioned in the starting that MF distributors are going extinct – “only 1000 tigers left” joke is floating in MF industry. Till date MF distributors have to compulsorily clear NISM exam & register with AMFI (Association of Mutual Fund in India) – this is further renewed every 4th year. But now SEBI issued guidelines that even retired bankers & teachers can sell mutual funds without exam or registration. Though they will able to sell limited product which are simple to understand both by advisor & client – consistent performance is one of the criteria.

10. Direct Plan (applicable from 1st Jan 2013): Right now funds have 2-3 classes like retail, institutional & super institutional – categorization is done on basis of investment size & the only difference is expense ratio. Now SEBI has asked mutual funds to have only 2 classes – normal & direct. Introduction of new direct class means that if someone directly invest with Asset Management Company, he will be paying less expenses – may be 0.5% to 1% differential. So it is good for DIY (Do It Yourself) clients where decrease in expenses will improve their returns. But is Direct that easy choice.

Thus the mutual fund which is normally most active investment vehicle for the household saving in many of the European countries (Discussed in Chapter 4) could also reach similar heights in Indian scenario which is some how eluded till date.

Conclusion - The structure of the Indian capital market and the banking institutions as they exist today reveals a fairly advanced financial system. However, reforms in this sphere is call of the day. The process has begun to bring the Indian financial system in line with the international financial system to facilitate globalization. India has adopted a gradualist Approach to the reforms. An important feature of India's reform programme, when compared with reforms underway in many other countries, is that it has emphasised gradualism and evolutionary transition rather than rapid restructuring or "shock therapy". This gradualism has often been the subject of
criticism by the advocates for faster reform both inside and outside the country. But we need to understand that these reforms were not introduced in the background of a prolonged economic crisis or system collapse of the type which would have created a widespread desire for, and willingness to accept, radical restructuring. Except balance of payment crisis in June 1991, which was certainly severe but not prolonged, there has been no raised eyebrows on Indian economy and the reason of driving abrupt change or fast reforms. Stringent prudential norms will go together with improved supervision. That the international community has shown confidence in our ongoing reform process is evident from the spurt in collaborations and inflow of foreign funds. Although India has witnessed significant progress in the implementation of reforms over the past two years, more liberalization is yet to come. As far as the financial market reforms are concerned, the tempo of implementation will have to be accelerated so that economic development accelerates and the goal of globalization becomes a reality. The current reforms clubbed with stress on Secondary sector with “Make in India” programme will certainly take India to a real growth path.
Books and References:

*29 Financial Sector Reforms: Realities and Myths IJMT, Volume 19, Number 1, January - June 2011


*35 Banga, 2007

Chapter 6 :

Effect of Liberalization

India is currently passing through an exciting phase of structural reforms. With its varied geographical and ethnic diversity, India provides a classical example of a transformation from a socialist pattern to mixed market based economy. The inevitability of globalization and the redundancy of an isolated economy has led to a spate of structural reforms in India in many important sectors. Broadly, the package of reforms can be grouped as: trade policy reforms, industrial policy reforms, fiscal reforms and financial sector reforms. Economic reform is not an isolated process. Only an integrated approach covering all sectors can ensure success. Reforms were also initiated in all the sectors in India also. The scholar will confine the discussion of the reforms to the extent of liberalization in the field of financial industry specific to Banking, Insurance and Mutual Fund sectors only.

Various data of all the concerned sectors has been collected by the research scholar. The source of the data is official publications of govt agencies such as RBI reports, SEBI report, IRDA report, Govt of India’s own data base. Some reports and data has been extracted from top research and consulting agencies like Price Waterhouse inc., KPMG, Allen Cooper etc as they have done research themselves also and many times different govt and private organisation have awarded the contract to study the market or situation. It was observed that there is no standardization of publication of data in various report of RBI, IRDA, SEBI and all such organization. The data records keeping has many missing elements where there is no official record available in public domain. The research scholar has tried to assimilate the data of
various sources and pour into one graph and table, still the missing table and graphs on some issue could not be fully overcome. This is very serious limitation on the study.

The various hypothesis which will be examined for examining the effect of liberalization has already been mentioned. The research scholar will examine the hypothesis and give the interpretation of the same before moving to the next hypothesis.

**H01**: There could be a significant change in revenue and transactions and its pattern.

The scholar will examine the growth in the Indian financial sector. This includes increase in business in the bank on most of the count, the growth of the premium income for insurance company, No of companies or banks operating in that business, increase in no of branches, Insurance density and Insurance penetration on absolute terms etc and in comparison to the world standards. The scholar will also examine the pattern of generation of this revenue meaning thereby, the percentage and its change, of business generated through various modes and models of distribution.

<table>
<thead>
<tr>
<th></th>
<th>As per Census 2001</th>
<th></th>
<th>As per Census 2011</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Total number of households</td>
<td>Number of households availing banking services</td>
<td>Percent</td>
<td>Number of households availing banking services</td>
</tr>
<tr>
<td>Rural</td>
<td>138,271,559</td>
<td>41,639,949</td>
<td>30.1</td>
<td>167,826,730</td>
</tr>
<tr>
<td>Urban</td>
<td>53,692,376</td>
<td>26,590,693</td>
<td>49.5</td>
<td>78,865,937</td>
</tr>
<tr>
<td>Total</td>
<td>191,963,935</td>
<td>68,230,642</td>
<td>35.5</td>
<td>246,692,667</td>
</tr>
</tbody>
</table>

**Household having reach to banking service**

Table - 6/1

Source RBI report 2013
Table 6/2: Domestic Credit Provided by Banking Sector (% of GDP)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Brazil</td>
<td>43.0</td>
<td>87.6</td>
<td>71.9</td>
<td>74.5</td>
<td>96.9</td>
<td>95.8</td>
<td>95.2</td>
<td>98.3</td>
</tr>
<tr>
<td>China</td>
<td>53.3</td>
<td>89.4</td>
<td>119.7</td>
<td>134.3</td>
<td>120.8</td>
<td>145.1</td>
<td>146.3</td>
<td>145.5</td>
</tr>
<tr>
<td>Euro area</td>
<td>93.6</td>
<td>97.0</td>
<td>119.4</td>
<td>127.3</td>
<td>142.8</td>
<td>152.6</td>
<td>156.0</td>
<td>153.6</td>
</tr>
<tr>
<td>India</td>
<td>37.0</td>
<td>50.0</td>
<td>51.4</td>
<td>58.4</td>
<td>67.7</td>
<td>70.4</td>
<td>73.0</td>
<td>75.1</td>
</tr>
<tr>
<td>Japan</td>
<td>165.7</td>
<td>255.3</td>
<td>304.7</td>
<td>317.6</td>
<td>302.4</td>
<td>329.8</td>
<td>329.0</td>
<td>340.9</td>
</tr>
<tr>
<td>Russia</td>
<td>-</td>
<td>-</td>
<td>24.9</td>
<td>22.1</td>
<td>23.9</td>
<td>33.7</td>
<td>38.4</td>
<td>39.6</td>
</tr>
<tr>
<td>South Africa</td>
<td>76.4</td>
<td>97.8</td>
<td>152.5</td>
<td>178.5</td>
<td>173.8</td>
<td>184.2</td>
<td>182.4</td>
<td>167.0</td>
</tr>
<tr>
<td>South Korea</td>
<td>43.4</td>
<td>51.9</td>
<td>74.7</td>
<td>88.3</td>
<td>109.4</td>
<td>109.4</td>
<td>103.1</td>
<td>102.3</td>
</tr>
<tr>
<td>UK</td>
<td>36.2</td>
<td>118.2</td>
<td>130.2</td>
<td>161.9</td>
<td>213.5</td>
<td>229.2</td>
<td>222.6</td>
<td>213.8</td>
</tr>
<tr>
<td>US</td>
<td>120.2</td>
<td>151.0</td>
<td>198.4</td>
<td>225.4</td>
<td>222.0</td>
<td>234.9</td>
<td>232.9</td>
<td>233.3</td>
</tr>
<tr>
<td>World</td>
<td>93.5</td>
<td>130.6</td>
<td>158.9</td>
<td>162.1</td>
<td>154.7</td>
<td>169.1</td>
<td>167.4</td>
<td>165.3</td>
</tr>
</tbody>
</table>


Table 6/3: INSURANCE PENETRATION AND DENSITY IN INDIA

<table>
<thead>
<tr>
<th>Year</th>
<th>Life</th>
<th>Non-Life</th>
<th>Industry</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Density (USD)</td>
<td>Penetration (percentage)</td>
<td>Density (USD)</td>
</tr>
<tr>
<td>2001</td>
<td>9.1</td>
<td>2.15</td>
<td>2.4</td>
</tr>
<tr>
<td>2002</td>
<td>11.7</td>
<td>2.59</td>
<td>3.0</td>
</tr>
<tr>
<td>2003</td>
<td>12.9</td>
<td>2.26</td>
<td>3.5</td>
</tr>
<tr>
<td>2004</td>
<td>15.7</td>
<td>2.53</td>
<td>4.0</td>
</tr>
<tr>
<td>2005</td>
<td>18.3</td>
<td>2.53</td>
<td>4.4</td>
</tr>
<tr>
<td>2006</td>
<td>33.2</td>
<td>4.10</td>
<td>5.2</td>
</tr>
<tr>
<td>2007</td>
<td>40.4</td>
<td>4.00</td>
<td>6.2</td>
</tr>
<tr>
<td>2008</td>
<td>41.2</td>
<td>4.00</td>
<td>6.2</td>
</tr>
<tr>
<td>2009</td>
<td>47.7</td>
<td>4.60</td>
<td>6.7</td>
</tr>
<tr>
<td>2010</td>
<td>55.7</td>
<td>4.40</td>
<td>8.7</td>
</tr>
<tr>
<td>2011</td>
<td>49.0</td>
<td>3.40</td>
<td>10.0</td>
</tr>
</tbody>
</table>

1. Insurance density is measured as ratio of premium (in US Dollar) to total population.
2. Insurance penetration is measured as ratio of premium (in US Dollars) to GDP (in US Dollars).
3. The data of Insurance penetration is available with rounding off to one digit after decimal from 2006.
Source: Swiss Re, Various Issues.
Insurance Density In India

Source - IRDA report 2012

Insurance Penetration In India

Table - 6/4

Table - 6/5
Table 6/6

No. Of Life Insurance Cos. as on 31st March

Table 6/7

TOTAL LIFE INSURANCE PREMIUM

LIC | Private | Total
<table>
<thead>
<tr>
<th>Year</th>
<th>Deposits</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000-01</td>
<td>10552.33</td>
</tr>
<tr>
<td>2001-02</td>
<td>12026.99</td>
</tr>
<tr>
<td>2002-03</td>
<td>13556.23</td>
</tr>
<tr>
<td>2003-04</td>
<td>15755.30</td>
</tr>
<tr>
<td>2004-05</td>
<td>18375.59</td>
</tr>
<tr>
<td>2005-06</td>
<td>21646.79</td>
</tr>
<tr>
<td>2006-07</td>
<td>26969.34</td>
</tr>
<tr>
<td>2007-08</td>
<td>33200.61</td>
</tr>
<tr>
<td>2008-09</td>
<td>40632.01</td>
</tr>
<tr>
<td>2009-10</td>
<td>47524.56</td>
</tr>
<tr>
<td>2010-11</td>
<td>56158.74</td>
</tr>
<tr>
<td>2011-12</td>
<td>64535.49</td>
</tr>
<tr>
<td>2012-13</td>
<td>74296.77</td>
</tr>
<tr>
<td>2013-14</td>
<td>85331.38</td>
</tr>
<tr>
<td>2003-04</td>
<td>15755.30</td>
</tr>
</tbody>
</table>

Table : 6/8
Table: 6/10

AUM Growth
Mutual Fund

Ch: 6/11: The share of Mutual Fund* in Households' Gross Financial Savings

*Mutual Funds other than UTI
Sources: SEBI
Chart - 6.12 The share of AUM of Mutual Fund in GDP

Note: GDP at factor cost current prices
Sources: RBI, AMFI & CSO
<table>
<thead>
<tr>
<th>Ch. 6/13</th>
<th>Trends in Transactions on Stock Exchanges by Mutual Funds</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Equity</td>
</tr>
<tr>
<td></td>
<td>Gross Purchase</td>
</tr>
<tr>
<td>2000-01</td>
<td>17</td>
</tr>
<tr>
<td>2001-02</td>
<td>12</td>
</tr>
<tr>
<td>2002-03</td>
<td>14</td>
</tr>
<tr>
<td>2003-04</td>
<td>36</td>
</tr>
<tr>
<td>2004-05</td>
<td>45</td>
</tr>
<tr>
<td>2005-06</td>
<td>10</td>
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<td>2006-07</td>
<td>13</td>
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<tr>
<td>2007-08</td>
<td>21</td>
</tr>
<tr>
<td>2008-09</td>
<td>14</td>
</tr>
</tbody>
</table>
**Intrepretation :**

Banking Industry has undergone radical changes and it has been continuous. There has been impact on the deposits, credit extended and all other parameters. The rate of growth has also undergone radical change and it has grown exponentially after 2005-06. The pattern of the business generated has also changed in the banking industry. More and more no of branches are being opened in the semi urban and the rural sector. The share of domestic credit which was almost static between 1990 and 2000 got sharp change and it reached to the 1.5 times but if we compare the same with the international scenario, we can observe that it is far behind. (See graph 6/2)

Insurance industry has undergone mixed changes. If we look at the graph 6.4 for Insurance Density and 6.5 for Insurance Penetration, we can see that growth of the insurance market has not been singular but if we compare the same with those of the whole insurance industry of world then we can see that the same trend has been there all over. But when we interpret the business in terms of generation of premium, both for life and non life industry then we can find as given in graph 6.7 and 6.9, there has been continuous growth, except for the fact that rate of growth has changed. The liberalization has not only impacted the business in terms of revenue but it has given more option to people as more and more insurance company opened the branch. A market which was having only one player has reached to a level that it has to total 24 companies till 2011. Table 6.7 and 6.9 also show the change in the transaction pattern. The share of the private companies both in life as well as general has been changing. The share of the private companies has been increasing with the passage of each year. When we look at the mutual fund we find the mixed bag of outcome. There has been very high changes and there is practically no pattern. The
growth pattern has been disrupted in 2003 to 2005 due to the factors not related to
the liberalization or sluggishness in the economy, as there is no reflection in banking
and insurance business, but due to the change in the commission structure and
change in exit and entry load of the mutual fund schemes. The agents commission
has also undergone serious change in this period.

**Ho 2:** There is a significant change in ratio of various products sold by
financial sectors, due to liberalization

**One** of the biggest effects of liberalization is the availability of more products and
change in product mix. New and new companies and banks added into the system.
There has been addition of the new products and services in the financial industry.
<table>
<thead>
<tr>
<th>Fortnight Date Final</th>
<th>Loan cash credit and overdrafts</th>
<th>Inland Bills Purchased</th>
<th>Inland Bills Discounted</th>
<th>Commercial paper Book Value</th>
<th>Shares Public Sector undertakings Book Value</th>
<th>Shares Private Corporate Book Value</th>
<th>Others (Shares) Book Value</th>
<th>Bonds Public Sector undertakings Book Value</th>
<th>Bonds Private Corporate Book Value</th>
<th>Others (Bonds) Book Value</th>
<th>Units of UTI and other mutual funds Book Value</th>
<th>Shares Public Financial Institutions Book Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mar 31, 2000</td>
<td>4151.16</td>
<td>63.55</td>
<td>138.27</td>
<td>58.96</td>
<td>13.32</td>
<td>45.95</td>
<td>0.00</td>
<td>338.77</td>
<td>212.12</td>
<td>0.00</td>
<td>54.70</td>
<td>14.48</td>
</tr>
<tr>
<td>Mar 30, 2001</td>
<td>4850.44</td>
<td>57.65</td>
<td>194.98</td>
<td>71.21</td>
<td>14.34</td>
<td>42.77</td>
<td>0.00</td>
<td>376.58</td>
<td>253.16</td>
<td>0.00</td>
<td>62.68</td>
<td>8.71</td>
</tr>
<tr>
<td>Mar 29, 2002</td>
<td>5638.87</td>
<td>57.59</td>
<td>196.16</td>
<td>77.41</td>
<td>17.14</td>
<td>42.95</td>
<td>0.00</td>
<td>469.92</td>
<td>268.47</td>
<td>0.00</td>
<td>51.45</td>
<td>12.73</td>
</tr>
<tr>
<td>Mar 28, 2003</td>
<td>6974.04</td>
<td>58.56</td>
<td>212.15</td>
<td>36.16</td>
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<td>1.53</td>
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<td>313.14</td>
<td>58.08</td>
<td>21.29</td>
<td>182.25</td>
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<td>2.94</td>
<td>278.35</td>
<td>267.00</td>
<td>2.92</td>
<td>269.24</td>
<td>20.61</td>
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<td>Mar 27, 2009</td>
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<td>117.14</td>
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<td>200.81</td>
<td>27.89</td>
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<td>29.59</td>
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<td>254.81</td>
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<td>400.67</td>
<td>3.02</td>
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<td>4.15</td>
<td>476.03</td>
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<td>1030.48</td>
<td>168.96</td>
<td>73.50</td>
<td>296.53</td>
<td>5.26</td>
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</tr>
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<td>1127.40</td>
<td>270.64</td>
<td>89.47</td>
<td>337.65</td>
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<td>1073.48</td>
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<td>483.43</td>
<td>23.95</td>
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<td>Mar 29, 2013</td>
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<td>265.83</td>
<td>1127.40</td>
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<td>89.47</td>
<td>337.65</td>
<td>8.66</td>
<td>498.27</td>
<td>1073.48</td>
<td>8.65</td>
<td>483.43</td>
<td>23.95</td>
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<td>344.04</td>
<td>1174.10</td>
<td>422.69</td>
<td>84.98</td>
<td>365.67</td>
<td>30.06</td>
<td>627.31</td>
<td>1150.05</td>
<td>30.06</td>
<td>469.21</td>
<td>35.87</td>
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</tbody>
</table>
Table - 6/15 : ASSETS UNDER MANAGEMENT (₹ CRORE)

![Graph showing asset management over years with categories: Life Fund, Pension & General Annuity & Group Fund, ULIP Fund.]

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Fire</td>
<td>20643</td>
<td>26673</td>
<td>29498</td>
<td>314965</td>
<td>333092</td>
<td>37745</td>
<td>413298</td>
<td>345920</td>
<td>388458</td>
<td>386927</td>
<td>455512</td>
</tr>
<tr>
<td>Marine</td>
<td>98515</td>
<td>10538</td>
<td>12148</td>
<td>111754</td>
<td>122810</td>
<td>9</td>
<td>162784</td>
<td>179382</td>
<td>195615</td>
<td>216759</td>
<td>251877</td>
</tr>
<tr>
<td>Motor</td>
<td></td>
<td></td>
<td>87335</td>
<td>106966</td>
<td>126852</td>
<td>133350</td>
<td>150469</td>
<td>181805</td>
<td></td>
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<tr>
<td>Health</td>
<td></td>
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<td>112219</td>
<td>136852</td>
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<td>150469</td>
<td>181805</td>
<td></td>
<td></td>
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<tr>
<td>Other</td>
<td>67574</td>
<td>77248</td>
<td>97369</td>
<td>113272</td>
<td>125215</td>
<td>43489</td>
<td>512929</td>
<td>488604</td>
<td>558698</td>
<td>622522</td>
<td>737801</td>
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</tbody>
</table>

Figures in Lakhs
Source: Handbook on Indian Insurance Statistics 2010-11

Table - 6/16
**Product Mix in Non Life Insurance Company**

Table 6/17  
Source of Date : Handbook on Indian Insurance Statistics 2010-11

**Mutual Fund – Based on sales pattern**

<table>
<thead>
<tr>
<th>Scheme</th>
<th>1990-00</th>
<th>2000-01</th>
<th>2001-02</th>
<th>2002-03</th>
<th>2003-04</th>
</tr>
</thead>
<tbody>
<tr>
<td>Open End</td>
<td>36673</td>
<td>78788</td>
<td>163144</td>
<td>314239</td>
<td>587480</td>
</tr>
<tr>
<td>Close End</td>
<td>3599</td>
<td>5042</td>
<td>1379</td>
<td>467</td>
<td>2710</td>
</tr>
<tr>
<td>Ratio</td>
<td>9.31%</td>
<td>6.40%</td>
<td>0.85%</td>
<td>0.15%</td>
<td>0.46%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Open End</td>
<td>822004</td>
<td>1057118</td>
<td>1800158</td>
<td>4337041</td>
<td>5261429</td>
</tr>
<tr>
<td>Close End</td>
<td>17704</td>
<td>41032</td>
<td>138335</td>
<td>127334</td>
<td>111008</td>
</tr>
<tr>
<td>Ratio</td>
<td>2.15%</td>
<td>3.88%</td>
<td>7.68%</td>
<td>2.94%</td>
<td>2.11%</td>
</tr>
</tbody>
</table>

- Chart no 6/18  
- Data source – RBI report
Ration of closed to open mutual fund:

![Line graph showing ratio over time]

**Chart no. 6 / 19**

Based on investment pattern:

<table>
<thead>
<tr>
<th>Period</th>
<th>Equity</th>
<th>Debt</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>April 2008-Mar 2009</td>
<td>144068</td>
<td>327744</td>
<td>471812</td>
</tr>
<tr>
<td>April 2007-Mar 2008</td>
<td>217578</td>
<td>298605</td>
<td>516183</td>
</tr>
<tr>
<td>April 2006-Mar 2007</td>
<td>135948</td>
<td>153733</td>
<td>289681</td>
</tr>
<tr>
<td>April 2005-Mar 2006</td>
<td>100436</td>
<td>109805</td>
<td>210241</td>
</tr>
<tr>
<td>April 2004-Mar 2005</td>
<td>45045.3</td>
<td>62186.5</td>
<td>107232</td>
</tr>
<tr>
<td>April 2003-Mar 2004</td>
<td>36663.6</td>
<td>63169.9</td>
<td>99833.5</td>
</tr>
<tr>
<td>April 2002-Mar 2003</td>
<td>14520.9</td>
<td>46663.8</td>
<td>61184.7</td>
</tr>
<tr>
<td>April 2001-Mar 2002</td>
<td>12098.1</td>
<td>33583.6</td>
<td>45681.8</td>
</tr>
<tr>
<td>April 2000-Mar 2001</td>
<td>11375.8</td>
<td>13512.2</td>
<td>24888</td>
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</table>
Difference in the investment pattern in individual and corporate:

Source - PWS & CII report on mutual fund industry 2014
Chart - 6/22
<table>
<thead>
<tr>
<th></th>
<th>In percent</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Individual</td>
</tr>
<tr>
<td>Debt Schemes</td>
<td>38</td>
</tr>
<tr>
<td>Equity Schemes</td>
<td>56</td>
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<tr>
<td>ETFs and FOFs</td>
<td>2</td>
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<tr>
<td>Liquidy / Money Market</td>
<td>4</td>
</tr>
</tbody>
</table>

Chart – 6/23      
Source – PWC & CII

**Interpretation:**

The products of each financial institution may be divided into several categories depending on the various qualities. There are a number of product categories in each financial institution, and each category has a large number of products. The scholar will examine a regular and singular change in product mix. That means during the intervening period there will be homogeneous increase or decrease in the share of the particular product. Any institution depending upon the marketing strategy launches new product after making some cosmetic changes but the current study has not taken those into account. The products which are launched for general consumer have only been taken into consideration. Many institutions develop products tailor made subject to the suitability of the requirement of large institution is outside the scope of this research. The shift in the products between the different banking products has not been any significant and it has not been continuous. The products have changed the proportion for very short period and then they have gone back to the original proportions. The result of change cannot be interpreted to be outcome of any liberalization. The same characteristics has been visible in the mutual fund industry also. The ratio of open ended fund and closed ended fund has been changing. There is no pattern visible. The same is the status of ratio of debt fund and equity fund. There is no pattern visible.
But if we look into the product distribution of life insurance industry as given in the chart 6/15, we can observe that a category annuity and pension product which was almost NIL in 2001-01 has acquired a very sizable proportion and has grown in a very significant manner over the years. Another product category which is acquiring a very significant proportion in the product basket is ULIP based product. There was insignificant sale of this product but over the years this acquired a proportion of about 27%. Similarly, in general insurance category, health insurance had almost nil presence in initial years but now it has reached a level of approx. 23% in the product as visible in chart 6/17.

**HO**: There could be a significant change in the cost efficiency, earning efficiency and the profitability in the organization who got transformed during the liberalization period.

<table>
<thead>
<tr>
<th>Year (End-March)</th>
<th>As Percentage of Gross</th>
<th>Year (End-March)</th>
<th>As Percentage of Gross</th>
</tr>
</thead>
<tbody>
<tr>
<td>1996-97</td>
<td>15.70</td>
<td>2005-06</td>
<td>3.30</td>
</tr>
<tr>
<td>1997-98</td>
<td>14.40</td>
<td>2006-07</td>
<td>2.50</td>
</tr>
<tr>
<td>1998-99</td>
<td>14.70</td>
<td>2007-08</td>
<td>2.30</td>
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<tr>
<td>1999-00</td>
<td>12.70</td>
<td>2008-09</td>
<td>2.30</td>
</tr>
<tr>
<td>2000-01</td>
<td>11.40</td>
<td>2009-10</td>
<td>2.40</td>
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<tr>
<td>2001-02</td>
<td>10.40</td>
<td>2010-11</td>
<td>2.50</td>
</tr>
<tr>
<td>2002-03</td>
<td>8.80</td>
<td>2011-12</td>
<td>3.10</td>
</tr>
<tr>
<td>2003-04</td>
<td>7.20</td>
<td>2012-13</td>
<td>3.20</td>
</tr>
<tr>
<td>2004-05</td>
<td>5.20</td>
<td>2013-14</td>
<td>3.80</td>
</tr>
</tbody>
</table>

Gross NPA of schedule commercial bank - in million

**Chart 6/24**
NPA as Percentage of Gross Advances Source: RBI report

Operating expenses percentage to Net Premium - Private vs. LIC

Source: Handbook on Indian Insurance Statistics 2011-12 published by IRDA

Life Insurance - Source of data: Handbook of Indian Insurance Statistis 2011-12

<table>
<thead>
<tr>
<th></th>
<th>2009-10</th>
<th>2010-11</th>
<th>2011-12</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit/(Loss) after Tax</td>
<td>251.15</td>
<td>939.98</td>
<td>110.64</td>
</tr>
<tr>
<td>Equity Capital</td>
<td>1.66</td>
<td>2.24</td>
<td>3.24</td>
</tr>
<tr>
<td>Operation Expenses</td>
<td>4674.17</td>
<td>5451.25</td>
<td>6424.88</td>
</tr>
<tr>
<td>Commission Paid</td>
<td>4566.91</td>
<td>5152.73</td>
<td>6156.58</td>
</tr>
<tr>
<td>Total Premium</td>
<td>34888</td>
<td>50034</td>
<td>55748</td>
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<tr>
<td>Operating Exp/Premium</td>
<td>9.33</td>
<td>3.78</td>
<td>9.64</td>
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</table>
Interpretation:

There has been significant change in the various parameter of profitability in the financial industry. There has been significant change in NPAs of the banking sector with a few exception years. There has been significant change in the operating expenses of Private life insurance and private general insurance. The Opex of the public sector companies has been almost static. The ongoing reduction of Opex in pvt. Life and general insurance company, if continues for more time will lead to overall reduction of Opex of insurance industry which is not yet visible. This may due to the ongoing expansion of the private company. The operational expenses of mutual fund industry has not been taken into account as there is no public disclosure available. It is not required by law also. The loading of expenses has been capped by SEBI also depending upon the nature of the fund.
Research Questions:

Question 1: There could be a change in the various indices of Indian Economy

The research will look into the possibility of examining the direct effect of liberalization on the indices of Indian economy in a consistent manner. The effect on the economy is sustainable or it gets reversed due to certain factors beyond the control.
**Interpretation**: The growth in India and change in the various indices of economy is visible as depicted in the charts given above. But the pace of growth has been quite uneven. The liberalization has given its result but the result is not very highly significant. This factor can only be compared and then interrelated as the growth can be outcome of normal passage of time also. As it has been discussed in Chapter 4, if we compare the growth of India with China, Pakistan and Brazil who were similar economies at some point of time or another we can very well say that liberalization has certainly taken its root and resulted into growth but the growth has not been so significant as it was in case of China and Brazil, but certainly it has given better result than Pakistan. The effect of sub prime crisis is visible on the Indian economy during 2008 and it had a delayed effect. But after the crisis it took some time for the economy to get back to the same pace. But again the economy had gone to the downward swing in 2011. It is very difficult to isolate the effect of liberalization on the various factors of economy but on a long term view as given in the graph 6/33. If we look at the sectoral distribution of GDP then we can conclude
that the growth has not affected the sectoral distribution of GDP in any perceptible manner.

So, to conclude the effect of liberation on the various indices, it can be commented that the liberalisation has affected the various indices in different manner. There has not been any singular pattern. The factor of globalization has affected the Indian economy in varied intensity.

Research Questions:

Question – 2:

There could be a significant change in manpower deployment and direct employment

One of the main purposes of liberalization is to provide impetus to the Indian economy. The another important purpose of the liberalization is increase in employment and expansion of service to reach to the target group in the best manner. The data on this issue is both in the form of direct data and Indirect data.
Opening of Branches of commercial banks as per the distribution of population - (Chart 6 /34)

<table>
<thead>
<tr>
<th>Year</th>
<th>RURAL</th>
<th>SEMI-URBAN</th>
<th>URBAN</th>
<th>METROPOLITAN</th>
<th>TOTAL</th>
</tr>
</thead>
<tbody>
<tr>
<td>2006-07</td>
<td>226</td>
<td>750</td>
<td>874</td>
<td>625</td>
<td>2475</td>
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<tr>
<td>2007-08</td>
<td>569</td>
<td>1233</td>
<td>1270</td>
<td>974</td>
<td>4046</td>
</tr>
<tr>
<td>2008-09</td>
<td>708</td>
<td>1280</td>
<td>1051</td>
<td>957</td>
<td>3996</td>
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<td>2009-10</td>
<td>1033</td>
<td>1722</td>
<td>1415</td>
<td>1141</td>
<td>5311</td>
</tr>
<tr>
<td>2010-11</td>
<td>1497</td>
<td>2303</td>
<td>945</td>
<td>1001</td>
<td>5746</td>
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<tr>
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<td>2614</td>
<td>2740</td>
<td>1246</td>
<td>1010</td>
<td>7610</td>
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<tr>
<td>2012-13</td>
<td>3222</td>
<td>2686</td>
<td>1032</td>
<td>822</td>
<td>7762</td>
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<tr>
<td>2013-14</td>
<td>5227</td>
<td>2884</td>
<td>1509</td>
<td>1123</td>
<td>1074</td>
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<tr>
<td>Total</td>
<td>1509</td>
<td>6</td>
<td>15598</td>
<td>9342</td>
<td>7653</td>
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</tbody>
</table>

![Chart 6 / 35](image-url)
### Employment in Banking Sector

<table>
<thead>
<tr>
<th>Year</th>
<th>Public Sector (End-March)</th>
<th>Private Sector (End-March)</th>
<th>Number of Employees</th>
</tr>
</thead>
<tbody>
<tr>
<td>1998-99</td>
<td>19.41</td>
<td>8.70</td>
<td>40.37</td>
</tr>
<tr>
<td>1999-00</td>
<td>19.31</td>
<td>8.65</td>
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<td>2000-01</td>
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<td>42.00</td>
</tr>
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<td>2001-02</td>
<td>18.77</td>
<td>8.43</td>
<td>41.17</td>
</tr>
<tr>
<td>2002-03</td>
<td>18.56</td>
<td>8.42</td>
<td>41.39</td>
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<td>39.97</td>
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<td>40.17</td>
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<td>17.61</td>
<td>12.04</td>
<td>44.79</td>
</tr>
</tbody>
</table>

**Chart 6 / 36**

### Employment Banking Sector

- **Number of Employees**
- **Private Sector (End-March)**
- **Public Sector (End-March)**

**Chart 6 / 37**
### No of Reporting Banks

<table>
<thead>
<tr>
<th>Fortnight Date Final</th>
<th>No of Reporting Banks</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mar 31, 2000</td>
<td>297</td>
</tr>
<tr>
<td>Mar 30, 2001</td>
<td>286</td>
</tr>
<tr>
<td>Mar 29, 2002</td>
<td>294</td>
</tr>
<tr>
<td>Mar 28, 2003</td>
<td>288</td>
</tr>
<tr>
<td>Mar 26, 2004</td>
<td>286</td>
</tr>
<tr>
<td>Mar 25, 2005</td>
<td>285</td>
</tr>
<tr>
<td>Mar 31, 2006</td>
<td>210</td>
</tr>
<tr>
<td>Mar 30, 2007</td>
<td>179</td>
</tr>
<tr>
<td>Mar 28, 2008</td>
<td>170</td>
</tr>
<tr>
<td>Mar 27, 2009</td>
<td>166</td>
</tr>
<tr>
<td>Mar 26, 2010</td>
<td>163</td>
</tr>
<tr>
<td>Mar 25, 2011</td>
<td>163</td>
</tr>
<tr>
<td>Mar 30, 2012</td>
<td>169</td>
</tr>
<tr>
<td>Mar 29, 2013</td>
<td>151</td>
</tr>
<tr>
<td>Mar 29, 2013</td>
<td>151</td>
</tr>
<tr>
<td>Feb 27, 2015</td>
<td>147</td>
</tr>
</tbody>
</table>

### No Of Schedule Commercial Banks

#### Chart 6 / 38

### Life Insurance

<table>
<thead>
<tr>
<th></th>
<th>2000-01</th>
<th>2005-06</th>
<th>2009-10</th>
</tr>
</thead>
<tbody>
<tr>
<td>No of Individual agents</td>
<td>115709</td>
<td>1422609</td>
<td>2917454</td>
</tr>
<tr>
<td>No of branches</td>
<td>2000</td>
<td>3816</td>
<td>11927</td>
</tr>
<tr>
<td>No of direct employees</td>
<td>NA</td>
<td>152449</td>
<td>257940</td>
</tr>
</tbody>
</table>

#### Chart - 6 / 39
Trends in mutual funds - Chart 6 / 41

**Interpretation:**

The data given above gives a very clear indication that there has been massive change in the turnover and revenue generation in each sector. The banking sector
has undergone metamorphic change. The branches of banks were increased and more no of branches were added in the semi urban and rural sector. The increase in employment has not been very substantial in the review period but despite introduction of high level of automation, there could be little growth in the employment was made possible. The no of branches were increased by the banking sector and this happened with very little or almost no impact on Opex. The Insurance sector has undergone massive change. The Life Insurance industry witnessed a two and half fold increase in the nos. If we view this under the light of international scenario we will be able to appreciate the fact this increase is really a miracle which was made possible. As given in chart 6/39, there was increase in employment in terms of direct employment but also employment based on commission. The mutual fund industry has undergone similar change. The employment in this sector can only be concluded thru the indirect data as the direct data on this sector is not possible.

There are a large no of persons who are not qualified under AMFI but sell the mutual fund on behalf of brokers and corporate agents. The increase in the mutual fund business will have to give indication that there has been increase in the no of agents and employees who are dependent on the performance of the mutual fund sector. There was significant change in the employment as a result of liberalization.
Chapter 7:

Conclusion and recommendation

The regulatory and supervisory mandate for the financial sector in India is vested in several different bodies with reasonably well delineated domains. The apex Regulatory and supervisory bodies along with their main jurisdictions are (i) Reserve Bank of India (RBI) [banks, nonbanking finance companies (NBFCs) and microfinance institutions (MFIs)], (ii) Securities and Exchange Board of India (SEBI) (securities markets), (iii) Insurance Regulatory Development Authority (IRDA) (insurance sector), (iv) Forward Markets Commission (FMC) (forward commodity markets) and (v) Pension Fund Regulatory and Development Authority (PFRDA) (pension funds). In addition to these apex bodies, there are a number of tier 2 bodies performing certain regulatory and supervisory functions such as the National Bank for Agriculture and Rural Development (NABARD), Deposit Insurance and Credit Guarantee Corporation (DICGC), National Housing Bank (NHB), etc. The Ministry of Finance is also a key player in the finance sector, being responsible for financial planning and legislation.

Summary:

The first chapter deals with the introduction of the title of the thesis. It deals with the fact that Indian reforms was initiated with a little different approach than it was initiated in other parts of the world. It was a step by step approach instead of sudden change as initiated by any other countries. It also enumerates the various sectors where reforms have taken place and their present status. The present status and the
background of the economic status of the country with reference to the banking, insurance and mutual fund industry has been given.

The second chapter deals in the review of literature. There are some studies conducted by different scholars on the issue of liberalization but it has been observed that it was never connected with the generation of employment and well being of Indian mass. There was no connect with the liberalization of India and that of other BRICS countries or neighbouring countries or SAARC countries or similar economies of the world.

The third chapter analyses the new economic policy and its implementation. It has been observed that the economic policy notified in 1991 is the last economic policy given by the government and there has been many initiatives that have been announced by different governments of different political parties. Some of the policies announced recently by the new government under the leadership of Mr. Narendra Modi, Prime Minister is yet to show the result.

The fourth chapter analyses the effectiveness of India's liberalization in comparison to the liberalization of some countries who are similar to India for some reason or other. These countries include some of BRICS countries and some SAARC countries. They were in almost similar economic status on some point of time or other but they approached some different path of liberalization. For example China and India had almost same Per Capita GDP at some point of time before both the countries embraced liberalization. But now the status is very different. Same is the case of Brazil which had very rates almost unmanageable inflation has come out of all perils and turned to be a developed economy.
The fifth chapter deals in the Financial sector reforms. It has gone into the details of the various steps and compulsions of the reforms. It also deals with the background of the reform. There were various was committee set up to examine the needs of reforms, ways of reform then committee was steup to suggest the ways of implementation of various reforms etc. This chapter deals with the details of Mehlotra committee, Narsimhan committee I & II, Dave committee, Mukherjee Committee etc. It goes on to examine the details of the effect of implementation of various committee and the traces the growth of Indian financial market otherwise also. The sixth chapter examines the hypothesis of this research paper. The author has taken support of various graphs and tables that has been published at various websites and journals to analyse the effects of liberalization of financial sectors.

**Conclusions:**

Going thru all the reports and research findings it is very clear that India has adopted a path of liberalization in 1991 with the introduction of New Economic Policy. This policy and its implementation was very well done for initial some years which brought the country out from sure to reach ", Default Of Payments ". The country was almost at the brink of being declared as defaulter of payments. But gradually the effect of this policy was fizzled out. There was instability in political scenario. The willingness and vigour of implementation of next phase of reform became absent. India adopted a very careful approach of reform, It went into each step and next step in very slow manner. Here we can find the difference in implementation of reforms in China and Brazil, where it was implemented with very different pace and vigour. Our saving rates were and still it is high but it was never so high that we could finance our NON plan expenditure which has always been under the strain due to high debt interest payments. Like Brazil who made pension as compulsion and reach to world No 8 in
pension market, we never force implemented any strategy. One another difference in approach with India and China is the adoption of sector of economy for growth. These two countries have almost started reforms in similar time but China adopted manufacturing i.e. secondary sector as thrust area for reform whereas India adopted software and such other things i.e Tertiary sector as thrust areas of reform. There could be compulsion in China as they were not having English speaking people who could render the services into Tertiary sector. But it seems there was some fear in the mind of Indian reformist also there in implementation of reform in Secondary sector. The labour laws and political scenario of the country was perhaps not ripe enough to embrace strong wind of change. Today we are taking a path in the name of “Make In India” which should have been taken 20 years back. It is very known fact that we donot have too many employable population who can be employed in Tertiary sector. When we look into the reforms made by Brazil, China in Insurance sector we find that these two countries have opened Insurance for 100% foreign equity participation in almost all the sections of Insurance, whereas we are struggling to give 49% and imposing a series of riders to ultimately nullify the effect. The role of various regulator of financial sector is still a matter of examination. When we compare the banking sector we find that we are way behind in giving advances in comparison to the developing country and our expenses are higher that many developed country. There has been hardly any increase in generation of employment by banking Industry. The liberalization has not been strong enough that it could increase the nos of commercial banks so that employment could be generated and more advances and loans could be granted. The availability of credit is still far from a large section of society. Government has realised the gap of this phenomenon and established MUDRA BANK but the performance of this bank is yet to be seen. Mutual fund industry has also undergone metamorphic change but the pace of development
has no direct effect to the liberalization as it has happened in other parts of the world. The AUM %age ratio to GDP is hardly of any significant level. So, despite so high population we are not able to mark ourself strong in any financial system at par with any developed economy. The reach of Mutual Fund has only to the top towns of the country. Mutual fund, which should have been primary source of mobilization of saving apart from banks have not reached to any respectable level performance. The increase in offices, no of persons engaged has also remained almost stagnant.

**Recommendation for further study:**

It would be really interesting to analyse the performance of various regulators of financial industry. The role of the regulator should be examined with the angle that if they are playing the role of promoting and facilitating these business in India or they are just playing the role of watch dog and witch hunting. Is there any land mark which govt has prescribed or expected to these regulators? It would also be very desirable to see the after effect of some of the landmark regulations given by these regulators. The performance of SEBI and IRDA, who are comparatively yet to establish their credibility has to be investigated and analysed in some future research. The scholar will also suggest further studies on the role and performance of intermediaries associated with both Insurance and Mutual fund industry as the same was outside the scope of this research but during the course of study some definite pattern has emerged in the business performance. It was observed that the business of Mutual Fund is mainly dependent on the corporate business not on the individual household saving mobilisation. The business is only localised to big towns and metropolis only.
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