Chapter 6
Role of Financial Institutions in boosting
the Indian Economy
6.1 Role of RBI in boosting the Indian Trade.

As we all know that RBI is the apex bank of the country and has a lot of power authority over the financial institutions that are working across the country. RBI plays an important role in boosting the economy by allowing various kinds of duties and taxes and the vice-versa as per the situation. During the inflationary and deflationary trend RBI makes the use of its monetary polices in making the situation under control. RBI helps in the following ways:

2. Paper less Trade
3. Boosting bullion market

RBI policy seen boosting corporate debt market

India's corporate debt market is set to become more transparent and usher in better trading practices thanks to measures announced in the central bank's mid-year monetary policy review. But investments by banks in the primary market could temporarily decrease as a result of stricter accounting and prudential norms that the Reserve Bank of India plans to introduce. RBI said it will soon put in place measures for adequate information dissemination. It asked banks to adopt internal rating systems before investing in bonds issued through private placement.

The RBI for the benefit can issue detailed operating guidelines in consultation with banks and financial institutions.

Analysts expect these moves to streamline the functioning of the much-neglected corporate debt market by ensuring compliance with tighter investment norms, especially by banks and financial institutions.

Banks are among the largest investors in bonds, although they have traditionally been more active in the less risky government securities market.

Debt dealers expect that the guidelines may hurt investment in bonds of state-run firms, especially those issued only against a guarantee or a letter of comfort from the government as banks may be reluctant to invest unless these instruments are rated.
Currently, banks invest in such debt on the strength of the government guarantee. In order to control the debt market RBI from time to time keeps bringing the different policies that have to be followed by the banks and other institutions that are working under it.

**PAPERLESS TRADE**

The central bank also pushed for converting existing bonds and debentures into paperless form by June 2002, a move first announced in the credit policy announcement in October 2000.

This is expected to reduce processing time.

The RBI also reiterated that fresh investments in bonds must be in paperless form starting from October 30 2008. Dealers expect this to push up volumes in the corporate debt market, which is generally seen as illiquid due to a 15-day to two-month gap between striking a deal and transferring the instrument in the investor's name. Daily volumes average around Rs 500-600 million, a far cry from the Rs 20-40 billion traded in the government bonds market.

Paper less trade also facilitates the time consumption and also keeping the economy updated with the latest technology.

**DOWNGRADES**

The market for primary debt was hushed through most of September 2008 in the immediate aftermath of the terror attacks in the United States, with only a few state-run banks and financial heavyweights stepping in to raise funds from the market.

It started to pick up gradually in October 2008 as investor confidence improved after fears of pressure on the rupee waned and as inflation remained benign.

Some dealers, however, are concerned the market may again screech to a halt till the implications of the guidelines are clarified.

A downgrade of bonds of some leading companies in recent weeks may also sap the bond market of some of its momentum, some dealers said.
Other debt dealers, however, were of the view that most of the downgrades were expected and already factored in, and would therefore have little impact on secondary trade.

"During a period of slowdown, downgrades are more or less expected" Depending on credit quality, the paper would go from being traded 100 basis points over other paper to around 150 points above the market; in the long-run, yields would realign".

Boosting Bullion Market

India is the largest consumer in the bullion market and a stronger Indian bullion market and trade can only be possible if the Reserve Bank of India (RBI) gives necessary support to the banks who are the main financiers to the bullion trade, he said adding banks too should become proactive towards gold and reconsider their skepticism towards lending against gold,

it is important that government remove the existing import duty on gold and allow free export of gold products

Currently, import of gold of numbered bars attract import duty of Rs 100 per ten grams and Rs 250 for unnumbered tola bars. Also, export of gold is not allowed. Both of these aspects, among others, impede the growth of bullion market in India.

The restriction on export of gold does not allow Indians to take advantage of the current trend of high gold price of $375 per troy oz which is expected to rise further to around $420 levels
bullion futures is allowed, India has good scope for regularising spot gold market
there are to be three more such commodity exchanges which too will offer trading in futures of bullion along with other commodities

Both the government and the Reserve Bank of India (RBI) need to be proactive towards gold .If we are to attract international attention and participation in the bullion market here, we need to have transparent, international, investor-friendly easy access and multi-currency settlement system on our commodity futures exchanges. Also, while we need to remove existing deterrents like cash management, local tax complexities, we need to improve necessary infrastructure for smooth, transparent bullion futures. Without the existence of good reliable custodial and
depository system in place, we simply can't hope to become a global bullion trading centre. Above all, the bullion trading community needs first to improve their own image and reputation in the eyes of the authorities.

India in World Gold Industry

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<tr>
<th>(Rounded Figures)</th>
<th>India (Tons)</th>
<th>(In World Tons)</th>
<th>(In % Share)</th>
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<td>145000</td>
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<td>Annual Recycling</td>
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<td>Annual Demand</td>
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<td>Annual Imports</td>
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<td>Annual Exports</td>
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In 2006, it was estimated that 2870 tons of gold were produced worldwide. About 80 percent of that gold production was used to make jewelry, the majority of which was sold in India, Europe and the United States of America. Gold jewelry is universally popular, loved for its lustrous yellow color and untarnishing character. In many Asian countries, such as India, Thailand, and China, gold is important to religious ceremonies and social occasions, such as the Chinese New Year and Hindu marriages in India.
Role of Monetary policies of RBI

In a world of policies in the financial sector, nothing could get as alien as the Monetary Policy. Terms like M3, CRR, SLR, PLR and OMO would make you think that the typical IT-bug has caught the financial sector. But take a closer look as the Monetary and Credit Policy is crucial to all of us and more so to the banking sector.

For the uninitiated, this policy determines the supply of money in the economy and the rate of interest charged by banks. The policy also contains an economic overview and presents future forecasts.

Monetary Policy

The Monetary and Credit Policy is the policy statement, traditionally announced twice a year, through which the Reserve Bank of India seeks to ensure price stability for the economy.

These factors include - money supply, interest rates and the inflation. In banking and economic terms money supply is referred to as M3 - which indicates the level (stock) of legal currency in the economy.

Besides, the RBI also announces norms for the banking and financial sector and the institutions which are governed by it. These would be banks, financial institutions, non-banking financial institutions, Nidhis and primary dealers (money markets) and dealers in the foreign exchange (forex) market.

Announcement of the Monetary Policy.

Historically, the Monetary Policy is announced twice a year - a slack season policy (April-September) and a busy season policy (October-March) in accordance with agricultural cycles. These cycles also coincide with the halves of the financial year.

Initially, the Reserve Bank of India announced all its monetary measures twice a year in the Monetary and Credit Policy. The Monetary Policy has become dynamic in nature as RBI reserves its right to alter it from time to time, depending on the state of the economy.
However, with the share of credit to agriculture coming down and credit towards the industry being granted whole year around, the RBI since 1998-99 has moved in for just one policy in April-end. However a review of the policy does take place later in the year.

**Difference between monetary and fiscal policy.**

Two important tools of macroeconomic policy are Monetary Policy and Fiscal Policy.

The Monetary Policy regulates the supply of money and the cost and availability of credit in the economy. It deals with both the lending and borrowing rates of interest for commercial banks.

The Monetary Policy aims to maintain price stability, full employment and economic growth.

The Reserve Bank of India is responsible for formulating and implementing Monetary Policy. It can increase or decrease the supply of currency as well as interest rate, carry out open market operations, control credit and vary the reserve requirements. The Monetary Policy is different from Fiscal Policy as the former brings about a change in the economy by changing money supply and interest rate, whereas fiscal policy is a broader tool with the government.

The Fiscal Policy can be used to overcome recession and control inflation. It may be defined as a deliberate change in government revenue and expenditure to influence the level of national output and prices.

For instance, at the time of recession the government can increase expenditures or cut taxes in order to generate demand.

On the other hand, the government can reduce its expenditures or raise taxes during inflationary times. Fiscal policy aims at changing aggregate demand by suitable changes in government spending and taxes.

The annual Union Budget showcases the government's Fiscal Policy. The objectives of the monetary policies are to maintain price stability and ensure adequate flow of credit to the productive sectors of the economy. Stability for the national currency (after looking at prevailing economic conditions), growth in employment and income are also looked into. The monetary
policy affects the real sector through long and variable periods while the financial markets are also impacted through short-term implications.

There are four main 'channels' which the RBI looks at:

- Quantum channel: money supply and credit (affects real output and price level through changes in reserves money, money supply and credit aggregates).
- Interest rate channel.
- Exchange rate channel (linked to the currency).
- Asset price.

In recent years, the policy had gained in importance due to announcements in the interest rates. Earlier, depending on the rates announced by the RBI, the interest costs of banks would immediately either increase or decrease. A reduction in interest rates would force banks to lower their lending rates and borrowing rates. So if we want to place a deposit with a bank or take a loan, it would offer it at a lower rate of interest. On the other hand, if there were to be an increase in interest rates, banks would immediately increase their lending and borrowing rates. Since the rates of interest affect the borrowing costs of corporates and as a result, their bottom lines (profits), the monetary policy is very important to them also.

But over the past 2-3 years, RBI past Governor Y.V. Reddy had preferred not to wait for the Monetary Policy to announce a revision in interest rates and these revisions have been when the situation arises.

Since the financial sector reforms commenced, the RBI has moved towards a market-determined interest rate scenario. This means that banks are free to decide on interest rates on term deposits and loans. Being the central bank, however, the RBI would have a say and determine direction on interest rates as it is an important tool to control inflation. The bank rate is a tool used by RBI for this purpose as it refines banks at the this rate. In other words, the bank rate is the rate at which banks borrow from the RBI.
The scenario prior to recent Liberalization

Prior to recent liberalization, the RBI resorted to direct instruments like interest rates regulation, selective credit control and CRR (cash reserve ratio) as monetary instruments.

One of the risks emerging in the past 5-7 years (through the capital flows and liberalization of the financial sector) is that potential risk has increased for institutions. Thus, financial stability has become crucial and there are concerns relating to credit flows to the agricultural sector and small-scale industries.

The terms CRR and SLR mean

CRR, or cash reserve ratio, refers to a portion of deposits (as cash) which banks have to keep/maintain with the RBI. This serves two purposes. It ensures that a portion of bank deposits is totally risk-free and secondly it enables that RBI control liquidity in the system, and thereby, inflation.

Besides the CRR, banks are required to invest a portion of their deposits in government securities as a part of their statutory liquidity ratio (SLR) requirements. The government securities (also known as gilt-edged securities or gilts) are bonds issued by the Central government to meet its revenue requirements. Although the bonds are long-term in nature, they are liquid as they can be traded in the secondary market.

Since 1991, as the economy has recovered and sector reforms increased, the CRR has fallen from 15 per cent in March 1991 to 5.5 per cent in December 2001. The SLR has fallen from 38.5 per cent to 25 per cent over the past decade.

Impact of a cut in CRR have an impact on interest rates

From time to time, RBI prescribes a CRR or the minimum amount of cash that banks have to maintain with it. The CRR is fixed as a percentage of total deposits. As more money chases the same number of borrowers, interest rates come down.

Change in SLR and gilts products impact interest rates
SLR reduction is not so relevant in the present context for two reasons:

First, as part of the reforms process, the government has begun borrowing at market-related rates. Therefore, banks get better interest rates compared to earlier for their statutory investments in government securities.

Second, banks are still the main source of funds for the government.

This means that despite a lower SLR requirement, banks' investment in government securities will go up as government borrowing rises. As a result, bank investment in gilts continues to be high despite the RBI bringing down the minimum SLR to 25 per cent a couple of years ago.

Therefore, for the purpose of determining the interest rates, it is not the SLR requirement that is important but the size of the government's borrowing programme. As government borrowing increases, interest rates, too, rise. Besides, gilts also provide another tool for the RBI to manage interest rates. The RBI conducts open market operations (OMO) by offering to buy or sell gilts.

If it feels interest rates are too high, it may bring them down by offering to buy securities at a lower yield than what is available in the market.

**Monetary Policy affect the domestic industry and exporters in particular**

Exporters look forward to the monetary policy since the central bank always makes an announcement on export refinance, or the rate at which the RBI will lend to banks which have advanced pre-shipment credit to exporters.

A lowering of these rates would mean lower borrowing costs for the exporter.

**There is similarity in the stock markets and money movement.** Most people attribute the link between the amount of money in the economy and movements in stock markets to the amount of liquidity in the system. This is not entirely true.

The factor connecting money and stocks is interest rates. People save to get returns on their savings. In true market conditions, this made bank deposits or bonds (whose returns are linked to
interest rates) and stocks (whose returns are linked to capital gains), competitors for people's savings.

A hike in interest rates would tend to suck money out of shares into bonds or deposits; a fall would have the opposite effect. This argument has survived econometric tests and practical experience. At any point of time, the price level in the economy is determined by the amount of money floating around. An increase in the money supply - currency with the public, demand deposits and time deposits - increases prices all round because there is more currency moving towards the same goods and services.

Typically, the RBI follows a least-inflation policy, which means that its money market operations as well as changes in the bank rate are generally designed to minimise the inflationary impact of money supply changes. Since most people can generally see through this strategy, it limits the impact of the RBI's monetary moves to affect jobs or production.

The markets, however, move to the RBI's tune because of the link between interest rates and capital market yields. The RBI's policies have maximum impact on volatile foreign exchange and stock markets.

Jobs, wages and output are affected over the long run, if the trends of high inflation or low liquidity persist for very long period.

If wages move slower than other prices, higher inflation will drive real wages lower and encourage employers to hire more people. This in turn ramps up production and employment.

This was the theoretical justification of a long-term trend that showed that higher inflation and employment went together; when inflation fell, unemployment increased.

**Measures to regulate money supply**

The RBI uses the interest rate, OMO, changes in banks' CRR and primary placements of government debt to control the money supply. OMO, primary placements and changes in the CRR are the most popular instruments used. Under the OMO, the RBI buys or sells government bonds in the secondary market. By absorbing bonds, it drives up bond yields and injects money
into the market. When it sells bonds, it does so to suck money out of the system. The changes in CRR affect the amount of free cash that banks can use to lend - reducing the amount of money for lending cuts into overall liquidity, driving interest rates up, lowering inflation and sucking money out of markets. Primary deals in government bonds are a method to intervene directly in markets, followed by the RBI. By directly buying new bonds from the government at lower than market rates, the RBI tries to limit the rise in interest rates that higher government borrowings would lead to.

Some Monetary Policy terms:

Bank Rate

Bank rate is the minimum rate at which the central bank provides loans to the commercial banks. It is also called the discount rate.

Usually, an increase in bank rate results in commercial banks increasing their lending rates. Changes in bank rate affect credit creation by banks through altering the cost of credit.

Cash Reserve Ratio

All commercial banks are required to keep a certain amount of its deposits in cash with RBI. This percentage is called the cash reserve ratio. The current CRR requirement is 8 per cent.

Inflation

Inflation refers to a persistent rise in prices. Simply put, it is a situation of too much money and too few goods. Thus, due to scarcity of goods and the presence of many buyers, the prices are pushed up.

The converse of inflation, that is, deflation, is the persistent falling of prices. RBI can reduce the supply of money or increase interest rates to reduce inflation. The highest inflation rate for the year 2008 is 7.83% , which is all time high.
Money Supply (M3)

This refers to the total volume of money circulating in the economy, and conventionally comprises currency with the public and demand deposits (current account + savings account) with the public.

The RBI has adopted four concepts of measuring money supply. The first one is M1, which equals the sum of currency with the public, demand deposits with the public and other deposits with the public. Simply put M1 includes all coins and notes in circulation, and personal current accounts.

The second, M2, is a measure of money supply, including M1, plus personal deposit accounts - plus government deposits and deposits in currencies other than rupee.

The third concept M3 or the broad money concept, as it is also known, is quite popular. M3 includes net time deposits (fixed deposits), savings deposits with post office saving banks and all the components of M1.

Statutory Liquidity Ratio

Banks in India are required to maintain 25 per cent of their demand and time liabilities in government securities and certain approved securities.

These are collectively known as SLR securities. The buying and selling of these securities laid the foundations of the 1992 Harshad Mehta scam.

Repo

A repurchase agreement or ready forward deal is a secured short-term (usually 15 days) loan by one bank to another against government securities.

Legally, the borrower sells the securities to the lending bank for cash, with the stipulation that at the end of the borrowing term, it will buy back the securities at a slightly higher price, the difference in price representing the interest.
Open Market Operations

An important instrument of credit control, the Reserve Bank of India purchases and sells securities in open market operations.

In times of inflation, RBI sells securities to mop up the excess money in the market. Similarly, to increase the supply of money, RBI purchases securities.
6.2 Fiscal Policies

Fiscal Policies is the means by which a government adjusts its levels of spending in order to monitor and influence a nation's economy. It is the sister strategy to monetary policy, with which a central bank influences a nation's money supply. These two policies are used in various combinations in an effort to direct a country's economic goals. The tools of the fiscal policies are Public Expenditure and Public revenue.

Public expenditure is the motivating force for raising public revenue and therefore gets precedence in treatment. The broad purpose of public expenditure are the preservation of the society and to improve the quality of life of the people. The former is achieved through the maintenance of defence forces, police, courts and other administrative set up. Maintenance of transport system and communications and provision of education almost invariably are the responsibility of the State. But, in addition, with the increasing role of the State in economic and social affair, it has to invest huge sums in development activities and provide for much needed social services. With growing consciousness amongst the masses, even bigger demands are placed on Government, necessitating heavy expenditure which often is met only through loans on which interest is payable.

Public revenue is raised by taxes, both direct and indirect, profits from various financial institutions and Government undertakings, interest from loans given to other government, local bodies and other institutions etc. Revenue sources are supplemented, for the purpose of meeting capital outlays, by public borrowings, external grants and loans. Government also has the authority to raise loans from the central bank on long term bonds.

Above mentioned fiscal tools are generally employed by the State in order to achieve specific goals set by the state. But generally resources required for developmental purposes cannot be adequately raised through taxation, market borrowings or from public enterprises. Therefore a recourse is taken to deficit financing. Deficit financing refers to the excess of total expenditure over total budgetary resources.

Fiscal Policy in India

Fiscal policy in India has a multi-dimensional role. It helps in directing the flow of funds into certain priority channels, either directly through public expenditure or indirectly by means of
various fiscal incentives and disincentives. It also helps in regulating the aggregate demand and aggregate supply of goods and services. More than that, it helps in achieving certain social objectives, the chief amongst which is the ironing out of the inequitable distribution of income and wealth.

India has extensively used the various tools of fiscal policy (public expenditure and public revenue) in its achievement of socio economic goals of the economy. Over the past four decades, public finance has made rapid strides in India. There has been a phenomenal expansion in the scope and sphere of public sector activities, public expenditure and public revenue. The share of the public sector in NDP has increased to about one-fourth in 2004-05 from merely 5% in 1950-51. Combined tax revenue of the union and the state governments as a part of NDP has gone up from about 10% in 1950-51 to about 17% in 2006-07.

The objective of fiscal policy in India are same as spelt before that is rapid economic growth, expansion of employment, reduction of disparities of income and wealth and price stability etc. In order to achieve these objectives, the public sector has been assigned a vital role. The specific tasks which have been assigned to it are: (1) to provide proper infrastructural facilities to the agriculture and industrial sectors (ii) to develop basic and capital goods industries through direct investment. (iii) to improve the economic condition of the people and to provide employment to increasing number of people (iv) to reduce income and wealth disparities.

In order, to finance the above functions, to meet the growing demand for additional social overheads, such as schools, health etc., and to meet the mounting defence expenditure the government relies on public revenue and public debt. These include taxation and other sources such as fees etc., profits of public sector units, market borrowing, deficit financing and retained earnings of the RBI. In addition to the above sources which are internal, external sources such as aids, assistances and loans etc., are also tapped for meeting the public expenditure of the government.

An overview of India's Five Year Plans after the period of liberalisation:

**PLAN PROGRESS**

Each Five Year Plan involves an appraisal of the past/a reformulation of basic national policies in the light of experience gained and the drawing up of a guide map for action in the future. This
blue print for development, however, needs to be adaptable to take care of changing situations and priorities which arise from time to time. In order to provide for this flexibility, the Five Year Plan is implemented through the mechanism of Annual Plans which are prepared each year within the broad framework provided in the Five Year Plan, but incorporating such directional changes as are warranted for each year. The Annual Plans while setting out the details of the programmes to be implemented during each year also provide the basis for budgetary provision for the Plan for that year.

**Annual Plans**

Formulation of the Annual Plan every year gives the Planning Commission an opportunity to assess the previous year's plan performance and suggest strategic modifications as required, keeping in view long term growth targets. In the third quarter of each financial year the Planning Commission indicates to the State Governments and Central Ministries, the more important short term objectives that should be kept in view for the formulation of the Annual Plan for the following year. The States and the Central Ministries are requested to furnish their Plan proposals including physical targets and the corresponding financial outlay required, conforming to the guidelines referred to above and the overall framework of their respective Five Year Plans. The State Governments are advised to furnish, in addition, their estimates of financial resources including the proposals for mobilising additional resources for their Annual Plans, keeping in view the resource and outlay targets fixed for the Five Year Plan.

The Annual Plan proposals and resources estimates submitted by the State Governments are discussed in detail during November-December in the Planning Commission. Similarly, indepth discussions are held with the representatives of the Central Ministries/Departments regarding their Annual Plan proposals. The Planning Commission also reviews the progress of the Plan each year in both financial and physical terms on the basis of the detailed information obtained from the Central Ministries and State Governments. The plan outlays arrived at in the meetings between the Deputy Chairman and the State Chief Ministers/Lt. Governors in respect of State Plans and at meetings taken by Secretary, Planning Commission with the Secretaries of Central Ministries/Departments regarding the Central Plan as approved by the Commission, become the basis for budgetary provision for the Plan for the ensuing year.
The Annual Plan, 1990-91 envisaged a public sector plan outlay of Rs. 64716.80 crores/ registering an increase of 12.36 per cent over the previous Annual Plan in current prices. The Central sector plans outlay was fixed at Rs. 39329.26 crores, whereas the outlay for the States and UTs was envisaged as Rs. 25387.54 crores. The Annual Plan, 1990-91, formulated in the context of Eighth Plan, aimed at maintaining the tempo of economic development through enhanced investment and outlay in the public sector, with increased emphasis on the States Plan. The Plan laid special emphasis on rural oriented programmes/schemes. The Ministries/Departments were requested to undertake a fresh examination of individual schemes/programmes that are continuing from the Seventh Plan or earlier. The need for a quick zero-based analysis and for consolidating various schemes into a compact group of thrust programmes were emphasised. Similarly, the States and Union Territories were requested to consolidate/integrate Area Development Programmes into sustainable programmes with the twin objectives of ecological improvement and employment creation.

Formulation of Annual Plan 1991-92:

The process of formulation of the Annual Plan 1991-92 was initiated with the issue of detailed guidelines to the Central Ministries/Departments and to State Governments and UTs indicating priorities and programme thrust to be kept in view while formulating their Plan proposals in the month of June, 1990. The basic objectives, priorities and the thrust areas of the Eighth Five Year Plan (1990-95) as detailed in the Approach Paper to the Eighth Plan, approved by the National Development Council, were to provide the broad frame-work for the formulation of the Annual Plan 1991-92. It was also proposed that the plan discussions concerning the Annual Plan 1991-92 and the Eighth Five Year Plan would be taken up in tandem. Accordingly, the States, UTs, and the Central Ministries/Departments were requested to submit their proposals for the Eighth Five Year Plan and for the Annual Plan 1991-92 simultaneously.

The above mentioned guidelines comprised of the objectives and thrusts, quantitative dimensions and inter-sectoral priorities as envisaged for the Eighth Five Year Plan in the Approach document. It was stressed therein that every programme/scheme that had found place in the
Seventh Plan will need to be subjected to a critical zero-based analysis in order to see whether it satisfies the priorities indicated in the Approach. It was also urged that the pattern of investment be restructured, to the extent possible, in favour of areas, sectors and production processes with ample productive employment potential.

Working Groups had been constituted for the formulation of the States Plan. Wrap-up meetings with representatives of each State/UT were arranged and outlays arrived at for 1991-92 keeping in view the recommendations of the various Working Groups including those of the Working Group on financial resources.

Thereafter, meetings were held between the Deputy Chairman of the Planning Commission and the Chief Ministers/Lt. Governors of the State/Union Territory to finalise their respective Annual Plan outlays.

As regards the Annual Plan of the Central Ministries/Departments, the concerned Subject Divisions of the Planning Commission held in-depth discussions with the nodal Ministries on both physical and financial performance particularly in the case of proposals relating to industrial and infrastructure sectors.

Detailed exercises regarding the aggregate budgetary support as well as the internal and extra budgetary resources of the public sector enterprises likely to be available for the year 1991-92 were undertaken through close coordination between the Commission and the Ministry of Finance.

Background notes were prepared by the subject Divisions in the light of their discussions with the officers of the Central Ministries. These notes and the results of exercises on the financial resources mentioned above, formed the basis for the series of discussions that the Secretary and the Senior Officers of the Commission held with the representatives of the Central Ministries/Departments. The Ministry/Department-wise outlays were tentatively formulated at these meetings. These outlays, as subsequently finalised internally in the Commission, were later communicated to the various Ministries/Departments including the Ministry of Finance for incorporation in the Expenditure Budget - (Centre) 1991-92.
Objectives of the Eighth Five Year Plan India:

The main objectives of the Eighth Five Year Plan (1992-97) India are:

- to prioritize the specific sectors which requires immediate investment
- to generate full scale employment
- to promote social welfare measures like improved healthcare, sanitation, communication and provision for extensive education facilities at all levels
- to check the increasing population growth by creating mass awareness programs
- to encourage growth and diversification of agriculture
- to achieve self-reliance in food and produce surpluses for increase in exports
- to strengthen the infrastructural facilities like energy, power, irrigation
- to increase the technical capacities for developed science and technology
- to modernize Indian economy and build up a competitive efficiency in order to participate in the global developments
- to place greater emphasis on role of private initiative in the development of the industrial sector
- to involve the public sector to focus on only strategic, high-tech and essential infrastructural developments
- to create opportunities for the general people to get involved in various developmental activities by building and strengthening mass institutions

The 8th Five Year Plan (1992-97) Targets

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<td>GDP growth per annum</td>
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<td>Foreign Capital inflow as a % of GDP</td>
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<td>Current account Deficit as % of GDP</td>
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<td>Total Exports (Rupees million)</td>
<td>697,510</td>
<td>823,380</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total Imports (Rupees million)</td>
<td>731,010</td>
<td>887,050</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

The 8th Five Year Plan was envisaged to focus on:

- Population control
- Employment generation
- Universalisation of elementary education

Plan Allocation

In the 7th Plan, 70% of the total budgetary support to the Central Ministries went to social, infrastructure and agriculture sectors. In the 8th Plan this figure went up to 81.7%. The investment in agriculture has been declining as a proportion to the total investment. Agriculture has to keep growing under the constraint of limited availability of land, for which non-agricultural demands are also increasing.
Financing the Plan

At the time of formulation of the 7th Plan, it was envisaged that nearly 40% of the total public sector outlay would be financed by the balance from the current revenues and by contribution from public enterprises. This, ultimately, turned out to be only 20% of the total outlay and the balance was met through borrowings - which adversely affected the Balance of Payments situation. Thus, these contributions from State Public sector enterprises have to increase substantially in the 8th Plan. Generation of more savings by the government also becomes a crucial element underlying the financing pattern of public investment. Crucial decisions relating to resource mobilisation and containment of expenditure (including subsidies) are called for in order to fund the 8th Plan in a non-inflationary manner and to avoid a debt related problems.

Comparative Analysis of the Eighth Five Year Plan

<table>
<thead>
<tr>
<th>Plan</th>
<th>Investment as a % of GDP(Target rate)</th>
<th>Current Account Deficit as % of GDP(Target rate)</th>
<th>Domestic Savings as % of GDP(Target rate)</th>
<th>Foreign Capital Inflow as % of GDP(Target rate)</th>
<th>GDP Growth Per Annum(Target rate)</th>
</tr>
</thead>
<tbody>
<tr>
<td>7th Plan</td>
<td>22.7</td>
<td>2.4</td>
<td>20.3</td>
<td>1.6</td>
<td>5.8</td>
</tr>
<tr>
<td>8th Plan</td>
<td>23.2</td>
<td>1.6</td>
<td>21.6</td>
<td>1.4</td>
<td>5.6</td>
</tr>
</tbody>
</table>

From the above table it is clear that the 7th Five Year Plan targeted a GDP growth rate of 5.8% while the 8th Five Year Plan projected a 5.6% growth rate. The achievements show that the GDP shot up to a whopping 6.3% during the 8th Five Year Plan and to 4.3% during the 7th Five Year Plan. Hence the 8th five year plan had overshooted its target. The target set for the current account deficit during the 7th Five Year Plan was fixed at 2.4% while it was set at 1.6% during 8th Five Year Plan.

Results show that the 8th Five Year Plan had been more successful in this regard as the deficit was reduced by 0.7% in the 8th Five Year Plan and by only 0.1% in the 7th Five Year Plan. With
regard to domestic savings as a percentage of GDP the 8th Five Year Plan reached 24.4% while in the 7th Year Plan the figure was 20.2%. As far as the contribution of the export earnings is concerned the 8th Year Plan contributed 10.1% to the GDP while the 7th Year Plan contributed 9.9% to the GDP. The import volume as a percentage of GDP was also more during the 8th Five Year Plan (10.9%) compared to the 7th Five Year Plan (10.3%). In a nutshell the 8th five year Plan was more successful in meeting its objectives as compared to the previous five year plan.

Ninth Five Year Plan

Evolution of the 9th Five Year Plans: Some facts

Passed after 50 years of Indian independence, the 9th Five Year Plan was formulated to act as a tool for solving the economic and social problems existing in the country. The Plan in fact, was born out of the government’s realization that the latent economic reserves of the country which were still not explored, should be utilized for the overall development and benefit of the Indian economy in the coming five years. However, this could only be done when the Indian government offers strong support and priority to the social spheres of the country, focusing especially on the complete elimination of poverty.

Taking into consideration the past weaknesses, the 9th Five Year Plan endeavored to formulate fresh actions to initiate improvement in the overall economic and social sectors of the nation. To this effort, there was mutual contribution from the general population of India as well as the governmental agencies. This joint private and public attempt ultimately assured development of the Indian economy.

Primary objectives of the 9th Five Year Plan:

Each and every Five Year Plan of the Indian government is formulated, keeping in mind the fulfillment of certain objectives. The 9th Five Year Plan is no exception. The main objective of this Plan is to achieve the following goals:

- Industrialization at a rapid pace
- Reduction in poverty level
- Gaining self-sufficiency on local resources
Complete employment for all countrymen
Price stabilization should be initiated to hasten up the rate of growth of the Indian economy
Control the ever-increasing rate of population
Creating an independent market, for enhancing private financial investments
Promotion of social events like conservation of specific benefits for special social groups, female empowerment, etc.
Achieving self sufficiency in food production

Generation of equal opportunities for employment and taking steps to reduce poverty

In Ninth Five Year Plan, the State Government proposed greater emphasis on human development, increasing agricultural production and productivity, development of infrastructure, provision of basic amenities to the population, generating adequate employment and removal of regional/social disparities during the Ninth Plan period. The approved outlay for the Ninth Plan is Rs. 20,075 crores. Major sector-wise distribution of outlays in the Ninth Plan and Annual Plans are as follows:

<table>
<thead>
<tr>
<th>S.No.</th>
<th>Major Sector</th>
<th>Ninth Plan (Undivided to total Plan)</th>
<th>%age to total Plan</th>
<th>%age to approved Annual Plan outlay</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Agriculture &amp; Allied Activities</td>
<td>1129.50</td>
<td>5.63</td>
<td>9.24/8.45</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>8.96</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>7.33</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>7.49</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>9.65</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>8.43</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>9.78</td>
</tr>
<tr>
<td>3</td>
<td>Irrigation and Flood Control</td>
<td>2722.02</td>
<td>13.56</td>
<td>13.33/17.63</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>15.49</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>18.77</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>18.06</td>
</tr>
<tr>
<td></td>
<td>Energy</td>
<td>Industry and Mining</td>
<td>Transport</td>
<td>Science, Technology &amp; Environment</td>
</tr>
<tr>
<td>---</td>
<td>------------</td>
<td>---------------------</td>
<td>-----------</td>
<td>-----------------------------------</td>
</tr>
<tr>
<td>4</td>
<td>3479.46</td>
<td>17.33</td>
<td>17.61/18</td>
<td>16.95</td>
</tr>
<tr>
<td>5</td>
<td>1112.97</td>
<td>5.55</td>
<td>5.70/1.97</td>
<td>1.44</td>
</tr>
<tr>
<td>6</td>
<td>562.92</td>
<td>2.80</td>
<td>3.70/3.12</td>
<td>2.28</td>
</tr>
<tr>
<td>7</td>
<td>210.20</td>
<td>1.05</td>
<td>1.65/1.48</td>
<td>0.66</td>
</tr>
<tr>
<td>8</td>
<td>317.53</td>
<td>1.58</td>
<td>1.86/1.82</td>
<td>1.92</td>
</tr>
<tr>
<td>9</td>
<td>8506.69</td>
<td>42.37</td>
<td>36.36/37.66</td>
<td>42.43</td>
</tr>
<tr>
<td>10</td>
<td>28.12</td>
<td>0.14</td>
<td>0.37/0.33</td>
<td>0.22</td>
</tr>
</tbody>
</table>

* Inclusive of part expenditure for undivided MP.

Like all other Five Year Plans made so far, the 9th Five Year Plan (1997-2002) is formulated, executed and supervised by the Planning Commission.

In the Ninth Five Year Plan period from 1997 to 2002, the recorded rate of growth was merely 5.35%. However, this economic growth rate is a percentage point lesser than the GDP growth of 6.5% targeted during this period.

**Tenth Five Year Plan (2002-07)**

The **Tenth Five Year Plan India (2002-2007)** aimed to transform the country into the fastest growing economy of the world and targets an annual economic growth of 10%. This was decided after India registered a 7% GDP growth consistently over the last decade. This GDP growth of
7% is much higher than the world's average GDP growth rate. Thus, the Planning Commission of India sought to stretch the limit and set targets which would propel India to the super league of industrially developed countries. In a nutshell, the Tenth Five Year Plan India envisaged -

- More investor friendly flexible economic reforms
- Creation of congenial investment environment
- Encourage private sector involvement
- Setting up state-of-the-art infrastructure
- Capacity building in industry
- Corporate transparency
- Mobilizing and optimizing all financial resources
- Implementation of friendly industrial policy instruments

Following are the highlights of the 10th Five Year Plan approved by the National Development Council (NDC):

* 8 per cent average GDP growth for the period 2002-07
* Creation of 50 million employment opportunities in the next 5 years
* Reduction of poverty ratio by 15 percentage points by 2012
* Emphasis to be placed on completion of partially completed or on-going projects and upgradation of existing capital assets before starting new projects
* Rapid privatization of Public Sector Enterprises (PSEs), particularly those, which are working well below capacity
* The policy of disinvestments of public sector undertakings should be pursued so as to enable the realization of Rs 16,000 crore per annum to finance the plan
* Progressive reduction in fertiliser subsidy as well as elimination of petroleum subsidy
* Food subsidy should be better targeted through targeted public distribution system and specific programmes for the poor like Food for Work Programme
* Curtailment of pay and allowance bill of the Government
* All children in school by 2003; all children to complete 5 years of schooling by 2007
* Reduction in gender gaps in literacy and wage rates by at least 50 per cent by 2007
* Reduction in the decadal rate of population growth between 2001 and 2011 to 16.2 per cent
* Increase in literacy rates to 75 per cent within the Plan period
* Increase in forest and tree cover 25 per cent by 2007 and 33 per cent by 2012
* All villages to have sustained access to potable drinking water within the Plan period
* Legal and procedural changes for facilitating quick transfer of assets, including such measures as repeal of Sick Industrial Companies (Special Provision) Act (SICA), introduction of a bankruptcy law, facilitating foreclosure, accelerating judicial processes
* Lower tariffs on imports to remove anti-export bias
* Rationalization of the domestic tax structure, and the consequent simplification of the export promotion regime
* Evolve a positive agenda for its future negotiations at the WTO
* Improving tax/GDP ratio of the Centre and states through inclusion of services in tax base, removal of tax exemptions and concessions, harmonization of tax rates, tightening of tax administration, and adopting an integrated VAT regime
* Reduction of budget-based subsidies by raising user charges of departmental services, reducing expenditure by cutting administrative and establishment cost and privatization and through Centre's initiative switching over to ad valorem rates of royalty on minerals
* Reducing staff strength through adoption of policy of net attrition and constituting a pension and amortization fund to make committed payments like terminal benefits and debt servicing, self-financing
* Enacting a 'Fiscal Responsibility and Budget Management' bill under which borrowings shall be restricted to attain a non-rising debt to GDP ratio from current levels in order to reduce the burden of interest payments
* Improving internal resources of states' PSUs by implementing power sector reforms and reducing the burden of contingent liabilities on state budgets through a legislative or administrative ceiling on the issue of state guarantees
* Simplifying laws and procedures for investment
* Eliminating inter-state barriers to trade and commerce
* Reforming development financial institutions for long-term financing of small and medium enterprises
* Removal of government and Reserve Bank of India restrictions on financing of stocking and trading
* Calibration of the cost of borrowed funds for enhancing competitiveness
* Essential Commodities Act should be repealed and replaced by an emergency act
* Encouraging Foreign Direct Investment so as to achieve the annual target of 7.5 billion dollars
* Exemptions under corporate tax should be progressively eliminated
* Single excise rate
* Expansion of service tax net
* Alignment should be made of customs tariff rates with average Asian rates
* Exemptions and concessions that distort the tariff structure should be eliminated
* Improvement of the operational efficiency of railways and power sector units
* Reduction in staff strength and constitution of a pension and amortisation fund to make committed payments like terminal benefits and debt servicing self-financing
* User charges must be raised to cost-recover levels
* Project based assistance needs to be encouraged
* Rationalization of Centrally Sponsored Schemes (CSSs) and Central Sector Schemes (CSs) using zero based budgeting
* Railway Tariff Regulatory Authority needed to oversee the pricing of passenger and freight traffic services

Opening of civil aviation sector and setting up a regulatory framework for the sector Adoption of integrated approach to improvement in agriculture sector by utilising waste and degraded lands

The Tenth Plan deliberately skipped resource mobilization by way of disinvestment. In fact, the controversial public sector disinvestment issue was considerably laid down by the Planning Commission

**Highlights of the Tenth Five Year (2002-07)**

2006-07 Economic trend

- The overall growth of GDP during the second quarter (July-September) of 2006-07 was 9.2 per cent as compared to 8.4 per cent during Q2 in 2005-2006.
- The Post-Monsoon season rainfall from October 1, 2006 to December 6, 2006 was normal/excess in 33 per cent of meteorological sub-divisions.
- Food grain stocks were 12.38 million tonnes as on October 1, 2006.
Overall industrial growth was 10.3 per cent during April-October, 2006 as compared with 8.6 per cent in April-October, 2005.

Core infrastructure sectors achieved an average growth rate of 7.5 per cent during April-October, 2006 as compared with 5.2 per cent in April-October, 2005.

Broad Money (M3) growth (year-on-year) was 18.7 per cent as on November 10, 2006 as compared with 17.2 per cent last year.

Exports grew by 35.0 per cent in dollar terms during April-October, 2006. Imports increased by 33.0 per cent in April-October, 2006.

Forex reserves (excluding Gold and SDRs) stood at $167.60 billion at the end of November, 2006.

Today India is in the 8per cent plus GDP growth region, the second highest in the world. But this is not good enough. The service sector is growing rapidly. The software sector is growing at 30 per cent per annum. The growth of IT-enabled services is at 75 per cent a year. Insurance and banking is deepening its roots through a new public-private partnership. Other services are also growing rapidly. The manufacturing sector, for several years in a low capacity utilization mode, is reviving steadily. Agriculture is not growing this year but has grown in recent years.

Infrastructure is not the dark shadow over the economy. The highway network construction programme has been a success. Rural road development is happening. Telecom is transformed with competition and lowering costs to the consumer, though industry concerns need resolving. New ports have been operational. Airport modernization is on the way. Power reforms are actually moving - not halted - particularly in the distribution sector. The real concern continues to be the railways. India, therefore, had the potential to achieve an 8 per cent growth and it did achieve the growth rate of 9.9% plus whereas Average Real GDP Growth: 9.4 percent (2006-07). GDP at current prices: US$ 1010 billion (2006-07)

Objectives of the 11th Five Year Plan

The central vision of the Eleventh Plan is to build on India’s strengths to trigger a development process which ensures broad-based improvement in the quality of life of the people, especially
the poor, SCs/STs, other backward castes (OBCs), minorities and women. The National Development Council (NDC), in approving the Approach to the Eleventh Plan, endorsed a target of 9% GDP growth for the country as a whole. This growth is to be achieved in an environment in which the economy is much more integrated into the global economy, an integration that has yielded many benefits but also poses many challenges. If this is achieved, it would mean that per capita GDP would grow at about 7.6% per year to double in less than ten years. However the target is not just faster growth but also inclusive growth, that is, a growth process which yields broad-based benefits and ensures equality of opportunity for all. This broad vision of the Eleventh Plan includes several inter-related components: rapid growth that reduces poverty and creates employment opportunities, access to essential services in health and education especially for the poor, equality of opportunity, empowerment through education and skill development, employment opportunities underpinned by the National Rural Employment Guarantee, environmental sustainability, recognition of women’s agency and good governance.

The broad macroeconomic framework of the Plan envisages a continuation of the uptrend in domestic investment and savings observed in the Tenth Plan taking domestic investment from an estimated 35.9% of GDP in 2006–07 to an average of 36.7% of GDP in the Eleventh Plan period. This is expected to be supported by the domestic savings rate of 34.8% of GDP in the Eleventh Plan period. These investment rates are broadly consistent with achieving an average growth rate of 9% per year in the Eleventh Plan period. The Plan also implies a substantial increase in the total resources for the Central and State Plans from 9.46% of GDP in the Tenth Plan to 13.54% of GDP in the Eleventh Plan. This outcome depends upon government non-Plan expenditure, especially subsidies remaining under control and a significant improvement in the IEBR of the public sector in both the Centre and the States.

The macroeconomic projections involve a rise in the current account deficit from 1.1% of GDP in 2006–07 to an average of 1.9% of GDP in the Eleventh Plan period, based on oil prices at the average level of 2006–07. The recent hardening of oil prices, if it continues, will involve a further increase in the current account deficit by up to 1 percentage point of GDP. Even if this were to happen, it will be feasible to finance the increased deficit given India’s export potential and the prospect of continuing inflows of foreign investment. The real challenge in the
persistence of high oil prices lies in the need to pass on these prices to consumers which could moderate growth a little in the short run.

On balance, the Plan target of 9% per year appears achievable with some downside risks if oil prices harden further. The broad sectoral composition of growth associated with this projection involves doubling the growth rate of agriculture to 4% per year compared with a little over 2% per year in the Tenth Plan and raising the industrial growth rate from 9.2% in the Tenth Plan to between 10% and 11% in the Eleventh Plan. Further, manufacturing is targeted to grow at over 12% per year and this is expected to provide high-quality employment.
6.3 Disinvestment

Disinvestment was initiated by selling undisclosed bundles of equity shares of selected central PSEs to public investment institutions (like the UTI), which were free to dispose off these shares in the booming secondary stock market. The process however came to an abrupt halt when the market collapsed in the aftermath of Harshad Mehta led scam, as the asking prices plummeted below the reserve prices. Since the stock market remained subdued for much of the 1990s, the disinvestment targets remained largely unmet.

The change of government at the Centre in 1996 led to some rethinking about the policy, but not a reversal. A Disinvestment Commission was constituted to advise the government on whether to disinvest in a particular enterprise, its modalities and the utilization of the proceeds. The commission, among other things, recommended (Disinvestment Commission, 1997):

- Restructuring and reorganization of PSEs before disinvestment
- Strengthening of the well-functioning enterprises, and
- To utilize the disinvestment proceeds to create a fund for restructuring of PSEs.

In response to the public debate, and to the commission’s recommendations, some large and well-functioning PSEs were declared “jewels” (Navaratnas) in the government’s crown, and were granted greater managerial and financial autonomy. However, disinvestment did not pick up as the share prices remained subdued because of the scandals that rocked the financial markets. Apparently some PSEs stocks were part of the scandal, which this time also involved the UTI. The new government that came to power in 1998 preferred to sell large chunks of equity in selected enterprises to “strategic” partners – a euphemism for transfer of managerial control to private enterprises. A separate ministry was created to speed up the process, as it was widely believed that the operating ministries are often reluctant to part with PSEs for disinvestments as it means loss of power for the concerned ministers and civil servants. The sales were organized through auctions or by inviting bids, bypassing the stock market (which continued to be sluggish), justified on the grounds of better price realization. Notwithstanding the serious discussion on the utilization of disinvestment proceeds, they continued to be used only to bridge the fiscal deficit.
Strategic sale in many countries have been controversial as it is said to give rise to a lot of corruption, discrediting the policy process. Aware of such pitfalls, efforts were made to be transparent in all the stages of the process: selection of consultants to advice on the sale, invitation of bids, opening of tenders and so on. Between 1999 and 2003, much greater quantum of public assets were sold in this manner, compared to the earlier process, though the realized amounts were consistently less than the targets – except in 2003 (Table 2 and 3).

Nonetheless, there are series of allegations of corruption and malpractice in many of these deals that have been widely discussed in the press and the parliament. Instances of under pricing of assets, favoring preferred buyers, non-compliance of agreement with respect to employment and retrenchment, and many incomplete contracts with respect to sale of land, and assets have been widely reported.9

Thus, during the last 13 years Rs. 29,520 crores were realized by sale of equity in selected central government PSEs, (in some cases) relinquishing managerial control as well (Table 4). This formed less than one per cent of central government’s cumulative fiscal deficit in this period.

Amid disinvestment and privatization, some new PSEs are also created. For instance, many departmental activities were being corporatised (setting up of BSNL for instance) with a view to disinvestment. New PSEs are also formed to take up newer activities like road development corporations (promoted by state governments to execute highways and irrigation projects).

Legal issues in the D-P process:

Legality of the disinvestment process has been challenged on a variety of grounds that slowed the sale of public assets. However, there were two significant judicial rulings that broadly set the boundaries of the D-P process. These are:

1. Privatisation is a policy decision, prerogative of the executive branch of the state; courts would not interfere in it.
2. Privatisation of the PSE created by an act of parliament would have to get the parliamentary approval.
While the first ruling gave impetus for strategic sale of many enterprises like Hindustan Zinc, Maruti, and VSNL etc. since 2000, the second ruling stalled the privatization of the petroleum companies, as government was unsure of getting the laws amended in the parliament.

Privatization at the state level:
A sizable proportion of the state level enterprises are “welfare corporations” largely intended to meet social welfare objectives, and to secure resources from public sector banks and development financial institutions. However, many SLPEs are also involved in manufacturing and mining activities to utilize local resources and to cater to the regional markets. SLPEs as a whole make sizable financial losses.

Privatization at the state level began somewhat earlier than at the Centre. Sale of the state government’s equity holding in Allwyn Nissan Limited in Andhra Pradesh in 1989, UP State Cement Corporation to Dalmia Group, and Auto Tractors in 1991 – were precursors to the national level policy changes (Bajaj, 1994). By 2003, 35 such SLPEs have been privatized. But, interestingly, over five times as many enterprises (180) were shut down during this period (Table 5).

Employment in PSEs:
As Figure 1 shows, employment in the central PSEs has declined from about 2.2 million in 1991-92 to about 1.7 million a decade later. A marginal rise in 2001-02 is on account of the shift of employment from department of telecommunication to incorporation of BSNL as a corporate entity. If one traces employment in a set of same enterprises over the 1990s, perhaps the decline would be greater. The fall in employment is clearly the result of voluntary retirement scheme (VRS) initiated using the National Renewal Fund, as part of the structural adjustment programme.

There has been an effect on employment after privatization Perhaps it is too early to get firm evidence since substantial privatization occurred only during the last four years. However, popular reports suggest some retrenchments and compulsory retirement of workers. Reportedly some private firms have violated their contract in this regard (Modern Foods, for instance). There are also reports of employment generation at BALCO on account of capacity expansion.

Performance of PSEs after disinvestment and privatization:
In principle, disinvestment is unlikely to affect economic performance since the state continues to be the dominant shareholder, whose conduct is unlikely to be influenced by share prices.
movements (or return on equity). Privatization can be expected to influence economic outcome provided the firm operates in a competitive environment; if not, it would be difficult to attribute changes in performance solely to the change in ownership.

Assessing the principles, premises, and performance of the D-P process:

Right from the beginning in the UK, privatization has been a policy in search of an economic rationale— to borrow the title of Kay and Thompson's (1986) well-known contribution. Mainstream economics is largely agnostic about the role of ownership, focusing mainly on how market structure affects performance of firms (Vickers and Yarrow, 1991). If privatization is seen as a means of raising resources for the budget, it can be analytically shown to be cheaper to sell public bonds than public assets. Instead of seeking the reasons for privatization, one could instead ask why a certain firm should remain in public sector. Some would contend that with rapid technological change, natural monopoly, as a powerful argument for public ownership has simply disappeared. Such an argument would surely hold for telecommunications, not but for the rest of public monopolies. Based on studies of privatization of natural monopolies, Ravi Ramamurthy (1999) contended:

Sectors such as railways, however, are harder to regulate after privatization (see Ramamurthi, 1997). The regulatory task can be especially difficult in sectors such as highways, or water or sewage, where competition is weak or totally absent, investments are lumpier, externalities are much more important, and payback periods run 8-10 years or more, thereby increasing uncertainty and risk for contracting parties. Renegotiations are likely to be the rule, brought on by unanticipated developments or simply opportunism on the part of investors and governments. History is full of examples in which such arrangements have fallen apart a few years after they were signed.

In fact, it is mainly the property right theorists who have underlined the role of ownership on economic performance. But in the twentieth century, with the separation of ownership from control in modern industry, there is a serious agency problem regardless of its ownership. The view that the secondary capital market and the market for managers provide adequate discipline on a firm's performance is at variance with evidence, especially the US experience (more about it later).

The evidence on the efficiency effects of privatization. It is highly mixed, to put it mildly. Florio (2004), perhaps the most recent and definitive quantitative account covering the longest time
period of the UK experience, does not show any measurable efficiency gains on account of the changes in ownership. World Bank’s official study (Ghalal et al, 1995), perhaps the most careful exercise at making pair-wise comparisons of comparable firms in many countries, was extremely cautious in suggesting welfare gains. In fact, one of the authors of the study, Pankaj Tandon, in an independent paper was more categorical in rejecting the hypothesis of efficiency gains from privatization in less developed countries. If this selective review of evidence is anything to go by, then one should have a modest expectation from whatever privatization that has happened in India.

Britain, the cradle of modern capitalism, has witnesses the public policy pendulum swing from nationalization to privatization (or denationalization) many times over, in the 20th century. While the US has a model of private ownership, and control with public regulation, continental Europe and Japan have, by and large, stayed steady with greater public ownership in such industries. Although there have been some privatization in these economies, such attempts have remained relatively modest with limited changes in ownership and control of national assets. Thus, there seems to be no unique ‘model’ that is universally sound for promoting efficiency and resource use. Perhaps it has a lesson for us: we have to search for a solution suited for our conditions that are broadly consistent with economic reasoning.

Before seeking evidence on the effects of the D-P in India, perhaps it would be useful to ask how valid were the premises of the disinvestment policy to begin with. It is widely believed, as large and growing share of the fiscal deficit was on account of PSEs’ financial losses getting rid of them would restore the fisc back to health. How valid was such a diagnosis? Nagaraj (1993) had shown, using a widely accepted methodology that PSEs’ financial losses were not the principal cause of the growing fiscal deficit in the 1980s, and in fact PSEs’ share in the fiscal deficit had steadily declined in the decade. In other words, the government per se was largely responsible for the growing fiscal deficit, not the enterprises owned by it.

Updating these estimates for the 1990s using a more refined method, the estimated deficits of the general government confirmed our previous findings (Figure 2). Government’s share (in terms of equity and debt) as a proportion of PSEs’ total fixed investment shows a steady decline since the mid-1970s, suggesting a gradual tightening of their budget constraint (Figure 3). The decline in government’s contribution is being met increasingly by a rise in internal resources (Figure 4).
These long-term trends indicate, contrary to the widely held views, the growing fiscal deficit since the 1980s is not on account of financial losses of the enterprises.

The above evidence suggests that the popularly used indicator of net profit as a proportion of total equity does not adequately reflect PSEs' financial performance. While such a measure may be useful for a private shareholder, it has many shortcomings to gauge the return on public investment. For many reasons, PSEs tend to be over capitalized. First, while these enterprises are expected to develop infrastructure on their own using budgetary resources (adding to their capital costs), state government agencies usually vie with each other to provide larger and better infrastructure for private firms, thus reducing their capital cost. Therefore, depreciation charges for PSEs tend to be much larger. Second, capital structure of PSEs is seldom designed to maximise returns for the shareholder, namely the government. Usually PSEs are granted large loans in the initial year; when they are unable to service the loans, these are often converted into equity to reduce their debt repayment burden. Thus, many PSEs have high equity, not by design but by default, adversely affecting the net profitability ratio. Moreover, from an economic viewpoint, capital structure of an enterprise is of secondary importance compared to return on capital employed.

It is widely believed that PSEs' respectable profitability ratio (gross profits to capital employed) is mainly on account of the surpluses of the petroleum sector enterprises whose pricing includes an element of taxation. Interestingly, as shown in Figure 5, the profitability ratio has improved since the 1980s even excluding the petroleum sector enterprises — a clear evidence on improvements in PSEs financial performance. But could it be merely due a faster rise in administered prices of PSEs' output (on account of their monopolist position in the domestic market)? This is not so, as evident from the fact that the ratio of deflators of public sector output and GDP has declined since the mid-1980s (Figure 6).

If PSEs' financial performance has improved as shown above, what then accounts for the growing deficits? The problem seems to lay in poor financial returns in electricity boards, road transport corporations and railways, which are probably not adequately reflected in the above measures. For instance, revenue-to-cost ratio in SEBs has remained less than one for much of the 1990s, a decade of much talked about reforms, despite a steady rise in physical efficiency of thermal power plants (as measured by plant load factor) (Figure 7).
If the above reasoning and evidence is persuasive, then they suggest that the empirical premises for the ownership reforms were rather thin. While undoubtedly public sector’s financial performance needed an improvement, they were not, in the main, on account of the central PSEs that were the targets of the D-P. They mainly lay in (i) the growing expenditure and subsidies of the government, and (ii) poor return on investment in electricity, irrigation and road transport. In all these cases, the real problem is not so much public ownership, but pricing of public utilities and government’s inability to collect user charges, for a variety of political and social reasons. To sum up, as the sale of equity has been quantitatively a modest, in relation to the size of public sector in India, it is hard to judge the efficacy of the reform effort. Moreover, it is perhaps too early to be definitive about the outcomes. Analytical bases of the policy reform were fragile to begin with, and comparative experience does not give much optimism for measurable efficiency gains from these changes in ownership of industrial assets. Above all, if the evidence reported is anything to go by, the premises of the D-P policy were rather weak.

Policy Options

With over a decade of sustained efforts to redraw the boundaries of the ownership of public industrial assets, there has hardly been any political or professional consensus on the need for, and the modalities of, privatisation. This can be interpreted to mean either of the two possibilities: that there is a great potential for the sale of public equity, or, that there are practical difficulties of doing it. Realistically speaking, if ownership reform is a policy imperative then the options before us seem limited to the following:

1. Rule out large-scale privatization, considering (a) the shallow domestic stock market, (b) relatively small size of the private corporate sector, and (c) the widespread political opposition to transfer of managerial control to foreign-owned firms, and (d) social costs of such transfers.

2. In principle, disinvestment without a change in management is unlikely to make much difference to efficiency. It may help raise limited resources from the capital market, mainly reflecting the government monopoly in the industry. But this is a costly source of finance with high transaction costs. Given excess liquidity currently in the financial system it would be cheaper to sell bonds domestically to raise the required finances.
3. Financially unviable (loss making) PSEs need to be drastically restructured or closed down. However, these enterprises are invariably located on valuable real estate, as most of these industrial enterprises were the locus of urban and regional industrial development. Empowered committees consisting of all the stakeholders could be created to shut down such enterprises, dismantle the plant and machinery, and sell the real estate in a transparent manner; and/or develop the real estate jointly with institutions like the LIC or state housing boards. Workers are unlikely to object to such proposals if they are assured of a fair share of the sale proceeds either in cash or part of the housing to be built using the land.

4. In consumer goods industries like hotels etc, where PSEs may have quality assets in prime locations but lack sound management, long term leases or management contracts could be a viable option. However, efficacy of this option lies in the design of contracts. If they were highly loaded against government it would vitiate the purpose.

5. Need for the institutional mechanism of disinvestment commission with representatives from different stakeholders to deliberate on all the above matters in a transparent manner. Doing it administratively by a ministry would perhaps discredit the D-P policy.

If we admit that there are genuine limitations of selling off of PSEs – core of which belong to energy, infrastructure, and industries of strategic interest in national development – then there is perhaps no credible alternative but to improve the functioning of these enterprises. We, then, are back to the old question: how to improve PSEs performance where a change in ownership is unlikely to make much difference.

There is a large (administrative) literature (including many valuable official reports) addressing such a question; much of it dwells on the autonomy and accountability of enterprises posed mainly in terms of administrative controls of the government as the ultimate “owner”, and procedural accountability of the managers. One of the widely advocated suggestions is to create industry wise holding companies – for instance, Arjun Sengupta Committee’s main suggestion (Government of India, 1984) – as an institutional buffer between an enterprise and the government. But the evidence on this organizational form is perhaps not encouraging, as it often implies creation of another tier of bureaucracy, undermining the autonomy of the firm or factory level managers.
Economic analyses of public sector performance, however, seem to have largely ignored the institutional ‘black box’, by focusing mainly on the macroeconomic effects of public investment and planning for growth. Many studies critical of India’s growth and its distribution have identified political economic reasons for poor performance of PSEs. More recently, in line with the current orthodoxy, some have advocated ownership reform, which we have argued to be of limited value.

Problem of corporate governance:
In the evolution of modern capitalism, with separation of ownership from control as firms grow in size and complexity, agency problem arises: how to ensure that the managers (“promoter” in Indian parlance) work to maximise return on shareholders’ capital. Given the information asymmetry, managers could pursue their private goal disregarding the shareholders’ interests. This is at the heart of the problem of modern literature on corporate governance. Various institutional and contractual mechanisms have evolved in the last century to grapple with this problem.

In the context of efficiency of resource use in a socialist economy, Oskar Lange sought to solve the problem of how to ensure that managers of public firms maximized efficiency consistent with the goals set by the central planners. However, looking at the microeconomics of firms in a socialist economy, Jonas Kornai argued that they were unlikely to be efficient because of the soft budget constraint: that is, firms do not go bankrupt or managers do not lose their jobs for their poor performance. Firms can always renegotiate their contracts with the planners to hide their inefficiency.

In India public sector firms are often face with multiple objectives, and multiple owners or monitors – central government, state governments, legislators, public auditors and so on. Managers may not necessarily maximise profits as they could always highlight a particular achievement to suit their convenience. Managers may be risk averse as they face constitutionally mandated procedural audit by the CAG if an enterprise is majority government owned. Managers’ efficiency objectives may come in conflict with dysfunctional political interference in operational matters (at the expense of policy issues) to meet narrow political goals. However, at the same time, poor performance by managers does not involve any punishment as they can renegotiate the output prices, budgetary support, or have access to soft and/or government guaranteed loans; in other words they do not face a hard budget constraint.
Thus, the agency problem is endemic to all economic systems. Moreover, problem of soft budget constraint is not restricted to socialist economies but evident in market economies as well when the firm is question is large and considered of strategic importance for the economy, though perhaps to much lesser extent. Rescue of Chrysler Corporation – the third largest automotive firm in the US – in the late 1970s and United Airlines after “9/11” in the US are clear instances of state support for failing companies. Such support is more common in financial sector, where failure of firms can have significant systemic risk.

Comparative experience:
Experience of the last century shows that different economic systems have sought to solve this problem in a variety of ways, with varying degrees of success. The Soviet system was perhaps quite capable of solving the problem in the initial phases of ‘extensive growth’ with a clear objective of maximisation of national output. However the system began to falter, as the economy got more complex, in the phase of ‘intensive growth’ when objective was to increase productivity of resources .The command economy was unable to resolve the agency and incentive problems at the micro level because of the soft budget constraint.

As noted earlier, in the Anglo Saxon economies, the secondary stock market acted as the disciplining device on corporate performance and as market for managers. In principle, stock prices that summarise all publicly available information on the firm performance should provide adequate signals for managers to act optimally. The system is also seems capable of providing risk capital to spur rapid technological progress, as witnessed in the role that venture capital funds played in promoting the Internet revolution. However, given the agency problem, there is enormous scope for abuse of the system, adversely affecting the shareholders’ interests and possibly hurting economic efficiency in the aggregate. Hostile takeovers and leveraged buyouts have exposed the inefficiency of such a disciplining mechanism .The recent implosion of some of the world’s biggest companies, astronomical rise in managerial remuneration disproportionate to performance of firms, and widespread abuse of stock options by top managements in firms like Enron and Tyco by the turn of the last century have seriously dented the credibility of the stock market based principles of corporate governance.
Evolution of the Indian system:

In light of above, one can characterize India's economic development over the first three decades of planned economic development. A bank-centric system was broadly put in place with an elaborate network of public sector banks, development finance and investment institutions. Though banks, especially the DFIs, had representation on company boards by virtue of their large debt and equity holding (both public and private), there was no attempt to nationalise private corporate firms, or to interfere with managerial control of existing promoters unless the firms were mismanaged. Thus, the system was broadly supportive of development of private enterprise consistent with the national objectives. Moreover, as Indian enterprises are predominantly family-managed, public financial institutions sought modernise corporate governance (like introduction of professional managers in the boards) and financial practices, without questioning the rights of management of the promoters. But, the role of the financial institutions was largely subordinated to the implementation of quotas and licenses. Financial system, thus, could not adequately develop expertise in screening investment projects, market and technologies, and assessing market risk. They had little role disciplining corporate managers with financial carrots and sticks. In other words, banks and financial institutional were not encouraged to develop their "reputational capital", that is perhaps central to a sound financial system. A close reading of the early studies by R K Hazari (1986) on licensing, and later Narasimham Committee report on shifting from physical to financial controls (Ministry of Finance, 1985) seem to suggest that they proposed to nudge the institutions towards a bank centric system of financing and corporate governance.

Although development banks increasingly financed PSEs investments, they had limited role in governance of these enterprises, was largely in the hands of the operating ministries and were subjected to parliamentary controls. Parliament constituted Committee on public undertakings (COPU) that looked into the functioning of selected PSEs. Similarly, CAG is constitutionally mandated to audit PSEs in which the central government held more than 50 per cent of equity shares. While such measures of public accountability are in principle desirable in a democracy, in practice, the parliamentary committees had little role in ensuring efficacy of resource use in these publicly owned firms. As measures of enforcing sound corporate governance, these methods were not effective.
However, overlooking the hard task of institutional design to suit the specificities of large, heterogeneous, democratic industrializing economy of India the reforms initiated in the 1990s have sought to improve PSEs' financial performance by transferring ownership and control to private sector, and resort to stock market based discipline. As the above discussion clearly demonstrates, regardless of ownership agency problem exists is ubiquitous, and problems of soft budget persist in varying degree when the firms involved are large and strategic. Further, private ownership would not guarantee improvement in efficiency if the market structure remained the same; on the other hand a private monopoly, could be worse than a public one.

A suggestion for reform:

On the basis of the above, if we accept that the real problems facing PSEs are, (i) dysfunctional political interference, (ii) constitutionally mandated procedural audit and (iii) soft budget constraint, then following measures can be suggested:

- Reduce the government holding in PSEs to less than 50 per cent by transferring share to mutually complementary firms by creating Japanese style keiretsu, tied around a public sector bank or financial institution. For instance interlocking of equity holding among steel, coal and electricity firms; or petroleum exploration, refining and petrochemical complexes. Such a measure would eliminate the procedural audit as well as political interference on the day-to-day operational matters.

- However, to ensure public accountability managers may be asked to make presentations to the parliamentary sub-committees on efficiency of resource use. At the same time, managers should have clearly defined security of tenure for say 3 or 5 years to ensure continuity and to show measurable performance.

- Harden the budget constraint for PSEs by a clear sunset clause on budgetary support or government guarantee for loans, except for specific public purpose oriented investments.

- Given that banks provide substantial equity and loans, they would, in principle, have incentive to monitor PSEs performance to retain their reputational capital.

- However, question would still remain who will monitor the banks? There are no easy answers to it. Given the increasing independence of the Reserve Bank, it is conceivable to device a system to where the central bank and other regulatory authorities are given the responsibility of appointing top managers of banks. Such a scheme of delegated monitoring is in principle is
better for efficiency. Such a monitoring could focus on long-term corporate goals such as productivity growth market shares, and R&D outcomes.

To ensure that PSEs do not abuse their oligopolistic position in the domestic market, reasonably open trade and investment regime could impart the discipline of the world market.

Pranab Bardhan (1991 and 1993) has argued in favour of such a system for India to overcome the problem of soft budget constraint and a way to acquire dynamic comparative advantage. Applying the recent advances in information economics and drawing from the recent experience, Stiglitz and his associates caution developing economies against moving from financial repression to financial liberalization. Such attempts have more often than not, led to many financial crises. Arguing against such polar extremes, these scholars have advocated Japanese style relationship banking system or Korean style hard budget constraint banking as desirable forms of financial system, which they define as “financial restraint”.

While public sector enterprises' contribution to national development is widely acknowledged, their poor financial return has been a matter of deep and enduring concern, especially since the mid-1980s when, for the first time, the central government's current revenues were found inadequate to meet its current expenditure. Though firm and industry level studies of PSEs have often highlighted gross inefficiencies and poor profitability, many of them have also suggested their unquantifiable (or difficult to quantify) non-economic benefits. However, macroeconomic discourse in India has largely focused on the "crowding-in" effects of public investment, and the need for institutional structures to insulate the PSEs from political and bureaucratic interference to improve their financial returns. Deeper analyses have sought to offer political economic explanations for continuation of such a state of affairs.

As a means to restore budgetary balance, after the crisis in 1991, government sold a small fraction of its equity shares in selected public sector enterprises to public investment institutions. Though quantitatively modest, it signaled a major departure in public policy; it was the thin end of the wedge that led to transfer of managerial control in a few PSEs about a decade later. The policy shift was also significant, as it deflected the contours of the discourse on public sector
reform from institutional design and corporate governance to a change in ownership in favour of private sector as a means to overcome the inefficiencies. The shift in debate was consistent with the changes in the discussions on economic policies worldwide.

Quantitatively, the Disinvestment and privatisation have been modest so far, as proportions of the targets, revenues realised, or as a proportion of the fiscal deficit. Disinvestment did not secure much revenue, as the stock market was subdued during much of the 1990s on account of a series of scandals that repeatedly rocked the financial markets. Sale of substantial chunks of equity with transfer of managements that took place in the last 3-4 years has yielded sizable revenues. But most of these sales have been contentious with a series of legal cases pending in the courts, and enormous adverse commentary on them in press and the parliament.

Should we persist with the policy of ownership reform? Realistically speaking, prospects for the D-P appear limited, as the bulk of the public investments (in terms of capital employed) are in infrastructure and industries of strategic importance, where market failures and national interests seem too significant to be left unattended by public policy. There is little that is credible in economic theory that argues ownership as the principal basis for economic outcomes. Moreover, accumulating evidence on privatisation across the world does not give any prospect of this policy making a genuine difference to firm level performance on a sustainable basis.

If the above assessment is reasonably persuasive, then we are back to the earlier question: how to design an institutional mechanism that limits (if not overcomes) the agency problem that is at the heart of modern capitalism with the separation of ownership and control of large firms, that puts hard budget constraint on firms, and reduces dysfunctional political bureaucratic interference. Solution to this problem seems closely tied to financing of investment, and financial system that provides resources for development and performs the function of a disciplining device on firms. While disinvestment and privatisation necessarily lead towards stock market based discipline, we have argued that history and theory do not seem to support it to be the superior alternative. We are inclined to favour the Japanese and German style interlocking of ownership of complementary PSEs tied together with a bank that enforces greater managerial accountability, and encourages long term outlook of output growth and acquisition of technological capabilities.

Admittedly, there are a numerous enterprises with modest investments that are in the public sector fold that operate in competitive markets or do not serve any strategic purpose. Among
these, loss making ones can be disposed off by selling the real estate of these enterprises by creating empowered committees of all stakeholders in these enterprises. Workers are unlikely to oppose such moves if there is a reasonable and transparent sharing of proceeds of such sales. The remaining PSEs operating broadly in “competitive” environment can be granted greater autonomy, or give out to private parties on management contracts or on lease. To undertake these tasks, there is a need for a body like the disinvestments commission with representation from all stakeholders to workout the modalities of undertaking these changes.

Table 1: What successive Finance Ministers have said about D-P in their budget speeches

<table>
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<tr>
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199
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Source: Sarma (2004): 2195

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Social and infrastructure sector

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</tr>
<tr>
<td>2</td>
<td>Modern Food Industries Limited (MFIL)</td>
</tr>
<tr>
<td>3</td>
<td>Bharat Aluminium Company Limited (BALCO)</td>
</tr>
<tr>
<td>4</td>
<td>CMC Ltd. (CMC)</td>
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<tr>
<td>5</td>
<td>HTL Ltd. (HTL)</td>
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<tr>
<td>6</td>
<td>IBP Co. Ltd. (IBP)</td>
</tr>
<tr>
<td>7</td>
<td>Videsh Sanchar Nigam Limited (VSNL)</td>
</tr>
<tr>
<td>8</td>
<td>Indian Tourism Development Corporation (ITDC)</td>
</tr>
<tr>
<td>9</td>
<td>Hotel Corporation of India Limited (HCI)</td>
</tr>
<tr>
<td>10</td>
<td>Paradeep Phosphates Limited (PPL)</td>
</tr>
<tr>
<td>11</td>
<td>Jessop and Company Limited</td>
</tr>
<tr>
<td>12</td>
<td>Hindustan Zinc Limited (HZL)</td>
</tr>
<tr>
<td></td>
<td>Maruti Udyog Limited (MUL)</td>
</tr>
<tr>
<td>13</td>
<td>Indian Petrochemicals Corporation Ltd. (IPCL)</td>
</tr>
</tbody>
</table>

Table 2: Actual Disinvestment from April 1991 onwards and Methodologies Adopted
<table>
<thead>
<tr>
<th>Year</th>
<th>No. of Companies for which equity sold</th>
<th>Target receipts for the year (Rs. in Crore)</th>
<th>Actual receipts (Rs. in Crore)</th>
<th>Methodology</th>
</tr>
</thead>
<tbody>
<tr>
<td>1991-92</td>
<td>47 (31 in one tranche and 16 in other)</td>
<td>2500</td>
<td>3038</td>
<td>Minority shares sold by auction method in bundles of “very good”, “good”, and “average” companies.</td>
</tr>
<tr>
<td>1992-93</td>
<td>35 (in 3 tranches)</td>
<td>32500</td>
<td>1913</td>
<td>Bundling of shares abandoned. Shares sold separately for each company by auction method.</td>
</tr>
<tr>
<td>1993-94</td>
<td>-</td>
<td>3500</td>
<td>0</td>
<td>Equity of 7 companies sold by open auction but proceeds received in 94-95.</td>
</tr>
<tr>
<td>1994-95</td>
<td>13</td>
<td>4000</td>
<td>4843</td>
<td>Sale through auction method, in which NRIs and other persons legally permitted to buy, hold or sell equity, allowed to participate.</td>
</tr>
<tr>
<td>1995-96</td>
<td>5</td>
<td>7000</td>
<td>361</td>
<td>Equities of 4 companies auctioned and Government piggy backed in the IDBI fixed price offering for the fifth company.</td>
</tr>
<tr>
<td>1996-97</td>
<td>1</td>
<td>5000</td>
<td>380</td>
<td>GDR (VSNL) in international market.</td>
</tr>
<tr>
<td>1997-98</td>
<td>1</td>
<td>4800</td>
<td>902</td>
<td>GDR (MTNL) in international market.</td>
</tr>
<tr>
<td>1998-99</td>
<td>5</td>
<td>5000</td>
<td>5371</td>
<td>GDR (VSNL) / Domestic offerings with the participation of FIIs (CONCOR, GAIL). Cross purchase by 3 Oil sector companies i.e. GAIL, ONGC &amp; Indian Oil Corporation</td>
</tr>
<tr>
<td>1999-00#</td>
<td>4</td>
<td>10000</td>
<td>1860</td>
<td>GDR—GAIL, VSNL—domestic issue, BALCO restructuring, MFIL’s strategic sale and others</td>
</tr>
<tr>
<td>Year</td>
<td>Target</td>
<td>Proceeds</td>
<td></td>
<td></td>
</tr>
<tr>
<td>------------</td>
<td>--------</td>
<td>----------</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1991-91</td>
<td>2,500</td>
<td>3038</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1992-93</td>
<td>2,500</td>
<td>1913</td>
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<td></td>
</tr>
<tr>
<td>1993-94</td>
<td>3,000</td>
<td>-</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Year</td>
<td>No. of Enterprises</td>
<td>No. privatized</td>
<td>No. Proposed to be privatized</td>
<td>Closed</td>
</tr>
<tr>
<td>----------</td>
<td>--------------------</td>
<td>----------------</td>
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<tr>
<td></td>
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<tr>
<td>1994-95</td>
<td>4,000</td>
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<td>1995-96</td>
<td>7,000</td>
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<td></td>
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<tr>
<td>1996-97</td>
<td>5,000</td>
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</tr>
<tr>
<td>1997-98</td>
<td>4,800</td>
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<tr>
<td>1998-99</td>
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<tr>
<td>1999-00</td>
<td>10,000</td>
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<tr>
<td>2000-01</td>
<td>10,000</td>
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<tr>
<td>2001-02</td>
<td>12,000</td>
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</tr>
<tr>
<td>2002-03</td>
<td>12,000</td>
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<tr>
<td>2003-04</td>
<td>14,500</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

# Figures inclusive of amount realized by way of control premium, dividend/dividend tax and transfer of surplus cash reserves prior to disinvestment etc.

Source: Economic Survey 2003-04

Table 4: Status of Privatisation of SLPEs (as on March 31, 2003)
<table>
<thead>
<tr>
<th>State</th>
<th>Total</th>
<th>35</th>
<th>103</th>
<th>180</th>
<th>288</th>
<th>519</th>
</tr>
</thead>
<tbody>
<tr>
<td>Goa</td>
<td>16</td>
<td></td>
<td></td>
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<td></td>
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<tr>
<td>Gujarat</td>
<td>49</td>
<td>3</td>
<td></td>
<td></td>
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<tr>
<td>Haryana</td>
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<tr>
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<td></td>
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<td></td>
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<td></td>
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<tr>
<td>Jammu-Kashmir</td>
<td>23</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Karnataka</td>
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<td>5</td>
<td></td>
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<tr>
<td>Kerala</td>
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<td>15</td>
<td></td>
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<tr>
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<tr>
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<td>Mizoram</td>
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<td></td>
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</tr>
<tr>
<td>Nagaland</td>
<td>6</td>
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<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Orissa</td>
<td>67</td>
<td>1</td>
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<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Pondicherry</td>
<td>11</td>
<td></td>
<td>5</td>
<td></td>
<td></td>
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<tr>
<td>Punjab</td>
<td>53</td>
<td>1</td>
<td>4</td>
<td>24</td>
<td>10</td>
<td>25</td>
</tr>
<tr>
<td>Rajasthan</td>
<td>29</td>
<td>1</td>
<td></td>
<td>11</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sikkam</td>
<td>11</td>
<td></td>
<td></td>
<td>2</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tripura</td>
<td>9</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>UP</td>
<td>104</td>
<td>24</td>
<td>23</td>
<td>30</td>
<td>68</td>
<td></td>
</tr>
<tr>
<td>West Bengal</td>
<td>81</td>
<td>10</td>
<td></td>
<td>5</td>
<td>20</td>
<td>62</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>1158</strong></td>
<td><strong>35</strong></td>
<td><strong>103</strong></td>
<td><strong>180</strong></td>
<td><strong>288</strong></td>
<td><strong>519</strong></td>
</tr>
</tbody>
</table>

Appendix

Industrial Policy statement in 1991

Public Sector

Portfolio of public sector investment will be reviewed with a view to focus the public sector on strategic, high-tech and essential infrastructure. Whereas some reservation for the public sector is being retained there would be no bar for areas of exclusivity to be opened up to the private sector selectively. Similarly the public sector will also be allowed entry in areas not reserved for it.

Public enterprises which are chronically sick and which are unlikely to be turned around will, for the formulation of revival/rehabilitation schemes, be referred to the Board for Industrial and Financial Reconstruction (BIFR), or other similar high level institutions created for the purpose.

A social security mechanism will be created to protect the interests of workers likely to be affected by such rehabilitation packages.

In order to raise resources and encourage wider public participation, a part of the government's shareholding in the public sector would be offered to mutual funds, financial institutions, general public and workers.

Boards of public sector companies would be made more professional and given greater powers.

There will be a greater thrust on performance improvement through the Memoranda of understanding (MOU) systems through which managements would be granted greater autonomy and will be held accountable. Technical expertise on the part of the Government would be upgraded to make the MOU negotiations and implementation more effective.

To facilitate a fuller discussion on performance, the MOU signed between Government and the public enterprise would be placed in Parliament. While focusing on major management issues, this would also help place matters on day-to-day operations of public enterprises in their correct perspective.

Appendix 2

Public Sector Enterprises and Fiscal Deficit

Alternative estimates for India

To test if PSEs growing deficits is the principal reason for the increasing fiscal imbalance, we need consistent time series information that includes all PSEs, at all levels of government (in a federal set up), after reconciling transactions among them. Since India's National Accounts Statistics (NAS) seem to provide such data set, it perhaps offers an opportunity to test the hypothesis in a limited way. Moreover, as quality of Indian data is accepted to be better than many developing countries, such an exercise appears a useful starting point.

Nature and the limitations of the data set

In NAS, public sector consists of (i) administrative departments, (ii) departmental enterprises (DEs) like railways, telecom, postal and irrigation services, and (iii) non-departmental enterprises (NDEs) that include corporate entities like Steel Authority of India, statutory organizations like state electricity boards and road transport corporations. NDEs are further disaggregated into (a) non-departmental financial enterprises and (b) non-departmental non-financial enterprises (NDNFES). If PSEs are publicly owned organizations that produce goods and services whose selling price is related to costs, then DEs plus NDNFEs would include all PSEs in India.

However, the NAS data has some limitations: (i) given the format of the published information, it is not always possible to aggregate DEs and NDNFEs, (ii) since the data are not presented in balance sheet format, widely appreciated financial ratios cannot be computed, and (iii) considerable delay in publication of these tables. Although these categories are comprehensive (compared to the easily available information on central government PSEs), we cannot present all our results for total PSEs; some times they are restricted for NDNFEs only. However, as the information is available for three decades, results based on it could have considerable value. Results reported in Nagaraj (1993) follows the above method. However, this method has some limitations. For instance, it excludes DEs, underestimating the deficits of PSEs. While the overall deficit is estimated using the NAS, the fiscal deficit is based on the public finance statistics that
does not fully capture the transactions between the government and its enterprises. To overcome these limitations, we use Anand Gupta's (1993) method that consistently uses NAS.

To arrive at the true size of India's fiscal deficit, Gupta outlined a method to estimate gross fiscal deficit of the general government including its enterprise sector, by reconciling various accounts of the public sector. In other words, his method estimates capital finance accounts for various parts of the public sector, and aggregates them to compute the fiscal deficit (excluding non-departmental financial enterprises).
6.4 Exim Policies

The Govt. of India, Ministry of Commerce and Industry announces Export Import Policy every five years. The current policies cover the period 2002-2007. The Export Import Policy (EXIM Policy) is updated every year on the 31st of March and the modifications, improvements and new schemes are effective w.e.f. 1st April of every year. Exim policy deals with Export Oriented Units and Special Economic Zones. Similarly, Govt. of India also release the Hand Book of Procedures detailing the procedures to be followed in each of the schemes covered in the Exim Policy The objective of Exim policies is to accelerate the growth in export of services so as to create a powerful and unique ‘Served From India’ brand, instantly recognized and respected the world over.

Following are the highlights of the Exim Policy 2002-07

Exim Policy (2002-7)

Highlights of EXIM Policy, 2002 - 2007

1-Special Economic Zones (SEZs)

Offshore Banking Units (OBUs) shall be permitted in SEZs. Detailed guidelines are being worked out by RBI. This should help some of our cities emerge as financial nerve centres of Asia.

Units in SEZ would be permitted to undertake hedging of commodity price risks, provided such transactions are undertaken by the units on stand-alone basis. This will impart security to the returns of the unit.

It has also been decided to permit External Commercial Borrowings (ECBs) for a tenure of less than three years in SEZs. The detailed guidelines will be worked out by RBI. This will provide opportunities for accessing working capital loan for these units at internationally competitive rates.
II-Employment oriented Agriculture

Export restrictions like registration and packaging requirement are being removed today on Butter, Wheat and Wheat products, Coarse Grains, Groundnut Oil and Cashew to Russia. Quantitative and packaging restrictions on wheat and its products, Butter, Pulses, grain and flour of Barley, Maize, Bajra, Ragi and Jowar have already been removed on 5th March, 2002. Restrictions on export of all cultivated (other than wild) varieties of seed, except Jute and Onion, removed. To promote export of agro and agro based products, 20 Agri export zones have been notified.

In order to promote diversification of agriculture, transport subsidy shall be available for export of fruits, vegetables, floriculture, poultry and dairy products. The details shall be worked out in three months. 3% special DEPB rate for primary & processed foods exported in retail packaging of 1 kg or less.

b) Cottage Sector and Handicrafts

(i) An amount of Rs. 5 crore under Market Access Initiative (MAI) has been earmarked for promoting cottage sector exports coming under the KVIC.

(ii) The units in the handicrafts sector can also access funds from MAI scheme for development of website for virtual exhibition of their product.

(iii) Under the Export Promotion Capital Goods (EPCG) scheme, these units will not be required to maintain average level of exports, while calculating the Export Obligation.

(iv) These units shall be entitled to the benefit of Export House status on achieving lower average export performance of Rs.5 crore as against Rs. 15 crore for others; and

(v) The units in handicraft sector shall be entitled to duty free imports of an enlarged list of items as embellishments upto 3% of FOB value of their exports.
(c) Small Scale Industry

With a view to encouraging further development of centres of economic and export excellence such as Tirupur for hosiery, woollen blanket in Panipat, woollen knitwear in Ludhiana, following benefits shall be available to small scale sector:

i. Common service providers in these areas shall be entitled for facility of EPCG scheme.

ii. The recognised associations of units in these areas will be able to access the funds under the Market Access Initiative scheme for creating focused technological services and marketing abroad.

iii. Such areas will receive priority for assistance for identified critical infrastructure gaps from the scheme on Central Assistance to States.

iv. Entitlement for Export House status at Rs. 5 crore instead of Rs. 15 crore for others.

(d) Leather

Duty free imports of trimmings and embellishments up to 3% of the FOB value hitherto confined to leather garments extended to all leather products.

(e) Textiles

i. Sample fabrics permitted duty free within the 3% limit for trimmings and embellishments.

ii. 10% variation in GSM be allowed for fabrics under Advance Licence.

iii. Additional items such as zip fasteners, inlay cards, eyelets, rivets, eyes, toggles, velcro tape, cord and cord stopper included in input output norms.

iv. Duty Entitlement Passbook (DEPB) rates for all kinds of blended fabrics permitted. Such blended fabrics to have the lowest rate as applicable to different constituent fabrics.

(f) Gem & Jewellery

i. Customs duty on import of rough diamonds is being reduced to 0%. Import of rough diamonds is already freely allowed. Licensing regime for rough diamond is being abolished. This should help the country emerge as a major international centre for diamonds.

ii. Value addition norms for export of plain jewellery reduced from 10% to 7%. Export of all mechanised unstudded jewellery allowed at a value addition of 3% only. Having already
achieved leadership position in diamonds, now efforts will be made for achieving quantum jump on jewellery exports as well.

(iii) Personal carriage of jewellery allowed through Hyderabad and Jaipur airport as well.

(III) Technology oriented

(a) Electronic hardware
The Electronic Hardware Technology Park (EHTP) scheme is being modified to enable the sector to face the zero duty regime under ITA (Information Technology Agreement)-1. The units shall be entitled to following facility:

- Net Foreign Exchange as a Percentage of Exports (NFEP) positive in 5 years.
- No other export obligation for units in EHTP.
- Supplies of ITA I items having zero duty in the domestic market to be eligible for counting of export obligation.

(b) Chemicals and Pharmaceuticals
All pesticides formulations to have 65% of DEPB rate of such pesticides.
Free export of samples without any limit.
Reimbursement of 50% of registration fees for registration of drugs.

(c) Projects
Free import of equipment and other goods used abroad for more than one year.

(IV) Growth Oriented

a) Strategic Package for Status Holders
The status holders shall be eligible for the following new/ special facilities:

(i) Licence/Certificate/Permissions and Customs clearances for both imports and exports on self-declaration basis.

(ii) Fixation of Input-Output norms on priority;

(iii) Priority Finance for medium and long term capital requirement as per conditions notified by RBI;
(iv) Exemption from compulsory negotiation of documents through banks. The remittance, however, would continue to be received through banking channels;

(v) 100% retention of foreign exchange in Exchange Earners’ Foreign Currency (EEFC) account;

(vi) Enhancement in normal repatriation period from 180 days to 360 days.

Neutralising high fuel costs

I. Fuel costs to be rebated by it in Standard Input Output Norms (SIONs) for all export products. This would enhance the cost competitiveness of our export products. The value of fuel to be permitted as a percentage of FOB value of exports for various product groups is as under:

<table>
<thead>
<tr>
<th>Product Group</th>
<th>Value of fuel as a percentage of FOB value of exports</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bulk Drug and Drug Intermediates</td>
<td>5%</td>
</tr>
<tr>
<td>Dye and Dye Intermediates</td>
<td>4%</td>
</tr>
<tr>
<td>Glass</td>
<td>5%</td>
</tr>
<tr>
<td>Ceramic Products</td>
<td>5%</td>
</tr>
<tr>
<td>Paper made from wood pulp/ waste paper</td>
<td>5%</td>
</tr>
<tr>
<td>Pesticides (Technical)/ Pesticides formulation from Basic Stage</td>
<td>5%</td>
</tr>
<tr>
<td>Refractory items</td>
<td>7%</td>
</tr>
<tr>
<td>Ferrous engineering products manufactured though forging/ casting process</td>
<td>7%</td>
</tr>
<tr>
<td>Non ferrous basic metal</td>
<td>4%</td>
</tr>
<tr>
<td>Plastic and plastic products from basic/ monomer</td>
<td>5%</td>
</tr>
</tbody>
</table>
(c) Diversification of markets

Setting up of "Business Centre" in Indian missions abroad for visiting Indian exporters/businessmen. ITPO portal to host a permanent virtual exhibition of Indian export product.

ii) Focus LAC (Latin American Countries) was launched in November, 1997 in order to accelerate our trade with Latin American countries. This has been a great success. There is tremendous potential for trade with the Sub Saharan African region. During 2000-01, India’s total trade with Sub Saharan African region was US$ 3.3 billion. Out of this, our exports accounted for US$ 1.8 billion and our imports were US$ 1.5 billion. The first phase of the Focus Africa programme shall include 7 countries namely, Nigeria, South Africa, Mauritius, Kenya, Ethiopia, Tanzania and Ghana. The exporters exporting to these markets shall be given Export House Status on export of Rs.5 crore.

iii) Links with CIS countries to be revived. We have traditional trade ties with these countries. In the year 2000-01, our exports to these countries were to the extent of US$ 1082 million. In this group, Kazakhstan, Kyrgyzstan, Uzbekistan, Turkmenistan, Ukraine and Azerbaijan to be in special focus in the first phase.

d) North Eastern States, Sikkim and Jammu & Kashmir

Transport subsidy for exports to be given to units located in North East, Sikkim and Jammu & Kashmir so as to offset the disadvantage of being far from ports.

(e) Re-location of industries

To encourage re-location of industries to India, plant and machineries would be permitted to be imported without a licence, where the depreciated value of such relocating plants exceeds Rs. 50 crores.
(V) **Reduction in transaction time & cost**

With a view to reducing transaction cost, various procedural simplifications have been introduced. These include:

**DGFT**

i. A new 8 digit commodity classification for imports is being adopted from today. This classification shall also be adopted by Customs and DGCI&S shortly. The common classification to be used by DGFT and Customs will eliminate the classification disputes and hence reduce transaction costs and time. Similarly, Ministry of Environment and Forests is in the process of finalization of guidelines to regulate the import of hazardous waste.

ii. Further simplification of all schemes.

iii. Reduction of the maximum fee limit for electronic application under various schemes from Rs. 1.5 lakh to Rs. 1.00 lakh.

iv. Same day licensing introduced in all regional offices.

**Customs**

Adoption and harmonisation of the 8 digit ITC(HS) code.

The percentage of physical examination of export cargo has already been reduced to less than 10 percent except for few sensitive destinations.

The application for fixation of brand rate of drawback shall be finalised within 15 days.

**Banks**

Direct negotiation of export documents to be permitted. This will help the exporters to save bank charges. 100% retention in EEFC accounts.

The repatriation period for realisation of export proceeds extended from 180 days to 360 days.

The facility is already available to units in SEZ and exporters exporting to Latin American countries.

These facilities are being made available to status holders only for the present.

**(VI) Trust Based**

Import/ Export of samples to be liberalised for encouraging product upgradation.

Penal interest rate for bonafide defaults to be brought down from 24% to 15%.

No penalty for non-realisation of export proceeds in respect of cases covered by ECGC insurance...
package. No seizure of stock in trade so as to disrupt the manufacturing process affecting delivery schedule of exporters.

i. Foreign Inward Remittance Certificate (FIRC) to be accepted in lieu of Bank Realisation Certificate for documents negotiated directly.

ii. Optional facility to convert from one scheme to another scheme. In case the exporter is denied the benefit under one scheme, he shall be entitled to claim benefit under some other scheme.

iii. Newcomers to be entitled for licences without any verification against execution of Bank Guarantee.

(VII) Duty neutralization instruments

(a) Advance Licence
Duty Exemption Entitlement Certificate (DEEC) book to be abolished. Redemption on the basis of Shipping bills and Bank Realisation Certificates.
Withdrawal of Advance Licence for Annual Requirement (AAL) scheme as problems were encountered in closure of AAL and the significance of scheme considerably reduced due to dispensation of DEEC. The exporters can avail Advance Licence for any value. Mandatory spares to be allowed in the Advance Licence upto 10% of the CIF value.

(b) Duty Free Replenishment Certificate (DFRC)
Technical characteristics to be dispensed with for audit purpose.

(c) Duty Entitlement Passbook (DEPB)
Value cap exemption granted on 429 items to continue.
No Present Market Value (PMV) verification except on specific intelligence.
Same DEPB rate for exports whether as CBUs or in CKD/SKD form,
Reduction in rates only after due notice.
DEPB for transport vehicles to Nepal in free foreign exchange.
DEPB rates for composite items to have lowest rate applicable for such constituent.

(d) Export Promotion Capital Goods (EPCG)
EPCG licences of Rs.100 crore or more to have 12 year export obligation (EO) period with 5 year moratorium period.
EO fulfilment period extended from 8 years to 12 years in respect of units in agri-export zones.
and in respect of companies under the revival plan of BIFR. Supplies under Deemed Exports to be eligible for export obligation fulfilment along with deemed export benefit. Re-fixture of EO in respect of past cases of imports of second hand capital goods under EPCG Scheme