

CHAPTER VI

The Reform Process in India

6.1 Introduction

While the previous chapter sought to examine the economic policies adopted since India's independence in 1947 that led to an increasing investment in the public sector and the creation of a regulatory framework, both of which contributed to the crisis of 1991, the present chapter will look at the factors that contributed to the balance of payments crisis of 1991 and the government's response to that. It would also attempt to examine some of the policy changes that have taken place as part of the 'reform process.'

6.2 The Economic Crisis

In order to understand the imperatives behind the policy reforms initiated by the Government after 1991, it is necessary to envision the situation that India found herself at that point in time. As the discussion paper¹ prepared by the Ministry of Finance indicated, for the first time in its history, India was faced with the prospect of defaulting on its international commitments. The access to external commercial credit markets was completely denied; international credit ratings had been downgraded; and the international financial community's confidence in India's ability to manage its economy had been severely eroded. Fresh borrowing was possible only against the security of our gold reserves by physically

¹ Government of India (1993), *Economic Reforms: Two Years After and the Task Ahead*, Discussion paper, Ministry of Finance, New Delhi.

transporting the gold abroad. The discussion paper further points out that the economy suffered from serious inflationary pressures, emerging scarcities of essential commodities and breakdown of fiscal discipline. India was virtually at the 'verge of a calamitous economic precipice' (1993: 2).

The severity of the balance of payment crisis can be gauged from the fact that on 18 January 1991, as Jalan reveals, India's foreign-exchange reserves stood at only Rs. 1666 crores, which was 'barely sufficient to meet even the daily cash requirements of an economy of India's size' (1991: 3). The crisis itself was brought to a head, as Joshi and Little point out, by a steep fall in foreign exchange reserves to about \$ 1 billion, a sharp downgrading of India's credit rating and a cutoff of foreign private lending. But the basic underlying features of the crisis, according to them, were high inflation (12 per cent and rising), large fiscal and current account deficits (approximately 10 per cent and 3 per cent of GDP respectively) and a heavy and growing burden of domestic and foreign debt (EPW, 1993: 2659).

All these factors brought India close to default. As Nayyar puts it, the government was reduced to last-resort measures such as using stocks of gold to obtain foreign exchange, seeking emergency bilateral assistance from donor countries and borrowing under special facilities from multilateral financial institutions (1996: 7). Bhagwati indicates that in January 1991, the Government of India was forced to take IMF loans worth \$ 1.8 billion by drawing from the Compensatory and Contingency Financing Facility and the first tranche of the standby facility. He further points out that by October 1991, the borrowing had

been increased under instruments that entailed commitments and firm action both to control and reduce the budget deficit and to undertake structural reforms (1993: 68). The deregulation and disinvestments carried out since have been part of that reform process, which will be discussed subsequently. But before that, we will examine the reasons for the economic crisis that India faced.

6.2.1 Reasons for the crisis

Different economists have come up with different theories regarding the factors that led to the economic crisis. Joshi and Little, for example, felt that the roots of the crisis could be traced to India's reaction to the earlier crisis of 1979-81 when world oil prices doubled. According to them, this exogenous shock changed India's current account position from near balance in 1978 to a deficit of 2 per cent of GDP in 1981 (EPW, 1993: 2659). However, Bhagwati does not agree with this view. According to him, the two OPEC shocks of 1973 and 1979 had 'little role to play in this drama' (1993: 67). Though he accepts that the Gulf crisis of 1990 accentuated the fiscal crisis, he sees it as almost entirely 'home-made.' Nayyar, on the other hand, strikes a middle path when he states that the problems associated with these macro-economic imbalances were 'sharply accentuated, and perhaps brought forward in time, by the impact of the Gulf crisis on the economy in late 1990' (1996: 4). Even if this were to be so, the roots of the crisis can be traced to the macro and micro economic failings that resulted from the economic policies practiced since independence, some of which had been touched upon in the previous chapter.

However, the first and foremost thing is to realize that the balance of payments crisis which occurred in 1991, was 'neither sudden nor unexpected' (to use Nayyar's phrase). In fact, he goes to the extent of describing it as 'man-made and policy-induced.' According to Nayyar, the crisis 'was neither an accident nor a coincidence,' but was the 'direct consequence of financial profligacy on the part of the government.' He traces the origins of the crisis to the large and persistent macro-economic imbalances since the 1980s. He points out that the widening gap between the income and the expenditure of the government led to mounting fiscal deficits. As would be seen from the table below, the gross fiscal deficit touched 9 per cent (of the GDP) in 1986-87, as compared to around 6 per cent in the first half of the 1980s². This fiscal deficit had to be met by borrowing, mostly from the central bank and the people of India. As a result, Nayyar indicates, the internal debt of the government accumulated rapidly, rising from 35.6 per cent of GDP at the end of 1980-1981 to 53.5 per cent of GDP at the end of 1990-91.

The burden of debt servicing also mounted. There was a consequent increase in interest payments: from 2 per cent of the GDP and 10 per cent of the total central government expenditure in 1980-81, it increased to 4 per cent of the GDP and 19 per cent of the total central government expenditure in 1990-91. Nayyar points out that any growth process based on such borrowing was 'simply not sustainable.' According to him, the underlying fiscal crisis was bound to create a situation where the balance of payments would become 'unmanageable and inflation would exceed the limits of tolerance' (1996: 4).

² This used to be around 4 per cent in the mid-1970s as may be seen from the next table

Table 6.1 Fiscal imbalances and internal debt of the central government

Year	Gross fiscal deficit	Revenue deficit	Internal debt	Interest payments	Interest payments as a percentage of central government expenditure
1980-81	6.1	1.5	35.6	2.0	10.0
1981-82	5.4	0.2	35.0	2.0	10.9
1982-83	6.0	0.7	40.1	2.2	11.5
1983-84	6.3	1.2	38.7	2.3	12.4
1984-85	7.5	1.8	42.0	2.6	12.9
1985-86	8.3	2.2	45.5	2.9	13.3
1986-87	9.0	2.7	49.8	3.2	13.5
1987-88	8.1	2.7	51.8	3.4	15.2
1988-89	7.8	2.7	51.7	3.6	16.4
1989-90	7.9	2.6	53.2	3.9	17.4
1990-91	8.4	3.5	53.5	4.0	19.0

Source: Nayyar (1996: 5)

Like Nayyar, Naib too feels that the steady growth of government expenditure, particularly non-plan expenditure, has been the main reason for the country falling into a fiscal crisis (2004: 212). The position of the various deficits of the government is indicated in the following table. This inevitably led to a growth in interest payments which, as Naib points out, would have been covered by returns on productive capital expenditure and investment financed by debt in an efficient system. However, in an inefficient system it could well lead to what is commonly described as a 'debt trap' where countries take on additional debts to service existing ones.

Table 6.2 Deficit of Central Government: 1975-76 to 1990-91

(per cent of GDP)

Year	Fiscal Deficit ³	Budget Deficit ⁴	Primary Deficit ⁵	Revenue Deficit ⁶	Monetised Deficit ⁷
1975-76	4.1	0.5	2.5	1.1	0.0
1980-81	6.2	1.8	4.3	1.5	2.6
1981-82	5.4	0.9	3.4	0.2	2.0
1982-83	6.0	0.9	3.8	0.7	1.9
1983-84	6.3	0.7	4.0	1.2	1.9
1984-85	7.5	1.6	5.0	1.8	2.6
1985-86	8.3	2.0	5.5	2.2	2.4
1986-87	9.0	2.8	5.8	2.7	2.4
1987-88	8.1	1.7	4.7	2.7	2.0
1988-89	7.8	1.4	4.2	2.7	1.6
1989-90	7.8	2.3	3.9	2.6	3.1
1990-91	8.4	2.1	4.4	3.5	2.8

Source: *Economic Survey, 1992-93*, Government of India [cited in Naib, 2004: 212]

The adverse balance in trade also contributed to the overall imbalance. According to Nayyar, the liberalization of the trade regime which began in the late 1970s along with the new industrial policies that were introduced in the early 1980s created incentives for import-intensive industrialization and increased the import intensity of production (1996: 7). The second half of the 1980s also saw a surge in imports for the defence sector. On the other hand, export performance was, as Nayyar puts it, 'at best modest while the growth in remittances tapered off and import substitution in the petroleum sector slowed down.' Consequently, it was seen that the current account deficit doubled from an average of \$ 2.3 billion

³ Fiscal deficit is total expenditure including loans *minus* (revenue receipts + grants + non-debt capital receipts)

⁴ Budget deficit is the difference between all receipts and expenditure, both revenue and capital

⁵ Primary deficit is fiscal deficit less interest payments

⁶ Revenue deficit is the difference between revenue receipts and revenue expenditure

⁷ Monetised deficit is increase in net RBI credit to the Central government, comprising of the net increase in the holdings of treasury bills of the RBI and its contribution to the market borrowings of the government.

or 1.3 per cent of GDP during the first half of the 1980s to an annual average of \$ 5.5 billion or 2.2 per cent of GDP during the second half of the 1980s.

These persistent deficits had to be inevitably financed by borrowing from abroad with the result that there was a continuous increase in the external debt which, as may be seen from the table given below, rose from \$ 23.8 billion or 14.3 per cent of GDP at the end of 1980-81 to \$ 62.3 billion or 22.8 per cent of GDP at the end of 1990-91. As a result, the debt service burden also rose from 7.9 per cent of current account receipts and 14.9 per cent of export earnings in 1980-81 to 21.7 per cent of current account receipts and 29.8 per cent of export earnings in 1990-91. According to Nayyar, these strains, which mounted over the years, stretched to breaking point on account of the Gulf crisis. The balance of payments 'lurched from one liquidity crisis in mid-January 1991 to another in late-June 1991 and came to the verge of collapse.' On both occasions, foreign exchange reserves dropped to levels which were not enough to finance imports even for a fortnight (1996: 7).

Table 6.3 Current account deficits, external debt and debt servicing

Year	Current account deficit as a percentage of GDP	Medium and long-term external debt end-of-year		Debt servicing as a percentage of Exports	
		in US \$ million	as a % of GDP		Current Account Receipts
1980-81	1.2	23.8	14.3	14.9	7.9
1981-82	1.4	24.3	14.2	13.5	7.7
1982-83	1.3	27.9	15.6	14.6	8.7
1983-84	1.1	31.1	16.0	17.2	10.3
1984-85	1.2	31.9	17.1	19.8	11.7
1985-86	2.3	37.0	17.4	26.7	15.9
1986-87	2.0	43.8	19.4	39.4	31.0
1987-88	1.9	50.8	19.5	41.3	26.4

1988-89	2.6	53.5	21.1	38.9	25.4
1989-90	2.2	57.7	21.6	31.1	21.5
1990-91	2.3	62.3	23.8	29.8	21.7

Source: Nayyar (1996: 6)

The vulnerability on the balance of payments front was seen by Nayyar to have been accentuated by two other factors. First, it became exceedingly difficult to roll over the existing short-term debt because of adverse international perceptions of the situation. Second, he points out that the non-resident deposits, where the outstanding amount was more than \$ 10 billion, leveled off in September 1990 with a modest net outflow of \$ 0.3 billion in the period October 1990 to March 1991 and a massive net outflow of \$ 1.3 billion in the period April 1991 to September 1991 (1996: 7).

In his R. C. Dutt lecture on political economy, Deepak Nayyar makes the point that for a foreign exchange constrained economy, a difficult balance of payments situation was nothing new. In 1991, however, the problem got compounded by the fact that the fragile balance of payments situation 'coincided with, and was partly the outcome of, a deep macro-economic disequilibrium.' The macro-economic disequilibrium was attributed by Nayyar to the 'mounting imbalances in the fiscal system' where inadequate resource mobilization was compounded by a 'profligate increase in public expenditures.' This was seen to have been driven in part by the 'competitive politics of populism and in part by the cynical politics of soft options.' Consequently, as Nayyar says, it was no surprise that the total expenditure outpaced revenue receipts and fiscal deficits grew steadily larger (1996: 9).

The root cause of the fiscal crisis, however, was attributed by Nayyar to the revenue expenditure outpacing the revenue receipts. According to him, for the central government, the small but consistent revenue surplus of the 1970s was transformed into a revenue deficit which averaged 1.1 per cent of GDP in the period 1980-81 to 1984-85 and 2.6 per cent of GDP in the period 1985-86 to 1989-90. The financing of this revenue deficit through borrowing meant that borrowing was used to support consumption expenditure. According to him, 'beyond a point, such a fiscal regime was simply not sustainable' (1996: 9).

Nayyar repeatedly stresses that the 'origins of the crisis lie in the cavalier macro-management of the economy during the 1980s and not, as claimed by some, in a misplaced strategy of development since the mid-1950s' (EPW, 1993: 640). But the fact is that the 'macroeconomic crisis ... cannot be totally separated from the microeconomic failings' (Bhagwati, 1993: 71). According to Bhagwati, two factors that contributed to the macroeconomic crisis which the country faced were: (a) the failure of the public sector to generate investible resources, and (b) the explosive growth of governmental current spending that saw the budget deficit as a proportion of GDP rise from 6.4 to 9 per cent during the 1980s (1993: 67).

The two themes are intertwined in Jalan's analysis also. Like other economists, Jalan also points out that the current expenditure of the government as a ratio of GDP rose from 11.5 per cent in 1970-71 to almost 23.1 per cent in 1989-90 (1991: 177). The growth in expenditure, he felt, gave rise to large revenue deficits at the centre as well as the states and led to increased borrowings, both external and internal.

As we have seen in the previous chapter, part of this was on account of the public sector. Jalan (2002) indicates that an important assumption in the choice of post-independence development strategy was the generation of public savings, which could be used for higher levels of investment. However, in the case of India, this did not happen, and the public sector, according to him, instead of being a generator of savings for the community's good, became over time, a consumer of the community's savings. This reversal of roles, according to Jalan, had become evident by the early seventies, but the process reached its culmination by the early eighties. By then he states, the government began to borrow not only to meet its own revenue expenditure but also to finance public sector deficits and investments. He points out that during the period 1960-1975, total public sector borrowings (including government borrowings) averaged 4.4 per cent of GDP. These increased to 6 per cent of GDP by 1980-81, and further to 9 per cent by 1989-90. Thus, according to Jalan, the public sector, which was supposed to generate resources for the growth of the rest of the economy, gradually became a net drain on the society as a whole (2002: 6-7).

Jalan observes that the rising revenue deficit and declining public savings have had several adverse economic consequences. The first was a sharp increase in public debt (1991: 178), which has been discussed earlier in this section. The problem was compounded by the fact that as Nayyar points out, unfortunately there were no constraints on the domestic borrowing by the government (1996: 9).

Even in respect of commercial debt, Jalan noted a tenfold increase from a low level of about \$ 2 billion in 1980 to \$ 21.4 billion in 1989. He points out that

within a decade India had become one of the largest debtors among the developing world in terms of outstanding commercial debt (1991: 147).

Much of this debt was met from external borrowings. The rise in foreign borrowings was seen by Bhagwati as being 'a major component of the fiscal crisis.' He points out how the external public-sector debt as a proportion of GNP doubled during the 1980s to 21 per cent by 1987-8. In consequence, debt service as a proportion of exports increased more than threefold to 32 per cent in 1986-7 (1993: 68).

The fiscal crisis in turn led to the balance of payments crisis that triggered off the whole chain of events now referred to as the 'reform process.'

6.3 *The Reform Process*

We have already examined the interconnectedness between the macroeconomic problems and the microeconomic failings noticeable in the Indian economy that contributed to the economic crisis. The solution too meant that both issues had to be addressed. Most researchers have emphasized the dual nature of the strategy adopted by the government. Naib, for example, writes that the policy initiatives adopted a dual strategy: fiscal measures to bring about macro-economic stabilization and structural reforms in the industrial and trade policy (2004: 35).

The relationship between the stabilization needed to overcome the macroeconomic crisis and the reforms required to remedy microeconomic inefficiencies has also been emphasized by Joshi and Little. They emphasize that stabilization and structural reform must go 'hand in hand' (EPW, 1993: 2659) if the problems facing the Indian economy are to be properly addressed.

According to Jalan, the measures introduced by the Government of India, had two broad objectives. The first objective was the reorientation of the economy from a 'statist, centrally directed and highly controlled economy' to a 'market-friendly economy.' This, according to him, involved a substantial reduction in the role of the state in regulating the economy through direct controls. The second aspect, according to Jalan, referred to 'macroeconomic stabilization' which included a reduction in budget deficits as well as the use of specific instruments of macroeconomic policy (such as exchange rates and interest rates) to achieve certain macroeconomic objectives (such as increase in exports or a reduction in the inflation rate) (Jalan, 1992: xxi; 2002: 9).

This was the approach which the government adopted. First, the government initiated a programme of macroeconomic stabilization 'to restore international confidence in the economy and redress the imbalances which had emerged both in the external and domestic financial conditions' (GOI, 1993: 2). Exceptional financing was mobilized, as was indicated earlier, by drawing from the Compensatory and Contingency Financing Facility of the IMF to relieve the pressures of immediate debt servicing on the Balance of Payments and to build up foreign exchange reserves (GOI, 1993: 3). The rupee was devalued; the rate of growth of money supply was checked; and steps were taken to contain inflation on the one hand and to reduce the fiscal deficit on the other. As Kale points out, the immediate task of the government was to re-establish macroeconomic stability, prevent a default on debt payments, and bring down inflation, all of

which the government accomplished despite being one of the 'most fragile governments since independence' (Ganguly, 2003: 213).

Nayyar points out that the strategy adopted by India was not new, but broadly replicated the response of several developing countries in Latin America and sub-Saharan Africa to the debt crisis in the 1980s which was also guided by IMF programmes of stabilization and World Bank programmes of structural adjustment (1996: 12). According to him, any programme of macroeconomic stabilization has two objectives: (i) to preempt a collapse of the balance of payments situation and to reduce the current account deficit, and (ii) to curb inflationary pressures by reducing the rate of inflation. The principal instruments of stabilization were seen to be fiscal policy and monetary policy which provided the rationale for depreciating the rupee, reducing the fiscal deficit of the government and adopting a tight monetary policy (1996: 12).

While these were seen to essential components of any orthodox stabilization programme drawn up as part of an arrangement with the IMF, Nayyar points out that in response to a debt crisis, stabilization is often combined with adjustment and reform. According to him, it was in conformity with the orthodoxy that the government 'embarked on a wide ranging reform of the policy regime' (1996: 13), some of which would be explored in the subsequent sections⁸.

6.3.1 Reforms in Industrial Policy

The discussion paper prepared by the Ministry of Finance indicated that over the years, the 'industrial policy framework had come to be characterized by extensive

⁸ Changes brought about as a result of the 'first generation reforms' are mostly discussed here, except where it has been thought necessary to bring in later developments

bureaucratic control (1993: 7). While these controls might have served a purpose in the initial years of development, it was felt that over the years these had become inefficient and dysfunctional. They were seen to lead to protracted delays in decision-making and inefficient choices of scale, location and technology. Also, it bred inefficiency, was uneconomical and led to lack of competition. It was therefore felt necessary to restructure the system so as to eliminate bureaucratic control and allow 'greater play to entrepreneurial decision-making, subject to the normal disciplines of market competition' (1993: 7). In keeping with this objective, the Government through its *Statement on Industrial Policy* of 24th July, 1991, took a number of steps to dismantle the outdated control structure. The decisions applied to: (a) the Industrial licensing policy along with the procedural consequences; (b) Foreign investment and foreign technology agreements; (c) the Public Sector; and (d) the Monopolies and Restrictive Trade Practices (commonly known as the MRTP) Act.

6.3.1.1 Industrial licensing

Industrial licensing was done away with except in 18 specified industries where it was retained on account of security and strategic considerations, social concerns, grounds of safety, and environmental reasons. The industries where licensing was retained included electronic aerospace and defence equipment, industrial explosives, hazardous chemicals, drugs and pharmaceuticals, asbestos and asbestos-based products, paper and newsprint, raw hides and skins, coal and petroleum, sugar, liquor and cigarettes, motor cars, entertainment electronics, and white goods.

According to Kale, the July 1991 industrial policy statement reduced this number to eight, while a subsequent policy in 1993 further decreased the list of reserved industries to six, in which the government would retain at least a 51 per cent controlling stake. The six were coal and lignite; mineral oils; ammunition and defence equipment; atomic energy; radioactive minerals; and railway transport.

Kale points out that in March 1999, these six were further categorized into strategic and non-strategic sectors, and only ammunition and defence equipment, atomic energy, and railway transport were classed in the former category. In these sectors, the government would retain strategic control. For all other public sector firms, the decision to decrease government ownership below 51 per cent would be made on a case-by-case basis. However, the *Disinvestment Manual* of the Department of Disinvestment indicates that by December 2002, only the following three areas were reserved for PSUs: atomic energy, radioactive minerals, and railway transport.

So far as procedural consequences were concerned, all existing registration schemes were abolished. The location policy was made flexible and existing units were provided with what is called 'a new broad banding facility' to enable them to produce any article without additional investment (though as Bhagwati points out, the logic of ruling out product diversification in the first place is itself unclear).

6.3.1.2 Public Sector

The portfolio of public sector investments was reviewed with a view to focus the public sector on 'strategic, high-tech and essential infrastructure' (1991: 8). As a result, the list of industries reserved for the public sector was reduced from 17 to 6. These included arms and ammunition and other defence equipment, atomic energy, coal and mineral oils, mining of selected items, and rail transport. However, it was indicated that even these would not be exclusive to the public sector and private sector participation could be allowed 'selectively.'

In order to raise resources and encourage wider public participation, the Government also decided to disinvest part of its holdings in public sector enterprises to mutual funds, financial institutions, the general public, and to employees of those enterprises.

The improvement in public sector performance was sought to be achieved as Gupta indicates, through the system of Memorandum of Understanding between the government and the public sector enterprises under which the management would be imparted greater autonomy and would be held accountable (1994: 68). The Government also decided to make the Boards of public sector enterprises more professional and to provide them with greater autonomy.

Public enterprises which were chronically sick and could not be turned around would be referred to the Board for Industrial and Financial Reconstruction (BIFR), for formulation of revival or rehabilitation schemes. A National Renewal Fund was set up as a 'safety net' mechanism to protect the interests of workers

likely to be affected by such rehabilitation packages by providing them with compensation and retraining.

6.3.1.3 The MRTP Act

The Monopolies and Restrictive Trade Practices Act was amended to remove the 'threshold limits of assets in respect of MRTP companies and dominant undertakings' (1991: 9). This eliminated the requirement of obtaining prior approval of the government for establishment of new undertakings, expansion of undertakings, merger, amalgamation and takeover and appointment of Directors under certain circumstances (1991: 9). The emphasis of the Act shifted instead to the control and regulation of 'monopolistic, restrictive and unfair trade practices' (1991: 9).

6.3.2 Reforms in Trade and Tariff Policies

Like the industrial policy, the trade policy of the Government too had long been characterized, as the discussion paper pointed out, by 'direct administrative control over imports through licensing.' Not only were consumer goods imports generally banned, but even most imports of capital goods, raw materials components and other intermediates were subject to import licensing, especially where the items were also locally produced. This system of administrative, discretionary control over imports (and many exports) was buttressed by an exceptionally high customs tariff structure. The discussion paper noted that these policies had a number of unfortunate consequences: the benefits of foreign trade were suppressed; inefficient, high-cost industries, with uneconomic scales of production were encouraged; costs of traded inputs were high; exports could be

competitive only with large subsidies; the heavy protection to domestic industry discriminated against agriculture; discretionary arbitrariness, abuse and delays were widespread and exacted an especially heavy price in time, effort and money from small and medium producers; while the associated over-valuation of the exchange rate hurt exports, and remittances from abroad (1993: 8).

The new Export and Import Policy announced for the five year period from 1992 to 1997 sought to redress the deficiencies indicated above. The basic tenet of the new Exim policy was to free foreign trade from unnecessary and unproductive regulations and controls. Under the policy, all imports and exports were freed from quantitative and discretionary controls, except for a short negative list restricting the import and export of certain specified items on grounds of safety, security and environmental reasons.

Import duties were reduced in stages with the maximum duty being lowered to 150% in 1991, 110% in 1992, 85% in 1993, 65% in 1994, and 50% in 1995. Duties on capital goods have been reduced to levels around 25% for many categories, and even lower for export schemes and project imports, though certain types of machinery attract higher duty rates.

Kale points out that while in 1991, average Indian tariff rates, on a trade-weighted basis, stood at 87 per cent, this fell gradually over the course of the decade and hovered around 25 per cent from 1997 to 2001. Similarly, quantitative restrictions (QRs) were decreased throughout the decade and entirely eliminated in April 2001. She, however, indicates that the government 'continues

to employ other non-tariff barriers as well as tariffs, often at the behest of members of the business community' (Ganguly, 2003: 214).

So far as the exchange rate is concerned, the movement has been sequential as the discussion paper suggests: from first widening the replenishment licensing system into a broad based system of incentive licenses ('Eximscripts') given to exporters, then moving to a dual exchange rate (the so called 'partial convertibility') with elimination of most licensing controls except on consumer goods, and finally moving to the present unified exchange rate (1993: 8). The rupee was devalued in July 1991 and the Government abolished the subsidies that were being given to exporters under the Cash Compensatory Support Scheme.

The liberalization of the trade policy represented for the first time a possible shift from the structural approach that had characterized governmental policy since independence to what might appear to approximate at least a partial acceptance of market forces. It marks, as Gupta observes, 'a departure from the old regime of quantitative restrictions to the beginning of a new regime relying on price mechanisms' (1994: 71).

6.3.3 Reforms in Foreign Investment Policy

The Government's realization of the potential of foreign investment in accelerating the economic growth of the country particularly in view of scarce domestic resources led it to introduce a new foreign investment policy in 1991 designed, as the discussion paper indicates, to attract foreign investments in larger volumes, by simplifying rules and procedures and making the terms offered to foreign investors more in line with current practice all over the world (1993: 12).

Banga points out that India's FDI policy, as formulated under the Foreign Exchange Regulation Act (1973) had been one of the most restrictive in the world. Hence an important measure undertaken in the reform process was a relaxation of the policy regime relating to FDI (Kehal, 2005: 137).

According to Banga, FDI was sought because it was expected to augment investible resources and, more importantly, improve technological standards and the skills, efficiency and competitiveness of domestic industry. It was also expected to bring 'relatively' later technology into industry. Apart from this, as Mehta and Bhandari point out, FDI also provides much-needed foreign exchange to help bridge the balance of payments or trade deficit. According to them, in the wake of the late 1990s debt crises, FDI came to be viewed as an 'increasingly important source of external finance for developing countries' (Kehal, 2005: 181).

Some of the changes introduced by the government in its policies towards foreign investment⁹ in the first round are given below:

- Foreign investment approvals up to 51% equity in a specified list of 34 priority industries was made automatic, subject only to a registration procedure with the Reserve Bank of India.
- Investment above 51% equity was also permitted on the basis of case by case approvals given by a specially constituted Foreign Investment Promotion Board (FIPB) charged with expeditious processing of governmental approvals.

⁹ adapted from *Economic Reforms: Two Years After and the Task Ahead*, Discussion paper prepared by the Ministry of Finance, Department of Economic Affairs, Government of India, 1993, p. 12 and *India: Business Perspectives*, prepared by the Economic Co-ordination Unit of the Ministry of External Affairs, Government of India and Arthur Andersen, 1994, p. 22.

- The Foreign Exchange Regulation Act (FERA) was amended to remove a number of constraints earlier applicable to firms with foreign equity operating in India.
- Apart from becoming a member of MIGA (the Multilateral Investment Guarantee Agency), India also indicated her willingness to sign Bilateral Investment Protection Agreements with investing countries.
- Free repatriation of profits and capital investment was permitted, except for a short specified list of consumer goods industries where it is subject to dividend balancing against export earnings.
- Use of foreign brand names/trade marks for sale of goods in India was permitted, and
- Indian capital markets were opened to foreign institutional investors.

6.3.4 Financial sector reforms

According to Rakesh Mohan¹⁰, the objectives of the financial sector reform process in India initiated in the early 1990s were the following: (i) removal of financial repression that existed earlier; (ii) creation of an efficient, productive and profitable financial sector industry; (iii) enabling price discovery by the market determination of interest rates; (iv) providing operational and functional autonomy to institutions; (v) preparing the financial system for increasing international competition; (vi) opening the external sector in a calibrated fashion; and (vii) promoting the maintenance of financial stability even in the face of domestic and external shocks. He points out that while the major aim in the early phase of reforms, known as the first generation of reforms, was to create an efficient, productive and profitable financial service industry operating within the

¹⁰ see Mohan, Rakesh "Financial Sector Reforms in India: Policies and Performance Analysis," *Economic and Political Weekly*, Vol. 40, 2005, pp. 1106-1121

environment of operating flexibility and functional autonomy, the focus of the second phase of financial sector reforms starting from the second-half of the 1990s has been ‘the strengthening of the financial system and introduction of structural improvements’ (EPW, 2005: 1107).

The financial sector reforms are broadly divided into four parts by Mohan, namely, (a) banking reforms, (b) debt markets reforms, (c) forex markets reforms, and (d) reforms in other sectors of the financial sector. These are briefly touched upon below.

6.3.4.1 Reforms in the banking sector

After the nationalization of the major banks in the 1970s, the Indian banking system had become predominantly government owned. This was the situation prevailing in the early 1990s. According to Mohan, the banking sector reform had a two-pronged approach: improve the health of the banking sector through (a) introduction of international best practices in prudential regulation and supervision, and (b) increased competition (EPW, 2005: 1108). Measures were also initiated to ensure flexibility, operational autonomy and competition in the banking sector.

While banking sector reform in India has not involved any privatization, increase in capitalization was sought to be achieved through diversification of ownership to private investors up to a limit of 49 per cent, thereby keeping majority ownership and control with the government. Most of the banks have also come to be publicly listed which has not only enabled them to raise funds from the market through issue of IPOs etc, but would also, according to Mohan,

bring about 'greater market discipline in bank management, and greater transparency through enhanced disclosure norms.' On the other hand, greater competition was provided by the phased introduction of new private banks and expansion in the number of foreign bank branches.

6.3.4.2 Forex Markets reforms

Since the 1950s the Indian forex market had been heavily controlled along with increasing trade controls designed to foster import substitution. Consequent to this policy, both the current and capital accounts were closed and foreign exchange was made available by the Reserve Bank of India (RBI) through a complex licensing system. The task facing India in the early 1990s was therefore to gradually move from total control to a functioning foreign exchange market. According to Mohan, the move towards a market-based exchange rate regime in 1993 and the subsequent adoption of current account convertibility were key measures in reforming the Indian foreign exchange market. Authorized dealers of foreign exchange have been allowed to carry on a large range of activities, and banks too have been given large autonomy to undertake foreign exchange operations. A large number of products were introduced, and entry of new players allowed in the market.

6.3.4.3 Reforms in other segments of the financial sector

Reforms in other segments of the financial sector included measures aimed at establishing prudential regulation and enhancing the efficiency of non-banking intermediaries such as the non-banking financial companies (NBFCs) by bringing them under the regulation of the RBI. The insurance business which had

remained within the confines of public ownership until the late 1990s, has been opened up. Subsequent to the passage of the Insurance Regulation and Development Act in 1999, several changes were initiated, including allowing newer players/joint ventures to undertake insurance business on risk-sharing/commission basis. The Insurance Regulatory and Development Agency (IRDA) was also established to regulate and supervise the insurance sector. Steps have also been taken to liberalize, regulate and develop the capital markets. An important step in this direction has been the establishment of the Securities and Exchange Board of India (SEBI) as the regulator for equity markets.

Another important development under the reform process has been the opening up of the mutual funds to the private sector in 1992, which ended the monopoly of the Unit Trust of India (UTI), a public sector entity. The Indian capital markets were also opened up for foreign institutional investors (FIIs) in 1992. The Indian corporate sector, too, has been allowed to tap international capital markets. Similarly, overseas corporate bodies (OCBs) and non-resident Indians (NRIs) have been allowed to invest in Indian companies. Mohan indicates that FIIs have been permitted in all types of securities including government securities and they enjoy full capital convertibility. Mutual funds also have been allowed to open offshore funds to invest in equities abroad.

6.3.5 Evaluation of the structural reforms

As Jalan points out, in general terms, the impact of these policies can be said to have been positive and significant. Though he admits that there has been considerable debate in the country about the content, pace and results of the

reform process, he feels that, without entering into this debate, it can safely be said that compared to the past there was no doubt that India's economy is 'stronger and more resilient today than was the case a decade ago' (2002: 10).

Rakesh Mohan, on the other hand, refers to Ahluwalia¹¹ in stating that though the economic reforms in India were initiated following an external sector crisis, unlike in many emerging market economies where economic reforms were 'driven by crisis followed by a boom-bust pattern of policy liberalization,' in India, reforms have followed a 'consensus driven pattern of sequenced liberalization across the sectors,' which is why despite several changes in government, there has not been any reversal of direction in the reform process over the last 15 years. The pace may have differed, or even slackened, depending on the composition of the government and their economic predilections, but the overall policy objectives remain largely the same as it was when the reforms were first initiated.

Commenting on the pace of the reforms, Naib admits that in India the pace of implementation of reforms has been gradual. Explaining the reasons for this, he indicates that the compulsions of democracy in a pluralist society make it necessary to evolve a sufficient consensus across different interest groups before policy changes can be implemented. This, according to him, has slowed down the pace of the reforms (2004: 35). In fact this gradualism and consultative approach, though it might have slowed down the pace of reforms, has also brought a certain degree of stability that is necessary for sustaining the reform process over a long

¹¹ Ahluwalia, M. S. (2002), "Economic Reforms in India since 1991: Has Gradualism Worked?" *Journal of Economic Perspectives*, 16, (3), pp. 67-88

period of time, which is missing in many other countries. This is one of the strengths of the Indian system.

In this section, we shall try and assess the impact of the structural reforms effected since 1991 relating to the following sectors: industrial sector, trade, foreign investment, the public sector, and the financial sector¹². So far as the public sector is concerned, the focus here would be more on general reforms and disinvestment would be looked at separately later.

6.3.5.1 Industrial deregulation

The reforms in industrial policy were seen to have removed barriers to entry for new firms and limits on growth in the size of existing firms. Investment decisions, according to Nayyar, are no longer dependent upon government approval or constrained by State intervention. Kale too indicates that ‘in tandem with a diminished regulatory load, the Indian government also de-emphasized its investment role.’ According to her, private interests have become far more autonomous in their investment decisions, while at the same time their importance for economic growth and expansion has intensified (Ganguly, 2003: 214).

As examined earlier, industrial licensing has been abolished for all industries except those specified, irrespective of the level of investment. The law regulating monopolies has also been amended to remove the threshold limit and to eliminate the need for prior approval from government for capacity expansion,

¹² partly adapted from Nayyar, Deepak, (1996), *Economic Liberalization in India: Analytics, Experience and Lessons*, Centre for Studies in Social Sciences, Calcutta and Mohan, Rakesh “Financial Sector Reforms in India: Policies and Performance Analysis,” *Economic and Political Weekly*, Vol. 40, 2005, pp. 1106-1121

capacity creation, amalgamation, mergers or takeovers on the part of such companies.

While it is felt that dismantling of the complex regime of controls, particularly in the sphere of investment decisions, was both necessary and desirable, Nayyar is of the opinion that removal of barriers to entry is not sufficient for restructuring of the industrial sector. According to him, the problems associated with the barriers to exit would also have to be resolved. It is also felt that deregulation, by itself, would not reduce the degree of monopoly and increase the degree of competition in the industry. On the contrary, deregulation may not only not assure competition; it may sometimes in fact induce rent-seeking behaviour. Nayyar quotes certain instances where acquisitions, mergers or takeovers have enabled the enlarged corporate entities to capture a preponderant market share. To avoid this situation, he feels it is necessary that the market is governed 'either by calibrating competition or by suitable anti-trust legislation' (1996: 46).

6.3.5.2 Trade liberalization

The trade policy reforms introduced so far were seen to have three objectives: (a) to reduce discretionary controls on international trade transactions, (b) to reduce the nominal as also the effective protection available to domestic industry, and (c) to bring domestic prices closer to world prices. In pursuance of these objectives, there had been a rapid dismantling of quantitative restrictions on imports and exports, a substantial reduction of tariffs on imports combined with an abolition of subsidies on exports and several adjustments in the exchange rate (1996: 46).

According to Nayyar, these steps were taken on the presumption that this would shift resources from the non-traded goods sector to the traded goods sector and also that exposure to international competition would be conducive to efficiency in domestic firms (1996: 46).

However, according to him, because of 'structural rigidities' the economy might not be able to switch the resources from one sector to another. While on the one hand the rapid liberalization of the import regime might result in de-industrialization in some sectors, it could also lead to dumping especially since it was felt that imports had been liberalized without establishing a comprehensive system of anti-dumping laws for domestic firms to invoke and to use whenever necessary. Nayyar is of the opinion that if the industrial sector cannot cope with the pace of import liberalization or the practice of dumping, it may 'enforce closures rather than efficiency at a micro-level and reduce output and employment at the macro-level' (1996: 47).

6.3.5.3 Foreign investment

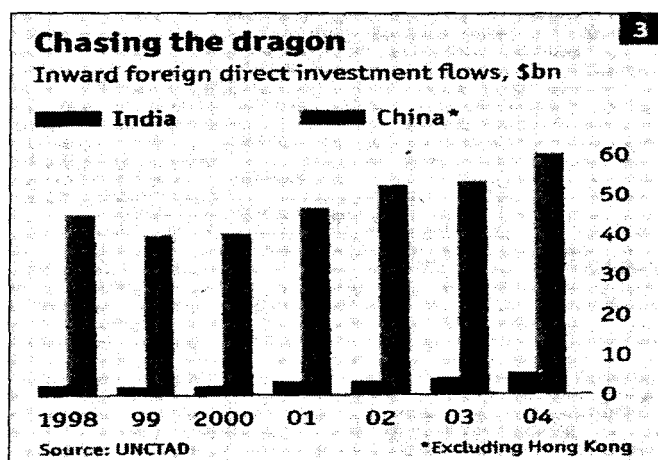
Globalization being one of the aims of the economic reforms instituted so far, the policy regime for foreign investment and foreign technology is seen to have been liberalized at a fast pace so that prior government approval is the exception and not the rule. According to Nayyar, the primary objective has been 'to enlarge non-debt-creating capital flows, while technology acquisition and market access appear as secondary objectives.'

However, as Nayyar observes, while changes in the policy regime may be necessary, they may not be sufficient to stimulate inflows of direct foreign

investment. While direct investment has been increasing, it was felt that the actual inflows were modest as a ‘proportion of total foreign capital inflows and marginal as a proportion of total investment in the economy.’ Nayar is of the view that the increase in direct foreign investment would not be enough to become an important source of financing either the current account deficit in the balance of payments or investment in the economy (1996: 48).

This is borne out clearly if we compare the level of FDI received by India vis-à-vis that of China as may be seen from the graph given below¹³.

Figure 4: FDI figures for India and China



As indicated by Kehal, India’s share among the developing countries in terms of attracting foreign direct investment is only 1.7 per cent as compared to China’s 17 per cent. Mehta and Bhandari point out that while both countries initiated reforms around the same time (1991), China’s FDI inflows were seen to have accelerated from \$ 10, 189 million in 1991 to \$ 46, 846 million in 2001. As against that, FDI flows to India increased from \$ 74 million in 1991 to \$ 3,403

¹³ Source: *The Economist*, Vol 377, Number 8450, Oct 29-Nov 4, 2005, p. 25

million in 2001. However, the share of Indian FDI inflows in Asia, which was 0.30 per cent in 1991, rose to 3.33 per cent in 2001, thus showing a rising trend. In fact, the only silver lining was that India was seen to have been able to attract a greater share of FDI inflows than all other emerging economies except China¹⁴. However, the share of FDI as a proportion of GDP was less than 1 per cent in case of India (0.707 per cent in 2001), while in case of China it was 3.8 per cent. Of course, China's larger FDI flows were stated to be partly due to it being the destination of choice for the large number of overseas Chinese business networks and family connections (*guanxi*)¹⁵, an advantage that India clearly does not possess.

The position is no better in the subsequent years. According to Chakrabarti (2006)¹⁶, in 2003 the cumulative FDI in China stood at over half a trillion US dollars as compared to India's slightly over US\$ 30 billion. He goes on to indicate that in 2003 China attracted a FDI inflow of US\$ 53.5 billion (about 12.4 per cent of its capital formation) while India received an inflow of US\$ 4.3 billion (about 4 per cent of capital formation). He points out that in 2004 too, China's FDI inflow was 12 times that of India's.¹⁷ Chakrabarti refers to a study by Morgan Stanley which held 'bureaucracy, poor infrastructure, rigid labour

¹⁴ see Mehta, R. and S. Bhandari, "Trends and Determinants of Foreign Direct Investment in Emerging Economies of Asia" in Kehal, H. S. (ed.), *Foreign Investment in Rapidly Growing Countries*, Palgrave Macmillan, Hampshire, 2005, p. 184

¹⁵ UNCTAD (1993), *World Investment Report*, cited by Yip, Vincent F., "International Mobility of Human Resources of Science and Technology and its Complementarity to Foreign Direct Investment and Economic Development in Asia" in Kehal (2005), p. 211

¹⁶ see Chakrabarti, Rajesh (2006), *The Financial Sector in India: Emerging Issues*, New Delhi: Oxford University Press

¹⁷ This is also borne out from the data given in Table 1A in Balasubramanyam, V.N. and David Sapsford's article "Does India need a lot more FDI?" in *Economic and Political Weekly*, Vol XLII, No 17, p. 1550

laws and an unfavourable tax structure' in India as responsible for this poor relative performance. *The Economist*,¹⁸ on the other hand, sees the caps that India imposes on FDI in a host of 'economically important, or politically sensitive, sectors' such as insurance, aviation, coal-mining, media etc as being one of the chief reasons for the discrepancy between India and China. However, Chakabarti is of the view that this difference should be viewed more as 'indicative of future growth opportunities in FDI inflows *provided India properly carries out its second generation reforms* and should not obscure India's significant achievement in attracting foreign investment in the years since liberalization' (2006: 8, emphasis added).

6.3.5.4 Restructuring the public sector

Naib points out that public sector reform has been a critical element in structural adjustment programmes all over the world and was also included in India's reform agenda. However, he is of the view that unlike in many other countries, where public sector reform has involved explicit programmes of outright privatization of public sector firms, combined with closure of unviable units, the approach adopted in India has been more limited. He observes that while in the 1980s, public sector reforms focused on increasing the functional autonomy of SOEs to improve their efficiency, in the 1990s this was combined with disinvestment involving sale of a portion of the government equity in SOEs while retaining the majority of equity and management control with the government (2004: 35).

¹⁸ Vol 377, Number 8450, Oct 29-Nov 4, 2005

Nayyar, on the other hand, found the objectives of public sector reform to be mainly threefold: (a) to reduce the activities of the public sector, (b) to facilitate the closure of sick units, and (c) to ease the burden of the exchequer on account of the public sector. As indicated earlier, it was felt that the public sector should focus only on those sectors which are of strategic importance, or high-tech, or constitute an integral part of the essential infrastructure. It was decided that enterprises which were chronically sick would be referred to the Board of Industrial and Financial Reconstruction (BIFR), which would decide whether these units can be revived or whether they should be closed down. However, as Joshi and Little point out, BIFR's own strong preference for reconstruction, and the legal procedures which make liquidation extremely difficult, together ensure that many moribund or loss-making companies continue to be a 'drag on rapid industrial growth' (1996: 213).

The 'centre-piece of public sector reform,' according to Nayyar, was disinvestment of government equity up to 20 per cent, subsequently extended to 49 per cent, in selected public sector enterprises in an endeavour to impart a commercial orientation to enterprises in the public sector (1996: 49). This would be discussed in the subsequent chapters and hence would not be dealt with in detail over here. However, it may be worthwhile to point out, as Joshi and Little have done, that by announcing its intention of not going beyond 49 per cent, in effect the government '**announced its intention not to privatize**' (emphasis added). They further point out that neither can this be 'considered in any way an alternative to privatization.' This is because, '*If the government owns more than*

half the equity, the firm is legally a government firm and subject to all the rules, regulations, and procedures connected with public ownership' (1996: 179 – emphasis added).

Nayyar is of the view that as compared to other areas, reforms in the public sector have been 'shallow and superficial.' According to him, the articulated objectives have been limited and inappropriate, and their pursuit half-hearted. He points out that while the number of industries reserved for the public sector has been reduced, there has been no systematic review of the portfolio of public investment that might lead to restructuring or rationalization. Some steps in terms of legislative amendments and administrative arrangements have also been taken which may make it possible to close units and retrench workers with suitable compensation. However, much of this, according to him, remains in the 'sphere of intentions, for the political constituencies for such changes have not yet been created' (1996: 49).

On the one hand, it was observed that non-plan budget support to the public sector, used mainly to finance losses, had been progressively withdrawn. While this would obviously reduce government expenditure, not only would this do nothing to ease the difficulties of such firms; it would in fact exacerbate it. According to Nayyar, the underlying philosophy seems to be to meet the needs of the government rather than to resolve the problems of the public sector.

The approach to public sector reform which emphasizes asset sales and closures is seen to represent 'the most rudimentary forms of privatization and restructuring.' Nayyar is extremely critical of the way the government has gone

about with this. He describes it as 'neither adjustment nor reform.' According to him, it is tantamount to 'selling the flagships and keeping the tramp-ships, or sending white elephants to the slaughter house, but there is no systematic attempt to address problems of efficiency and productivity.' He is of the view that privatization is a good strategy to impose discipline on the public sector so long as it is a potential, credible threat. According to him, it loses its virtue as soon as it becomes a reality (1996: 50).

According to Nayar, the dominant motive underlying the sale of government equity in the public sector has been the desire to mobilize resources for the exchequer. This, he says, 'is borne out by reality.' The capital receipts from such asset sales are seen to have been absorbed in the Union Budget to reduce the borrowing needs, and hence the fiscal deficit, of the central government, though in terms of macro-economic management, it is felt that it would obviously have been desirable to use capital receipts from such disinvestment to retire public debt or even to mop up excess liquidity as an anti-inflationary measure. On the other hand, from the perspective of the public sector, it may have been preferable to use the proceeds from the sale of government equity, at least in part, to restructure public enterprises, which does not seem to have happened.

Nixson and Arun likewise refer to the World Bank's *World Investment Report* (1995) which ranked India as being one of the countries which had been least successful in reforming its state enterprises. They are of the opinion that whether it is a question of granting managerial autonomy to public sector

enterprises or restructuring their operations or closing down of unviable sick units or handing over to private sector 'there has been no progress,' and feel that what is more disappointing is the fact that the disinvestment of the government equity in public sector enterprises is being utilized only to bridge budgetary gaps rather than to shore up the resources of the organizations concerned so as to enable them improve their profitability and efficiency (1996: 12).

6.3.5.5 Financial sector reforms

According to Nayyar, the objective of the financial sector reform was to improve the profitability of the state-owned commercial banking system and the functioning of the domestic capital market on the presumption that the discipline imposed by market forces would make both more efficient. The reforms in the context of commercial banks aimed at improving the profitability and restoring financial health of public sector banks, many of which were sick, while the creation of the Securities and Exchange Board of India (SEBI) was seen as an attempt to establish rules and regulations to govern the stock market and its intermediaries.

While it is not our intention to go into details of the financial sector reforms effected by the government and its impact on the economy, it would suffice to say that according to Nayyar, the financial sector reforms implemented in India so far have sought to reduce interventions practiced by the government and controls exercised by the central bank. However, he feels that while a restructuring of the financial sector was clearly necessary, the way the government has gone about it 'is characterized by some important limitations.' In

his view, the government has embarked on deregulation and liberalization in the financial sector without the necessary planning of its 'temporal sequence' and without a careful consideration of its wider implications (1996: 52).

Nayyar is of the opinion that the financial sector reform in India is based on the premise that the commercial banking system and the domestic capital market are 'over-regulated and under-governed.' While this presumption is felt to be 'broadly correct,' he feels that the process of reform unfolded so far suggests that deregulation has dispensed with the over-regulation, but the system remains under-governed because institutional and legal frameworks that would govern the market have not yet been put in place. In his view, this 'mismatch or asymmetry is fraught with risk' (1996: 52).

Mohan, on the other hand, feels that there has been a structural transformation in almost all segments of the Indian financial sector since the initiation of reforms. According to him, the reform process has strengthened the health of financial intermediaries, deepened financial markets and enhanced the instruments available in the financial system. He finds that at the level of individual institutions as well as at the systemic level, there has been 'considerable reinforcement of the framework of stability.' At the same time, he finds that there have also been 'discernible improvements in the competitiveness, efficiency and productivity of the Indian financial system.'

Despite the improvements noticed on account of the reforms effected so far, there are areas that have remained untouched and issues that need to be addressed. For example, Mohan finds that even after one and a half decade of

financial sector reforms, the sector continues to be dominated by predominantly public sector entities. He finds India's experience in this respect to be different from many other emerging market economies, especially the transitional countries, where financial sector reforms resulted in privatization of erstwhile public sector financial intermediaries. Mohan gives the example of insolvent banks to buttress his point. Rather than closing them down, he finds that policy-makers in India have shown a preference to merge such banks with healthy public sector banks.

Mohan indicates that in the late 1990s, India had proposed legislative change to enable reduction in government ownership up to 33 per cent in the public sector banks. It was proposed that notwithstanding such ownership pattern change, these banks 'would retain their public sector character.' The proposal, however, failed to meet parliamentary approval, indicating as Mohan says, 'a lack of political acceptability on privatization so far.'

While the public sector banks have been allowed to raise resources from the capital market with most of their issues having been over-subscribed, the government is wary of allowing them to dilute their stake further lest that affects the control it exercises over these banks. In fact, while addressing the Indian Banks' Association AGM on August 27, 2005, the Finance Minister (Shri P. Chidambaram) made it clear that the government would retain 51 per cent equity stake in public sector banks and that 'those that have attained this limit would have to identify newer forms of capital to strengthen their capital base.'¹⁹ It is

¹⁹ See the report titled "Centre to retain 51% of stake in PSU banks" in the *Deccan Herald* dated 28.8.2005

reported that the Finance Minister stated that the government's policy is to ensure that its equity does not, as a result of public issues by banks, go below 51 per cent. However, it is reported that he said that some new forms of capital would have to be identified in order to strengthen the capital base of those banks which have reached the limit of 51 per cent. Though the report does not indicate what these 'new forms' could be, it is obvious that restrictions on raising capital through equity would mean that the PSU banks would have to raise additional resources through debt, which would be costlier than equity and to that extent, may prove to be disadvantageous for these institutions.

The stand taken by the government is symptomatic of the ambiguities associated with the reform process in India in general and disinvestment in particular. On the one hand is the realization that institutions, whether they are PSEs or public sector banks, or for that matter even the government itself, would need to raise resources for its sustenance and growth. On the other hand is the reluctance to give up management control. This, in fact, is the problem that confronts not only the government but all political parties and is the reason for the lack of political support for disinvestment in India beyond a point. The problem is further compounded by the fact that in an era of coalition politics, decision-making is dependent on consensus building which is proving extremely difficult given the pulls and pressures exerted by the different parties. In fact, the lack of political acceptability of privatization is evident from the subsequent differences with the Left parties over the disinvestment of BHEL. This is one of the main issues affecting disinvestment proposals in India, as we shall see.

Further, as Kale points out, despite the reform momentum of the 1990s, several areas have been left untouched by the government so far. These include agriculture and land reform, labour reform, public sector reform and privatization. The latter two, in particular, she finds has ‘proven to be especially susceptible to political derailing.’ While public sector reforms in general has been discussed in the previous section, privatization, or disinvestment as it is commonly called in India²⁰, would be dealt with in the subsequent chapters.

²⁰ Apart from the fact that privatization is a politically unacceptable term in India, given the pressures of coalition politics where the government is dependent on the support of the Left parties, the use of the term ‘disinvestment’ also highlights the preference of the government to generally go in for partial disinvestment as compared to total disinvestment which the term ‘privatization’ would appear to imply.