Block 2
Development Strategies

BLOCK 2 DEVELOPMENT STRATEGIES

The state and market as institutions play significant role in the process of economic development. However, the role of these two institutions in India as an instrument of economic development has changed over time.

During the first four decades of development planning, India relied heavily on the public sector which was favoured as the engine of development. During this period, the state played mainly the regulatory, entrepreneurial and planning role. However, after 1991 the inward-looking development strategy was replaced by outward-oriented strategy popularly known as liberalisation, privatisation and globalisation (LPG) strategy, wherein private sector is considered as an engine of growth. Under this strategy, free functioning market acts as the guiding force in the major policy decisions and state works more as facilitator and promoter of economic activities and less as regulator. This block deals with re-defining the role of state and market and changing development strategies adopted over a period of time. The Block comprises **three units**.

Unit 6: **State and Market: Indian Context** throws light on the various forms of state intervention in economic activities, state's intervention for achieving the goal of efficiency and promoting equity and state's intervention in market as envisaged in Indian Constitution.

Unit 7: **Economic Reforms in India** covers the rationale behind economic reforms, the constituents of economic reforms and impact of economic reforms on Indian economy.

Unit 8: **Major Developments in Post Economic Reforms Period** identifies the key challenges on the road to India's development, analyse the hurdles in the process of restructuring public sector undertakings, highlights the pros and cons of public and private partnership, and underlines the need for insolvency and bankruptcy code (IBC) and the problems associated with it.

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UNIT 6 STATE AND MARKET: INDIAN CONTEXT

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6.0 OBJECTIVES

After reading this unit, you will be able to:

- differentiate between State and Government;
- describe different meanings of Market;

- identify different forms/instruments of State intervention;
- delineate the neoclassical rationale for State intervention in Market for efficiency;
- discuss the rationale for State intervention in Market for equity;
- explain State intervention mandated in the Constitution of India; and
- distinguish between intervention and interference.

6.1 INTRODUCTION

Political economy as evolved in the last few centuries in the West, dealt with the role of State in relation to economic affairs– both of public nature and private nature. As managing the State paraphernalia and making it help run the economy needed resources, fiscal operations of finding ways of mobilising resources and expending them had been an important aspect of a State's economic activities. With evolving complexities, monetary operations were generally parted from treasury functions of the government and entrusted with an independent and specialised agency, mostly within government domain and invariably under a separate law.

Societies and countries could progress because there were in existence certain institutions, which evolved over time practically in all civilised societies with variations and at differing pace. A legal framework ensuring existence of private property, an inheritance system for some assets and protection of contractual obligations has been a ubiquitous feature. It was realised quite early that many of resources are consumed in common and there had to be institutions to resolve issues should they arise in possession or use of such resources. In State-led societies, this task was given to or assumed by the State. State intervened in the economy for improving efficiency, enhancing equity, stabilising its activity level and balancing tradeoffs when they arose.

In the context of development, the expressed aspiration of post-war liberating colonies, led State in many newly independent countries to assume direct charge of running certain industries, besides educational and health facilities, regulating several others to seek efficiency and/or equity and promoting still others like financial institutions. In part, this was a reflection of the apparent success of the planning apparatus in the erstwhile USSR. But the USSR broke up and the constituents pursued market-oriented policies– known as perestroika (reforms) and glasnost (open-ness).

Relationship between State and Market across space and time has not been the same. So-called capitalism where quality and quantity of state invention distinctly differed from so-called socialism but both existed side by side for pretty long time. When most countries allowed market better, individual countries and regions differed not necessarily in proportion to the level of development. Over time, it appears that market dominated state and sought state to be a facilitator rather than a competitor by devising such formal institutions and designing them in such a way that market flourish and help the country grow. However, when crises struck such as the Great Depression of 1930s, the Great Recession of 2008-09 or Covid-19, the market operators sought the help from the State. In other times, either market sought or state sought the partnership between private sector and public sector in many development arenas which were traditionally taken up in

public sector for a pretty long time. This partnership had to be in terms of sharing of resources, risk and revenue. Anyway, there have been swings in the relationship between the two, market and state, in terms of domination, competition and cooperation. However, the unit, given the limitation of space, would not devote much time on this aspect.

The focus of this unit is on State intervention in individual markets for improving both the efficiency and equity of outcomes. In addition, State plays paternal role of encouraging or discouraging consumption of certain goods. It also chooses to regulate as well as promote quite a few private activities, including those of economic nature. The unit devotes space to discuss the nature of State and market, the rationale of State intervention in market for efficiency and equity. It also discusses State intervention in the context of India.

6.2 STATE AND MARKET

State and market are two great institutions which humans have evolved over time, among several others, to resolve inter-personal or inter-group issues in people's life that arise from living together. Both are overarching in their scope. Broadly speaking, one is political and the other is economic; but they also seek to intervene in each other's sphere.

State supposedly evolved to perform watch and ward functions, to defend the society from external aggression and internal disturbances while market evolved to benefit from voluntary exchange of goods (and services) which was greatly facilitated with the invention of money as medium of exchange.

However, State has often been intervening in, some would argue even meddling in, the economic spheres of life. Justifications varies from time to time, giving impression that State and market are hand in glove. Property rights and inheritance laws as well as people's entitlements and obligations, which were traditionally evolved have been recognised by the State which either accorded sanction or tweaked them a little here and there. Nevertheless, formal state institutions always alongside informal societal institutions where institutions mean the rules of conduct for individuals and other entities to avoid conflicts should they arise. Generally, there is a tendency for State to assume greater scope by formalising institutions and occasions arise for them.

6.2.1 State and Government

It would be pertinent to point out basic difference between State and government though they may be used interchangeably. State has four essential elements of population, territory, sovereignty, and government. In fact, government works for the State as its agent. People are a collectivity of individuals connected intractably. Territory belongs to the State over which it has sovereignty and jurisdiction; and government is supposed to preserve, protect and defend that territory. While State is sovereign, the government is not. In a democracy, it is often asserted that people are sovereign as they choose the State, rather the government, they would like to be governed by.

Government keeps coming and going as per rules of the State– best codified in the Constitution. While State may appear to be abstract, it is which asserts sovereignty of a community of people. All individuals living in the territory,

except those belonging to foreign States, are members of the State as its citizens. In India, there are 130 crore people, with 99.5 per cent being the citizens. While a few Indian citizens may be non-resident, few foreign citizens may be residents in India. In contrast, government is concrete, visible, and active, and involves a subset of people– some as representatives of people and some as employees in their service. For example, in India, there are around 545 MPs in the House of People, over 4000 MLAs in Stare Assemblies and over 30 lakh members in Panchayats and Municipalities, who are direct representatives of the people at some level of government.

Further, the form of government may vary from State to State. Government may be monarchial, aristocratic, dictatorship or democracy. It may have a presidential form or parliamentary one. It may be federal– with several fixed or flexible constituents, or unitary with centralised or decentralised administrative set-up. If federal, it may have several levels or tiers of governments. State exists independently of the form of government while people may choose the form of government.

However, the word State may have several meanings in popular usage. For example, in the Constitution of India, India is a State as well as a Union of States. (So is the case of the US.) Modern government normally has three wings, legislature, executive and judiciary. But the Constitution of India, for legal purposes, defines the State in Art 12, in relation to Fundamental Rights which must be adjudicated by Judiciary, as:

… "the State" includes the Government and Parliament of India and the Government and Legislature of each of the States and all local or other authorities within the territory of India or under the Government of India.

Finally, in the context of intervention, phrases State intervention and government intervention mean one and the same thing. When, however, it comes to failure, the phrase used is government failure– not State failure.

6.2.2 Market: Meaning and Forms

It seems, at some point in antiquity, quite possibly in different periods in different places, humans realised that voluntary exchange between two humans might lead to specialisation– thus to division of labour, and thereby raising production levels and thus bettering the possessions of both the exchangers. The same holds in inter-societal exchanges which might have been rare in the days when a society could still raid on other societies to improve upon its possessions. Once, a society is able to produce enough to maintain a regular army, it evolved as a State to defend itself against other societies. Rules for conduct of human affairs within a society had to be framed. Instruments might have had to be devised. For example, money is an instrument to facilitate exchange or transactions in market.

Size of market depends on the level of specialisation and division of labour, said Adam Smith. He is in fact referring to the size of economy in today's parlance, which is generally measured in terms of Gross Value Added (GVA). Another connotation, as in microeconomics, is a market for a commodity– good or service, or for a factor. Still another connotation is regular market referring to market place or periodic market referring to frequency. Nowadays, it may be real or virtual!

Market expanded as many goods got commoditised or commodified. For example, labour was not directly bought and sold earlier on wages, the labour price per unit of time– notwithstanding existence of slavery wherein a person can be bodily sold; later, it became like any other commodity. Many services like legal advocacy, consultancy, teaching, training, research, marketing, are also now on sale. In management science, market may mean a verb for advertisement.

Normally, we associate market with a place where we carry out purchase and sale of goods. Some are regular and some organised on periodic basis and some on occasions like festivals. There are virtual markets as well, as we are now becoming used to. However, in Economics, for analytical purposes, markets can be classified as asset markets, goods markets, and service markets; goods markets and factor markets; financial market, bond market and money market, etc. They present a platform with certain conditions to facilitate voluntary exchange of goods and services. Based on level of competition, they may be called monopoly, monopolistically competitive or oligopoly. The nature of State intervention invariably depends on the structure of the market. However, State intervention always take the form of influencing either the prices, quantity, or quality standards, or all of them.

If an institution means a set of rules to conduct affairs in a given domain, transactions such as exchange of goods and services, lending or borrowing of money, leasing, or mortgaging of assets (including intellectual property), accepting deposits and loaning them out or conducting other financial services like underwriting risk, all constitute separate markets– some of them may be inter-related.

There are conventions to transact business, some of which are instantaneous, some over time, some with attendant warrantee and conditionalities, some for future dates. For various reasons, the State may find it necessary to intervene by framing laws– rules, regulations, orders, guidelines etc.

6.2.3 Premises of Market

Market presupposes existence of property rights over resources and commodities– ownership of property by individuals, families, businesses, communities, and governments. Non-government ownership is often designated as private. Some properties are said to be common property. Property itself may be tangible or intangible. The former is physical – moveable and immoveable while the latter is mostly financial or intellectual. Market presumes that such property rights are alienable or transferable. So, farming field, town house, government bond, and molecule patent are all alienable. There may be new kind of rights like club membership, right to smoke or right to vote. You may have right to smoke in a railway coach which you may exchange it for consideration with someone who may find it obnoxious but you cannot legally exchange your voting right. So, you may have right to use but not to exchange. Likewise, you cannot pass on your right to smoke or right to vote to your children. They extinguish with your passing away. Government may give land to use but not to sell. Ownership is itself is a bundle of rights and you may possess some of those while others may be possessed by others. You rent in a house and you use; you lease in a piece of land and you cultivate it; you mortgage your financial papers and use borrowed money for some purpose, and you have an intellectual property and permit its use by others. In addition, it also presupposes existence of some rules of

inheritance of properties that survive the owner though some of them extinguish with the person.

Chattel (i.e., personal possession not related to real estate) seems to be the first form that came to be accepted as property and slaves appear to be the worst form of property. Both are the cases of means of production as are land, workshops, tools, and equipment. Socialist thinkers believe that means of production which occasion the employment of a sizeable number of workers have to be socially owned whereas capitalist proponents support private ownership. While some believe that private property provides incentive to exert harder, there are some, like Ludwig von Mises, who think that prices cannot be formed in the absence of private property over means (factors) of production.

There is often a distinction made between private property and personal property and another between consumption goods (means of consumption) and capital goods (means of production).

Mutual transfer of properties, including money, in a voluntary exchange is the basis of market. In case, there is a breach of generally acceptable behaviour there exists some mechanism, namely legal redress, to enforce it.

However, market may not exist in certain cases as goods may have peculiar characteristics. Or market may exist but may not yield efficient outcomes. So, private property may be a necessary condition for market to function, but not sufficient. Likewise, rules for succession or inheritance of certain properties are a necessary institution for a society but not sufficient.

Check Your Progress 1

1) Differentiate between State and Government.

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2) State the different meanings of State in political sense.

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3) Explain different nuances of a market.

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4) What are essential premises of market in terms of voluntary exchange?

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6.3 STATE INTERVENTION IN MARKET: INSTRUMENTS AND INSTITUTIONS

State intervenes practically in all spheres– economic, political, and social. In economic sphere, there are general interventions in the economy and there are interventions specific to individual markets. For example, RBI interventions aiming at supply of money which is for the economy as a whole, while interventions by TRAI to influence telecom sector in terms of price, quantum, and quality or standards are specific to the market for telecom services. State devises a variety of methods which are used for intervention and a variety of institutions through which intervention is carried out.

Beside policy formulation, legislation of law, framing of rules, and outlining guidelines, market specific instruments of State interventions can take the shape of production, provision, promotion, protection, restriction (on price, quantum or standards), regulation (on labour or environment), control and sharing information.

Likewise, there are variety of institutions through which interventions are carried out. These institutions are named as agency, association, authority, bureau, boards, committee, commission, corporation, council, foundation, institution, office, organisation, society or trust, which all have somewhat different legal status and organisational complexion. There may be ad hoc task forces, working groups, panels of experts, etc. Similarly, broad sectoral interventions take the shape of plan, scheme, programme, project, campaign, and mission.

For the purpose of elaboration, this unit chooses to classify micro interventions as they are, into four groups in terms of (i) Ownership and Operation, (ii) Regulation and Control, (iii) Promotion and Support, and (iv) Protection.

6.3.1 Ownership and Operation

There may be certain strategic industries/market where State does not trust private owners as it does normally. This is in the case of core defence, police activities or mintage, coinage, and note-issuing, which once upon a time private parties engaged in. There may be sectors where private capital may be shy as it may not have enough capital or venture may be too risky. State may choose to have monopoly over space industry or atomic energy industry or mining of atomic mineral resources. But the Government of the day may ideologically decide to control the commanding heights of the economy or establish a socialistic pattern of society. Or it may find no reason to do business. For example, in India, following Parliament's resolution to establish socialistic pattern of society in December 1955, the Industrial Policy Resolution of April 1956 included a whole set of 17 industries to be exclusively owned and operated by the Government. It included,

besides arms and ammunition, atomic energy, and minerals, electricity, railways, ships, aircrafts, coal, iron and steel, etc. If such industries are in private hands, they could be nationalised. The government or its agency, corporation, or company, would own, operate, control, and manage all operations related to production or disposal of the produce. Now, the circle is moving to the other side; instead of nationalisation of private enterprises, privatisation of state enterprises is being contemplated and carried out. As of now the move is towards public private partnership, if not outright privatisation, divest mentor joint ownership and operation.

6.3.2 Regulation and Control

There may be another set of industries essential for developing infrastructure or essential consumer goods, the government could think of regulating or controlling output and/or price. Once, the government compulsorily procured a certain portion of food grains at lower prices and thereafter decided to offer support prices in case market prices fell below that level. Further, once upon a time it was thought textile mills could compete with handloom and khadi which needed to be encouraged for employment and, therefore, their output could be controlled. License to produce was one of the conditions one had to fulfil before starting operations. Many metals, cement, antibiotics, fertilizers, machine tools, sugar, road transport, etc. could be put in that category. There was an Act, called Essential Commodities Act passed in 1955, which permitted the government to control production, supply and distribution of certain commodities like drugs, foodstuffs, fertilizers, etc., under certain circumstances. There are several other regulations put in place to assure, for example, quality of goods and services. Several agencies have now been put in place to certify quality of products by marking as ISI, Hallmark, Agmark, Ecomark, BSIV, etc.

6.3.3 Promotion and Support

Many industries may need financial support or promotion– say, in export. Government creates development finance institutions such as NABARD, SIDBI, NHB or EXIM Bank to support industries and trade. It also floats boards and councils to promote the interests of specific industries.

Needless to say, government generally support supply side of market through S&T/R&D activities, development of general infrastructure – including clusters, estates, market yards and other common facilities. It also supports technical education, training for skills, and extension centres.

6.3.4 Protection

Certain industries may need protection, besides support, from competition with easily substitutable products. There were hundreds of items which were reserved for production by small scale industries (micro and small enterprises). Under WTO obligations, slowly, protection by reservation has been withdrawn. However, there is still Purchase Preference Policy and Price Preference Policy. Under the former, government departments are supposed to give preference for products from small scale industries and under the latter, they could pay up to 15 per cent higher price than the lowest quotation from industry of any scale.

Check Your Progress 2

1) List the various instruments of specific market interventions.

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2) List the institutions and modes of State intervention in market.

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3) Explain the meaning of regulation in the context of intervention in market.

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6.4 STATE INTERVENTION IN MARKET FOR EFFICIENCY

State is supposed to protect life, liberty, and property of the individuals while market is about voluntary exchange of properties– though with quite extended meaning. It is obvious that State emerged after institution of private property had already come into existence. However, according to Marxist literature, State and market are said to be in hand-in-glove.

State is often pressed into service to intervene in the market should its legitimate functioning result in socially undesirable consequences. State is also asked to intervene in the market if the latter is found to be inadequate or incomplete in certain respects. Such a situation is called market failure as it results in higher prices and lower quantities compared to efficient operation of market.

In this section, the rationale of market intervention of State is afforded in terms of production and consumption as well as price, quantity, and quality. The purpose is to improve efficiency or reducing deadweight loss to the society. Let it be clear that these interventions are in white markets which follow all laws of the land. It is possible that some interventions may induce parties to go into black or conduct illegal operations.

6.4.1 Rationale for State Intervention in Market

Neoclassicals provide for clear-cut price formation in market under the condition MR = MC following certain simple assumption. They also highlight instances where markets are not functioning efficiently or may not be complete or may not exist altogether. They called that market failure or, breakdown of competition. Two major sources are (1) existence of externalities with production or consumption of private goods and (2) existence of market power or monopoly power or imperfect competition. Another source of market failure is (3) existence of imperfect and incomplete information. Purists may reduce everything into violation of assumptions of perfect competition (an idealised world) while practical people recognise existence of the extreme case of externalities as (4) existence of public good, as a separate reason. Further, from a society's perspective there are goods which merit consumption and there are goods whose consumption ought to be discouraged. For market, on their own may not be able to enforce this distinction. So, (5) existence of merit and demerit goods is another reason for state intervention.

In the case of perfect competition, marginal revenue (MR) of the producer, often called marginal benefit (MB), is equivalent to marginal social benefit (MSB) as there are no spillovers of benefit. So, MR=MB=MSB. Likewise, marginal cost (MC) is equivalent to marginal social cost (MSC) as no cost is externalised. So, MC=MSC. Usual equilibrium condition of MR=MC (or MB=MC) translates into MSB=MSC and thus efficient voluntary exchange ensures efficient social outcome. There is neither excess production nor shortage. When there is divergence between the two– private and social, this parity breaks down. Market will fail to produce socially efficient output or outcome. In such a situation, an external intervention in the market is required. For long, it has been suggested in neoclassical tradition that the intervention should come from the State. This is the rationale for State intervention. We briefly discuss these five instances of market failure to produce efficient social outcome, leading to State intervention.

6.4.2 Public Goods

There are certain goods which have certain peculiar characteristics such as non-rival consumption and non-excludability. Rival consumption means if I consume more, then less is available to you. If there is a shirt and if I wear it, it is not available to you. If I take away a portion of bread, less is available to you. This is true of any private good. But take the case of viewing a serial on TV, my viewing does not impact your viewing it. Both of us enjoy together with no rivalry. So, is the case with municipality produced street light. Excludability means one can be excluded from consumption if one does not fulfil say certain conditions to enjoy it. In a market, one who is not paying for the good or paying less than the prevailing price, can be excluded. One who is not major may be denied purchase of a cigarette pack or a bottle of liquor even though he is willing to pay. One may not be enrolled for a Ph.D. if he has not done a Master's degree. However, one may not be denied the consumption of streetlight or security by defence forces even when one is not contributing to production of these services. There is no way anybody can be excluded from consuming such goods. Either the prevalent technology does not permit it or cost of excluding is too high. It is often argued that marginal cost of supplying public goods like TV signals is

almost zero, it may not be necessary to price them. But its supply does cost, say in terms of high fixed cost, it is suggested that it should be public funded. Then, there exists problem of free-ridership as true preferences for such goods may not get revealed.

Public goods are goods which are non-rival in consumption and non-excludable from consumption whereas private goods which are both rival and excludable. However, it is not true that all goods in existence can be categorised in these two mutually exclusive groups. Goods may be non-rival but still excludable. Few more students may be accommodated in the class as marginal cost of teaching them is zero and consumption is non-rival up to a limit when the class size becomes too large for effective learning to take place. Such goods are often called club goods. There are goods, such as fishing in international water, where fishers are non-excludable, but extraction of fish is rival: more for me and less for you or more today and less tomorrow. So may be the case with oil extraction from two nearby wells with common stock underground. Such goods are often referred to as commons or common goods. Club goods and common goods are also referred to as quasi-public goods or semi-public goods.

For pure private goods, equilibrium condition $MSC = MB_A = MB_B$ where A and B are two consumers, decides the quantum of good that would be produced while in case of pure public goods, equilibrium condition $MSC = MB_A + MB_B$ should decide that quantum. In the case of a private good, marginal benefit curves are horizontally added while in the case of public good, they have to be vertically added. Needless to say, market may not produce any such good. State is therefore called for, for production of public goods.

We may further note that (1) public goods may be national or local or global depending upon their area of outreach and (2) there also exist public bads (global, national and local), like variety of pollutions, which have to be reduced or removed by the State.

6.4.3 Externalities

Most activities related to production of goods, and some involving consumption of goods, also produce bads, which impact others, called third parties– as they are neither producer (first party) nor consumers (second party) who benefit from production of the good. This phenomenon is known as externalities. Sugar or textile or leather factories produce effluents which find way into local water streams impacting those living nearby or depending on them for water. People living in the vicinity suffer from the polluted streams in terms of health hazards and incur expenditure on protection or medical treatment. Some of the production activities do produce benefits which accrue to those who do not pay for those benefits. A classic example is beekeeping. While collecting nectar bees pollinate the trees in the orchard. Free software or basic education are treated in the same category. Thus, we see externalities are negative or positive. The short point is that social cost or social benefit diverge from their private counterpart. Third party cost/benefits are also known as external cost/external benefit (EC/EB). Generally, marginal equilibrium conditions are written as:

For Negative Externality: MSC = MC (MPEC) + MEC while MR=MSB

For Positive Externality: MSB = MR (MPEB) + MEB while MC=MSC

where Marginal Private Economic Cost (MPEC) represents marginal cost and Marginal Private Economic Benefit (MPEB), marginal revenue. MEC and MEB are Marginal External Cost borne and Marginal External Benefit enjoyed by a third party. Since private parties tend to equate marginal (private) cost with marginal (private) benefit, quantum produced may not be socially efficient. While focusing on negative externalities, it was argued by Pigou to adopt 'polluter pays' principle. The suggestion is externalities should be internalised. Since then, many other suggestions have been offered. Allocation of tradable pollution permits is one. Subsidisation sought by private parties to adopt technologies to help reduce pollution is another. Coase had argued for assignment of property rights and private negotiation, but negotiation need to be enforced by State. So, State intervention is needed in such cases as well.

6.4.4 Monopoly Power

When there is only one producer, monopoly is obvious but monopoly power in terms of fixing price is not that obvious. A monopolist dealing in a commodity with an inelastic demand has higher monopoly power than one who is dealing in a commodity with an elastic demand. Elasticity of the demand curve faced by a firm depends on the number of firms in the market as also on substitutes (implying cross elasticity). Oligopolistic and monopolistically competitive firms have thus also some monopoly power. Thus, there is a degree of monopoly with firms not in a fully competitive market. Since for a firm in a fully competitive market, price is equal to marginal cost (P=MC), the divergence between the two, that is excess of P over MC, will determine the monopoly power. Lerner devised an index with formula as

$$\text{Degree of Monopoly Power} = (P - MC)/P,$$

which is zero when P=MC and 1 when marginal cost is zero. Since MC is equal to MR in equilibrium and MR=P(1- (1/e) where e is the measure of elasticity, the degree of monopoly can be shown to be equal to 1/e. Monopoly power is inverse of the elasticity of demand.

There may be good reason to permit monopolies in certain cases. Like in natural monopolies, it benefits the society to harness potential of a technology in terms of economies of scale. However, if producers are few or if a producer controls a good proportion of market, they enjoy market power, which manifests in the form of goods offered at a higher prices. In both cases, State is invited to intervene by regulating prices in addition to quantity and quality so that social outcomes are optimum. Monopoly restricting laws have been enacted in most countries. Competition Commissions are also instituted by the governments in many countries, including in India, to oversee that market power or market dominance is not misused to the disadvantage of consumers.

6.4.5 Information Asymmetries

One of the basic assumptions behind perfect competition is prevalence of full and complete knowledge among buyers and sellers of goods, which is hardly

ever the case in reality. With growing economic complexities, though knowledge has increased, so has ignorance or lack of adequate information to make good economic decisions. There is another aspect, information is often asymmetric between the two parties that may be involved in pursuing a transaction. State tries to reduce this asymmetry. There are acts and institutions setting quality standards to take care of– safety in case food articles, quality in case of metals, control of pollution, etc. Samuelson quotes the case of Eben Byers who was a steel mogul in the US. He took drug Radithor sold as an aphrodisiac and cure-all to relieve himself from his ailments. Byers died from its consumption. Later on, it was discovered that Radithor was distilled water laced with radium. State has a role in addressing such informational deficiencies.

6.4.6 Merit and Demerit Goods

There are often goods demanded by some people that may not be considered desirable by the society. State as an important pillar of society is expected to encourage consumption of merit goods. For example, children may not value education and its demand may be low. Competitive market may produce very little education to meet the needs of everyone. State encourages its consumption by subsidising it or making it free of tuition fee. Inoculation, immunisation, vaccination, sponsorship of cultural festivals may all fall in that category. Similarly, there may be goods such as intoxicating drugs tobacco, cigarettes or alcohol, the consumption of which a State may want to discourage. State could discourage consumption through several ways including imposing heavy taxes, restricting or banning the production. Some States in India have prohibited the consumption of alcohol or tobacco. At the moment, Gujarat and Bihar have banned production, imports and consumption of alcohol, while Haryana has lifted the ban imposed earlier.

Check Your Progress 3

1) What are the reasons for State interventions in specific markets?

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2) Explain the rationale of State intervention in the market on account of externalities in production and consumption.

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3) What is meant by a demerit good? How does government intervene in the market for demerit goods?

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6.5 STATE INTERVENTION IN MARKET FOR EQUITY

Market, even if technically efficient, is no guarantee for ensuring equitable outcomes in an economy. This is one reason why people could be against an unhindered play of markets. It is often reported that in market economies the share of better-off sections of the economy improved is proportionately at the expense of the less fortunate. Relative share of the worse-off actually comes down substantially even though, generally speaking, every section becomes better-off in absolute terms. State often redistributes property, puts ceilings on specific kind of property like land, discourages concentration of wealth and through taxation redistributes incomes by supply public goods that are consumed more by the less well off sections of the economy or by subsidising some of their consumption. This helps in addressing the equity concerns in the economy.

This section discusses the market interventions whereby State influences distribution of income among sections that contribute to production. It generally implies intervention in factor markets. However, certain goods, mainly necessities, may require the State to intervene in their specific order to ensure a more equitable access/distribution of such goods perspective. In contrast to intervention for efficiency, intervention for equity might increase deadweight loss of the society.

6.5.1 Goods Markets

Final Consumer Goods

State regulates prices for certain goods, including by the requirement to display maximum retail price for most goods. Many drug prices are notified with ceiling. In India, quite often, Essential Commodity Act is invoked to stabilise prices of onions, potatoes, salt, etc. Some agricultural products attract minimum support prices and procurement is made by some government agency, chiefly Food Corporation of India, at harvest time. At the same time, buffer stock of certain commodities, like wheat and rice, is maintained and it is released in market when prices rise.

Intermediate Inputs and Capital Assets

Irrigation water, power and chemical fertilizers like urea are sold to farmers in India at subsidised rates. In the similar vein, capital assets like milch cattle or pump sets were once subsidised for below poverty line households, with differential subsidy amounts– depending upon the social category the beneficiary belonged to.

6.5.2 Factor Markets

Labour Market

State often imposes Minimum Wage Act to improve wage levels in the labour market. It is generally welcome though quite a few economists find it counterproductive, not without logic, as it might increase unemployment by discouraging use of labour intensive techniques in production. The law is applicable for low level of workers– unskilled, semi-skilled and skilled. Beside price intervention, there are several other interventions seeking job security and income security. However, for most of India's independent history, minimum wages have not been fully enforced in most states. Of late, it has been argued that a floor on wages has been created by the MGNREGA guaranteed wages in many states, including in the backward states where minimum wages were not enforced in reality.

Credit Market

State may use a policy of differential rates of interest for different sectors to ensure adequate flow of credit, interest subvention for equity consideration and even in the context of tax policy. In India, such lending is called priority sector lending and sectors include agriculture, micro enterprises, higher education, affordable housing, etc. where certain floors in terms of credit flows are also enforced.

Entrepreneurship

State encourages private initiative if the promoters have good workable ideas by extending tax benefits, concessional credit and even training. Recent examples are Startup India and Standup India initiatives. Besides, there are interventions at creating skill sets among youth through state intervention or attempting vocational education.

Check Your Progress 4

1) How are interventions for equity different from those for promoting efficiency?

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2) Explain how intervention in the labour market by regulating wages may be counterproductive?

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3) How is intervention for development of entrepreneurial skill helpful in promoting equity considerations in a society?

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6.6 STATE INTERVENTION IN MARKET AND INDIAN CONSTITUTION

Part IV of the Constitution of India embodying the Directive Principles of State Policy, makes it amply clear that these principles, though not enforceable by any court, are fundamental in the governance of the country and that the State is obliged to apply these principles in enacting laws. These are said to be forerunners of the recognition by the UN of the right to development as an inalienable human right. Several Supreme Court judgements allow even tweaking of Fundamental Rights for pursuing Directive Principles provided that tweaking does not touch the basic features of the Constitution.

6.6.1 General Direction

Laws are the basic forms of intervention in the national life, ostensibly for the betterment that a Welfare State should stand for. As Art 38 says, State shall strive to promote the welfare of the people by promoting justice and reducing inequalities as enshrined in the Preamble to the Constitution. Development involves many aspects of life– social, economic, and political; and State may intervene in many of them. Directly relevant for this unit, however, are two clauses of Art 39 that direct the State to secure:

(b) that the ownership and control of the material resources of the community are so distributed as best to sub-serve the common good; and

(c) that the operation of the economic system does not result in the concentration of wealth and means of production to the common detriment.

From these two clauses, it appears that the State accepts the primacy of private ownership of material resources (Clause 39 (b)) and of market price mechanism (Clause 39 (c)) but asserts its interventionist power to correct distribution of material resources as well as to influence price mechanism so as to secure best welfare outcomes. There are several other Articles, all in Part IV, which can be seen as construing market intervention: Right to work (Art 41), Provision of just and human condition of work (Art 42), Living wage for workers (Art 43), and Participation of workers in management of industries (Art 43A). Organisation of agriculture and animal husbandry on modern and scientific lines (Art 48) and Protection and improvement of environment and safeguarding of forests and wild life (Art 48A) can also be accepted to fall in the same category.

6.6.2 Particular Areas

One can well see that there are suggested areas of market intervention– whether regulation or promotion, in the Seventh Schedule under Art 246 that delineates subject-matter of laws to be made by Parliament and by the Legislatures of States. List I (Union List) roughly enumerate them generally under entries 22 through 61, List II (State List) does so under entries 13 through 32, and List III (Concurrent List) lists them under 20 through 38. Many other entries also have relevance for market intervention while some of the entries noted above may not strictly be related with market intervention. Generally, there is separation in intervention between the two level of governments, Union and State. But there may be areas where Union and States are dealing with separate aspects of the same area, like mining or industry or communication. There may be an area where both the governments are competent to legislate, like electricity, but if there is conflict then the Parliamentary Act shall prevail over the Legislative ones. For rough mapping of entries of three lists across sectors, see the Appendix.

It may be noted that market intervention here means influencing production, consumption, and transportation as well as price, quantity, and quality. It should be noted that we have avoided mentioning fiscal and monetary instruments as they indirectly influence the market except those fiscal instruments which may be called sin taxes.

State intervention can be broadly classified as establishment, development, and welfare in economic matters. Development and welfare functions can be partly effected through intervention in market functions– sometimes to promote efficiency but at others to promote equity. However, any efficiency measure will have implications for equity and vice versa.

Check Your Progress 5

1) Which article of the Constitution of India specifically suggest that State has power to intervene in market?

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2) Where are listed areas of legislative intervention in the Constitution of India for Union and the States?

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3) What is the significance of the Concurrent List in the Constitution of India?

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6.7 STATE INTERVENTION AND STATE INTERFERENCE

There is a subtle difference between intervention and interference. Intervention is welcome move by a third party to resolve an issue between two parties, to improve the outcome. Interference is a move that is often resisted, not welcome, by the party which finds it disruptive, making outcome worse. Intervention is considered a positive move while interference is a negative one. What if a move by the State is welcome by one party and rued by the other?

State may not always be right. It is quite possible that State is unnecessarily intervening without good reasons. It is also possible that a State intervention may continue beyond the time it is needed. It is possible that it might become excessive and found to become interference. It is also possible that government has not well understood the situation and may have unnecessarily intervened. Something considered good in 1950s might not be needed in 2000s, suggesting that such moves have outlived their utility. There may be generational shift or ideological shift about the role of State. Their continuance might have counterproductive. Yet, a party may be gaining at the cost of another or the country as a whole.

It may be pointed that 1500 Parliamentary Acts that were found archaic, were repealed in recent years– quite a few of them were economic, impinging upon market functioning.

In India, we often discuss the movement from LPQ (License, Permit and Quota) raj to LPG (Liberalisation, Privatisation and Globalisation) regime. Reforms of 1950s are said to have been relevant during that period. Reforms of 1990s are currently continuing in the same direction. For example, liberalisation means removal of restrictions. So, restrictions are being removed gradually.

There may be several reasons for unnecessary intervention. One of them is rent-seeking nature of politicians and bureaucracy. Another is regulatory capture by industrial biggies whereby regulators get willingly captured by private interests. Still another is pursuit of self-interest by regulators. Similarly, often electorate demand, or political objectives of a ruling party may not be very rational or in the larger interest of the country. There are several others. Scholars of late have asserted that there exists what one can call government failure.

6.8 LET US SUM UP

State is perhaps the most important institution humans have evolved to sustain social living and resolve conflicts that may arise in societal affairs. Market is one of such societal affairs. It intervenes in market in general but also in specific markets to influence level of production, level of prices, quality of products or standards of service, etc. It devises several instruments as well as institutions through which it intervenes. It is to be appreciated that the relationship between State and Market has not been the same across space or time in terms of dominance, competition and cooperation. Despite a tendency of assertion by market, State is called for stabilisation in terms of crises; at other times, market seeks its entry through partnership into the development areas that for a long time were preserve of the State.

Neoclassical economists have over time enumerated the reasons as to when and where State is called upon to intervene in market for specific goods under the assumption that State is most efficacious institution to improve the outcomes. Microeconomic interventions can be undertaken for both purposes– improving efficiency and enhancing equity.

Efficiency interventions generally try to improve welfare (the sum total of producer surplus and consumer surplus and, if relevant, government revenue) and decrease deadweight loss which may be caused by imperfection in competition or presence of externalities. If the operation of a factor market results in further deterioration in the extant inequality, State may intervene to ameliorate the worsening of inequality. There are other interventions directly hitting at distribution but, in this unit, focus has been on those interventions which directly relate to specific markets.

The unit has also broadly touched the direction for intervention in market generally and specific markets through legislation as suggested in the Constitution of India which divides the areas of legislation between the Union and the States. It also hints that State may not always be right in intervening or choosing right kind of institution and instrument.

6.9 TERM- END EXERCISES

1) What do you mean by market failure? What factors can cause a market failure?
2) What do you mean by State or Government intervention? What does an intervention try to impact?
3) Explain neoclassical arguments favouring State intervention in specific market.
4) Show how a factor market may be efficient but not just.
5) Explain the significance of Article 39 (b) of the Constitution of India from the angle of market failure and government intervention.

6.10 KEY WORDS

Demerit Goods : Goods that consumers may like but are actually harmful though they do not appreciate it and therefore their

consumption is discouraged, are known as demerit goods.

Externality : Uncompensated effect of an activity on a third party who may neither be a producer nor a consumer of the activity.

Intervention : An action intentionally carried out to sustain an activity or resolve an issue between two parties engaged in an activity.

Market : An arrangement, actual or virtual, facilitating voluntary exchange between two parties.

Market Power : Ability of a firm (or a group of firms) to dictate prices or quantity of goods and services i.e. keep prices above or quantities below the level that would have prevailed under competition.

Merit Goods : Goods that are seen as being useful to consumers, but may not be appreciative and their consumption is generally encouraged by society or government.

Ownership : A bundle of rights over a real, financial, or intellectual property, which can be separated and held by different parties.

Private Goods : Goods that are rival in consumption and consumers can be excluded with ease are called private goods.

Public Goods : Goods that are non-rival in consumption and consumers cannot be excluded altogether are public goods.

Regulation : A directive, law, or rule maintained by an authority to control an activity or process.

State : A human institution of organised political community or body politic.

6.11 REFERENCES

Books on Microeconomics, Public Finance, and Environmental Economics which include relevant chapters, would be good enough for the Unit. www.britannia.com and www.tutor2u.net could be websites among those which can be consulted. Constitution of India contains reasons for intervention in market in Part IV and Part XI– particularly Chapter I. For swings in the relative importance between market and State and changing complexion of the relationship between the World Development Reports of 1996 and 1997 would be an interesting read. However, one can profitably read following books/articles for advanced understanding:

1) Francis M. Bator (1958). The Anatomy of Market Failure, Quarterly Journal of Economics, Vol. 72, No.2. Available on internet.

2) Bernard Salonie (2000). Microeconomics of Market Failure, The MIT Press, Cambridge, Massachusetts.

3) Gordon Tullock et al. (2002). Government Failure: A Primer in Public Choice, Cato Institute, Washington.

4) Clifford Winston (2006). Government Failure versus Market Failure: Microeconomics Policy Research and Government Performance, AEI-Brookings Joint Centre for Regulatory Studies, Washington.

6.12 ANSWERS OR HINTS TO CHECK YOUR PROGRESS EXERCISES

Check Your Progress 1

1) Government is only one component of State, other being People, Territory, and Sovereignty.

2) State word is also used for the constituent units of a State as it has practically all elements of State as defined in Political Science, the difference in some contexts being that 'sovereignty' being replaced by 'autonomy' in their designated spheres. States may be clubbed with Union Territories in certain references in India.

3) Market may mean the whole economy or its size, generally measured in terms of GVA. It may have broad types such as goods market, labour market, etc. But then, it has microeconomic connotation of market for a particular good.

4) Existence of private property or still better alienable property and laws of inheritance.

Check Your Progress 2

1) Production, provision, promotion, protection, restriction (on price, quantum or standards), regulation (on labour or environment), control and sharing information.

2) Agency, association, authority, bureau, board, committee, commission, corporation, council, foundation, institution, office, organisation, society or trust.

3) Price, quantity, and standards.

Check Your Progress 3

1) Existence of public goods, externalities, incomplete information, market power, merit/demerit goods.

2) Social cost is higher than private cost as part of the cost born by some third party. Social benefit is higher than private benefit as some benefit accrues to a third party.

3) Goods that are preferred by consumer but are discouraged for consumption by others in consumer's interest.

Check Your Progress 4

1) Efficiency mimics with equilibrium price and quantity in perfect competition. In markets where it does not obtain equilibrium price is higher but equilibrium

quantity is lower. As a result, there is some deadweight loss. Efficiency interventions try to reduce them. Equity intervention seek to disturb market equilibrium as its outcomes are perceived to be injurious to certain interests—say, labour.

2) Pegging wages at more than equilibrium level is likely to create surplus labour as supply quantity increases while demand quantity decreases. It might result in lower income to wage earners.

3) Enhancement of entrepreneurial skills is likely to improve entrepreneur's income.

Check Your Progress 5

1) Article 39(b).
2) Seventh Schedule of the Constitution under Article 246.
3) Both Parliament and State Legislature can legislate on the subject. Should there be a contradiction, legislation by Parliament shall prevail.

Check Your Progress 6

1) Intervention is welcome while interference is resisted.
2) Rent-seeking, regulatory capture, pursuit of self-interest, and irrational electoral demand.

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APPENDIX 6.1

An attempt to map subject areas across three lists of VII Schedule

Subject-matter	Union List	State List	Concurrent List
Land and Property		18	6
Agriculture		14	
Animal Husbandry		15, 16	17
Irrigation		17	
Fisheries	57	21	
Forests and Wild Life			17A, 17B
Mining	6, 53, 54, 55	23	
Industries, Factories, etc.	7, 52, 58, 59	24, 27	18, 33, 36, 37
Industrial Disputes	61		
Trade and Commerce	41, 42	26	33
Banking, Money Lending, etc.	45, 46	30	
Insurance	47		
Communication (Transport)	22, 23, 24, 25, 26,27,28,29,30,	13	31, 32
Electricity			38
Intellectual Property	48		
Trading corporation	43, 44	32	
Gas and Gas Works		25	
Monopoly, Combinations, etc.			21
Trade Unions, Social Security			22, 23, 24
Price Control			34
Economic and Social Planning			20

UNIT 7 ECONOMIC REFORMS IN INDIA

Structure

7.0 Objectives
7.1 Introduction
7.2 Economic Reforms: Meaning and Nature
7.3 India's Path to Economic Transformation
 7.3.1 Planned Economic Development
 7.3.2 Import Substitution in Industrialisation
 7.3.3 License Permit Quota Raj
 7.3.4 Public Sector Expansion and Nationalisation
 7.3.5 Beginning of Economic Reforms
7.4 Onset of Current Economic Reforms
 7.4.1 The Crisis
 7.4.2 Assessment and the Response
 7.4.3 Some Initial Steps Taken by the Government
7.5 Reforms for Macroeconomic Stabilisation
 7.5.1 Fiscal Reforms
 7.5.2 Monetary and Financial Reforms
 7.5.3 Currency Exchange Reforms
7.6 Reforms for Microeconomic Structural Adjustment
 7.6.1 Liberalisation of Business
 7.6.2 Privatisation of Public Sector Units and Disinvestment
 7.6.3 Globalisation of the Economy
7.7 Generations and Waves of Economic Reforms
7.8 Let Us Sum Up
7.9 Term-End Exercises
7.10 Key Words
7.11 References
7.12 Answers or Hints to Check Your Progress Exercises

7.0 OBJECTIVES

After reading this unit, you will be able to:

- define economic reforms;
- contrast efficiency-seeking reforms with equity-seeking reforms;
- delineate the nature of neoliberal economic reforms;
- narrate the crisis brewing in 1980s and precipitated by Gulf War in 1990;
- shed light into the background necessitating current genre of reforms;
- explain macroeconomic stabilisation and structural adjustment programmes; and
- make a distinction between the first generation and the second generation reforms.

7.1 INTRODUCTION

Every day, we in India keep hearing, or reading news about some or the other economic reforms that have been brought in or would be brought in shortly. They are either introduction of new interventions or withdrawal of old interventions by the government in managing the economic affairs of the country– particularly in the structure and operation of markets.

In the previous Unit, it was discussed as to why and how government intervenes in the market and also why and how, at times, it chooses to withdraw certain interventions. Introduction, modification, and withdrawal of government interventions depend partly on ideology, partly on evolving situation– both internal and external, and partly on the efficacy of the prevalent institutions to meet the development objectives.

Interventions brought in by the government are said to be 'reforms' when they are significant and, generally pro-active but they are short of being a revolution. It seems significant institutional/instrumental changes have often been called reforms and technological or social ones, revolutions. The latter are not necessarily always prompted or promoted by government but they invariably have a significant consequence for a society. Reforms too could be social– anti-sati or anti-slavery; economic– agrarian and industrial; political– parliamentary and electoral, etc. So could be revolutions– American or French Revolution on political front and Industrial Revolution or Green Revolution on economic front. However, reforms in this Unit will mean economic reforms and only those undertaken by the government. They thus refer to reforms in economic policy and management of the government.

In India, there were a set of reforms carried out after independence in several institutional arrangements, the first being in the sphere of land relations. They were duly referred to as reforms by policymakers and scholars though in legislative parlance few of the Acts were named 'reforms' (Even introduction of expenditure tax in mid-1950s was called a tax reform). Likewise, when in early 1990s steps were taken to liberalise business, privatise government enterprises, and open the economy for international trade and investment, they have been called reforms by policymakers and scholars alike but not necessarily in legalese where the word often used is regulation or management.

This unit proposes to explain the meaning and nature of economic reforms carried out since independence and post 1991, and discuss the features and contours of reforms carried out during these two different periods.

The unit is, however, intended to explain rather than assess the neoliberal reforms in terms of the political economy, which may not be very charitable. Assessment is invariably coloured by one's ideological persuasion.

7.2 ECONOMIC REFORMS: MEANING AND NATURE

Reform means improvement, amendment, correction, or rectification of an intervention that has proved less than satisfactory in its performance or found to be inadequate or inappropriate in terms of meeting its intended outcomes. They

could be carried out in agriculture, industry, labour, and trade sectors; in banking, insurance, and other financial sectors; and even education and health sectors. There could also be fiscal reforms – tax and expenditure reforms; monetary reforms– banking and financial; or currency reforms – exchange rate system and convertibility reforms. Pan-economy reforms are often said to be macroeconomic reforms – particularly when they address stabilisation issues, while sectoral reforms are often said to be microeconomic reforms as they influence production levels and prices of individual commodities. Yet, there may be such macroeconomic policies which embed microeconomic dimensions – say differential rates of interest for different sectors or differential charges for different power or transport categories of users.

As the economic context changed in Europe after industrial revolution, governments slowly but steadily moved towards compulsory education for children or imposing restrictions on their employment in factories. As feudal system gave way to capitalist order, demand for uniform adult suffrage emerged and, after a lot of dilly-dallying, it was eventually granted. These were termed as industrial reforms by scholars.

In India, we know of several social reforms for curbing many evil practices during medieval period as well as during the British Raj. Several political reforms were also undertaken in India after independence– the biggest being universal uniform adult suffrage. Electoral reforms were given shape. Administrative reforms and governance reforms have also been undertaken.

In much of the current Indian discourse, economic reforms have reference to liberalisation of business, privatisation of public undertakings, and globalisation of the economy which were ushered in 1991. If one carefully analyses the purposes behind the reforms undertaken after independence but before 1991 and those undertaken after 1991, one would discover that earlier set of reforms were generally equity seeking while later set of reforms are efficiency promoting. Proponents of equity seeking reforms argued that better distribution of income and wealth will also improve growth via demand side while opponents thought such moves would compromise growth as these would dent improvement in savings. Majority of analysts in those days were proponents of equity seeking reforms. Another way to differentiate the pre-1991 and post-1991 reforms could be in terms of their scope. The latter were more widespread and coordinated, unlike the attempts, even at promoting market efficiency in the pre-1991 period, such as in 1980s. Pre-1991 reforms attempted to establish a socialistic pattern of society where there was a pervasive regulatory control by the State. The public sector was expected to reach the 'commanding heights' of the economy with clearly demarcated priority sector industries reserved for this sector. Reversal of emphasis on public sector from the commanding heights of the economy since 1991, was said to unleash the market forces. Present genre of reforms has variously been said to be market-oriented, pro-market, market-friendly, pro-business and pro-competition, as tilt towards market was seen to be promoting competition. Some have considered it a State- retreat.

Welfare measures undertaken post-independence were considered liberal as similar measures were undertaken by the Liberal Party in early 20th century when it was in power in Britain. These were in contrast to those pursued by Conservative Party. In addition, there were measures which put restrictions on operation of private enterprises, which were said to be left-of-the centre and progressive (as

opposed to reactionary). Since, in the present dispensation, restrictions were to be liberalised, political thinking classified such reforms as neoliberal rather than liberal as (political) liberalism is altogether different from (economic) liberalisation.

Neoliberalism is said to be a phrase for resurgence of 19th century ideas of laissez faire and free-market capitalism. Liberalism in contrast had several shades but largely came to be associated with progressivism which suggested State to regulate market activities from welfare angles and undertake welfare-oriented policies.

Check Your Progress 1

1) Define economic reforms.

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2) Differentiate between equity-seeking reforms and efficiency-seeking reforms.

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3) Explain the meaning of neo-liberal reforms.

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7.3 INDIA'S PATH TO ECONOMIC TRANSFORMATION

India's journey began as a newly independent poor underdeveloped nation in 1947 – the year of its independence from the British rule. At that time, India was one of the poorest nations in the world in terms of income, wealth and material capacity. The country remained a virtually closed economy for nearly four decades after its independence, following an inward-looking development strategy. The first few plans focused on growth with strengthening of the manufacturing sector emphasizing heavy industries to form the backbone of the economy. Other principal areas of planning were agriculture and social development i.e. housing

and poverty alleviation. Some of the measures that shaped the development process in general and the process of industrialisation, in particular, involved the following:

7.3.1 Planned Economic Development

Post independence, the key goal was to achieve self-reliance in all possible dimensions of economic activities of the nation. Accordingly, a diversified industrial production base was meticulously planned out for India, ranging from simple consumer items to sophisticated capital goods and heavy machinery. Since 1951, India has grown as a planned economy with the inception of First Five Year Plan. India's initial development strategy, aimed at a 'socialistic pattern of development'. There was lack of faith in the market and the role of the State was considered the need of the hour. Trade received very little attention; while the nation's trade policy was characterised by pervasive import and exchange control. The architecture of India's post-colonial development policy framework was inspired by the soviet model of development. Indeed, the foundations of India's 2nd Five Year Plan model (Mahalanobis, 1953) closely resembled Feldman's model developed in the Soviet Union in the 1920s, which argued for a larger share of investment in the capital goods sector that may slow down growth in the short-run but would result in a much higher growth rate in the long run, accompanied with higher levels of consumption. As India was about to launch the Second Five Year Plan, Parliament passed in late 1954, a resolution establishing a socialistic pattern of society in India (which meant no more than seeking to be a welfare state within a capitalist order and a more egalitarian society). The focus thus shifted to industrialisation where a five-fold strategy was invoked: promotion of import-substitution led industrial development, tilt towards heavy industry in the pattern of industrial development, commanding heights of the economy (industrial space) for the public sector, regionally balanced industrial development, and promotion of small scale industries in the sphere left for private sector with a view to improving employment through reservation of items for production. Industrial Policy Resolution of 1948 was revised to strengthen government control in the Industrial Policy Resolution of 1956. Several private enterprises in manufacturing, transport, and services were nationalised in 1950s– and some more after 1955. The purpose was to check concentration of income and wealth and, thus, economic power in a few hands. Freight equalisation policy was implemented right from 1952 up to 1993, whereby transportation cost of industrially 'essential' items such as coal, steel, cement, etc. would be the same irrespective of distance. It is pointed out that eastern and central regions which had natural competitive advantage lost, whereas western, northern and southern regions gained.

7.3.2 Import Substitution in Industrialisation

National Planning Committee (1938) had suggested that India should focus on mother industries so that it is self-reliant. Mother industries are those industries that make other industries run successfully: power industry; industries for production of metals, heavy chemicals, machinery, and tools; and communication industries such as railways, telegraphs, telephones, and radios. Later, atomic energy and space were added. Besides self-reliance, there was a view that India did not have much to offer by way of exports in order to be able to import capital and essential goods for industrialisation.

As there were limited foreign exchange (forex) reserves, in view of low export potential of the economy, quantitative restrictions in terms of import license were imposed, in addition to high tariffs on intermediate and consumer goods, moderate tariffs on capital goods, and ban on import of some items. The control was further tightened in view of foreign exchange crisis during 1957-58 when the first loan had to be negotiated with the IMF. A market developed for use of these licenses and rent-seeking became rampart. Only in mid-1980s, some relaxations were afforded.

7.3.3 License Permit Quota Raj

The Industries (Development and Regulation) Act of 1951 made it compulsory for all new undertakings to seek license and for all existing undertakings to get registered. It was amended in 1953, requiring an undertaking to seek permission to produce new articles, to carry out substantial expansion, and to shift to a new location. And the applications were to be examined for half a dozen factors by the License Committee set up by the Act of 1951. Licensing was itself a cumbersome process: application to be cleared by Directorate General of Technical Development, then forwarded to the License Committee which would issue a letter of intent, based on which applicant could move to seek permission to import goods, enter into foreign collaboration, acquire land, issue new capital beyond a small limit or seek loan from a financial institution. Thus, barriers to entry were high.

This was all done with a view to prevent concentration of economic power, to ensure balanced regional development, and to encourage small scale industry (which were exempt from seeking license) and labour-intensive technology– though reservation of items for exclusive production started only in 1967 with 47 items and the list expanded periodically till 1989.

However, when an assessment of working of licensing system was made, it came to the fore that it did not serve the objective of the Industrial Policy Resolution 1956 as economic-power and regional concentration both increased. Industrial houses were able to manipulate the system and licensing authorities were willing to be manipulated for a consideration. Public sector financial institutions also favoured large industrial houses. The lesson learnt was not the recognition of government failure, but a thinking that led to further tightening of regulation for industries to make them fall in line. So, Monopolies and Restrictive Trade Practices Act was brought in 1970 providing for a Commission, which was set up to pursue the said objectives.

7.3.4 Public Sector Expansion and Nationalisation

Before Independence, there were some departmentally run commercial ventures such as postal service – including telegraph and telephone service, and railways (largely nationalised by 1944), besides captive ventures of 18 ordnance factories and central public works department. Provinces also had irrigation departments and captive public works departments. However, immediately after Independence, some public sector undertakings with ownership of the Government were started and by the time Planning Commission was established their number was five. These include Indian Telephone Industries, Damodar Valley Corporation, National News Print Limited, Oriental Insurance Limited, and Indian Rare Earths Limited.

A new industrial policy resolution was passed in 1956 in the Parliament, following the resolution on socialistic pattern of society. This policy resolution expanded the sphere of public sector and contracted that of private sector. With a view to creating and expanding infrastructure, generating financial resources, redistributing income and wealth, balancing regional development, and substituting imports by domestic production, quite a few industries were nationalised for one or the other reason– some for strategic importance of the industry, some in the interest of working class when industries were found falling sick, and some to safe keep technology.

Government of India and state governments went on creating and expanding public sector undertakings. By 1990, the number had reached 230 under Government of India. Majority of these are under the aegis of Department of Public Enterprises but there are about two dozen other departments which had at least one public sector enterprise– as statutory corporation or government company.

Reserve Bank of India, after its nationalisation in 1949, was entrusted with regulation of banks through Banking Regulation Act of 1949.Imperial Bank was nationalised as State Bank of India in 1955. Life Insurance of India was created in 1956 by merging more than 200 insurance and provident fund companies— including 16 foreign insurers. Most people recall nationalisation of 14 major banks in 1969, of 6 major banks in 1980, and of 107 general insurance companies (55 into companies and 52 insurance arms of companies) into General Insurance Corporation of India in 1972 with four subsidiaries for operations.

With independence, Government had asserted that it could nationalise any private or foreign venture. Starting with Air Corporation Act in 1953, Air India (an initiative of TATA) was nationalised and half a dozen regional airlines were merged and nationalised as Indian Airlines. One by one, electricity, steel, iron, coal, and oil industries were nationalised.

7.3.5 Beginning of Economic Reforms

However, after nationalisation of 6 major banks in 1980 (following the nationalisation of 14 banks in 1969), thinking started changing as it was felt that not only the goal of equity was not being satisfactorily realised but that of growth (efficiency) was also getting compromised. As a result of the oil price shock in 1979, there was pressure on forex reserve, the IMF was approached for a loan of SDR 5.0 billion to be availed over four years 1981-1984 under Extended Fund Facility with relatively lower rate of interest but it attracted conditionalities in terms of liberalisation of imports–particularly to exporters, adjusting public expenditure, tilting policies towards supporting private sector, etc. These conditionalities were substantially complied with but there was a lot of domestic criticism. As BoP situation improved, Government of India did not avail the last installment of SDR 1.1 billion. Meanwhile, it may be noted that China, post-Mao, had started moving towards market-oriented reforms around this time, or few years earlier.

With Rajiv Gandhi in power in 1984, and a new generation of ideas, easing of State control on industries in terms of expansion, import requirement, lowering of taxes, were also attempted. Capacities created beyond authorised levels were regularised with some limits. Under ‘broad-banding’ diversification into related

product did not now require a new license. Cement, steel, and fertilizers industries were decontrolled. Licensing for companies with investment below a certain level, willing to locate away from urban centres was not necessary. Definition of MRTP firms was relaxed. Imports for modernisation were liberalised. List of open general license (OGL) for import of capital and intermediate items was expanded, which permitted imports without tariff. Diversification was made liberal. Security and Exchange Board of India (SEBI) was constituted in 1988 by an executive order, to oversee the security market as price rigging was rampant. Communication infrastructure was laid out. Political reservations on Planning Commission came to the fore: Rajiv Gandhi called it a pack of jokers. These steps had to be halted as political support was lacking and bureaucracy was recalcitrant. These steps were held as hesitant reforms. It was also the time, the USSR adopted glasnost and perestroika and by the end of 1989, expediting the breakdown of the iron-curtain that divided the West from the Soviet East

Noticing that growth rate had considerably slowed down in 1970s for several reasons not the least of which was the bureaucratic over-zealousness in keeping control over everything, certain measures were taken in mid-1980s to relax the controls, particularly on imports. Such measures helped improve the growth performance of the economy, however macroeconomic imbalances also gained current.

While growth rate had improved in 1980s– thanks to relaxations on restrictions, deficit financing on government side, and liberal imports and unrestrained commercial borrowing generally made two macroeconomic parameters of fiscal deficit and current account deficit, unsustainable.

Check Your Progress 2

1) State reasons for adoption of import substitution in industrialisation of the country.

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2) Explain the meaning of license, permit and quota (LPQ) raj.

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3) State two major international developments that help change the development thinking.

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7.4 ONSET OF CURRENT ECONOMIC REFORMS

7.4.1 The Crisis

Fiscal profligacy of 1980s resulted in high fiscal deficit, public debt and external debt, thus creating internal and external imbalances. By 1990-91, gross combined (Union and State) fiscal deficit had crossed 10 per cent of GDP, combined public debt to 70 per cent of GDP, and external national debt ($83 billion) to 30 per cent of GDP– partly because of gradual withdrawal of foreign concessional aid. Debt service burden of the Union Government was more than 35 per cent of its revenue receipts. But more than that, forex reserves were so low as to account for only 7.0 per cent of total debt. Short-term debt to forex reserves was 145 per cent, making its debt-service ratio 35 per cent of exports. Current account deficit in the Balance of Payments crossed 3.0 per cent of GDP, largely on account of a gradual liberalisation of imports without the commensurate improvement in exports. Inflation also accelerated to double digit level despite three consecutive good monsoons and harvest.

Changes in the international context associated with the gulf war, triggered by Iraq attacking Kuwait in mid-1990, put India into a serious crisis as its import bill swelled and export receipts plummeted, and, thus, current account deficit on balance of payment accentuated. In this scenario, NRIs started withdrawing their deposits in foreign currency from banks. Short-term foreign capital also out-flowed. As a consequence, forex reserves depleted down to $1.2 billion in January 1991 and further depleted to $0.6 billion by June 1991– just equivalent to about three-weeks' imports. There was thus a full-blown BoP crisis at hand.

India sought help from the International Monetary Fund (IMF) to tide over BoP crisis by seeking an emergency loan of $2.2 billion. IMF gave a standby loan of $0.72 billion in January 1991 to be utilised in three months' time. For the first time, the country came to the brink of default in servicing the debt. India had to airlift some part of its gold stock (primarily the gold confiscated from smugglers) out of its forex reserves to Bank of England and Union Bank of Switzerland as collateral to secure loan on terms that were not too steep. This was the time when India had a caretaker government headed by PM Chandrashekhar (March-June 1991) at the Centre. With its back against the wall, the country had no option but to set into motion comprehensive economic reforms. It is often said that the crisis of 1991 was predictable, given the buildup of macroeconomic imbalances in 1980s, but the Gulf war precipitated it.

The loan contracted was too little. It was natural for the new Government which came into power with PV Narasimha Rao as Prime Minister and Manmohan Singh as Finance Minister to approach for a loan of $2.5 billion dollars from IMF and another of $0.5 billion from the World Bank. IMF and the World Bank were willing to rescue the Indian economy but sought compliance with conditionalities, as is their wont, in terms of implementing reforms package involving macroeconomic stabilisation policies and microeconomic (sectoral) structural corrections. IMF gave loan of SDR1.656 billion (equivalent to $2.2 billion) under non-concessional stand-by arrangement with a window of 15 months at 7.1 per cent rate of interest. World Bank which normally gives project specific loans, did come around to giving a loan of 0.25 billion for structural adjustment. Though these loans were not concessional, yet they were cheaper

than commercial ones– which were not available easily as the country's credit rating had dropped considerably.

Manmohan Singh and P.V. Narasimha Rao initiated the reforms in June 1991 with the presentation of the Union Budget. They found the conditionalities attached to the loans taken from international financial institutions as prudent pieces of advice but set up committees to suggest details for the path to reform the economic management of the country. These were efficiency seeking reforms. If there had to be a check on merger or acquisition of private firms, it was not to check monopoly or restrictive trade practices but to promote economic efficiency. If a public sector unit had to be sold (privatisation) or partly sold (divested), it was for improving its economic performance. The sole purpose was to improve efficiency in the economic system.

7.4.2 Assessment and the Response

Following two paragraphs of the budget speech of Manmohan Singh on 24 July 1991, sum up the direction that was to be taken over the subsequent three decades:

"In the macro-management of the economy, over the medium-term, it should be our objective to progressively reduce the fiscal deficit of the Central Government, to move towards a significant reduction of the revenue deficit, and to reduce the current account deficit in the balance of payments. It is only such prudent management that would enable us to curb the exponential growth in internal and external debt and limit the burden on debt servicing, for the Government and the country, to manageable levels. Indeed, we must make a conscious effort to reduce the internal debt of the Government and the external debt of the nation, so that we rely more and more on our own resources to finance the process of development."

"Macro-economic stabilisation and fiscal adjustment alone cannot suffice. They must be supported by essential reforms in economic policy and economic management, as an integral part of the adjustment process, reforms which would help to eliminate waste and inefficiency and impart a new element of dynamism to growth processes in our economy. The thrust of the reform process would be to increase the efficiency and international competitiveness of industrial production, to utilise for this purpose foreign investment and foreign technology to a much greater degree than we have done in the past, to increase the productivity of investment, to ensure that India's financial sector is rapidly modernised, and to improve the performance of the public sector, so that the key sectors of our economy are enabled to attain an adequate technological and competitive edge in a fast-changing global economy. I am confident that, after a successful implementation of stabilisation measures and the essential structural and policy reforms, our economy would return to a path of a high sustained growth with reasonable price stability and greater social equity."

7.4.3 Some Initial Steps Taken by the Government

Immediate response of the Central Government, within 10 days in power, was in terms of devaluation of rupee. The custodian of the value of rupee RBI devalued rupee, in quick succession on 1 July and 3 July 1991, by 9 per cent and 11 per cent against currencies of major trading partners, viz., US Dollar, British Pound, German Deutsch, and Japanese Yen (Chinese Yuan was not that important at that

stage). This was expected to make exports competitive. Commerce Ministry withdrew export subsidy and thus saved some public expenditure, as well as moved towards removing distortion in market prices. After an experiment with dual exchange rate for a year, external value of rupee was allowed to be determined by the market forces. In other words, rupee moved from fixed exchange regime to floating exchange rate. This was most important macroeconomic stabilisation measure on external front.

In the financial sector, RBI had freed banks to charge interest rates beyond floor rate, depending upon the risk perception of the borrower. Budget speech of 1991 suggested formation of a high-level committee (Narasimham Committee) to look into the structure, organisation, functions and procedures of financial institutions. It was felt that administrative intervention on interest rate had outlived its utility. It was pointed out that powers of Capital Controller of India (Government) would be transferred to SEBI which would be empowered through appropriate legislation. Likewise, Foreign Exchange Regulation Act (FERA, 1973) was set to be liberalised for non-resident Indians to make investment in India.

Recognising that entry barriers were promoted by proliferation of licensing regime and that it actually led to increase in the degree of market concentration, Finance Minister announced the new Industrial Policy as a part of his Budget Speech on 24 July 1991 (and second part on small scale industries on 6 August, 1991)). These committed the Government to take a series of initiatives in the five areas of (a) Industrial Licensing, (b) Foreign Investment, (c) Foreign Technology Agreements, (d) Public Sector Policy, and (e) MRTP Act. Highlighting that many small and medium sized entrepreneurs were hampered by the restrictive licensing regime, it was abolished, except for a set of industries in the categories of security and strategic importance, hazardous chemicals, overriding environmental reasons and items of elitist consumption. They were further liberalised. Items reserved for small scale industries were left untouched in 1991 but gradually done away with. List of industries reserved for public sector was pruned from 17 (in 1956) to 8.

While freeing Indian industry from official control, it said, opportunities for foreign investment should be exploited as it would bring in attendant advantages of technology transfer, management techniques, marketing strategies and export potential. Direct approval would be given up to 51 per cent. Likewise, Indian industries would be allowed to negotiate the terms of technology with foreign counterparts and this may induce Indian industry to undertake more research and development activities.

Public sector units which have done very valuable work in early years of the Indian economy, post-independence were now, in many cases, a burden on the public resources. In particular, the sick mills which were taken over by the Government continued to be sick. They were to be referred to the Board for Industrial and Financial Reconstruction. While there was no reason for public sector to supply consumer goods and services, it had expanded into these sectors. Emphasis was for the public sector to operate in reserved or strategic areas or where reasonable profitability was being maintained. Those public undertakings that were performing well were to be given management autonomy. Competition with private sector was to be encouraged. And in some cases, disinvestment of equity share was to be carried out.

MRTP Act was to be so tweaked that industries need not seek any prior approval for expansion, merger, takeover, amalgamation, or diversification. MRTP Commission could, suo moto or on complaint, check if any industrial establishment was indulging in monopolistic, restrictive, or unfair trade practices and take appropriate action.

Check Your Progress 3

1) What triggered the BoP crisis in 1991?

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2) Why did the Government negotiate non-concessional loans with IMF and World Bank?

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3) What were some immediate steps taken by the Government to address the BoP crisis?

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7.5 REFORMS FOR MACROECONOMIC STABILISATION

It can broadly be said that the World Bank as a development bank lends over a long-term horizon which generally helps a country with finances to carry out its long-term projects, while International Monetary Fund help a country to tide over short-term Balance of Payments difficulties. Both generally provide finance in terms of certain foreign currencies constituting Special Drawing Rights (SDR)presently – U.S. dollar, Euro, Chinese yuan, Japanese yen, and Pound sterling. Both help a country in terms of desired foreign currency assets, which can be used for meeting international liquidity obligations. As lenders, both the institutions have been found to impose certain conditions – often referred to as conditionalities if the borrowing country is not able to procure credit from

commercial channels on affordable terms. World Bank insists on reforms in specific sectors– often called structural adjustments, and IMF insists on reforms in macroeconomic policies – fiscal, monetary and exchange rate policies. But both consult each other on each negotiation as IMF has started giving loans for medium terms which goes beyond original mandate of tiding over BoP difficulties.

7.5.1 Fiscal Reforms

An important macroeconomic parameter of focus under the stabilisation framework is fiscal deficit. In a world where fiscal deficit is considered inevitable or unavoidable for spurring growth, containing unemployment, and carrying out welfare measures (not, necessarily reducing inequality), containment of fiscal deficit to a reasonable level is considered a desirable first step in stabilsing an economy. Beyond that desired level of fiscal deficit, not only is the value of domestic currency threatened and can get eroded internally but it can lose value externally as well. This desired level of fiscal deficit would vary from country to country and is usually contested by academicians and scholars, but policy-makers may agree that a for a developing country like India it could be around 3 per cent of GDP.

This fiscal balance has to be ensured by managing efficiently both revenue side – basically taxation and expenditure side so that borrowing is not too high and that debt servicing does not dominate revenue expenditure through rising interest payment. Keeping this in mind, tax rates which went on increasing during 1950-70, were moderated substantially – guided by the thinking underpinning the Laffer's curve hypothesis. Tax nets were widened while exemptions and deductions were pruned; tax structure was reoriented in favour of direct taxes as indirect taxes are seen to be price distortionary and regressive in nature; attempt was made to change the basis of indirect taxes from gross sales proceeds to value added; customs duties had to be brought down in keeping with the new economic thinking as well as in compliance to WTO rules; attempts were made to realise higher profits and dividends from public sector enterprises; efforts were also made to recover cost from sale of services provided by government (whether transport, power or irrigation); and improved fees were realised for use/allocation of natural resources through better price discovery mechanism (whether oil, gas, coal, minerals, or spectrum). There were political impediments and success was limited as some of these steps were also undermined by scams.

Attempts were made to streamline public expenditure by abolishing/and improved targeting of subsidies; downsising/rightsising staff, abolishing administered price mechanism in some sectors like oil and gas; lowering interest payment by improving management of public borrowings; and moderninsing and rationalising defencespending.

Despite a slew of reforms, the two sides of the budget could not match well, necessitating heavy borrowing and at times borrowing to service past borrowing.It was finally considered prudent to bind the government by Fiscal Responsibility and Budget Management (FRBM) Act, which could be passed in 2003. The Act has put limits to fiscal deficit, revenue deficit, level of debt and contingency liabilities and stipulated annual reduction in each of them. Though the Act had provided an escape route to deal with situation that arose during 2008, yet the Act itself had to be amended in 2012 and 2015. Timelines for meeting the FRBM targets had to postponed repeatedly.

7.5.2 Monetary and Financial Reforms

Fiscal policy relates to the Government and has to be formulated to provide finances to the Government and implemented under the guidance of the Ministry of Finance, by different administrative agencies. Monetary policy and financial policy are formulated and implemented largely by the country's Central Bank which is the Reserve Bank of India (RBI) in the case of India. Fiscal and the monetary policy are financially linked through Government's debt instruments. The Indian financial system of the pre-reform period essentially catered to the needs of planned development in a mixed-economy framework where the Government sector had a predominant role in the economic activity. It was felt that there had been too much direction and regulation from government on financial sector operations, in terms of investment, credit allocation, branch expansion, and even internal autonomy of financial institutions. As a result, Public Sector Banks and other financial institutions failed to use their commercial judgement in ensuring efficiency in their operations with respect to rate of return, profitability, maintaining capital adequacy, minimising non-performing assets, or providing satisfactory customer service. They turned to become 'service' organisations whose financial problems would inevitably be taken care of by the Government. This had to change.

Traditional monetary and financial instruments were largely inflexible– not reflecting demand and supply forces of the market, and there was urgent need for reforms. India embarked on a substantial liberalisation in the early nineties. Two official reports, viz., the Report of the Committee on Financial System (Reserve Bank of India, 1991) and the Report of the Committee on Banking Sector Reforms (Government of India, 1998),both chaired by M Narasimham established the foundation of the financial sector reforms post 1991. The Narasimham Committee1991, devoted to enhancing operational freedom in the commercial banking sector, recommended measures like reduction of pre-emption of banks' investible resources [via a reduction of cash reserve ratio (CRR) and statutory liquidity ratio (SLR)[1]] and gradual elimination of the administered interest rate structure. Narasimham Committee 1998 recommended further measures for modernising the banking sector through better regulation and supervision, and introduction of prudential norms. It also suggested a review of the bank ownership structure in India.

Other elements of financial sector reforms in India include significant reduction of fiscal dominance of monetary policy[2] (including removal of automatic monetisation of fiscal deficit); dismantling of the complex administered interest rate structure to enable the process of price discovery; providing operational and functional autonomy to public sector institutions; preparing the financial system for increasing international competition; opening the external sector in a calibrated

[1]gradual reduction of CRR from 15% to about 4%, and reduction in the SLR from nearly 40% to 21.5% between the early 1990s and the mid-2010s have made a huge improvement to the availability of lendable resources to the banking sector.

[2]Fiscal dominance of monetary policy has moderated in India as a result of a series of fiscal and monetary policy reforms that include, (i) moving to a market-determined interest rate system by introducing auctions of government debt, (ii) phasing out of the automatic monetisation of fiscal deficits through the two Supplemental Agreements between the Government of India and the Reserve Bank of India, and (iii) curbing the monetisation of debt by enacting the Fiscal Responsibility and Budget Management (FRBM) Act, 2003 that prevented the Reserve Bank from subscribing to primary issuances of government securities from April 1, 2006.

manner; and promoting financial stability in the wake of domestic and external shocks. More recently a number of measures have been initiated towards inculcating a credit culture through enforcement of creditors' rights, and hastening the process of credit recovery. All these measures were designed to create an efficient, productive and profitable financial sector.

Information technology has played a key role in this transformative journey of Indian banking. Technology has enabled more effective, lower cost and real-time delivery of financial services, through the establishment of a modern payments system. Also, Information Technology has allowed development of several instruments of liquidity and finance. Following global trends, many development finance institutions also assumed the role of, or converted into, commercial banks and some commercial banks were allowed into insurance and mutual funds business. In the recent years, quite a few non-banking financial institutions – investment companies, loan companies, housing finance companies, infrastructure companies – have emerged and are doing well and some development financial institutions such as NABARD, SIBDI, EXIM, and NHB are also performing well. While banks and non-banking financial institutions are regulated by RBI, quite a few regulatory bodies have been instituted to look after insurance business, pension funds, etc. Securities and Exchange Board of India (SEBI) which regulates capital market/stock exchanges has been strengthen and the Forward Markets Commission (FMC) which looks after commodity futures has also been reformed.

7.5.3 Currency Exchange Reforms

Under import substitution strategy and paucity of earnings through exports, allocation of foreign exchange by RBI was severely restricted through complex import licensing system. Rupee remained linked to sterling pound for along time till 1975 when it was pegged with a basket of currencies involving India's important trade partners. This remained in effect till 1993. In July 1991, in quick succession through two devaluations, value of rupee was brought down by around 20 per cent. This was a part of understanding arrived at with the IMF for securing standby loan. Since 1993, rupee is on floating exchange rate and its external value (with respect to each currency) is determined by market forces though RBI does intervene in foreign exchange market if it finds that there is excessive volatility by buying or selling foreign currencies in spot as well as in futures market. Thus, ours is a managed float system or managed flexible regime as are most of other countries.

As India wanted to attract Foreign Direct Investment, it liberalised conversion of rupee into foreign currencies but only on the current account. Once, India built sufficient forex reserves in terms of foreign currency assets, it gradually permitted its resident companies to convert rupee into foreign currencies to facilitate overseas investment. This is in effect conversion of rupee on capital account. Restriction on capital account convertibility however continue, we have some distance to travel before full capital account converitabilty. This is perhaps a lesson drawn from South-East Asian crisis in the late 1990s.

Check Your Progress 4

1) Why was Fiscal Responsibility and Budget Management Act legislated?

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2) Explain the role of Cash Reserve Ratio and Statutory Liquidity Ratio.

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3) State the status of convertibility of rupee.

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7.6 REFORMS FOR MICROECONOMIC STRUCTURAL ADJUSTMENT

We all often hear that Economic Reforms mean liberalisation, privatisation, and globalisation (LPG), which have replaced license, permit, and quota (LPQ) as the latter had run out their course and had become stale, corrupt, and counter-productive creating a high cost economy. This section intends to explain the meaning of LPG and some steps that were taken up in India.

7.6.1 Liberalisation of Business

If restrictions are imposed by the Government on private economic activities, the policy regime may be termed as a regulated and controlled business regime. By contrast, if no restrictions are imposed, the policy regime may duly be called one of *laissez faire* (a French phrase for let do or let go) – a euphemism for free market. However, in a society with State, economy cannot be completely free of restrictions (or incentives). When some of existing restrictions are removed or relaxed, it can be said that economic activity is being liberalised: it is about removing the burden of restrictions. In case restrictions are further tightened, policy can be said to be restraining or constraining one. It is quite possible that in some spheres, in any given period, policies are made more restrictive and other areas, more liberal.

In industrial sector, India had managed to create considerable barriers to entry and expansion: license for entry, license for expansion, license for diversification, license for imports of capital goods and intermediate goods, permission for amalgamation, control on issue of shares and debentures, restrictions on prices – of goods, services and factors, compulsory procurement of a portion of output by government, check on foreign investment, restrictions on foreign collaboration for technology and even on location of industry. These were once the order of the day in the pre-reform era of the 1970s and 1980s. There were certain restrictions on factor markets – particularly, labour – for wages and social security. These were said to be choking the initiative and enterprise of the people. However, it was pointed out that big industrialists could still circumvent almost all the restrictions with connivance or cooperation of rent-seeking bureaucracy for graft. Those who could manipulate the system, developed vested interest in its continuation; they could reap monopoly profits as the competition they faced was very low or even non-existent. The end result was corruption and delays in execution of projects. General assessment was that this hampered growth (efficiency) without promoting social justice (equity).

Government of India, with Prime Minister Narasimha Rao and Finance Minister Manmohan Singh, in July-August 1991 and in April 1993, spearheaded many liberal provisions or undertook promotional measures in the areas of (a) licensing business, (b) foreign investment, (c) foreign technology agreements, (d) establishment, merger, amalgamation, takeover of companies or appointment of directors in corporate governance, and (e) exiting from business. Licensing was made mandatory only for 18 categories– later reduced to 15 by delisting refrigerators, air-conditioners, and washing machines. Procedures for foreign investment and foreign technology collaboration were sought to be promoted. Labour laws were made a little easier for businessman.

One wonders whether the move was to de-bureaucratise the processes or promote marketisation. It was perhaps both.

7.6.2 Privatisation of Public Sector Units and Disinvestment

By 1990, the world had changed; its zeitgeist had changed. The new mantra was 'government's business is not to do business' or 'government has no business to do business'. This was in tune with the trend towards privatisation of public assests. There was a time in 1940s when nationalisation was seen as way forwarded in the capitalist world, particularly in the UK, even in the wake of the World War II and then there came a time in 1980s when privatisation became the mantra for reforming economic management.

It was felt during 1980s in India that government was unnecessarily directly operating industries in many areas where it ought not to and that many of public sector units were not performing up to the mark by parameters set for them. In the former case, Government could simply withdraw by selling its stakes. This is called disinvestment. In the latter case, undertakings were to be so reformed that they perform well even if meant partnership with private sector in terms of ownership and/or management. But the issue soon became who would buy a loss-making unit? Buyers insisted that they would cut down staff which was oversized or non-performing. Short of funds, Government decided to sell shares of performing undertakings. Moreover, shares of such companies could be sold at high premium. In certain cases, one Government company bought the shares

of another Government company and, thus, Government could get non-debt creating capital receipts.

Various models were tried for privatisation. There could be three simple models: (i) ownership, (ii) organisational, and (iii) operational. Disinvestment or divestment is related to ownership question. Sometimes, it is suggested that Indian Railways may be corporatised. Here ownership does not change but organi–ational structure changes; it is no more run by the department or a board under it. Corporation works at arm's length distance. Unit can be leased to private hands for long period.

Disinvestment of ownership, if made for 50 per cent or more along with handing over control and management is called strategic disinvestment. If dilution is for less than 50 per cent, which it has to be in case of undertakings in (strategic) areas reserved for public sector, it is called non-strategic. Government sold some of its hotels and some of the companies like BALCO completely. Government keeps selling part of its shares through several methods. To begin with it sold shares to other public sector financial companies like LIC and GIC. There have been around 200 successful attempts.

There is another experiment called public-private partnership which was attempted particularly in building up the momentum on development of infrastructure projects.

7.6.3 Globalisation of the Economy

The term globalisation has several meanings, varying from exposure to competition with the world leaders in a particular product market to free trade in goods, services and factors. Globalisation of an economy with world economy could be thought in terms of economic relations but they ought to be in terms of interface of markets rather than between governments and in terms of bilateral (or multilateral) flows rather than unilateral flows like aid. But if Government of one country bans imports, puts quota restrictions or creates a high tariff wall by imposing 300 per cent duty, how could producers in a country sell even if there were buyers in another country. There could be rationale behind such restrictions: protection of domestic industry from competition, insufficiency of forex availability due to weak export earnings, etc. However, it is argued that such measures protects inefficiencies of domestic producers and harms the consumers. Removal of such restrictions could induce domestic producers to be either competitive or switch to other products. In other words, open the economy for trade and investment creating the scope for consumers to benefit with better quality and invariably cheaper products.

We know that multinational and transnational corporations have plants in several countries. They produce goods and services in the host countries and sell in the domestic markets of the host country, instead of exporting from home country, as it saves them transportation cost. This requires movement of capital across borders. Thus, globalisation of an economy would mean:

a) Reduction in tariff barriers with a view to allowing freer flow of goods to and from the country;

b) Freer flow of foreign capital in terms of investment – both direct and portfolio – by ensuring conducive atmosphere and easy approval of projects;

c) Freer flow of technology through purchase or lease of IPRs; and

d) Freer movement of labour and manpower.

When India started liberalising its economy, WTO was under negotiation in Uruguay Round. It became operational in 1995 and sought freer trade through unrestricted competition by removal of non-tariff barriers and substantial reduction in tariff barriers as also removal or reduction of subsidies. WTO extended the areas traditionally covered by GATT (General Agreement on Trade and Tariff) by including GATS (General Agreement on Services) and TRIPS (Trade Related Intellectual Property Rights), and TRIMS (Trade Related Investment Measures). Thus, goods, services, technology, and capital were covered in some way.

Since Doha Round of WTO could not be satisfactorily concluded, countries have simultaneously gone for forming Free Trade Areas, Comprehensive Economic Cooperation/Partnership, Customs Union, etc. European Union is the chief example, though not related with failure of WTO. India has negotiated quite a few, in fact more than two dozen, regional or bilateral partnerships.

Check Your Progress 5

1) Distinguish liberalisation from laissez faire.

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2) Explain the meaning of disinvestment in a public sector enterprise.

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3) Delineate the elements of globalisation of an economy.

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7.7 GENERATIONS AND WAVES OF ECONOMIC REFORMS

Reforms are often said to be a continuing process but scholars and policymakers have a tendency to categorise reforms into certain categories– calling them as

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levels, generations, waves, or, following digital style, versions. It is also suggested that while neoliberal reforms have a universal constitution, different nations may have different pace and sequence. IMF scholars suggest that they may not exactly fall in neat time sequence. They also suggest that reforms may be guided by two perspectives: (i) global and (ii) national. We shall adhere to national perspective.

While following neoliberal direction, different nations will have some uniqueness of their own in terms of pace and sequencing as their economic conditions differ. Politics and bureaucracy will determine the pace and sequencing. For example, such reforms were halted when India had unstable governments with limited terms in the late 1980s and the late 1990s. Reforms may have suffered, rather reversed, during the East Asian Currency Crisis or the Great Recession of 2008-09 and there was call for more open global financial architecture.

At the end of last century, it was assessed that reforms that were easy to implement in terms of resistance of bureaucracy or politicians, were carried out in the initial phase. First, they were to be carried out in terms of conditionalities imposed by loan sought from IMF and WB. Second, they could be carried out by executive actions, not seeking political support, as recommended by the committees set up for the purposes. Devaluation of rupee, ease of restrictions for establishing an enterprise and expansion of capacity, easing import restrictions, de-reservation of items for small scale industries, diluting government shares in public sector undertakings, etc. did not require legislative interventions. They have been called first generation reforms and the period was identified as 1991-1999. In terms of digital jargon, they have been termed as Reforms 1.0 under Prime Minister PV Narasimha Rao and Finance Minister Manmohan Singh during 1991-96. Some reforms in the subsequent period were in the nature of deepening of measures previously taken so that reversing them was not easy anymore.

In order to appreciate the distinction between generations of reforms, one should remember the difference between an Act and the Rules under it. Practically, every Act passed by a Legislature has a clause “Power to Make Rules” by the Executive. Rules generally describe the procedure, forms, schedule, direction, fees, fines, etc. but can include regulations, orders, bylaws, etc. Executive makes them and is obliged to submit to the Legislature for scrutiny within a limited period, which in practice is scant. Changing rules is far easier than changing Act. Second generation reforms are said to be those that require legislative sanctions through enactment or amendment. There are others who think that the second generation reforms refer to consolidation of first generation reforms plus reforms related to legal, regulatory, and political institutions. During 1999-2004, for example, many Acts were passed under NDA government, which had bearing on Economic Reforms. Some of them are: Repeal of Urban Land Ceiling Act, Prevention of Money Laundering Act, Fiscal responsibility and Budget Management Act, Central Vigilance Commission Act, and Competition Act. In compliance, several regulatory authorities were instituted. Subsequently, many Reform Acts were passed by UPA government: Factory Regulation Act, Limited Liability Partnership Act, Replacement of Companies Act of 1956 by Companies Act of 2013, etc. It does not mean that no legislative attempts were made in 1991-96. For example, SEBI was given statutory status in 1992.

Some scholars and policymakers, deliberating on 25 years of Economic Reforms in 2016, recommended an agenda for Economic Reforms 2.0. Others have referred

to this agenda forpost-2014 reforms as Reforms 3.0 or even Third Wave of Reforms. What does it mean? Some say it is about reforms in governance, including judiciary. Some say it is formalisation of the economy, which means, thanks to ILO, formalisation of informal enterprises and informal jobs. Others have included in this agenda steps for extension of taxation nets/base, digital modes of payments, etc. Still others like to include the formalisation of shadow economy.

Many reforms were carried out since 2014, Goods and Service Tax being the major one. Monetary Policy Committee was instituting by amending RBI Act in Finance Act of 2016 and is a major step in monetary management where three members are nominated by Government of India.

Though there is no agreement on clearly marking of generations of neoliberal reforms yet there is some convergence. Some would include social security measures and some would include the local government reforms, which have little to do with neoliberal strand. Analytical clarity is lacking in the area. Yet, roughly speaking, first, second and third generation reforms can be associated with executive, legislative, and governance actions.

Check Your Progress 6

1) Distinguish between first generation reforms and second generation reforms.

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2) Explain the meaning of formalisation of economy.

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7.8 LET US SUM UP

Indian economy is said to have embarked upon reforms in 1991 though it is acknowledged that a few steps towards present genre of reforms were taken in 1980s– in the wake of conditionalities agreed for a whopping SDR 5.0 billion of loan from IMF in the first half of 1980s. It must be noted that economic reforms carried out in 1950s were quite different in content, orientation and objectives than those which had to be carried out since 1991. There are several ways of distinguishing them. In this unit, they have been distinguished as equity-seeking reforms and efficiency-seeking reforms. Reforms in the post-1991 context are recognised as neoliberal in political terms and market-oriented in economic terms.

A background of policies pursued during 1950-80 is discussed in a way that they present a contrast to the direction taken up thereafter. Our colonial past, huge economic disparities, ideological thinking of the times, nationalisation of industries in the West and success of development planning in the USSR had largely guided our course of economic policy in those days.

Despite improvement in growth performance in the decade of 1980s, the macroeconomic fundamentals were mismanaged and Gulf War of 1990 precipitated the economic crisis at home. By now, mandate of IMF had changed in view of breaking-up of Bretton Woods system of fixed exchange rate and it was seeking more fundamental reforms than just devaluation of currency to correct persistent BoP deficit. IMF-World Bank combine was clear about the direction of change in domestic policies. The domestic economic thinking was also slowly converging towards the same.

Some immediate steps were taken like devaluation of rupee much before IMF loan was agreed upon or enunciation of new industrial policy. Some Committees were immediately set up to suggest course of reforms to be taken up in due course. But Indian economy chose its own pace and sequencing, being careful that reforms have 'human face'.

Trends in macroeconomic stabilisation policies are illustrated under captions of fiscal reforms, monetary and financial reforms, and currency exchange reforms while those of microeconomic structural adjustments are discussed under liberalisation of business, privatisation of public sector units and disinvestment, and globalisation of the economy.

A categorisation of reforms in terms of their content and objectives has been provided in terms of identifying different generations or waves of neoliberal economic reforms.

7.9 TERM- END EXERCISE

1) Discuss the nature and features of neoliberal reforms.
2) Differentiate between intervention of restriction and that of liberalisation.
3) What do you mean by disinvestment? Why should ownership of a public sector undertaking be diversified?
4) Delineate characteristics of macroeconomic stabilisation reforms.
5) Approach to define formalisation of an economy.

7.10 KEY WORDS

Disinvestment : Selling government equity in a public enterprise to a private or public enterprise whereby sale proceeds are appropriated by the Government as non-debt creating capital receipt.

Economic Reforms : Correcting mismatch between instruments of intervention and objectives in economic affairs of a country by the government.

Financial Reforms	:	Improving the nature of interventions in financial markets comprising banks and non-bank financial institutions as well as stock market so as to meet the desired level and composition of savings and investment. It may involve regulatory framework.
Fiscal Reforms	:	Correcting interventions in tax- and non-tax instruments, expenditure pattern, and debt mix in a way that they meet the fiscal objectives of the government.
Globalisation	:	Opening economy for trade and investment by relaxing restrictions of movement of goods, services, capital and intellectual property.
Liberalisation	:	Relaxing the restrictions imposed on carrying out business operations.
Nationalisation	:	Acquisition of a private enterprise, in part or full, by a government.
Privatisation	:	Sharing ownership (or management) of an existing public sector enterprise with private parties or completely selling public assests.
Stabilisation Programmes	:	Interventions that improve stabilisation parameters of fiscal balance, balance of payment, price inflation, and unemployment.
Structural Adjustment Programmes	:	Interventions that lead to reduce market distortions—basically, price distortions.

7.11 REFERENCES

There are several sources related to this topic– some explaining, some supporting, some opposing, and some critiquing economic reforms in general or particular reforms or in relation to Indian economy. Any good book on Indian economy would provide the facts. The World Bank and IMF websites would also be good sources to help one understand the direction of reforms that have been suggested, if not imposed, by the duo. Yet, one would greatly benefit from

1) Bhaduri, Amit and Deepak Nayyar, (1996). *The Intelligent Person's Guide to Liberalisation*, New Delhi: Penguin.

2) McCartney, Matthew, (2016). *Political Economy, Growth and Liberalisation in India 1991-2008*, Routledge.

3) Mohan, Rakesh (edited), (2017). *India Transformed: 25 Years of Economic Reforms*, Penguin Random House.

Some websites such as rbi.org.in and indiareforms.csis.org and several entries under Wikipedia could be consulted for developments in areas related with economic reforms.

7.12 ANSWERS OR HINTS TO CHECK YOUR PROGRESS EXERCICES

Check Your Progress 1

1) Correction in instruments and institutions of government intervention to meet the objectives in better terms.

2) Reforms that primarily seek redistribution of income and wealth, and possibly consumption in favour of the disadvantaged sections of the society are equity-seeking ones while those that focus on improving growth performance through efficient use of resources are efficiency-seeking ones.

3) Neoliberal reforms are those reforms which attempt to make market work with less restrictions and withdrawal of State from activities which market could perform. Since political liberalism got historically associated with 'progressivism' which advocated restrictions on market and increased role of State, policy of relaxation of restrictions on market functioning was considered to be neoliberal.

Check Your Progress 2

1) Dominant view of the leaders of Independence was that Indians do deserve to have all comforts of the Western world. Since our limited export potential could not allow to import unrestricted amount of goods and gadgets, we decided on an industrialisation strategy which favoured produced substitutes of imported goods in home.

2) For a pretty long time, one needed a lot of licenses or permits to start and run an industrial enterprise. For purchase of scarce material, say steel or cement or sugar, one needed to have a permit. If one needed imported material needing foreign exchange, in addition to license or permit, one was assigned a quota. The regime was popularly called license, permit and quota raj in contrast to liberalisation, privatisation and globalisation one.

3) One was market-oriented Economic Reforms which were initiated in Communist China in 1978 under the leadership of Deng Xiaoping after the death of Mao Zedong in 1976. The other was enunciation of Glasnost and Perestroika in the erstwhile USSR under the leadership of Mikhail Gorbachev.

Check Your Progress 3

1) Invasion and occupation of Kuwait by Iraq in August 1990 and Iraq's refusal to vacate it led a wide scale War against it under the leadership of the US army in which 35 nations had participated. It swelled import bill and slumped exports, plummeting forex reserves.

2) As India's creditworthiness had come down, external commercial borrowings became difficult. Second, non-concessional loans from international agencies are still cheaper. Internally, also, there was a feeling that reforms are called for.

3) Government of India devalued rupee against foreign currencies, drastically modified the industrial policies, and made several taxation changes, and also set up several committees to make recommendations to the Government.

Check Your Progress 4

1) Despite introduction of several reforms, fiscal parameters such as revenue deficit and fiscal deficit were not reaching the desired levels whether at Union or State level. The Act was a kind of imposition of self-discipline.

2) Cash reserve ratio (CRR) keeps banks fairly liquid while statutory liquidity ratio (SLR) directs credit towards government by purchase of government bonds. Cash reserves with the Central Bank, do not normally earn interest to the bank while government bonds do. However, CRR checks the credit creating activity and SLR crowds out finance for private sector.

3) As of now, rupee is convertible into foreign currencies on the basis of market forces. However, it is not normally convertible on capital account.

Check Your Progress 5

1) Liberalisation means relaxation in restrictions while laissez faire means absence of restrictions.

2) Divestment or dilution of government ownership in a public sector enterprise. Proceeds accrue to government as non-debt creating capital receipt.

3) When residents (including companies) of an economy are free to produce anywhere or consume anywhere or products of anywhere, an economy is said to be globalised. It amounts to freedom to trade and freedom to investment; in practical terms, it means lessening of restrictions on imports/ exports and investment. Movement of labour is not articulated at the same level.

Check Your Progress 6

1) First generation reforms are usually reckoned with those that can easily accomplished through executive orders, with minimal legislative requirement while seconds generation reforms need political sanction through legislation.

2) Bringing informal segments of an economy, including jobs, into formal contact with the government through any channel.

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UNIT 8 MAJOR DEVELOPMENTS IN POST ECONOMIC REFORM PERIOD

Structure

8.0 Objectives

8.1 Intoduction

8.2 Privatisation and Restructuring of Public Sector

8.3 Difference between Disinvestment Privatisation

8.3.1 Forms of Privationsation

8.4 Need for Privatisation

8.5 Disinvestment in India

8.6 Problems Related to Disinvestment Process/Modes

8.7 Conditions Required for Success of Privatisation Policy

8.8 Public Private Partnership (PPP)

8.9 PPP Models in India

8.9.1 Government Incentives for PPPs

8.10 Challenges of PPP

8.11 Insolvency and Bankruptcy Code (IBC)

8.12 Concept and Importance of IBC

8.12.1 Objectives of IBC

8.12.2 The Insolvency and Bankruptcy Code Ecosystem

8.12.3 Salient Features of IBC

8.12.4 Working of IBC

8.13 Let Us Sum Up

8.14 Term-end Exercises

8.15 Key Words

8.16 References

8.17 Answers or Hints to Check Your Progress Exercises

8.0 OBJECTIVES

Having gone through this unit, you will be able to:

- explain the concept of privatisation;
- distinguish between disinvestment and privatisation;
- analyse the hurdles in the way of restructuring of public sector undertakings;
- highlight the pros and cons of public private partnership;
- narrate the suitability of public private partnership;
- discuss the need for insolvency and bankruptcy code (IBC); and
- point out the problems and performances of IBC.

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8.1 INTRODUCTION

The economic systems world over have been deregulated and controls that existed in the past have been relaxed in great measure. At the same time, governments have been attempting to open more economic activity to private players– both domestic as well as foreign. Liberalisation, Privatisation and Globalisation (LPG) forms part of a wider reform process, as discussed in the previous unit. The narrative of "Rising India" over the past quarter century describes India's economic rise and, as a consequence of that rise, India's globalisation and integration with rest of the world. Further, there is a growing recognition that India was liberating itself from the historical past.

The turn of the century was when a new narrative about independent India began to take root internationally. India had not only come out of a serious economic crisis in 1991-92, but had landed on its feet. Trade liberalisation, industrial delicensing and decontrol and fiscal stabilisation contributed to an increase in the share of foreign trade and manufacturing output in national income, contributing also to improved prospects for growth. Investors' confidence in the economy got a boost, resulting in a build-up of its growth potential. New firms began to come up and so did new industries. However, the slowing down of the economy in the second decade of this millennium be it due to cyclical or structural factors, has raised questions about India's growth potential and the government's management of the economy. A new narrative can only be built on the foundations of improved economic performance. A return to the earlier growth path is predicated upon altering recent perceptions about India's economic prospects and policies, the political choices made and geopolitical options explored.

The most contentious of all economic reform measures since 1991, is disinvestment. Disinvestment and privatisation have been two policies common to all Central Governments since 1991. The economic reforms initiated in the country provide the policy environment towards public private partnership (PPP) in infrastructure development. Insolvency is a complex subject. Bankruptcy laws accept that business ventures can fail and allow entrepreneurs to get a fresh start. The passage of the Insolvency and Bankruptcy Code in May 2016 was a key reform which is set to alter the relationship between debtors and creditors. Given this backdrop and the more general narrative on India's economic reforms since 1991 discussed earlier, this unit will discuss various facets of three ongoing debates having repercussion on the performance of Indian economy and these are:

i) Privatisation and restructuring of public sector,

ii) Public private partnership, and

iii) Insolvency and bankruptcy code (IBC).

8.2 PRIVATISATION AND RESTRUCTURING OF PUBLIC SECTOR

Privatisation describes a direction of change or a fundamental reordering of claims in a society. Its meaning depends on the point of departure– the public-private balance previously forged in a particular domain. The term 'privatisation' connotes a wide range of ideas. In its narrow sense it is the process of transferring ownership of a business, enterprise, agency, public service or public property from the public

sector (i.e., government) to the private sector. In the wider sense it means government outsourcing of services or functions to private firms. According to V.V. Ramanadham (1989) privatisation is a term that is employed to convey a variety of ideas. The idea that it most prominently suggests is that of 'denationalisation' (in the sense of transferring the ownership of a public enterprise to private hands).

Another idea in vogue is 'liberalisation and deregulation' unleashing forces of competition[1]. The concept of privatisation is, in fact, to be understood, not merely in the structural sense of who owns an enterprise, but in the substantive sense of how far the operations of an enterprise are brought within the discipline of market forces.

8.3 DIFFERENCE BETWEEN DISINVESTMENT AND PRIVATISATION

Though privatisation and disinvestment are terms that are used interchangeably, there is a difference between them with regard to the ownership. Disinvestment may or may not be an outcome of privatisation. When it comes to defining the term, privatisation involves transforming the ownership of a public sector business to the private sector known as a "strategic buyer". In privatisation, full ownership is transferred to the strategic partner. In a broader sense, privatisation refers to transfer of any government function to the private sector including governmental functions like revenue collection and law enforcement.

In disinvestment, the same transformation process happens while retaining 26 per cent or in some cases 51 per cent of share right (i.e. the voting power) with the public sector organisation. Here, the ownership is not transferred to strategic buyer. Divestment is said as the opposite of Investment. Investment means acquisition of certain assets; divestment means the release of assets. A business may be that a particular arm of it is not compatible with its core business and hence may decide to shelve or divest this business. Divestment may be done for various economic or social reasons.

8.3.1 Forms of Privatisation

Various forms of privatisation vary in the extent to which they move ownership, finance, and accountability out of the public sector. The spectrum of alternatives runs from total privatisation (as in government disengagement from some policy domain) to partial privatisation (as in contracting-out or vouchers). Thus, privatisation may include policies anywhere along this spectrum; however, the implications of privatisation vary with its degree. According to Ramanadhan (1989) privatisation cover three sets of approaches like ownership, organisational, and operational measures. It is important to remember that all these measures more often are equated with transfer of ownership and transfer of managerial and operational control to private hands.

[1] Competition plays a key role in ensuring productive, efficient, innovative and responsive markets. It ensures availability of 'goods' and 'services' of acceptable quality at affordable price to the consumers. Competition law, also referred to as anti-trust law, aims at promoting or maintaining market competition by regulating anti-competitive conduct. The first Indian competition law was the Monopolies and Restrictive Trade Practices (MRTP) Act, enacted in 1969 to encourage fair play and fair deal in the market besides promoting healthy competition. In line with the international trend and to cope with changing realities introduced by the reforms of 1990s, India reviewed the MRTP Act, 1969, and enacted the Competition Act, 2002.

8.4 NEED FOR PRIVATISATION

The industrial policy of July 1991 is considered as a precursor of economic reforms which brought a change in the approach towards Public Sector Undertakings (PSUs). In the affairs of the public sector, it has been a game of politics throughout, and still is, despite the talk of structural adjustments and economic reforms. Some of the important factors leading to the need for privatisation are as under:

i) PSUs in India have no autonomy. As a result, a culture has developed that their major clientele are not the customers who pay for their services, but the ministers and officials of their controlling ministries.

ii) PSUs have many objectives imposed on them, some of which affect their efficiency and profitability. In fact, PSUs suffer from multiple principals and multiple objectives. As a rule, interventions through PSUs are both inefficient and costly. India needs privatisation to improve efficiency and to liquidate recurring liabilities for the government.

iii) Ownership should not matter to performance. That it does in India is a reflection on the poor understanding of business by the bureaucracy. It also indicates their lack of accountability. Poor performance only impacts on government budgets, not on individual officials.

iv) It is important to note that there are limitations being government as owner. Rao (1998) has emphasised that "the enterprise comes under a Ministry of Government, and is subject to scrutiny by Parliament. The Government of the party in power exercises ownership through the Minister while the permanent civil service translates the will of the Government through the management of the enterprises. But the Minister and civil servant are temporary occupants of the owner's chairs because of frequent changes in their portfolios. There are controls exercised on the enterprise at all levels."

v) "Public sector managers, who perform better in the liberated circumstances of private sector enterprises, have been known to complain that they are crippled by various regulations in a public sector entity. Unless a radical transformation is made to liberate the public sector manager from multiple scrutiny by organs of investigation and vigilance, a level playing field cannot be established between the public sector and the private sector" (Venkitaramanan, 2005).

Privatisation per se does not lead to efficiency. Decontrol is probably a more important principle than privatisation; and many of the supposed positive attributes of privatisation can be imparted to public enterprises. In India, wholesale transfer of assets to private sector both on grounds of efficiency and equity is not easily acceptable. On the other hand, organisational efficiency requires a different approach. The framework of principal-agent relationship in private ownership has an advantage over public ownership. In the sense that both the principal and the agent have stakes in the efficient functioning of the enterprise and there is unanimity on the objective function to be maximised.

Check You Progress 1

1) Provide wider meaning of privatisation.

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2) Distinguish between privatisation and disinvestment.

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3) What are the different forms of privatisation?

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4) Point out the need for privatisation in India.

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8.5 DISINVESTMENT IN INDIA

Disinvestment in public enterprises was proposed as a policy option in the Industrial Policy Statement of July 1991. The Government will divest its equity in piecemeal. Reforms in public sector undertakings (PSUs) have taken many forms, ranging from privatisation to subjecting them to a hard budget constraint, introducing competition to toning up financial sector. India's disinvestment has its roots in economic compulsion. Disinvestment can cover various forms. Which forms and which units are chosen at any time is guided by market conditions and the desire to get the maximum value for currently owned assets. This is a matter of careful examination and surveillance of much strategic thinking. For framing proper strategies of disinvestment of shares of PSUs, a committee under the

chairmanship of Dr C. Rangarajan was appointed in 1993 which recommended disinvesting up to 49 per cent of PSUs equity for industries explicitly reserved for the public sector and over 74 per cent in other industries. But the then Government did not take any decision on the Committee's recommendations.

The Government constituted a five-member Public Sector Disinvestment Commission under the Chairmanship of Shri. G.V. Ramkrishna in August 1994 for drawing a long-term disinvestment programme for the PSUs referred to the Commission. The Commission submitted a dozen reports suggesting a slew of measures including strategic sale, equity sale and closure, besides making general recommendations on 58 PSUs. However, in November 1999, the Commission was wound up and a Department of Investment and Public Asset Management was created under Ministry of Finance.

Successive governments since 1991 declared their intent to disinvest but little progress has been made over the years. The record of performance of Government on disinvestment has been uniformly poor. The present process of disinvestment of PSUs is indiscriminate, unplanned and lacks clear policy on the government's part. According to department of investment and public asset management, since the inception of the process of disinvestment in 1991-92 to January 2020 an amount of Rs 3,54,307.75 have been mobilised through disinvestment proceeds.

The process of disinvestment has evolved from public offering of shares to strategic sale of equity to select partners to complete asset selling. The strategic sale method confers a better valuation and paves the way for a technological up-gradation of the target company. The main disadvantage of the sale of minority stakes has been lower realisation as management control is not transferred. Minority sales also give the impression that the main objective of the government is to raise funds for reducing its fiscal deficit, and not to improve performance or governance. Yet, because the share offer route is politically more acceptable, all governments have relied on it.

8.6 PROBLEMS RELATED TO DISINVESTMENT PROCESS/MODES

Controversies abound with regard to the mode of disinvestment. Ultimately, the issue relating to disinvestment revolve around three questions– why, how and how much. Dr G. S. Gupta (1998) has pointed out that the question of how to privatise raises several issues:

i) Which approach is the best for which unit?

ii) Are various approaches substitutes/complementary?

iii) How to motivate politicians/bureaucrats/employees/ towards privatisation?

iv) When to sell assets/equity?

v) How to value assets/equity?

vi) What proportion of equity to sell? Whom to sell; retail investors, multinational, expatriates, NRIs?

vii) Does privatisation fetch sustainable revenue?

viii) How to close in the absence of exit policy/voluntary retirement scheme?

ix) How to sequence privatisation?

x) Would disinvestment crowd out private investment?

There is no definite answer to any of these questions. These problems are very complex and it is not possible to find out an easy way out.

Abhijit Roy (2002) has observed that Indian opinion seems to be divided in two camps. The privatisers say that "the government has no business to be in business" hence divestment is the only way out. The other camp holds the view that the government should not hand over the family silver to crooks and charlatans who dominate Indian businesses. Nor do they want the government companies to be handed over to the MNCs. Whatever the merits of the arguments, one cannot ignore either of these two opinions. One does not have to be dogmatic in one's approach. The goal should be to achieve a vibrant corporate sector in the medium term consisting of various types of ownership patterns. E. A. S. Sarma (2004) has rightly observed that the disinvestment policies of the successive government remained hazy.

Lessons of privatisation in other countries and the Indian experience support adoption of a pragmatic approach to privatisation, rather than its total rejection. It is clear that privatisation has not been very popular. PSUs would have to be freed from control by ministries. And this freedom would have to be structured institutionally. There is the need for distancing government from control and management over public enterprises to enable them to run more efficiently. Autonomy must be the object, not raising revenues. Ownership must not mean interference in governance and management of companies by government representatives.

8.7 CONDITIONS FOR SUCCESS OF PRIVATISATION POLICY

The mixed empirical evidence on privatisation is warning against sweeping generalisations about the impact of privatisation. Dr Mahbub Ul Haq (the man behind Human Development Reports published by of the United Nations Development Programme) has cautioned economies privatising their public sector, as part of a structural adjustment and economic reform programme, must bear in mind that they do not commit the "seven sins of privatisation". The seven sins of privatisation are:

i) confused objectives,

ii) lack of transparency,

iii) concentration of assets,

iv) lack of competition,

v) a poor financial strategy,

vi) the dominance of fiscal objective of financing deficits, and

vii) lack of political consensus.

Revenue maximisation should not be the objective of privatisation. Efficiency and equity are the relevant objectives and the success of privatisation should be evaluated against these objectives. Long-term efficiency gains are more important

than short-term revenue gains. The lack of transparency in the privatisation process is counter-productive and facilitates abuse. Often privatisation has become a way of enriching a minority, resulting in gains for private fronts. This exposes privatisation to political controversy. Privatisation should not simply imply transfer of rents from the public to the private sector. Privatisation should not result in a greater concentration of assets. Rather, the process of divestment of public equity must ensure greater competition through more dispersed ownership. Privatisation cannot be based on an unrealistic labour strategy. The 'golden handshake' should not exceed the sale value of the assets being privatized. The first requirement after privatisation of an enterprise is to retire a country's debt, and relieve future generation from this burden. Privatisation should not be carried through executive orders but through the Parliament and after an open debate which facilitates a consensus. Executive orders can be reversed and this creates uncertainty, often sub-optimal reaslisation of proceeds from privatisation.

The Eleventh Finance Commission (2000) has noted in its report that major structural reforms initiated in the nineties have virtually by-passed the PSUs. It points out that PSUs should be freed from the shackles of ministries, and their management has to be autonomous, professional, accountable, transparent and durable for a good length of time. It is important to note that the centre's efforts at privatisation of the PSUs have not gone beyond a fractional disinvestment of a few profit-making PSUs. There has been no uniformity of views either among the political parties or among the economists about the necessity for privatisation. "Contrary to popular supposition, neither the theory nor the empirical evidence on privatisation provides unqualified support for the belief that privatisation leads to outcomes superior to those under public ownership" (T T Ram Mohan, 2001).

Privatisation of public sector units has never been an easy task. Across the globe, countries have tackled the hurdles in very different ways. But their governments have weighed the good it could deliver with the odds it may bring and evened the two out amicably. The privatisation process entails a very careful analysis of specific circumstances including the specific setting of an enterprise and larger socio-economic context. All that can be done is to build and sustain pressure on the government to get out of activities with which it ought not to be involved, and concentrate on those with which it should, like education, health, the supply of drinking water and other essential services. Only then will a perspective emerge. The scales seem to tilt in favour of the disinvestment process, no matter how much is the protest from political and vested quarters. After all, disinvestment has not been an easy job for any country in the world. Privatisation is not an end in itself. It is a means of ensuring the efficiency of PSUs and the markets they operate in. Government may have the right intentions, but it needs a better method to accommodate the realities of a noisy political economy.

Check Your Progress 2

1) Trace the evolution of disinvestment policy in India.

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2) Highlight the problems associated with modes of disinvestment.

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3) Narrate the factors leading to success of Privatisation policy.

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8.8 PUBLIC PRIVATE PARTNERSHIP (PPP)

The expression PPP is a widely used concept world over but is often not clearly defined. There is no single accepted international definition of what a PPP is (World Bank, 2006). A public-private partnership, or P3, is a contract between a governmental body and a private entity, with the goal of providing some public benefit, either an asset or a service. Public-private partnerships typically are long-term and involve large corporations on the private side. A key element of these contracts is that the private party must take on a significant portion of the risk because the contractually specified remuneration – how much the private party receives for its participation – typically depends on performance. In the Indian context, the term PPP is used very loosely. According to the National Public Private Partnership Policy 2011, "a Public Private Partnership (PPP) means an arrangement between the government/statutory entity/government owned entity on one side and a private sector entity on the other, for the provision of public assets and/or public services, through investments being made and/or management being undertaken by the private sector entity, for a specified period of time, where there is well defined allocation of risk between the private sector and the public entity and the private entity receives performance linked payments that conform (or are benchmarked) to specified and pre-determined performance standards, measurable by the public entity or its representative".

Since the need for infrastructural development in India is on the rise, the public private partnership is the way to go forward as it provides innovation and diversity, higher productivity, efficient and cost-effective delivery of projects. Facing constraints on public resources and fiscal space has brought about renewed interest in PPP. With the announcement of industrial policy of July 1991, a new wave for PPP was felt and it was decided to allow private participation in the power sector which opened up the doors for independent power producers. The National Highways Act, 1956 was altered in 1995 to empower private support. In 1994, through a focused offering process, licenses were conceded to eight-cell cellular telephone utility administrators in four metro urban areas and 14 administrators in 18 state circles. The overarching objectives of such partnerships are:

i) Harness private sector efficiencies in asset creation, maintenance and service delivery;

ii) Provide focus on life cycle approach for development of a project, involving asset creation and maintenance over its life cycle;

iii) Create opportunities to bring in innovation and technological improvements; and,

iv) Enable affordable and improved services to the users in a responsible and sustainable manner.

In short, the main objectives of pursuing PPP model in India relate to the following:

i) Expansion and improved infrastructure

ii) Risk sharing.

iii) Optimum allocation of resources.

iv) Innovations.

v) Aid in growth of other sectors.

(vi) The catalyst for the economy.

vii) More employment generation.

viii) Improves the image of the country.

ix) Attract FDI.

PPP Cell under Department of Economic Affairs (DEA): For looking at various aspects of PPP, the PPP cell was set up in 2006 in the Department of Economic Affairs (DEA), Ministry of Finance which acts as the Secretariat for Public Private Partnership Appraisal Committee (PPPAC), Empowered Committee (EC), and Empowered Institution (EI) for the projects proposed for financial support through Viability Gap Fund (VGF). The PPP Cell is responsible for policy level matters concerning PPPs, including policies, schemes, programmes, model concession agreements and capacity building. The PPP Cell is also responsible for matters and proposals relating to clearance by PPPAC, scheme for financial support to PPPs in infrastructure (VGF Scheme) and India Infrastructure Project Development Fund (IIPDF).

Check Your Progress 3

1) Provide meaning of PPP.

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2) Explain the need for PPP in India?

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3) What is the administrative machinery for PPP in India?

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8.9 PPP MODELS IN INDIA

In India, PPPs take a wide range of forms varying in purpose, involvement of the private entity, legal structure and risk-sharing. The private sector participation in the infrastructure building have taken place broadly through corporatisation of existing PSUs (e.g. GAIL, ONGC, IOC, etc.), greenfield investment for development of new projects, PPP in the form of BOT or BOOT model in the road sector and concession agreements with the private sector such as rehabilitate, operate, and transfer. India majorly follows 3 types of PPP models out of many models available. They are:

i) Hybrid Annuity Model (HAM)

ii) Build-Operate-Transfer (BOT)

iii) Engineer-Procure-Construct (EPC)

HAM is a mixture of BOT and EPC where the financing, risks, operations, etc. are distributed between Government and a private partner. The following table would show the difference in these models:

	BOT	EPC	HAM
Risk	Private	Public	Private (60 per cent) Public (40 per cent)
Finance	Private	Public	Private (60 per cent) Public (40 per cent)
Operations and Management	Private	Public	Private
Revenue	Private	Public	Public

Source: https://www.jatinverma.org/public-private-partnership-in-india)

i) BOT (build operate transfer) models used for two-thirds of the total PPP projects in India. User-fee based BOT model widely used in medium- to large-scale projects, especially in energy and transport (road, ports and airports). Annuity-based BOT model commonly used in sectors/projects not meant for cost recovery by levying a fee on sectors such as health and education.

ii) Modified design-build (turnkey) contracts yield time and cost saving benefits; also enable efficient risk-sharing and improve quality.

iii) Performance- based management/ maintenance contracts suitable for sectors (water supply, sanitation, solid waste management and road maintenance) constrained by the availability of economic resources to improve efficiency.

8.9.1 Government Incentives for PPPs

The Government has facilitated the PPP sector by offering:

i) **Viability Gap Funding (VGF):** Viability Gap Funding of up to 40 per cent of the cost of the project can be accessed in the form of a capital grant.

ii) **India Infrastructure Project Development Fund (IIPDF):** It helps the Central and the State Governments and local bodies through financial support for project development activities (feasibility reports, project structuring etc.) for PPP projects.

iii) **India Infrastructure Finance Company Ltd (IIFCL):** It provides long-term debt for financing infrastructure projects that typically involve long gestation periods since debt finance for such projects should be sufficient to meet the requirements.

iv) **Foreign Direct Investment (FDI):** Up to 100 per cent FDI in equity of special purpose vehicles (SPVs) in the PPP sector is allowed on the automatic route for most sectors.

The proposals shall include the requisite information necessary for satisfying the eligibility criteria.

8.10 CHALLENGES OF PPP

Despite the success of PPP model in India, there is ample scope to improve its working. Along with the advantages of the PPP projects, the negatives have also surfaced in the forms of various bottlenecks and challenges. "The Indian public sector suffers from peculiarly Indian constraints. Political interference in recruitment, competitive trade union activity (witness the posters in every railway station), rigidities on salaries and writs in courts on service matters, reduce the efficiency of personnel management in the public sector. Activities of oversight agencies – vigilance, comptroller and auditor general, etc– cause extreme risk aversion in decision-making, reducing the efficiency of procurement and operational decisions" (Somanathan and Natarajan, 2019).

In addition to above constraints, Gautam Ray (2014), has observed that "despite progress and bright future prospects, investors continue to face many challenges and perceive many hurdles. At the same time, project authorities are finding it difficult to implement initiatives that are afflicted by higher cost, inflation and/ or unrealistic estimates of streams of expected revenue, and some approved projects get delayed or abandoned because investors cannot secure financial closure due to their unrealistically aggressive bids. Litigation and disputes over land acquisition and other issues present further problems. Perhaps the most important challenge before state governments is to develop well-designed PPP projects in social infrastructure so that private investors, including NGOs, are sufficiently motivated to invest".

To develop the PPP projects in India, the Kelkar Committee (2015) recommended that:

i) PPPs should not be used by the government to evade its responsibility for service delivery to citizens.

ii) This model should be adopted only after checking its viability for a project, in terms of costs and risks. PPP structures should not be adopted for very small projects, since the benefits are not commensurate with the costs.

iii) PPP must not be a short cut only to save money or bridge fiscal gaps or transfer risks; it should be used to improve service quality or bring efficiency improvements.

iv) The prevention of Corruption Act, 1988 should be amended to distinguish between genuine errors in decision making and acts of corruption by public servants.

The Committee has emphasised that India's success in deploying PPPs as an important instrument for creating infrastructure will depend on a change in attitude and in the mind-set of all authorities dealing with PPPs, including public agencies partnering with the private sector, government departments supervising PPPs, and auditing and legislative institutions providing oversight of PPPs. It is pertinent to note that PPPs have contributed towards the growth and development of the Indian economy in multiple ways. Combining the professionalism of the corporate sector with the welfare objectives of the state has resulted in projects which are known for their world class facilities and advanced amenities. For example, several airports including Mumbai airport and the T3 of Delhi airport are built on the PPP model. The PPP has seen several successful infrastructural projects over the past decade.

It has rightly been observed that "selection of right PPP model for a right project at a right time through realistic planning would go a long way in providing meaningful and hassle-free infrastructure development, which ultimately would increase the infrastructure standards and thereby sustain the overall macroeconomic developments of the country" (Lakshmanan, 2008).

Check Your Progress 4

1) Discuss the different models of PPP adopted in India.

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2) What incentives government provide for having PPP in India?

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3) Describe the challenges and how to go forward with PPP in India?

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8.11 INSOLVENCY AND BANKRUPTCY CODE (IBC)

India's financial distress resolution mechanism is broken. Companies that fall into hard times spend six or eight years trying to resolve the situation. Banks are saddled with massive amounts of non-performing loans that are a drain on their resources and also affect their willingness to lend to new and deserving projects. Ultimately, the honest and successful companies and individuals that borrow from the banks pay for these inefficiencies in terms of higher interest rates. Over the past 20 years, there have been a number of attempts to reform India's insolvency regime. None of them have been fully effective. While one can find a number of specific reasons for their failure, the one overarching reason (at least in the case of laws) is the lack of legal infrastructure to effectively implement the laws. Our courts are overburdened, understaffed, and lack basic physical infrastructure.

In late 2014, Ministry of Finance setup the Bankruptcy Legislative Reforms Committee (BLRC), under the chairmanship of Dr T K Viswanathan (former Union law secretary), with the objective of building a full-fledged bankruptcy code. Based on the committee's recommendations, the government introduced the "Insolvency and Bankruptcy Code". After half-a-century of efforts and nine committees, insolvency in India has become easier. The IBC 2016, addresses all these endeavours to prevent insolvency, provides a market determined and time-bound mechanism for resolution of insolvency, wherever possible, along with facilitators for quick and effective resolution, and promotes ease of exit, wherever required.

In this context, it is well to remember that the economy witnessed freedom of entry in the 1990s and freedom to compete in the 2000s. The IBC Code of 2016 provides the ultimate economic freedom, freedom to exit, and a mechanism to address honest business failures..

18.12 CONCEPT AND IMPORTANCE OF IBC

Bankruptcy is a legal status usually imposed by a Court, on a firm or individual unable to meet debt obligations. As all businesses cannot succeed, it is perfectly normal for some businesses to fail, making it important to emphasise on corrective action. India's new Bankruptcy Code– "Insolvency and Bankruptcy Code, 2016" attempts to create a formal insolvency resolution process (IRP) for businesses, either by coming up with a viable survival mechanism or by ensuring their speedy liquidation. The code makes a clear distinction between insolvency and bankruptcy. The former is a short-term inability to meet liabilities during the

normal course of business. The latter is a longer-term view on the business. The code envisages a new regulator– the Insolvency and Bankruptcy Board of India. The implementation of the IBC has been one of the most important reforms in recent years. Banks and other creditors can now take the defaulting company to the National Company Law Tribunal to initiate insolvency proceedings. There is now a real chance that promoters can lose control and are no longer in a position to take creditors for a ride.

8.12.1 Objectives of IBC

The objectives of IBC are:

i) to promote entrepreneurship,

ii) availability of credit,

iii) balancing interests of all stakeholders by consolidating and amending laws relating to reorganisation and insolvency resolution of corporate persons, partnership firms and individuals in a time bound manner and for maximisation of value of assets of such persons and matters connected therewith or incidental thereto.

iv) to simplify and expedite the Insolvency and Bankruptcy Proceedings in India.

v) to protect the interest of creditors including stakeholders in a company.

8.12.2 The Insolvency and Bankruptcy Code Ecosystem

Following are the components of IBC ecosystem:

i) National Company Law Tribunal (NCLT) – The adjudicating authority (AA), has jurisdiction over companies, other limited liability entities.

ii) Debt Recovery Tribunal (DRT) has jurisdiction over individuals and partnership firms other than Limited Liability Partnerships.

iii) The Insolvency and Bankruptcy Board of India (IBBI) – apex body for promoting transparency and governance in the administration of the IBC; will be involved in setting up the infrastructure and accrediting IPs (Insolvency Professionals (IPs) & IUs (Information Utilities).

iv) It has 10 members from Ministry of Finance, Law, and RBI.

v) Information Utilities (IUs) – a centralised repository of financial and credit information of borrowers; would accept, store, authenticate and provide access to financial data provided by creditors.

vi) IPs- persons enrolled with IPA (Insolvency professional agency (IPA) and regulated by Board and IPA will conduct resolution process; it will act as Liquidator/ bankruptcy trustee; they are appointed by creditors and override the powers of the board of directors.

vii) IPs have the power to furnish performance bonds equal to assets of the company under insolvency resolutions

viii) Adjudicating authority (AA) – would be the NCLT for corporate insolvency; to entertain or dispose of any insolvency application, approve/ reject resolution plans, decide in respect of claims or matters of law/ facts thereof.

8.12.3 Salient Features of IBC

The following are the salient features of the IBC:

i) IBC proposes a paradigm shift from the existing "debtor in possession" to a "creditor in control" regime. An impartial law respecting rights of all creditors by acknowledging that all classes of creditors to play a vital role in the insolvency process. However, the 'secured lenders' will have significant influence over the reorganisation process.

ii) The code aims to resolve insolvencies in a strict time-bound manner – the evaluation and viability determination must be completed within 180 days. Moratorium period of 180 days (extendable up to 270 days) for the Company. For start-ups and small companies the resolution time period is 90 days which can be extended by 45 days.

iii) Introduce a qualified insolvency professional (IP) as intermediaries to oversee the Process. Insolvency professionals will assist in the resolution, liquidation and bankruptcy proceedings envisaged in the code. This will help in preserving value and time.

iv) Provides for the setting up of "Insolvency and Bankruptcy Board of India" (IBBI) to regulate professionals/agencies dealing with insolvency and informational utilities.

v) Emphasis on symmetry of information between creditors and debtors by ensuring availability and access to essential information to all creditors by setting up of Information Utilities as a depository of financial information.

vi) The code allows the corporate debtor itself to initiate the insolvency–resolution process once it has defaulted on a debt. Also, operational creditors (including the Centre, State governments and local authorities) are permitted to initiate the resolution process.

The Code has a clear-cut grievance resolution mechanism for various stakeholders involved in insolvency resolution. Only the National Company Law Tribunal (NCLT), National Company Law Appellate Tribunal (NCLAT) and the Supreme Court have the jurisdiction to deal with any appeal concerning the Code. At its heart, it suggests a commercial resolution without burdening the courts excessively. It would result in a better business environment and ease in debt rising.

8.12.4 Working of IBC

The law heralds a new era in how India's economy resolves bad debts and inconsistent treatment in resolving cases. The threat of IBC is forcing debtors to pay up, as operational creditors have recovered more than Rs. 1 lakh crore even before their insolvency applications were admitted by NCLTs.

"In over three years of the Insolvency and Bankruptcy Code, the number of bankrupt companies liquidated under the regime has far exceeded the number of corporate resolutions, by nearly four times. According to the data released by the Insolvency and Bankruptcy Board of India (IBBI), while 156 of the cases admitted under the Corporate Insolvency Resolution Process (CIRP) have been resolved

till September 2019, the liquidation process has started in as many as 587 cases. Thus, IBC has liquidated many more companies than it has resolved.

It should be noted that IBC has provided creditors and other stakeholders the ammunition to obtain the maximum value for stressed assets by shifting the balance of power from debtors. The IBC, undoubtedly, since the time of its enactment has evolved considerably. According to the World Bank, before IBC, the time taken to resolve stressed loans was 4.3 years and recovery rate was 26 per cent for financial creditors. There has been a marked improvement in the recovery process which is already leading to billions of dollars being invested in the country due to the protection of creditor rights.

In December 2019 the Union cabinet approved fresh amendments to the Insolvency and Bankruptcy Code (IBC) aimed at strengthening its functioning. The amendments seek to ring-fence assets of companies from offences committed by the previous management or promoters. The government should now step up its efforts to ensure that the promise of speedy resolution, one of the most appealing aspects of the IBC, is delivered upon.

A lot has been said and written on the IBC. Implementation of the IBC is a real challenge. This is an innovative law awaiting correct execution. In 2019, with the Supreme Court upholding the Insolvency and Bankruptcy Code (IBC) in its entirety, the resolution process will move faster now. The success of the ambitious IBC is dependent on its institutions like the regulator, the adjudicating authority and the professionals involved. Nevertheless, IBC 2016 is an evolving legislation, still being interpreted by courts and being constantly amended to harmonise IBC with our related legal policy.

Check Your Progress 5

1) The concept of IBC adopted in India. Highlight the importance of IBC.

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2) Point out the objectives and ecosystem of IBC.

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3) Discuss the working of IBC.

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8.13 LET US SUM UP

Public sector enterprises were considered necessary when they came into existence. The current thinking is that the reasons, howsoever plausible in the past, are no longer valid for the continued existence of the public sector. Disinvestment in public sector enterprises (PSEs) was proposed as a policy option during the initial phase of economic liberalisation in 1991. Privatisation means transferring control to a private party. This can be done with or without transferring ownership. Disinvestment, which is a form of ownership transfer, comes under the umbrella of privatisation. Disinvestment means no transfer of control even if public shareholding is diluted. The objectives of privatisation are: greater efficiency, revealing the true and full cost of the service provided, promotion of technological advancement, development of capital markets, broadening the wealth and achieving widespread private ownerships in society, raising extra-revenues for the government, and reducing the power of public employee unions.

The public Private Partnership (PPP) is an agreement between the government and the private sector for the purpose of provisioning of public services or infrastructure. With a common goal in mind the public and the private sector bring on their experiences and strengths resulting in the accomplishment of mutual objectives. Using the finances of the private firms to complete the PPP ventures has led to conservation of national and governmental resources. The PPPs are ensuring the effective utilisation of state assets in a manner that is productive as well as profitable. Infrastructure created using these partnerships is of a superior quality.

India lacked an ecosystem that encouraged dismantling of companies and sale of its divisions. Insolvency and Bankruptcy Code, 2016 is considered as one of the biggest insolvency reforms in the economic history of India. This was enacted for reorganisation and insolvency resolution of corporate persons, partnership firms and individuals in a time- bound manner for maximisation of the value of assets of such persons. In order to, realise the benefits of IBC, the time taken to find and implement resolutions has to come down drastically.

8.14 TERM-END EXERCISES

1) Explain the concept of privatisation. Provide an overview of the reasons for privatisation.

2) What are the methods of privatisation? Which methods are being followed in India? Examine the problems and prospects of privatisation in India.

3) What is disinvestment? What is the difference between privatisation and disinvestment? What conditions are needed for making disinvestment policy a success?

4) What do you mean by the concept of Public Private Partnership (PPP)? Which sector is most suitable for PPP policy?

5) What policy is being followed by the government of India regarding PPP? How has India benefited from PPP collaboration? Give concrete examples.

6) What precautions are needed for going to PPP agreement? Explain the challenges being faced by PPP projects in India?

7) Explain the concept of Insolvency and Bankruptcy Code (IBC). How can you distinguish between Insolvency and Bankruptcy? What factors propelled the enactment of IBC in India?

8) Describe the objectives, importance and salient features of IBC in India. Which are the components of eco-system to implement the IBC?

9) Discuss the working of IBC in India. What challenges are being encountered by IBC? How does government trying to meet such challenges?

8.15 KEY WORDS

Autonomy : Autonomy is the capacity to make an informed and uncoerced decision. Autonomous organisations or institutions are independent or self-governing.

Corporatisation : Corporatisation refers to the restructuring or transformation of a state-owned asset or organisation into a corporation. These organizations typically have a board of directors, management, and shareholders. However, unlike publicly traded companies, the government is the company's only shareholder, and the shares in the company are not publicly traded.

Cyclical Slowdown of Economy : In simple words, a cyclical economic slowdown is a part of the business cycle having its peaks and troughs. The economy will be moving in cycles with periods of peak performance followed by a downturn and then a trough of low activity. These are expected to be short-term problems that could be addressed with an adequate mix of fiscal and monetary policies.

De-licensing : De-licensing refers to the policy of opening the economy and abolishing government control by removing the earlier restrictions and licenses.

Fiscal Stabilisation : Foremost among the techniques of stabilisation is fiscal policy. Fiscal policy as a tool of economic stability, however, has received its due importance under the influence of Keynesian

economies only since the depression years of the 1930s. In India the commonly used term is "fiscal consolidation" which refers to a process where government's fiscal health is getting improved and is indicated by reduced fiscal deficit. Fiscal consolidation is a reduction in the underlying fiscal deficit. It is not aimed at eliminating fiscal debt.

Golden Handshake (also known as VRS in India) : *Golden Handshake*, is an independent decision of employee to end his employment based on some decided agreement or contract, so as to terminate the legal relationship of employer – employee.

Structural Slowdown of Economy : A structural slowdown is a more deep-rooted phenomenon that occurs due to a one-off shift from an existing paradigm. The changes, which last over a long-term, are driven by disruptive technologies, changing demographics, and/or change in consumer behaviour. In such a scenario, a monetary and fiscal stimulus won't be enough to revive the economy. Fixing such problems would require the government to undertake some structural policies. The best example in this regard would be the reforms that were carried out to address the crisis in 1991.

8.16 REFERENCES

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8.17 ANSWERS OR HINTS TO CHECK YOUR PROGRESS EXERCISES

Check Your Progress 1

1) See Section 8.2
2) See Section 8.3
3) See Sub- section 8.3.1
4) See Section 8.4

Check Your Progress 2

1) See Section 8.5
2) See Section 8.6
3) See Section 8.7

Check Your Progress 3

1) See Section 8.8
2) See Section 8.8
3) See Section 8.8

Check Your Progress 4

1) See Section 8.9
2) See Sub- section 8.9.1
3) See Sub- sections 8.10

Check Your Progress 5

1) See Section 8.12
2) See Sub-sections 8.12.1 and 8.12.2
3) See Sub-sections 8.12.4