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**For Ph.D. Degree in Law,  
Under the Faculty of Law,  
Saurashtra University,**

**Thesis Presented**  
**LIBERALISATION, LAW AND DEVELOPMENT**

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## *Preface*

The economic liberalisation in India refers to ongoing economic reforms in India that started in 1991. After Independence in 1947, India adhered to socialist policies. In the 1980s, Prime Minister Rajiv Gandhi initiated some reforms. In 1991, after the International Monetary Fund (IMF) had bailed out the bankrupt state, the government of P. V. Narasimha Rao and his finance minister Manmohan Singh started breakthrough reforms. The new neo-liberal policies included opening for international trade and investment, deregulation, initiation of privatization, tax reforms, and inflation-controlling measures. The overall direction of liberalisation has since remained the same, irrespective of the ruling party, although no party has yet tried to take on powerful lobbies such as the trade unions and farmers, or contentious issues such as reforming labour laws and reducing agricultural subsidies. The main objective of the government was to transform the economic system from socialist to capitalist so as to achieve high economic growth and industrialize the nation for the well-being of the citizens. Today India is mainly characterized as a market economy.

As of 2009, about 300 million people-equivalent to the entire population of the United States – have escaped extreme poverty. The fruits of liberalisation reached their peak in 2007, when India recorded its highest GDP growth rate of 9%. With this, India became the second fastest growing major economy in the world, next only to China. An Organisation for Economic Co-operation and Development (OECD) report states that the average growth rate 7.5% will double the average income in a decade, and more reforms would speed up the pace.

In the context of the new economic policy paradigm, India has chosen to enact a new competition law called the Competition Act, 2002. The MRTP Act has metamorphosed into the new law, Competition Act 2002. The new law is designed to repeal the extant MRTP Act. As of now, only a few provisions of the new law have been brought into force and the process of constituting the regulatory authority, namely, the Competition Commission of India under the new Act, is on. The remaining provisions of the new law will be brought into force in a phased manner. For the present, the outgoing law, MRTP Act, 1969 and the new law, Competition Act, 2002 are concurrently in force, though as mentioned above, only some provisions of the new law have been brought into force.

Competition Law for India was triggered by Articles 38 and 39 of the Constitution of India. These Articles are a part of the Directive Principles of State Policy. Pegging on the Directive Principles, the first Indian competition law was enacted in 1969 and was christened the Monopolies And Restrictive Trade Practices, 1969 (MRTP Act). Articles 38 and 39 of the Constitution of India mandate, inter alia, that the State shall strive to promote the welfare of the people by securing and protecting as effectively, as it may, a social order in which justice social, economic and political shall inform all the institutions of the national life, and the State shall, in particular, direct its policy towards securing.

The capital market was not well organized and developed during the British rule because the British government was not interested in the economic growth of the country. As a result, many foreign companies companies depended on the London capital market for funds rather than on the Indian capital market.

The new industrial policy announced by the government in July 1991 emphasised the following four major measures to 'reform' the public sector enterprises: (i) reduction in the number of industries reserved for the public sector from 17 to 8 (reduced still further to 3 later on) and the introduction of selective competition in the reserved area; (ii) the disinvestment of shares of a select set of public sector enterprises in order to raise resources and to encourage wider participation of general public and workers in the ownership of public sector enterprises; (iii) the policy towards sick public sector enterprises to be the same as that for the private sector; and (iv) an improvement of performance through an MOU



(memorandum of understanding) system by which managements are to be granted greater autonomy but held accountable for specified results. In addition, there was a drastic reduction in the budgetary support to sick or potentially sick public sector enterprises.

The last ten years have seen major improvements in the working of various financial market participants. The government and the regulatory authorities have followed a step-by-step approach, not a big bang one. The entry of foreign players has assisted in the introduction of international practices and systems. Technology developments have improved customer service. Some gaps however remain (for example: lack of an inter-bank interest rate benchmark, an active corporate debt market and a developed derivatives market). On the whole, the cumulative effect of the developments since 1991 has been quite encouraging. An indication of the strength of the reformed Indian financial system can be seen from the way India was not affected by the Southeast Asian crisis.

However, financial liberalisation alone will not ensure stable economic growth. Some tough decisions still need to be taken. Without fiscal control, financial stability cannot be ensured. The fate of the Fiscal Responsibility Bill remains unknown and high fiscal deficits continue. In the case of financial institutions, the political and legal structures have to ensure that borrowers repay on time the loans they have taken. The phenomenon of rich industrialists and bankrupt companies continues. Further, frauds cannot be totally prevented, even with the best of regulation. However, punishment has to follow crime, which is often not the case in India.

Food Processing Industry is of enormous significance for India's development because of the vital linkages and synergies that it promotes between the two pillars of the economy, namely Industry and Agriculture. Food processing covers a spectrum of products from sub-sector comprising agriculture, horticulture, Plantation, animal husbandry and fisheries. Essentially, the food industry involves the commercial movement of food from field to fork.

Industrial licensing for all kinds of drugs has been abolished (it has recently been done for the last remaining bulk drugs produced by the use of recombinant

DNA technology, bulk drugs requiring in-vivo use of nucleic acids and specific cell-tissue targeted formulations). However the need for obtaining manufacturing licence under Drugs and Cosmetics Act, 1940 continues for all units whether organized or small scale. The State Drug Controllers are authorized to issue such licences in most cases.

After Independence, the Government of India spelt out its approach to the development of the industrial sector in the Industrial Policy Resolution 1948. This was followed by the Industrial Policy Resolution, 1956. In between, the government introduced the Industries (Development and Regulation) Act, 1951 to regulate and control the development of the private sector. In 1969, MRTP Act (Monopolies and Restrictive Trade Practices Act) was adopted to prevent concentration of economic power and control monopolies. Another legislation that had considerable implications for industrial policy (as far as the participation of foreign companies in industrial sector of India is concerned) was the Foreign Exchange Regulation Act (FERA) adopted in 1973. However, all these measures which guided and determined the State intervention in the field of industrial development failed in achieving the objectives laid down for them. They also created a number of inefficiencies, distortions and rigidities in the system. Therefore, the government started liberalizing the industrial policy in 1970s and 1980s. The most drastic liberalisation was carried out in 1991 when a New Industrial Policy was announced.

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## **Chapter - 1**

### **INTRODUCTION**

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## **Chapter – 1**

### **INTRODUCTION**

#### **1.1 General**

The industrial policies pursued till 1990 enabled India to develop a vast and diversified industrial structure. India attained self-sufficiency in a wide range of consumer goods. But the industrial growth was not rapid enough to generate sufficient employment, to reduce regional disparities and to alleviate poverty. It was felt that government controls and regulations had put shackles on the growth of different segments of Indian Industry. Lack of adequate competition resulted in inadequate emphasis on the reduction of costs, up gradation of technology and improvement of quality standards. It is to reorient and accelerate industrial development and accelerate industrial development with emphasis on the productivity growth and quality improvement to achieve international competitiveness that the industrial policy of 1991 was announced.

#### **Liberalisation**

Liberalisation is the process of freeing the economy from the stranglehold of unnecessary bureaucratic and other restrictions imposed by the State.

The main aim of the liberalisation was to dismantle the excessive control framework that curtailed the freedom of enterprise over the years, the country had developed a system of 'licence permit raj'. The aim of the new economic policy was to save the entrepreneurs from unnecessary harassment of seeking permission from Babudom (the bureaucracy of the country) to start an undertaking.

**Law :** Law here means legislative law

**Development :** Development in sense comprehensive development in per capita income, GDP = Gross Domestic Production

Similarly, the big business houses were unable to start new enterprises because the Monopolies and Restrictive Trade Practices (MRTP) Act had prescribed a ceiling on assets ownership to the extent of Rs.100 crores. In case a business house had assets of more than Rs.100 crores, its application after scrutiny by the MRTP commission was rejected. It was believed that on account of the rise in prices this limit had become outdated and needed a review. The second objection by the private sector lobby was that it prevented big industrial houses from investing in heavy industry and infrastructure, which required huge investment in order that the big business could be enthused to enter the core sectors – heavy industry infrastructure, petrochemicals, electronics etc. with big projects, the irrelevance of MRTP limit was recognized and hence scrapped.

The major purpose of liberalisation was to free the large private corporate sector from bureaucratic controls. It, therefore started dismantling the regime of industrial licensing and controls in pursuance of this policy, the industrial policy of 1991 abolished industrial licensing for all projects except for a short set of 18 industries.

On April 14, 1993, the Cabinet Committee on Economic Affairs (CCEA) decided to remove three more items from the list of 18 industries reserved for compulsory licensing. The three items were; motor cars, white goods (which include refrigerators, washing machines, air – conditioners , microwave ovens etc.) and raw hides and skins and patent leather. In case of cars and white goods the basic purpose of derecognition was to increase investment in industries in producing cars and white goods so that the demand of the large middle class ranging from 250 to 300 million can be satisfied. Liberalising the automotive sector led to better designs in two wheelers, unleashing, the urge to compete in global markets and widening the domestic markets through better quality and standards. It should be of interest to know that a car has

20000 components all manufactured in the small industry sector. The automotive component manufacturing in the small scale suddenly started looking up and by the turn of the decade of reforms, the component manufacturing captured global markets. The government, in response to the market demand, liberalized the industries producing, these goods and freed them from industrial licensing. Therefore, liberalization led to globalization.

The abolition of licensing for raw hides and skins and patent leather is motivated by the desire to push up exports. Since the potential for leather and good quality shoe exports is very large, the government decided to abolish licensing so that large – scale units could realize this potential by the use of modern technology.

The ceiling on assets fixed under MRTP Act has been abolished in order to permit large houses to undertake investment in the core-sectors – heavy industry, infrastructure, petro-chemicals, electronics etc, with a view to introduce competition.

The number of items requiring licensing was reduced to a short list of 15 industries. This freed the private sector to set up industrial units quickly.

## **1.2 Formulation of problem**

### **What Is Deregulation?**

Deregulation is a hot-button issue for many government officials and big businesses. This is because it is one of those issues where it seems that you cannot please everyone. Like anything else in life, when the rules are bent, it brings advantages to some who had a hard time being successful with the initial rules, while it may place a handicap on others who found a way to be successful despite these initial rules.

#### **1. Definition**

- Every industry has certain rules and regulations that it must abide by. These rules are created by industry associations and watchdogs, as well as the government. Deregulation occurs when the government pulls back from the industry a bit, therefore loosening its grip on particular rules and regulations.

#### **Purpose**

- The purpose of deregulation is to allow a particular industry to foster greater competition, create a freer marketplace and hopefully spur economic growth both within that marketplace and in general. When industries become deregulated it gives that industry's players greater leeway in which to improve their products, craft their brand and, ultimately, appeal more to consumers.

#### **Advantages**

- When deregulation works, there are numerous advantages--most of them to the consumer in the form of lower prices, more providers and better products. A company that was not doing so well and maintained only a small market share before deregulation would also be likely to benefit from this act. When



the company faces fewer restrictions, it might be able to explore avenues that the government had previously not allowed or severely restricted. With less red tape, this company could theoretically emerge from deregulation much more successful than it was before.

### **Disadvantages**

- A company that was doing quite well on its own despite government regulations would definitely see deregulation as a downside, as it will make the rules lax for its competitors. In essence, a successful company might view deregulation as a way of handicapping the competition, or allowing the competition to play by fewer rules in order to give it a fairer shot. This easing of rules can also lead to a breakdown within the entire industry as different players use this flexibility to their advantage--though it can ultimately end up being to their disadvantage. Such was the case in the 1980s when the savings and loan industry was deregulated. This deregulation allowed S&L institutions to act more like banks and adopt a federal charter instead of a state charter, thus increasing their capabilities and the number of institutions banks would have to compete with. One of the major acts that ushered in this era of deregulation was the Depository Institutions Deregulation and Monetary Control Act (DIDMCA), which was enacted in March 1980. This act made it possible for S&Ls to offer their customers more attractive interest rates on savings accounts, increase the limit on deposit insurance by 250 percent, and relax their restrictions somewhat on who could obtain a loan for developing, acquiring or constructing property. After the DIDMCA, and a number of other acts and reforms, gave the S&L industry significantly more autonomy to operate as it pleased, the industry began to collapse as lending got out of hand. The industry was so deregulated that lenders started approving their own loans, as well as those of unqualified

borrowers who wanted large sums of money for risky ventures. Before too long, the S&L industry had lent much more money than it should have, leading to an estimated \$150-billion government bailout.

### **Example: Airline Deregulation**

- The airline industry underwent deregulation in 1978 when the Airline Deregulation Act was signed into law. The purpose of this deregulation was to allow the airline industry and its companies to gain more control over where they wanted to fly and how much they wanted to charge. This fostered creativity among the industry's competitors as they looked for bigger and better ways to outdo each other to increase their market shares. Consumers benefited from this, as they now had a choice of more routes and destinations as well as lower fares--a win-win from their standpoint. According to a Government Accountability Office report from 1999, fare prices between 1979 and 1988 dropped between 5 and 9 percent (depending on airport size), and they continued to drop into the 1990s.<sup>1</sup>

### **India's Liberalization Era**

The Government of India started the economic liberalization policy in 1991. Even though the power at the center has changed hands, the pace of the reforms has never slackened till date. Before 1991, changes within the industrial sector in the country were modest to say the least. The sector accounted for just one-fifth of the total economic activity within the country. The sectoral structure of the industry has changed, albeit gradually. Most of the industrial sector was dominated by a select band of family-based conglomerates that had been dominant historically. Post 1991, a major restructuring has taken place with the emergence of more technologically advanced segments among industrial companies. Nowadays, more small and medium scale enterprises contribute significantly to the economy.

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<sup>1</sup> eHow.com <http://www.ehow.com/about 5076380 deregulation.html>

By the mid-90s, the private capital had surpassed the public capital. The management system had shifted from the traditional family based system to a system of qualified and professional managers. One of the most significant effects of the liberalization era has been the emergence of a strong, affluent and buoyant middle class with significant purchasing powers and this has been the engine that has driven the economy since. Another major benefit of the liberalization era has been the shift in the pattern of exports from traditional items like clothes, tea and spices to automobiles, steel, IT etc. The 'made in India' brand, which did not evoke any sort of loyalty has now become a brand name by itself and is now known all over the world for its quality. Also, the reforms have transformed the education sector with a huge talent pool of qualified professionals now available, waiting to conquer the world with their domain knowledge.

India, after all these years of economic reforms, is at the crossroads. While one road leads India to economic prosperity and glory, the other road leads it to social inequality. Presently, as India is one of the fastest growing economies in the world, the social aspects have been ridden roughshod by the economic benefits. What has been conveniently forgotten or suppressed till date have been the disparities, mainly the socio-economical issues. This has led to growing discontent among the population and it has gathered momentum since the reforms began 15 years ago. It will very soon reach a critical point wherein the very purpose for which the reforms were started, will start to lose their significance rapidly and throw the country back into the 'license raj' and 'unionist' era.

The chasm between the rich and the poor has increased so vastly that the rich are just getting richer and the poor are just getting poorer. The real benefits of the economic reforms have rarely percolated to the lowest strata of society. Just to illustrate the same with an example, most of the states today vie with one another to grab a project of any significance, be it chemical, auto or even IT. In doing so, the benefits they are offering, right from free land to tax sops are being given on a platter. But the benefits or savings that a company gains from this does not affect the lower strata of management, but

remains in the hands of the top management, thus depriving the former of the economic benefits. Also, most of the labor laws in the country are outdated and have not kept pace with economic reforms. Thus, the exploitation of the working class becomes much easier. A classic example is the BPO industry in our country. While most of them work in the nights, the pressure each employee faces to deliver results and the working conditions are appalling, to say the least.

The agricultural sector has also seen this disproportionate growth, as it is a field that has been left high and dry in the pursuit of agricultural reforms. The sector has been opened up to the multi-nationals, without having evolved a comprehensive cover for our farmers, most of who are poor and own very little land of their own. A case in point is the spate of farmer suicides that our country has witnessed in the past few years. The developed countries, which clamour for open-ended policies, have, in fact, some of the fiercest protection policies when it comes to their agricultural sector.

Small scale industries (SSIs), the heart and soul of many towns and villages, have been virtually ignored. More than half of them have closed down in the last few years in the face of intense competition from multi nationals who have unmatched financial and political muscle.

On a parting note, what are essential for India are economic reforms with a social face. The economic policies and their subsequent reforms must be accompanied by suitable clauses to benefit the economically weaker sections. Various schemes must be thoroughly scrutinized and efforts must be made to see that the rewards must reach everyone. Then India will not only be economically prosperous, but will also forge ahead towards its goal of world dominance.

### **1.3 Liberalisation to Liberalisation**

The liberalisation policy unveiled in July 1991, initiated wide ranging policy and regulatory reforms. Industry was freed from Licence Raj', public sector [imports were either reduced or removed completely] the number of industries reserved for small scale sector was pruned considerably and private investment was invited in sectors like electricity, telecommunications, roadways, ports, etc.

On the financial front, exchange rate was allowed to be determined by market forces, financial markets were liberalized, companies were allowed to tap the capital markets freely by abolishing the office of Controller of Capital Issues.

Below an attempt is made to list out reform measures taken in major sectors.

#### **Food processing**

Food Processing industry was one of the heavy beneficiaries of the liberalization. The sector was dominated by small organization. The dereservation of sectors identified for small scale sector attracted increased investment by large corporate and MNCs.

As per the new policy, industrial license not required for setting up food & agro processing plants. FDI up to 100 per cent is allowed under the automatic route in the food parks, cold chain and warehousing and under licensing in distilleries. Imports of capital goods including second hand machines are exempt from customs duties.

#### **Sugar**

Sugar was subject to a number of controls regulating its production, supply and prices in the pre-liberalisation period. The sector was delicensed in September 1998. Sugar companies are now free to set up new factories or expand their existing capacities without requiring any license. The only

stipulation required is maintenance of radial distance of 15 km between the existing sugar factory and the new one.

Further, the compulsory levy on sugar was reduced from 40 per cent of its production in 1991 to 10 per cent in March 2002. Sugar Development Fund (Amendment) Act, was passed in May 2002 to extend finance from the Fund for co-generation units and for production of anhydrous alcohol or ethanol from alcohol.

## **Pharmaceutical**

In 1991, the industrial licensing for the manufacture of all drugs and pharmaceuticals (except a few bulk drugs) was abolished. Further, in February 1999, reservation on five drugs reserved for public sector was also abolished.

Foreign investment through automatic route is allowed up to 100 per cent. Further, automatic approval for Foreign Technology Agreements is being given in the case of all bulk drugs and formulations, except a few. Rebate is also given on in-house R&D expenses.

Today around 75 per cent of the drugs manufactured by the pharma companies are outside price control. The industry wants complete freedom from price controls.

## **Textiles**

Though licensing was abolished in 1991, a separate National Textile Policy was formulated in 2000 with an object to facilitate the textiles sector to attain and sustain global standing in the manufacture and export of clothing. Technological upgradation, productivity enhancement and increased.

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### **Oil & Hydrocarbons**

As per the prevailing policy, foreign companies can invest up to 100 per cent of the equity in any venture in the petroleum sector subject to approval of the government. New exploration Licensing Policy (NELP) was launched in January 1999 by the government for accelerating the pace of hydrocarbon exploration in the country. So far 199 blocks have been awarded under six rounds of NELP.

The success of this measure is yet to be seen as the country's crude oil production has stagnated at around 33.00 mtpa for the last 15 years.

The Government has opened up the refining sector to private investment. FDI up to 100 per cent is allowed. Private companies are also encouraged to invest in the marketing of petroleum products. After the initial hiccup, the sector has started attracting Indian as well as foreign companies' attention off late. The total refining capacity is expected to cross 220 million tone mark by 2012.

### **Cement**

Cement industry was one of the first sectors to experience the benefits of liberalization. In February 1982 partial decontrol was introduced in cement and a liberal policy was adopted in respect of price and distribution. MRTP/FERA companies were allowed to set up projects.

Cement was decontrolled fully in March 1989 and delicensed in July 1991. It has also been listed as a priority industry in Schedule III of the Industry Policy Statement making it eligible for automatic approval for foreign investment up to 51 per cent.

The industry has responded very well to the government policies and today is the second largest producer of cement in the world. The total cement manufacturing capacity is expected to increase from 170 million tone to 250 million tone by 2012.

## **Steel**

The Indian iron and steel industry was deregulated in January 1992. The erstwhile control mechanism was dismantled paving the way for a market-centric industry. As per the extant policy, no license is required to setup steel mills. Further the industry has been removed from the list of industries reserved for the public sector. Automatic approval of foreign equity investment up to 100 per cent is allowed. Price and distribution controls have been removed from January, 1992. Restrictions on external trade, both in import and export have also been removed Import duty rates have been reduced drastically.

In the recent years, the country has seen huge increase in project investment in this sector. Till date, around 116 MoUs are signed to produce around 180 million tone of steel. The total steel making capacity is expected to cross 120 million tone by 2012. Large Indian steel companies Tata, Jindal and Essar are also expanding their overseas capacities through acquisition route.

## **Automobiles**

Auto industry is one of the beneficiaries of the industrial reforms. The new auto policy announced by the government in 2002 opened the automobile sector to 100 per cent foreign direct investment and removed the minimum capital investment norm for fresh entrants.



The led to a spate of investment intentions in the passenger cars and commercial vehicles segment. Today, almost every major international automobile manufacturer has a presence in India. Besides aiming to tap the growing domestic market, multinationals intends to make India as an export hub to cater to their global demands.

## **Power**

The passage of the Electricity Act 2003 in June 2003 is termed as an important landmark in the liberalisation of the power sector. Following this, the power generating was delicensed, captive generation was set free from all controls, power trading was recognized as an independent activity and open access was granted on transmission and distribution activities.

In addition to amending the Electricity Act twice, the government also set up the Central Electricity Regulatory Commission (CERC), the State Electricity Regulatory Commission (SERCs) to fix and regulate tariffs from time to time.

Despite these measures, power sector grew at a very slow pace. Though enough private proposals are pending for setting up new capacities, delay in clearance of projects and the poor financial conditions of state electricity boards have prevented them from committing huge investments.

## **Power distribution**

To strengthen the power distribution system in the country and to lessen the transmission loss the government of India approved a scheme called Accelerated Power Development and Reforms Programme (APDRP) in March 2003. Under this scheme the central government will fund 50 per cent of the project cost undertaken by state governments. The scheme has also identified 63 distribution circles as ideal for distribution reforms.

Though 16 states have opted for the scheme the pace of reforms is very slow.

## **Telecommunications :**

The phenomenal growth recorded in the telecom sector shows what economic reforms can achieve. Though the government faltered in the beginning the privatizing the sector, the corrective measures taken through the new National Telecom policy of 1999 ensured enough competition in areas like basic and cellular services, national long distance and Internet services. The Telecom Regulatory Authority of India (TRAI) was constituted in 1997 as an independent regulator in this sector.

The growth of Indian telecom network has been over 30 per cent consistently during the last five years. The total number of telecom subscribers has already crossed the 200 million landmark and is expected to grow further.

The 'Broadband Policy' announced in October 2004, expects to achieve a target of 40 million internet subscribers and 20 million broadband subscribers by 2010.

## **Roads**

For sustained economic growth existence of well connected roadways network is a must. To ensure this, the government established the National Highways Authority of India. NHAI announced National Highway Development Programme to upgrade the national highways in 1995. Further, to strengthen the rural connectivity the Pradhan Mantra Gramodaya Yojana (PMGY) was launched in December 2000 to provide connectivity to rural India.

NHAI was entrusted with the responsibility of implementing a greatly expanded National Highways Development Project spread over seven phases with an estimated expenditure of Rs.2,20,000 crore.. NHAI intends to execute most portion of the NHDP through public private partnership. In all 24,000 km length national highways will be created in the next 10 ten years. Model concession code is being developed to ensure higher participation from private parties.

The Central government has created a dedicated fund called Central Road Fund (CRF) from collection of cess on petrol and diesel. The fund is utilized for development and maintenance of national highways, state roads and rural roads.

Though private companies are willing to invest in road building, they are currently wary of decent returns on their investments. If government ensures this through a lucrative model concession agreement, the response from private sector would be phenomenal.

## **Shipping**

India has 12 major ports and around 180 minor and intermediates ports. Barring a few no other ports are of international standard. To attain this heavy infusion of funds is required. This can be achieved only with private participation.

The shipping ministry unveiled the Rs.100,400 crore National Maritime Development Policy in December 2005. Around half of the proposed investment is expected from the private sector. To ensure this the government allowed private participation in construction and operation of container terminals, bulk and specialized cargo berths, warehousing, dry dock and ship repair facilities, etc. However, the sector has managed to get only lukewarm reaction from the private sector.

## **SEZ**

It seems Indian government is in a hurry to set up SEZs across the country. The Special Economic Zone Act 2005 was enacted in February 2006. The government expects investment of the order of Rs.100,000 crore over the next three years.

So far 234 applications have been cleared by the Board of Approvals at the Union level and of which 100 SEZs have been notified at state levels. Though private sector response was huge, the wavering stands taken by the Union government in the recent past has made private investors to adopt a wait and watch policy before committing huge investments.

## 1.4 Object

India's is a mixed economic system is characterized by the existence of the private and public sectors. India has a multiplicity of sectors : private (dominant undertakings, foreign companies, etc.) public, joint, co-operative, workers' sectors and also 'tiny sector'. We hear of different sectors in different areas of the Indian economy : big sector, small sector, heavy sector, light sector, licensed sector, deceased sector, national sector, core sector, reserved sector, etc. India is a complex vector of sectors.

Secondly, a simple mixed economy is characterized by complementarily between central planning and pricing. India has a multiplicity of mechanisms at work : five-year plans, annual plans during plan holidays, pointed economic reform and reconstruction programmes during and after plan vacations, ideas of rolling plans, an elaborate system of controls and regulatory measures, attempts towards streamlining and simplification of procedures, private traders and public distributors for the same product and hence a system of dual prices, ceiling prices, floor prices, subsidized prices, statutory prices, retention prices, procurement prices, levy price and free market prices, contractionary monetary policies and expansionary fiscal policies etc. In India there is complex system of liberal rules, strict regulations, control mechanisms, planning and a host of price regulations which of course are being gradually relaxed.). The present day mixed economy of India has evolved through a series of policy formulations and legislations. It started with the Industrial Policy Resolution of 1948. This was followed by the Industries (Development & Regulation) Act 1951, the Directive Principles of State Policy 1950, the Industrial Policy Resolution 1956, the Monopolies and Restrictive Trade Practices (MRTP) Act, 1969 and its subsequent amendments MRTP Act now became competition Act 2002. The Industrial licensing policy, 1970, These enactments and now became (FEMA) policy formulations have been modified or supplemented from time to time by comprehensive five year plans, the 20 points programme, controls and regulations on prices, output, production, distribution and trade, various

nationalization schemes, anti-poverty schemes, and finally the economic reforms initiated in 1991.

During the decade of the 1980s the Indian mixed economy took a decisive direction. It all started with the announcement of the Industrial Policy statement of 1980. The purpose of this policy was to ensure attainment of socio-economic objectives such as optimum utilization of capacity, maximum production, employment generation, export promotion import substitution, consumer protection, correction of regional imbalances through the development of industrially backward areas and “economic federalism” with an equitable spread of investment among large and small units, among urban and rural units, etc. Some important provisions of the 1980 policy were.

- Regularisation of excess capacity.
- Development of “nucleus plans” (on the line so District Industries Centres)
- Reorientation of the public sector, including the development of its managerial cadres.

Liberalisation measures were supplemented by relaxation in price and distribution controls, amendments in the provisions of the MRTP Act relating to the definition of “market dominance”, exemption from the need to obtain MRTP clearance for production in sectors of “national priority”, etc.

During 1983-85, the industrial policy pursued by the Government of India placed emphasis on modernization and technological up gradation for better capacity utilization and larger production.

During 1985-87, the Government took a large number of measures to encourage the private sector. Some of these measures which were broadly referred to as “privatization” and “liberalisation”.

## **1.5 Significance**

The new economic policy was announced in July 1991 which is of for reaching importance. The new economic policy, among other things, has bearing on : (i) Industrial Licensing (ii) Foreign Investment and Foreign Technology Agreement (iii) MRTP regulations and (iv) Public Sector.

### **Industrial Licensing**

The statement of new economic policy emphasized that the system of industrial approval needed a number of changes to actively encourage and assist Indian entrepreneurs to exploit and meet the emerging domestic and global opportunities and challenges. The bedrock of policy measures must be to let the entrepreneurs make investment decisions on the basis of their own commercial judgment. Government policy and procedures must be geared to assist the entrepreneurs in their efforts by making essential procedures fully transparent, by even-inating delays and removing restraints on capacity creation, while, at the same time, ensuring that overriding national interest are not jeopardized.

The decisions taken in this respect are listed as under :

- Abolition of industrial licensing for all projects except for a short list of industries related to security and strategic concerns, social reasons, hazardous chemicals and overriding environmental reasons and items of elitist consumption. Industries reserved for the small scale sector would continue to be so reserved.
- Areas where society and strategic concerns predominate will continue to be reserved for the public sector.
- In locations other than cities of more than 10 laks. (1 million) population there will be no need for obtaining industrial approval s from the Central Government except for industries subject to compulsory licensing.
- Exemption from licensing will apply to all cases of substantial expansion of existing units.

- **Changes in MRTP Regulations :** A significant change initiated by the new policy was the removal of the Threshold limits of assets in respect of MRTP Companies and dominant undertakings. With this decision prior approval of the Central Government will not be required for the establishment of new undertakings, expansion of undertakings, merger, amalgamation and takeover of companies. Instead, emphasis will be on controlling and regulating monopolistic, restrictive and unfair trade practices as provided under the MRTP Act.
- **Public Sector Policy :** In the context of massive investments made, the policy statement noted two aspects of the performance of public enterprises. The mature enterprises have successfully expanded production, opened up new areas of technology and built up a reserve of technical competence in a number of areas.
- **Challenge of Global Competition and Quality Standards :** Industrial enterprises in India, after years of protection from foreign competition, have been exposed to competitive markets both within and outside since the policy of liberalisation was initiated in 1991. With the entry of MNCs and growth of foreign companies, domestic product markets are being increasingly subjected to forces of competition. On the other hand, export promotion is directly linked with the competitiveness of Indian products in markets abroad.

## 1.6 Design

The Legal Environment of Business for describing and analyzing the legal environment of business in India, there are some specific socio-economic legislations, they are

- Company Laws
- Laws relating to capital market
- MRTP (Monopolies and Restrictive Trade Practices Act) now repealed by competition Act 2002.
- FERA (Foreign Exchange Regulation Act) now became FEMA - Foreign Exchange Management Act.
- IRDA (Insurance regulatory & Development authority)
- Trade Unions Act.
- Bonus ordinance
- Factory legislations
- Social Security Enactments
- Laws for consumers protection.

This list is not exhaustive, it is just illustrative. There are many more legislations which are important from the stand point of business and industry in India.

### A. Company Laws

In the present political – legal environment, company laws include represents the principal laws affecting the organisation and management of corporate business. Originally this law used to be concerned with joint stock companies only, but today its scope has increased. It covers different types of companies – their incorporation, their constitution, their management and even the manner of their dissolution.

#### ➤ Recently Proposed Changes

A working group was constituted by The Government of India to suggest changes / modifications in the companies Act 1956.



Based on the recommendations of this group, the Government introduced in early May 1997 a draft companies Bill in Parliament.

- ✓ The total sections have been compressed from 678 to 457 and the total number of schedules from 15 to only 3.
- ✓ It restricts corporate in issuing inter-corporate loans and investment up to the maximum of 60% of their paid-up capital and free reserves, or 100 per cent of free reserves, whichever is higher.
- ✓ It proposes to reduce the period of payment of dividend from 42 days to 30 days of the rate of declaration.
- ✓ A company cannot invite deposits in case it has defaulted in the repayment of any prior deposit or part thereof or any interest thereon in accordance with the terms and conditions of such deposits.
- ✓ The bill seeks to rationalize the classification of companies. The provision with regard to deemed companies is sought to be deleted.

The Draft Bill has drawn wide-spread applause from the chambers of commerce and industry for addressing contemporaneous issues being faced by the corporate which it seeks to resolve in a pragmatic and result – appointed manner. It has been claimed that the bill provides for greater flexibility, self-regulation by companies and ensures transparency.

## **B. Capital Market**

- The Securities Contracts (Regulation) Act, 1956  
This Act is designed to regulate the functioning of stock exchanges in India to prevent undesirable transactions and dealings in securities.
- Securities and Exchange Board of India Act 1992 Promulgated as an ordinance on January 30, 1992. The SEBI Bill was passed by both houses of Parliament and became effective on April 4, 1992.  
The objects of SEBI Act are to develop the securities market on healthy and orderly lines and to provide adequate protection to investors. To

this end, it is necessary to promote a market which ensures. \* Fairness  
\* Efficiency \* Confidence \* Flexibility.

The capital market in India has witnessed tremendous growth in the recent past. There is increasing participation by the investing public. It is, therefore, imperative to sustain the confidence of investors by protecting their interests.

### **C. Monopolies and Restrictive Trade Practices (MRTP) Act, 1969**

The Monopolies and Restrictive Trade Practices (MRTP) Act has its genesis in the Directive Principles of State Policy embodied in the constitution of India. Article 39(b) and (c) there of lays down that the state shall direct its policy forwards ensuring.

- i. That the ownership and control and material resources of the community are so distributed as best to sub serve the common good, and
- ii. That the operation of the economic system does not result in the concentration of wealth and means of production to the common detriment.

The Objectives of the MRTP Act are :

- a) To prevent concentration of economic power to the common detriment and control of monopolies.
- b) To prohibit monopolistic trade practices; and
- c) To prohibit monopolistic trade practices; and

Monopolies usually benefit a few and cause detriment to many monopolies have a tendency to restrict competition with the result that the monopolistic concerns have a hold on the prices of commodities in the market which ultimately results in the exploitation of many at the hands of a few.

With the initiation of the market economy and the consequent Liberalisation since 1991, this objective has been substantially deleted. The

MRTP (Amendment) Act, 1991, has omitted provisions regarding the Central Government's permission for substantial expansion, establishment of a new undertakings, mergers, take-over etc. Establishments, howsoever big or small, are now free to expand, or establish new undertakings or effect mergers.

Consequently, the strategic alliance between Godrej Soap and Proctor and Gamble could not be questioned. Likewise the merger of Hindustan Lever and TOMCO, through objected to by certain quarters including the employees of TOMCO, was allowed by the supreme court.

The monopolies and Restrictive Trade Practices (MRTP) Commission has lost much of its teeth which were provided mainly to curb concentration of economic power. There has been a substantial increase in the number of cases taken up by the MRTP Commission on allegations of companies resorting to restrictive trade practices. But cases alleging violation of clauses relating to market dominance, etc. have been very few. A large number of companies have got deregistered following the announcement of relaxations in the Act. This deregistration trend is interpreted as a dear induction of the big houses gradually getting out of the MRTP Act'

Thus this MRTP Act was replaced by competition Act of 2002. This is an Act to provide, keeping in view of the economic development of the country for the establishment of a commission to prevent practices having adverse effect on competition to promote and sustain competition in markets, to protect the interest of consumers and to ensure freedom of trade carried on by other participants in markets, in India, and for matters connected there with or incidental thereto.

#### **D. Consumer Protection Act, 1986<sup>2</sup>**

There has virtually been a tradition of exploitation of consumers in India due to shortages and the sellers' markets, The consumers as buyers always had a poor bargaining power. Manufacturers and traders often follow unfair and unethical practices. Though much legislation have been enacted. They have failed to provide any effective protection to consumers due to lack of

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<sup>2</sup> Economic and Social Environment – Political dogleg Environment MS-3 Book Pg.75.

effective implementation. It is common knowledge that a number of deaths take place every year due to food adulteration, spurious liquor and contaminated / substandard medicines, etc. many manufacturers and traders, including multinationals, indulge in unethical practices. They make tall claims for their products which turn out to be false. The service sector is no exception to unethical practices and allurements.

To check the onslaught on consumers, a host of legislations had been enacted from time to time. This includes the Sale of Goods Act, 1930, Essential Commodities Act, 1955, the Prevention of Food Adulteration Act, 1954, Prevention of Black Marketing and Maintenance of Supplies of Essential Commodities Act, 1980, standards of weights and measures Act, 1956, Agricultural Products Grading and Marketing Act (AGMARK), 1937. Indian Standards Institution Certification Act, 1952, MRTP Act, 1969, etc. MRTP Act. Acquired the elements of consumer protection legislation with the amendments in 1984 when unfair trade practices were brought in its fold. However, in spite of these changes in the MRTP Act, the need was felt for a more comprehensive consumer protection legislation. As a consequence, the Consumer Protection Act, 1986 was born. It is described as a unique legislation of its kind in India to offer protection to consumers. The main objective of the Act is to provide better protection to consumers. Unlike other laws which are punitive or preventive in nature, the provisions of this Act are compensatory in nature. The Act intends to provide simple, speedy and inexpensive redressal to consumers' grievances.

- **Liberalisation and Consumer Protection** : A liberalized economic regime, it must be stated, is in itself a way of protecting the interests of consumers. Liberalisation affords the consumers an opportunity of choosing from a wide range of products & services, and this, coupled with competition brings in sharp focus the fundamental aspects of consumer liberalisation encourage domestic manufacturers to produce goods comparable to international standards. Unlike the protected regime of the past when manufacturers had almost licence to charge arbitrary prices, they are now constrained to charge competitive or reasonable prices due to the greater play of market forces.

## **1.7 Methodology**

The research methodology adopted here is non-doctrinal as it is based on secondary data such as text books, refereed journals, refereed conference papers, research books & collections parliamentary and government reports, industry and professional publications, websites etc.

### **Indian Experience**

The Indian economy has also witnessed a big change in the role of the Government over time. Ever since independence till around the 1980s, as our objective was to have planned economic development without adopting extreme forms of capitalism or communism. The unprecedented crisis in the Indian economy in 1990-91 was the last straw on the camel's back. Our foreign exchange reserves fell to an all time low level of \$2.2 billion. Inflation rate had already crossed the double-digit-figure and was actually at 14% fiscal deficit had risen to 8.4% of the Gross Domestic Product. The current account deficit on balance of payments was as high as \$ 9.9 billion. International Credit Rating agencies went on to considerably downgrade India's creditworthiness.

The Government and many economists agreed that a shock therapy was immediately required to pull the Indian economy out of the woods. The World Bank agreed to bail India out, but imposed certain conditionality's for doing so. It wanted 2 major types of programmes to be carried out firstly, there were to be short-term stabilization measures to control inflation and wipe out the balance of payments deficit. The rupee has been devalued to correct the balance of payments deficit. Secondly, there had to be structural reforms to make the Indian economy competitive and attain a high rate of growth with social justice. These have also been accepted and measures are being taken to liberalise and globalise the Indian economy.

As a result of all this, there was considerable rethinking, reinforced by the conditionality's imposed by the World bank to help India out of her difficulties steps began to be initiated in the 1980s and these gathered

considerable momentum in the 1990s. A sea change has thus come about in the economic role of the Government in India since the 1990s. Many of the sectors reserved for the public sector have now been thrown open to this private sector. More and More physical controls are being replaced by measures to guide the economy through the market mechanism. Restraints in the way of international trade and factor movements are being gradually reduced. The seeming intention is to make the Indian economy face international competition and become efficient in performance.

- **Structural Dimensions of Indian Economy :** The socio-economic environment of any country can be explained in terms of an institutional framework and a physical framework the economic policy statements of the government, economic plain documents, the political constitution economic regulations and controls, among others which define the role and status of private sector, public sector, multinationals corporations small business etc. The critical elements which constitute the institutional framework of an economic environment. The trends in economic variables such as income, price, output, investment, foreign trade, labour supply and other factor endowments and the structural relation among these variables constitute the physical framework of an economic environment.

Describing and analyzing the economic environment is a difficult task. Dissertation and personal judgment play an important part. Difficulties arise in the context of both institutional and physical framework. Just as various interpretations of policy statements are possible various conclusions could also be drawn from the economic data.

The purpose of gathering (mainly from official sources) and analyzing data is to obtain a clear picture of major economic trends and structural changes in the economy. The trends and structural co-efficient together enable us to make a quantitative assessment of the economic environment of a business / firm and thereby to outline strategies for macroeconomic management. A knowledge of economic trends and structural changes thus help the firm to plan out a corporate

strategy and policy to cope with short-run and long-run challenges of business environment. This argument is particularly valid for a developing country.

- **Economic Growth And Development** : “Growth” and “development” are sometimes used synonymously in economic discussion. Though the two terms are used interchangeably, they have different connotations. Economic growth means more output, while economic development implies both more output and changes in the technical and institutional arrangements by which it is produced and distributed.

Growth may well involve not only more output derived from greater amounts of inputs but also greater efficiency that is, an increase in productivity or an increase in output per unit of input. Development goes beyond this to imply changes in the composition of output and in the allocation of inputs by sectors. As with human beings, to stress “growth” involves focusing on height or weight (or national income), which to emphasize development draws attention to changes in functional capacities in physical coordination, for example, or learning capacity (or ability of the economy to adapt).

- **Economic Growth** : Economic growth may be defined as a significant and sustained rise in per capita real income. One must distinguish the ‘level’ from the rate of economic growth, though two concepts are obviously related. The level of economic growth of a country is measured by the size of national (or per capita) real income. The percentage change in this level over a year is the annual rate of growth.
- **Economic Development**<sup>3</sup> : “Economic development” is a broader concept than “economic growth” ; As an d when the economies grow in terms of national and per capita income levels, certain structural changes accompany the process of growth. Conceptually the trends in income and the structural changes together constitute economic development.

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<sup>3</sup> Economic and social environment MS-3 structure of Indian Economy Book-2 pg.6, 7&8.

The structural changes which are quite fundamental in character are inherent in the process of economic growth. The upward trend in per capita real income (that is, economic growth) implies, given the labour force participation rate, a rise in product per worker or labour productivity. An increase in labour productivity cannot result without capital accumulation and fundamental changes in the production function (functional relationship between flows of output and corresponding flows of inputs) of the economy. A progressive shifts in the production function is the direct outcome of technological advancement, and science is the base of modern technology.

- **Private Sector in India** : The private sector is subject to various regulations / laws so that subserves the social and economic objectives of economic planning for development. The unregulated capitalism in the western countries during the 19<sup>th</sup> Century and the first quarter of the twentieth century was found to be suffering from several limitations and evils. The Keynesian Revolution clearly brought out the role of government in ensuring stability in a capitalist economy. The 19<sup>th</sup> Century Police State (in the sense that its main function was limited to maintenance of law and order) has given way to 20<sup>th</sup> Century welfare state wherein the state plays an important regulatory and promotional role in the economic realm. The Keynesian Revolution has put the last nail into the coffin of virgin – pure – capitalism. The regulated or controlled capitalism is an observable fact now.
- **Nature and Scope of the Private Sector in India<sup>4</sup>** : The private sector refers to all types of individual and corporate enterprises domestic and foreign, in any field of productive activity with the intention of making a profit. The characteristic of the private sector enterprises is that their ownership and management lies in private hands. The “enlightened self-interest” guides the running of private enterprises. Enterprise initiative and strong profits motive are the most distinguishing features of private enterprise. Private enterprise with the

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<sup>4</sup> Economic and Social environment structure of Indian Economy Private Sector in India. Book-3, Pg.73-74.



above characteristics is an integral part of the capitalize economic system.

Since the Industrial Policy Resolutions of 1948 and 1956 the distinction between the private sector and the public sector has become increasingly significant. The industrial policy has made Indian economy a mixed economy. The Industrial Policy Resolution, 1956 (which is considered as the 'economic constitution of India') has clearly demarcated the scope and role of the public and private sector.

The resolution laid down three categories of industries which bear a close resemblance to the classification adopted in the 1948 Resolution but public and private sectors were sharply defined. The three categories were.

I. Schedule-A. This consisted of industries which were to be an exclusive responsibility of the state for eg. Arms and ammunition atomic energy, iron and steel.

II. Schedule B. This consisted of industries which were to be progressively state-owned and in which the state would generally set up new enterprises, but in which private enterprise would be expected only to supplement the effort of the state viz. mining industries, aluminum and other non-ferrous metals not included in Schedule A.

III. Schedule C. This consisted of all the remaining industries and their future development, in general was to be left to the initiative and enterprise of private sector.

The New Industrial Policy announced in 1991 has significantly reduced the role and scope of the public sector.

Broadly Speaking, the public sector is to assume the responsibility of developing basic and heavy industries, social and economic overbeads (infrastructure) while the private sector is left with the right to develop consumer goods industries. The private sector has in its fold the whole of agriculture and allied activities, plantations, internal trade, road freight traffic etc. As the most organized component of the private sector is the corporate

sector the private sector has indeed come to mean, in common parlance, the private corporate sector.

- **Growth and Structure of the Private sector in India<sup>5</sup>** : The importance of the private sector in the Indian economy can be assessed in terms of its contribution to national income and employment. According to the latest available statistics for the year 2009-2010 the public sector, including government administration contributed 25 per cent of the domestic product while the private sector contributed 75 per cent. The share of private sector is dominant in agriculture, forestry, fishing, small-scale industry retail trade, construction transport other than railways etc.

The largest industrial activity among the private sector corporate units in terms of paid-up capital was processing and manufacture of metal products followed by chemicals, textiles, leather and leather goods, manufacture of food stuffs, other processing and manufacture, commerce, agriculture and allied industries, construction, etc.

- **Small Scale Industry in India** : Small scale industry occupies a prominent place in the industrial economy of the work. Its contribution in terms of number of units, employment and industrial production is quite impressive in both developed and developing countries.

Small scale industry is a heterogeneous group in India. It comprises household industries, unregistered workshops and small scale factories. A manufacturing unit which makes use of only household labour is a household industrial unit. A manufacturing unit which employs 10 or more workers with power or twenty or more workers without power is a registered factory as per the Indian Factories Act, 1948.

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<sup>5</sup> Economic and Social Environment – MS-3 – Structure of Indian Economy – Book-2 Private Sector in India Pg.76-77.

- **Industrial Policy for Small Scale Industry<sup>6</sup>** : It was the New Industrial Policy (NIP) which marked the watershed in India's SSI Policy. It was in 1991 that the Government of India announced a separate industrial policy for SSI. Till then, policy measures for SSI formed a part and parcel of the general industrial policy of the country. Further, in all earlier industrial policies, emphasis was on protection as much as on development. The NIP, 1991 marked a departure from the past as the thrust was on SSI development more than anything else.

Several innovative policy guidelines are introduced :

- Equity participation in SSI for large (domestic and foreign) enterprises is allowed upto) 24 percent. This is to encourage modernization and technology up gradation.
- Introduction of technology up gradation schemes called "UPTECH", in selected centers in SSI chartered regions.
- Private industry can also set up industrial estates.

Thus, in terms of policy measures small scale industry has gained increasing importance, gradually and steadily. Though all the industrial policies have underlined the importance of SSI growth for Indian economy, the NIP of 1991 for SSI is distinct as it lays more thrust on SSI development through innovative schemes for improving competitiveness in the liberalized economic development.

- **Growth of Small Scale Industry in India** : The contribution of small scale industries to Indian economy in terms of employment generation, industrial production and exports is remarkable. This is specially true in the 90s. When the New Economic Policy (NEP) was introduced in 1991, there were widespread fears that economic liberalisation would adversely effect the growth of small scale industry. But contrary to all apprehensions, small scale industry has been growing unabatedly in the 90s. The growth in SSI production is much higher than that of the industry as a whole.

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<sup>6</sup> Social Economic Environment MS Structure of Indian Economy small Scale Industrial in India pg.90-91.

- **Problems & Prospects :** A small scale industrial unit is subject to visit of different kinds of government officials from different departments such as excise, labour, factory, pollution controls, electricity, etc. The visit are the ensure the adherence of SSI units to the rules & regulations applicable to them. However, small scale entrepreneurs in the process, are said to be subject to harassment and disruption of work. The visit of various inspectors to SSI units for law enforcement, commonly known as “Inspector Raj” is said to be a major bane of SSI sector.
- **Sickness in Indian Industry<sup>7</sup> :** The phenomenon of industrial sickness, both in large and small scale industry, has become quite widespread during the last several years. This was particularly significant in the small industry sector resulting in the closure of a number of units.

Sickness may arise due to a multitude of reasons. The effects, however, are the same, e.g. financial hardships and unemployment of labour engaged in the industrial units falling sick, and wastage of national resources. It is, therefore, considered essential not only to devise suitable measures for dealing effectively with sick industrial undertakings but also to make suitable arrangements for monitoring and detecting industrial sickness at early stage.

It is generally observed that a sick unit is one which works below 20 percent of its installed capacity. Also a sick unit is defined as one which operates at lower than break even point.

- **Factors Responsible for Industrial Sickness :** The factors responsible for industrial sickness can be divided into two categories : Exogenous Factors, and Endogenous factors.

Some of the exogenous factors relate to such factors as government policies pertaining to production, prices and distribution. Change in the investment pattern following new priorities in the plans is yet another factor. Further shortage of power, transport, raw materials,

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<sup>7</sup> Social and Economic Environment MS-3 structure of Indian Economy Book-2 Small Scale Industry in India & Sickness in Indian Industry Pg.96-97 and Pg.104

deteriorating industrial relations are some other factors to be noted in this connection. Such factors are likely to affect all units in an industry. These factors may cause sickness of the industry. If state policy is the cause of sickness, then corrective action should be taken at the government policy level. An illuminating example of government policy causing industrial sickness is the controlled cloth scheme. Another is the administered coal prices before nationalization of coal mines.

The most important endogenous factor causing industrial sickness has been weak management or mismanagement. In a large number of units, sickness was caused by bad management. In a highly protective environment (prior to 1991's new economic policy), many persons with no managerial abilities entered the field and set-up industrial enterprises. Some of them indulged in malpractices. Some took a short-sighted view of development and concentrated on making quick money.

- **Measures to tackle Industrial Sickness<sup>8</sup>** : One remedy for potentially viable sick units may be to do everything possible in order to revive them, the other may be to create an efficiency – oriented environment by encouraging competition and by reducing the stifling controls over the industry. The New Industrial Policy seeks to bring about necessary reforms in this respect.

With economic liberalisation and the new industrial policy announced in 1991. It is believed that there is a need to re-examine the role of Government in tackling the problem of industrial sickness. Meddling with the operation of inexorable economic laws in the name of reviving sick units may prove counter productive and detrimental to the effective working of the industrial economy of the country.

- **Planning Goals and Strategies** : The three major strategies that have been adopted in India since the beginning of the second plan are:

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<sup>8</sup> Economic and Social Environment MS-3 Structure of Indian Economy Sickness in Indian industry structure pg.109-111

- **Rao-Manmohan Model of Growth** : Rao-Manmohan model of Development was introduced in 1991. It emphasized privatization and globalization of the economy.
  - **First**, areas hitherto reserved for the public sector were to be opened to the private sector. Although the government failed to transfer the ownership of public sector undertakings to the private sector in view of the strong opposition by the workers and left parties, it did liberate the economy and opened areas of heavy industry and economic infrastructure to the private sector- both domestic and foreign.
  - **Secondly**, the government abolished licensing in all industries except a small list of 18 industries now reduce to 8 industries only. In other words, it removed bureaucratic shackles of investment.
  - **Thirdly**, it freed the MRTP companies from the ceiling on assets. This implied that even big business was allowed to invest without any ceiling being prescribed by the MRTP commission. Obviously, considerations of growth dominated more with the government than those of monopoly control.
  - **Fourthly**, foreign direct investment was facilitated. Automatic approvals for direct foreign investment upto 51 per cent in high priority areas. Were granted Government was even prepared to consider proposals involving more than 51 per cent equity on case by case base.
  - **Fifthly**, performance of the public sector undertakings was to be improved by granting them greater autonomy for this the memorandum of understanding (MOU) was devised and PSUs Management and boards were made more professionally.
  - **Lastly**<sup>9</sup>, to globalise the economy the government followed a policy of reducing import barriers and also one of encouraging, export promotion such a course would facilitate the free flow of

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<sup>9</sup> Economic & Social Environment – MS- Planning and Policies Book-3 Planning Goals and strategies – pg.16.

foreign capital and technology and thus help to modernize our economy.

➤ Rao-Manmohan Model of development has also been the subject of criticism. The main points of criticism are.

- i. The model has by-passed agriculture and agro based industries which are the major sources of employment generation.
- ii. The model has a very narrow focus since it emphasizes the corporate sector growth which accounts for only 10 percent of GDP.
- iii. Although in the Industrial Policy of 1991, multinational corporations (MNCs) were to be permitted in high priority areas, the government has been Indiscriminately permitting them even in consumer goods industries. Need it be emphasized that MNCs follow a highly capital intensive pattern of production and have the us restricted the growth of employment.
- iv. MNCs after entry in various joint ventures raise their equality to 51 per cent level or even more and thus push out the Indian partner. This has led to the Indian Industry asking for protection against the onslaught of multinationals.

To sum up, Rao-mohmohan model has succeed on growth by raising GDP growth rate to more than 6 per cent level, but it has failed on equity, employment and poverty removal.

- **Assessment of Industrial Policy (1980)**

The government intended to regularize excess capacities. It also proposed automatic expansion of capacity to all industries listed in the first schedule of Indian Industries (Development and Regulation) Act. The plea for doing this was the keen desire to make full use of installed capacity to maximize production. This policy was welcomed by big business because liberalisation indicated in the policy was silent endorsement of regularisation

on unauthorized excess capacity. The critics feel that the government should not have given blanket liberalisation in case of all industries but it should have acceded to the sanctioning of unauthorized capacities in case of those industries which were high priority areas for the country such as cement, paper, sugar, fertilizers, caustic soda, etc. but should have denied it to low priority areas like chocolates, baby foods, cosmetics, synthetic detergents, etc. 90 provide an open general licence for big business was not justified. To sum up, the industrial policy of 1980 favoured a more capital- intensive pattern of development and thus it attempted various measures of liberalisation for helping the large sector. It underplayed the employment objective.



## **1.8 Hypothesis**

### **Environment of Business**

The term “environment” refers to the totality of all the factors which are external to an beyond the control of individual business enterprises and their managements. Environment furnishes the macro context, the business firm is the micro unit. The environmental factors are essentially the “givens” within which firms and their managements must operate. For example, the value system of society, the rules and regulations laid down by the Government, the monetary policies of the Central Bank, the institutional set-up of the country the ideological beliefs of the leaders, the attitude towards foreign capital and enterprise, etc., all constitute the environment system within which a business firm operates. These environmental factors are many in numbers and various in form. Some of these factors are totally static, some are relatively static and some are very dynamic – They are changing every now and then. Some of these factors can be conceptualized and quantified, while others can be only referred to in qualitative terms. Thus, the environment of business is an extremely complex phenomenon.

Sometimes the environment may be classified into market environment and non-market environment depending upon whether a business firm’s environment is influenced by market forces like demand, supply number of other firms and the resulting price competition or non-price competition, etc., or by non-market forces like Government laws, social traditions, etc. finally, we may classify the environment into economic and non-economic. Non-economic environment refers to social, political, legal, educational and cultural factors that affect business operations. Economic environment, on the other hand, is given shape and form by factors like the fiscal policy, the monetary policy the industrial policy resolutions, physical limits on output, the price and income trends, the nature of the economic system at work the tempo of economic development, the national economic plan, etc.

By considering a firm as an economic institution in a market system. The market behavior of the firm reflects the nature of the economic decisions taken by the manager of the firm. Micro-economic decision – making by the

firm has never the less to be made within the broader macro-economic environment. As government is the manager of the economy. The nature of government ownership, control and regulation of the economic activities of a country provides form and shape to the nature of economic organizations. In a capitalist society, the private sector, induced by the profit motive and led by the free market, takes the major economic decisions of investment, production and distribution. In a socialist society most of the economic decisions are taken by the government which is guided by the social welfare motive and control planning. In a communist society economic decisions, including those of consumption, are taken by the state in the interest of the community as a whole. In a mixed economy, the private, public and joint sectors and the like all have some say in the major decisions that influence the functioning of a economy.

There are certain points can be made about the organisation and functioning of modern economics.

- i. In most economies both 'free market mechanism' and 'centralised planning' exist in different degrees even today. By 'free market mechanism' or 'price mechanism', we mean a free play of the market forces of demand and supply to determine an equilibrium solution of the allocation problem. Thus, the economy in which a business firm operates today is not an exclusively free economy making an indiscriminate use of prices and the markets. Rather it is directed by a system of planning, control, regulation and co-ordination.
- ii. In most economies, positive intervention by the government in day to day economic affairs has existed over several decades in the past planning is a from of governmental intervention. Besides this, the Government can also intervene through a system of controls and regulations. The "Welfare state" principle induces the government to enforce minimum wages, commodity controls, fair trade practices, etc. through legislation. The basic objectives of such economic legislations and policies are : growth, efficiency and equity. It is the intervening role of modern governments that has made most business firm socially responsible.

## **1.9 Sources**

Research depends on social legal aspects as it reveals development after doing away with the control and data is collected through secondary source it includes Censuses, Surveys, organizational records and data collected through qualitative methodologies or quantitative research it is based on statistical data and database research.

## **Chapter-2**

### **Free and Fair Competition**

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## **2.0 Introduction**

Since attaining Independence in 1947, India for the better part of half a century thereafter, adopted and followed policies comprising what are known as Command-and-Control laws, rules, regulations and executive orders. The competition law of India, namely, the Monopolies and Restrictive Trade Practices Act, 1969 (MRTP Act, for brief) was one such. It was in 1991 that widespread economic reforms were undertaken and consequently the march from Command-and-Control economy to an economy based more on free market principles commenced its stride. As is true of many countries, economic liberalisation has taken root in India and the need for an effective competition regime has also been recognized.

In the context of the new economic policy paradigm, India has chosen to enact a new competition law called the Competition Act, 2002. The MRTP Act has metamorphosed into the new law, Competition Act 2002. The new law is designed to repeal the extant MRTP Act. As of now, only a few provisions of the new law have been brought into force and the process of constituting the regulatory authority, namely, the Competition Commission of India under the new Act, is on. The remaining provisions of the new law will be brought into force in a phased manner. For the present, the outgoing law, MRTP Act, 1969 and the new law, Competition Act, 2002 are concurrently in force, though as mentioned above, only some provisions of the new law have been brought into force.

Competition Law for India was triggered by Articles 38 and 39 of the Constitution of India. These Articles are a part of the Directive Principles of State Policy. Pegging on the Directive Principles, the first Indian competition law was enacted in 1969 and was christened the Monopolies And Restrictive Trade Practices, 1969 (MRTP Act). Articles 38 and 39 of the Constitution of India mandate, inter alia, that the State shall strive to promote the welfare of the people by securing and protecting as effectively, as it may, a social order in which justice social, economic and political shall inform all the institutions of the national life, and the State shall, in particular, direct its policy towards securing.

1. That the ownership and control of material resources of the community are so distributed as best to sub serve the common good; and
2. That the operation of the economic system does not result in the concentration of wealth and means of production to the common detriment.

In October 1999, the Government of India appointed a High Level Committee on Competition Policy and Competition Law to advise a modern competition law for the country in line with international developments and to suggest a legislative framework, which may entail a new law or appropriate amendments to the MRTP Act. The Committee presented its Competition Policy report to the Government in May 2000 [the report will be referred to hereinafter as High Level committee 92000]. The draft competition law was drafted and presented to the Government in November 2000. After some refinements, following extensive consultations and discussions with all interested parties, the Parliament passed in December 2002 the new law, namely, the Competition Act, 2002.

## 2.1 Salient features Of New Competition Policy

- The industries (Development and Regulation) Act, 1951 may no longer be necessary except for location (avoidance of urban-centric location), for environmental protection and for monuments and national heritage protection considerations, etc.
- The Industrial Disputes Act, 1947 and the connected statutes need to be amended to provide for an easy exit to the non-viable, ill-managed and inefficient units subject to their legal obligations in respect of their liabilities.
- The Board for Industrial Finance & Restructuring (BIFR) formulated under the provisions of Sick Industrial Companies (Special Provisions) Act, 1985 should be abolished.
- World Trade Organization (WTO) : There should be necessary provision and teeth to examine and adjudicate upon anti-competition practices that may accompany or follow developments arising out of the implementation of WTO Agreements. Particularly, agreements relating to foreign investment, intellectual property rights, subsidies, countervailing duties, anti-dumping measures, sanitary and phytosanitary measures, technical barriers to trade and Government procurement need to be reckoned in the Competition Policy/Law with a view to dealing with anti-competition practices. The competition law should be made extra territorial.
- **MRTP Act**

It is suggested that :

- The MRTP Act 1969 may be repealed and the MRTP Commission wound up. The provisions relating to unfair trade practices need not figure in the Indian Competition Act as they are presently covered by the Consumer Protection Act, 1986.
- The pending UTP cases in the MRTP Commission may be transferred to the concerned consumer Courts under the Consumer Protection Act, 1986. The pending MTP and RTP Cases in MRTP Commission may be taken up for adjudication by the CCI from the stages they are in.

## **2.2 Components Of Competition Act**

The rubric of the new law, Competition Act, 2002 (Act, for brief) has essentially four compartments :

2.2.1 Anti-Competition agreements

2.2.2 Abuse of Dominance

2.2.3 Combinations Regulation\

2.2.4 Competition Advocacy

### **2.2.1 Anti Competition Agreements**

Firms enter into agreements, which may have the potential of restricting competition. A scan of the competition laws in the world will show that they make a distinction between horizontal and vertical agreements between firms. The former, namely the horizontal agreements are those among competitors and the latter, namely the vertical agreements are those relating to an actual or potential relationship of purchasing or selling to each other. A particularly pernicious type of horizontal agreements is the cartel. Vertical agreements are pernicious, if they are between firms in a position of dominance. Most competition laws view vertical agreement generally more leniently than horizontal agreements, as, prima facie, horizontal agreements are more likely to reduce competition than agreements between firms in a purchaser seller relationship, an obvious example that comes to mind is an agreement between enterprises dealing in the same product or product. Such horizontal agreements, which included membership of cartels, are presumed to lead to unreasonable restrictions of competition and are therefore presumed to have an appreciable adverse effect on competition. In other words, they are per se illegal. The underlying principle in such presumption of illegality is that the agreements in question have an appreciable anti-competitive effect. Barring the aforesaid four types of agreements, all the others will be subject to the rule of reason test in the Act.

### **2.2.2 Abuse of Dominance**

Dominant position has been appropriately defined in the Act in terms of the position of strength, enjoyed by an enterprise, in the relevant market, in



India, which enables it to (i) operate independently of competitive forces prevailing in the relevant market; or (ii) affect its competitors or consumers or the relevant market, in its favour.

Section 4 enjoins, No enterprise shall abuse its dominant position. Dominant position is the position of strength enjoyed by an enterprise in the relevant market which enables it to operate independently of competitive forces prevailing in the market or affects its competitors or consumers or the relevant market in its favour. Dominant position is abused when an enterprise imposes unfair or discriminatory conditions in purchase or sale of goods or services or in the price in purchase or sale of goods or services. Again, the philosophy of the Competition Act is reflected in this provision, where it is clarified that a situation of monopoly per se is not against public policy but, rather, the use of the monopoly status such that it operates to the detriment of potential and actual competitors.

At this point it is worth mentioning that the Act does not prohibit or restrict enterprises from coming into dominance. There is no contract whatsoever to prevent enterprises from coming into or acquiring position of dominance. All that the Act prohibits is the abuse of that dominance position. The Act therefore targets the abuse of dominance and not dominance per se. This is indeed a welcome step, a step towards a truly global and liberal economy.

### **2.2.3 Combinations**

The Competition Act also is designed to regulate the operation and activities of combinations, a term, which contemplates acquisitions, mergers or amalgamations. Thus, the operation of the Competition Act is not confined to transactions strictly within the boundaries of India but also such transactions involving entities existing and/or established overseas.

Herein again lies the key to understanding the Competition act. The intent of the legislation is not to prevent the existence of a monopoly across the board. There is a realization in policy-making circles that in certain industries, the nature of their operations and economies of scale indeed dictate the creation of a monopoly in order to be able to operate and remain

viable and profitable. This is in significant contrast to the philosophy, which propelled the operation and application of the MRTP Act, the trigger for which was the existence or impending creation of a monopoly situation in a sector of industry, subsequently, that the combination has an appreciable adverse effect on competition. There is a rider that the CCI shall not initiate an inquiry into a combination after the expiry of one year from the date on which the combination has taken effect.

#### **2.2.4 Competition Advocacy**

In line with the High Level Committee's recommendation, the Act extends the mandate of the Competition Commission of India beyond merely enforcing the law (high Level Committee, 2000). Competition advocacy creates a culture of competition. There are many possible valuable roles for competition advocacy, depending on a country's legal and economic circumstances.

The Regulatory Authority under the Act, namely, Competition Commission of India (CCI), in terms of the advocacy provisions in the Act, is enabled to participate in the formulation of the country's economic policies and to participate in the reviewing of laws related to competition at the instance of the Central Government. The Central Government can make a reference to the CCI for its opinion on the possible effect of a policy under formulation or of an existing law related to competition. The Commission will therefore be assuming the role of competition advocate, action pro-actively to bring about Government policies that lower barriers to entry, that promote deregulation and trade liberalisation and that promote competition in the market place.

Perhaps one of the most crucial components of the Competition Act is contained in a single section under the chapter entitled competition advocacy.

### 2.3 Can Competition Act Replace MRTP Act

In view of the policy shift from curbing monopolies to promoting competition, there was a need to repeal the Monopolies and Restrictive Trade Practices Act. Hence, the Competition Law aims at doing away with the rigidly structured MRTP Act. The Competition Law proposed is flexible and behavior oriented.

After the Act was placed on the web-site and came into the public domain, a question often asked is whether it is not still the old law in substance although not in form. A clear answer to this question is in the title of this section. The Act is a new wine in a new bottle. The differences between the old law (namely the MRTP Act, 1969) and the new law (the Competition Act, 2002) may perhaps be best captured in the form of a table displayed below :

S.No.	MRTP Act, 1969	Competition Act, 2002
1	Based on the pre-reforms scenario	Based on the post-reforms scenario
2	Based on size as a factor	Based on structure as a factor
3	Competition offences implicit or not defined	Competition offences explicit and defined
4	Complex in arrangement and language	Simple in arrangement and language and easily comperehensible
5	14 per se offences negating the principles of natural justice	4 per se offences and all the rest subjected to rule of reason.
6	Frowns upon dominance	Forwns upon abuse of dominance
7	registration of agreements compulsory	No requirement of registration of agreements
8	No combinations regulation	Combination regulated beyond a high threshold limit.
9	Competition Commission appointed by the Government	Competition Commission selected by a Collegiums (search committee)

10.	Very little administrative and financial autonomy for the Competition Commission	Relatively more autonomy for the Competition Commission
11.	No competition advocacy role for the Competition Commission	Competition Commission has competition advocacy role
12.	No penalties for offences	Penalties for offences
13.	Reactive and rigid	Proactive and flexible
14	Unfair trade practices covered	Unfair trade practices omitted (consumer for a will deal with them)
15	Does not vest MRTP Commission to inquire into cartels of foreign origin in a direct manner	Competition Law seeks to regulate them.
16	Concept of Group Act had wider import and was unworkable	Concept has been simplified

The Act is therefore a new wine in a new bottle. Wine gets better as it ages. The proposed Law provides for a Competition fund, which shall be utilized for promotion of competition advocacy, creating awareness about competition issues and training in accordance with the rules that may be prescribed. The extent MRTP Act 1969 has aged for more than three decades and has given birth to the new law (the Act) in line with the changed and changing economic scenario in India and rest of the world and in line with the current economic thinking comprising liberalisation, privatization and globalization.<sup>10</sup>

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<sup>10</sup> [www.google .com/mrtp&competition article](http://www.google.com/mrtp&competition%20article)

## **2.4 Acquisition and mergers**

There has been a drastic change and enhancement in this process of globalization and also liberalisation during the last three decades. In the pursuit of this globalization, India has responded by opening up its economy, removing controls and resorting to liberalisation in 1991. The result of the globalization and liberalisation is that the Indian market is facing competition from within and outside. The last 2 years have witnessed significant cross-border mergers and acquisitions activity by Indian companies in India and abroad on a scale that is unprecedented. It is understood the Merger & Acquisition (M&A) deals in India will cross \$100 billion this year, which is double last year's level and quadruple of 2005. Thus, keeping in view the economic developments of the country, to prevent practices having adverse effect on competition, to promote and sustain competition in markets, to protect the interest of consumers and to ensure freedom of trade carried on by participants in markets, in India, a new competition Law has been enacted. The companies use merger, a type of combination, as a business strategy to grow and consolidate and to eliminate competition. Though mergers are considered as a legitimate means by which firms may grow and are generally as much part of industrial evolution and restructuring as new entry, growth and exit; mergers and amalgamation a create market power, which may be abused. In order to control the abuse of such mergers and amalgamation the Competition Act 2002 now provides are regulatory mechanism.

### **Mergers and Effects :**

In competition Law Merger is used in broad sense. It covers a proper merger, amalgamations, acquisition of shares, voting rights, assets, or acquisition of control over an enterprise. A Merger is broadly speaking, a transaction that brings about a change in the control of different business entities enabling one business entity effectively to control a significant part of the assets or decision making process of another. Though Merger is a normal activity within the economy and used to expand the business by the companies. However some mergers could adversely affect the competition.

Through Mergers companies trying to achieve the Market Power, which in turn can impact negatively upon competition. Mergers lead to concentration and use of market power because of two reasons (a) Reduction of number of entities in the market and; (b) Increased market share of the merged entity. As a result the merged entity is able to exercise market power and in turn, this may lead to the prices being raised above the normal level, restricted output, increase in rival cost, increased barrier to the new entities etc.

### **Competition Act, 2002 and the Regulation of Mergers**

Prior to the Competition Act, 2002, the Companies Act, 1956 and the Monopolies and restrictive trade Practices Act, 1969 (before the 1991 amendments) are the statutes, which regulate mergers. MRTP Act, 1969 still had powers under provisions relating to restrictive trade practices (RTP) and monopolistic trade practices (MTP) to take action against merger that was anti competitive but due to amendment in 1991 in the MRTP Act for making easy the liberalization process it failed to completely control the unfair mergers.

On August 28, 2009 the Ministry of Corporate Affairs issued a notification pursuant to which the Monopolies and restrictive Trade Practices Act 1969 was repealed and replaced by the Competition Act 2002 with effect from September 1 2009. The Competition Act attempts to make a shift from curbing monopolies to curbing practices that have adverse effects on competition both within and outside India. \$125 million) to notify the Competition Commission before acquiring a company outside India.

### **Relevant Market**

Compromising all those products or services which are regarded as interchangeable or substitutable by the consumer, by reason of characteristics of the products or services, their prices and intended use.

For the purposes of determining whether a combination would have the effect of or is likely to have an appreciable adverse effect on competition in the relevant market, the Commission will have due regard to all or any of the following factors, namely.

- actual and potential level of competition through imports in the market;
- extent of barriers to entry into the market;
- level of combination in the market;
- degree of countervailing power in the market;
- likelihood that the combination would result in the parties to the combination being able to significantly and sustainably increase prices of profit margins;
- extent of effective competition likely to sustain in a market;
- extent to which substitutes are available or are likely to be available in the market;
- market share, in the relevant market, of the persons or enterprise in a combination, individually and as a combination;
- likelihood that the combination would result in the removal of a vigorous and effective competitor or competitors in the market;
- nature and extent of vertical integration in the market;
- possibility of a failing business;
- nature and extent of innovation;
- relative advantage, by way of the contribution to the economic development by any combination having or likely to have appreciable adverse effect on competition; and
- whether the benefits of the combination outweigh the adverse impact of the combination if any

Thus, if a merger within the jurisdictional requirement of the enactment and is having in appreciable adverse effect on competition to be determined on the basis of the aforesaid factors within the relevant market in India, the combination will be void as per the Competition Act, 2002,

## **Forms Filing and Cost**

The Competition Commission has prescribed certain forms under The Competition Commission of India (Combination) Regulations, in which the notice to the Commission shall be given. A fee of approximately \$50,000 which may increase to \$100,000 in certain cases, shall be paid with the notice. Further, the Competition Commission will issue a show-cause notice if it is of a prima facie opinion that the combination is likely to cause an appreciable adverse effect on competition in India. A fee of \$40,000 is to be filed along with the response to the show-cause notice.

## **Exemptions**

The Competition Commission of India (Combination) Regulations, exempts 13 transactions from the preview of combinations but these exempted transactions are also required to notify to the commission. It means these transactions are not exempt from the reporting requirements.

Extra Territorial Jurisdiction of the competition act

**Section 3** of the act governs anti-competitive agreements and prohibits

“Agreements involving production, supply, distribution, storage, acquisition or control of goods or provision of services, which cause or are likely to cause an ‘appreciable adverse effect on competition in India.’”

**Section 4** of the act prohibits the abuse of a dominant position by an enterprise. Under the Monopolies Act, a threshold of 25% constituted a position of strength.

**Section 6** of the competition Act states that no person or enterprise will enter into Combination which cause or is likely to cause an appreciable adverse effect on competition within the relevant market in India and such a combination will be void. A ‘combination’ is either a merger of two enterprises or the acquisition of the control, shares, voting rights or assets of an



enterprise or an enterprise that belongs to a group if it meets the jurisdictional requirements set forth below. Although the Act does not expressly so state, the term 'combination' include horizontal, vertical and conglomerate mergers.

### **Criteria under Section 5 (threshold for mergers)**

The most important legal issue in merger analysis is jurisdictional, that is, which mergers or amalgamations are important enough to be considered 'combinations' which attract regulatory scrutiny. Section 5 of the competition act defines combination by providing threshold limits on assets and turnovers. At present, any acquisition, merger or amalgamation falling within the ambit of the thresholds constitutes a combination. The following transactions will constitute a combination.

- Transactions among Indian companies with combined assets of \$250 million; or \$750 million in turnover of the merged entity
- Cross-border transactions involving both Indian and foreign companies with combined assets of \$500 million or \$1.5 billion in turnover; and
- Transactions that have a territorial nexus with India, where the acquirer has \$125 million in assets or \$375 million in turnover in India.

### **For acquiring groups, the threshold figures are much higher :**

- \$1 billion in assets and \$3 billion in turnover in India respectively;
- Assets in excess of \$2 billion; or
- Turnover of more than \$6 billion outside India.

The threshold criterion could create a deadlock because once an entity or group grows to a size of the prescribed limits, all combinations – however small will be covered by the regulations. It is to be noted that the Competition Act, 2002, does not make a distinction between horizontal, vertical and conglomerate mergers and provides the same threshold test for all of them.

## **Regulatory Provisions of Competition Act, 2002**

According to the present amended act it is mandatory for any company to notify mergers when the combined assets or turnover are beyond the threshold limits provided in section 5 of the Competition Act. The act makes it mandatory to give notice to the commission within 30 days of the decision of the parties' boards of directors or of execution of any agreement or other document for effecting the combination. The terms 'agreement' and 'other document' are not defined. The general industry perception is that a memorandum of understanding or a letter of intent will qualify as an 'agreement.'

### **210-day waiting period and thresholds**

The Competition Act provides for a post-filing review period of 210 days, during which the merger cannot be consummated and within which the Competition Commission is required to pass its order with respect to the notice received. If the commission fails to pass an order within the time limit, the proposed combination will be deemed to be approved. The 210 day period applies in case of cross-border transactions outside India where one of the contracting parties has a substantial presence in India. Regardless of the size of the transaction, notification is required where the combined asset value or turnover in India exceeds a certain value. This means that it is mandatory for a foreign company with assets of more than \$500 million that has a subsidiary or joint venture in India with a substantial investment. In the Indian Competition Act, 2002 has the extra territorial jurisdiction. Section 32 provides that the commission shall have the power to Competition Commission shall have the power to enquire into an agreement or abuse of dominant position or combination even if the act has taken place outside India or the party or enterprise is outside India provided it has an appreciable adverse effect on competition in India. Further the Commission is allowed under proviso to section 18 to enter in the memorandum or arrangement with the prior approval of the Central Government. Section 32 states that, notwithstanding that any restrictive agreement, any party to such agreement any enterprise

abusing the dominant position, or any combination or party to the combination is outside India, the competition Commission of India has the power to enquire into if it has an anti competitive effect within the relevant market in India.

## **Inferences**

The Competition Act, 2002 contains a comprehensive Merger review process. It brings various new concepts under the provision of combinations like relevant market, assets/turnover outside India and the new test of appreciable adverse effect etc. Undoubtedly, the Competition Act will play a significant role in the development of the Indian economy. Indian markets cannot function in isolation; they need to align themselves with their investors in an increasingly flat world to the commission. It means these transactions are not exempt from the reporting requirements.

## **Extra Territorial Jurisdiction of the competition act**

In the Indian Competition Act, 2002 has the extra territorial jurisdiction. Section 32 provides that the commission shall have the power to Competition Commission shall have the power to enquire into an agreement or abuse of dominant position or combination even if the act has taken place outside India or the party or enterprise is outside India provided it has an appreciable adverse effect on competition in India. Further the Commission is allowed under proviso to section 18 to enter in to memorandum or arrangement with the prior approval of the Central Government. Section 32 states that, notwithstanding that any restrictive value. This means that it is mandatory for a foreign company with assets of more than \$500 million that has a subsidiary or joint venture in India with a substantial investment (above \$25 million) to notify the Competition Commission before acquiring a company outside India.

## **Relevant Market**

Relevant market means' the market which may be determined by the Commission with reference to the relevant product market or the relevant geographic market or with reference to both the markets'. Relevant geographic market means' a market comprising the area in which the conditions of competition for supply of goods or provision of services or demand of goods or services are distinctly homogenous and may be distinguished from the conditions prevailing in the neighboring areas. Relevant product market means 'a market comprising all those products or services which are regarded as interchangeable or substitutable by the consumer; by reason of characteristics of the product or services, their prices and intended use.

For the purposes of determining whether a combination would have the effect of or is likely to have an appreciable adverse effect on competition in the relevant market, the Commission will have due regard to all or any of the following factors, namely;

- actual and potential level of competition through imports in the market;
- extent of barriers to entry into the market;
- level of combination in the market;
- degree of countervailing power in the market;
- likelihood that the combination would result in the parties to the combination being able to significantly and sustainably increase prices or profit margins;
- extent of effective competition likely to sustain in a market;
- extent to which substitutes are available or are likely to be available in the market;
- market share, in the relevant market, of the persons or enterprise in a combination, individually and as a combination;
- likelihood that the combination would result in the removal of a vigorous and effective competitor or competitors in the market;
- nature and extent of vertical integration in the market;

- possibility of a failing business;
- nature and extent of innovation;
- relative advantage, by way of the contribution to the economic development, by any combination having or likely to have appreciable adverse effect on competition; and
- whether the benefits of the combination outweigh the adverse impact of the combination, if any

Thus, if a merger within the jurisdictional requirement of the enactment and is having an appreciable adverse effect on competition to be determined on the basis of the aforesaid factors within the relevant market in India, the combination will be void as per the Competition Act, 2002.

## 2.5 The MRTP Act, 1969, and competition Act, 2002

### MRTP Act, 1969

As stated earlier, the Mahalanobis Committee in 1964 and the Monopolies Enquiry Commission in 1965 revealed the tendencies of increasing concentration in the industrial sector of the economy. To curb these tendencies and control the monopolistic and restrictive trade practices of the large business houses, the Government of India adopted the Monopolies and Restrictive Trade Practices (MRTP) Act in 1969 and the MRTP Commission was set up in 1970. The preamble to the Act described it thus: "An Act to provide that the operation of the economic system does not result in the concentration of economic power to the common detriment for the control of monopolies, for the prohibition of monopolistic and restrictive trade practices: and matters connected therewith or incidental thereto."

**Inter-Connected and Dominant Undertakings.** The MRTP Act covered two types of undertakings viz., national: monopolies and product monopolies. National monopolies were covered by Section 20(a) of the Act and were either, 'single large undertakings' or 'groups of inter-connected undertakings' (i.e., large houses) which had assets of at least Rs. 100 crore (prior to 1985, this limit was Rs. 20 crore). Product monopolies covered under Section 20(b) and called 'dominant' undertakings were those which; controlled at least one-fourth of production or market of a product and had assets of at least Rs. 3 crore (earlier on; this limit was Rs. 1 crore). By the end of March 1990; 1,854 undertakings were registered under the MRTP Act. Of these 1,787 belonged to large industrial houses and the remaining 67 were dominant undertakings. The New Industrial Policy, 1991, scrapped the assets limit for MRTP companies.

**Monopolistic, Restrictive and Unfair Trade Practices.** According to the MRTP Act, a restrictive trade practice (RTP) means a trade practice which has, or may have, the effect of, preventing, distorting or restricting competition in any manner. A monopolistic trade practice (MTP) is a trade practice which has, or is likely to have, the effect of (i) maintaining prices at an unreasonable

level, or (ii) unreasonably preventing or lessening competition, or (iii) limiting technical development or capital investment to the common detriment, or (iv) allowing the quality to deteriorate. Prior to 1984, the MRTP Act was restricted to monopolistic and restrictive trade practices only. In 1984 the Act was extended to unfair trade practices also.

**Purview of the MRTP Act.** A large number of types of agreements were specified in the MRTP Act which fell under its purview. Each one of these was required to be duly registered with the Registrar of Restrictive Trade Practices including the names of parties to the agreement. Registered undertakings were subject to the following control on their industrial activities: (a) if it was proposed to expand substantially the activities of the undertaking by issuing fresh capital or by installation of new machinery or in any manner, notice to the Central Government was required to be given and approval taken (Section 21); (b) if it was proposed to establish a new undertaking the prior permission of the Central Government was required to be obtained (Section 22); and (c) if it was proposed to acquire or merge or amalgamate with another undertaking the sanction of the Central Government was required to be taken (Section 23). The responsibility to see that there was no concentration of economic power to the common detriment was that of the government.

**The Process of Liberalisation.** With a view to expanding industrial production, the government considerably liberalised the Operations of the MRTP Act from time to time. The result was that the large business houses were given the green signal to enter a number of industrial fields which were formerly closed for them. Even the illegally set Up industrial capacity was regularised. Some of the important liberalisation measures announced over time were as follows:

1. The 1973 industrial policy statement opened up a large number of industries to the large houses. These included not only the core industries but also industries having direct linkages with such core industries and industries with a long-term export potential. Initially there were 19 such industries (listed in Appendix I) and gradually their number rose to 35.

2. With a view to providing fillip to production in industries of high national priority and/or those meant exclusively for export, the government introduced Section 22-A in the MRTP Act whereby it could notify industries or services to which Section 21 and 22 of the Act would not apply, (a) In October 1982 all 100 per cent export-oriented industries established in the Free Trade Zone were exempted from Sections. 21 and 22 of the Act. (b) In May 1983 the government notified that companies registered under the MRTP Act was eligible to set up, without the approval of the government, new capacities in industries of high national priority or industries with import substitution potential or those using sophisticated technology. However, the companies were required to fulfil certain conditions to avail the exemptions.

3. The government identified some industries which were specially important from export angle. These industries were allowed 5 per cent automatic growth per annum, up to a limit of 25 per cent in a plan period over and above the normal permissible limit for 25 per cent excess production over the authorised capacity. Large houses did not require separate approval under the MRTP Act for such automatic growth.

4. In a major liberalisation of the industrial licensing policy announced on December 24, 1985, the government permitted the unrestricted entry of large industrial houses and companies governed by the Foreign Exchange Regulation Act (FERA) into another 21 high-technology items of manufacture. With this permission, the large industrial houses falling within the purview of the MRTP Act and FERA companies were allowed to freely take up the manufacture of 83 items (previously the number of items was 60).

5. Under the provisions of the Sick Industrial Companies (Special Provisions) Bill 1985, the government removed sick industrial companies from the purview of the MRTP Act for purposes of modernisation, expansion, amalgamation or merger.

6. For promoting, the development of backward areas, the government extended the scheme of delicensing in March 1986 to MRTP/FERA companies in respect of 20 industries in Appendix-I for location in centrally



declared backward areas. The scheme was later extended to 49 industries for location in any centrally declared backward area and to 23 non-Appendix-I industries for location in category 'A' backward districts. The conditions permitting MRTP and FERA companies to establish non-Appendix-I industries were also liberalised.

7. The government announced a new scheme on April 7, 1988. Effective from April 1, 1988, as per this scheme, the industrial licences/registrations with technical authorities were to be automatically re-endorsed at the highest level of production actually achieved by the industrial undertaking in any of the financial years between April 1, 1988, and March 31, 1990. This was a major concession as it implied automatic re-endorsement of capacity at the highest level of production achieved during 1988 and 1990.

8. An important relaxation came in 1985 when the government raised the limit of assets for the purpose of MRTP Act from Rs. 20 crore to Rs. 100 crore. After the Government of India decided to liberalise economic policy in 1991, provisions in respect of concentration of economic power were deleted by omitting Part A of Chapter III of MRTP Act with effect from September 27, 1991. After omission of these powers, MRTP Commission became a toothless tiger as it was now required to look after cases relating to unfair trade practices and restrictive trade practices only.

## **Competition Act, 2002**

Since the adoption of the economic reforms programme in 1991, corporates have been pressing for the scrapping of the MRTP Act. The argument is that the MRTP Act has lost its relevance in the new liberalised and global competitive scenario. In fact, it is said that only large companies can survive in the new competitive markets and therefore 'size' should not be a constraint. Thus, there is a need to shift our focus from curbing monopolies to promoting competition. In view of this, the government appointed an expert committee headed by **SVS** Raghavan to examine the whole issue. The Raghavan Committee submitted its Report to the Government on May 22, 2000 wherein it proposed the adoption of a new competition law and doing

away with the MRTP Act. Accordingly, the government decided to enact a law on competition. Competition Bill, 2001 was introduced in Parliament and passed in December 2002. The Act is called Competition Act, 2002. The Act was amended in September 2007.

Competition Commission of India. The Act provides for the establishment of the Competition Commission of India (CCI). According to Section 18, it shall be the duty of the Commission to eliminate practices having adverse effects on competition, to promote and sustain competition in markets in India, to protect the interests of consumers and to ensure freedom of trade carried on by other participants in market in India. Some protagonists of private sector have argued that there is no requirement of CCI because all that is required is removal of licensing requirements and knocking down of entry barriers. However, the fact of the matter is that the market does not always guarantee competition. There will always be unfair and restrictive business practices. Besides, mergers and acquisitions would need to be scrutinised. It is on account of this reason that most countries have competition or free trade commissions. This explains the rationale of CCI in India.

Overall Scheme. Competition Act, 2002 is designed for the following purposes: (1) Prohibition of anticompetitive agreements, (2) Prohibition of abuse of dominant position, and (3) Regulation of combinations.

**1. Prohibition; of Anti-Competitive Agreements.** Section 3 of the Act makes provision for prohibition of anticompetitive agreements. According to Section 3(1) of the Act, "no enterprise or association of enterprises or person or association of persons shall enter into any agreement in respect of production, supply, distribution, storage, acquisition or control of goods or provision of services, which causes or is likely to cause an appreciable adverse effect on competition within India." Section 3(2) states that any agreement entered into in contravention of the provisions contained in Section 3(1) shall be void.

## **2. Prohibition of Abuse of Dominant Position.**

Section 4(1) of the Act states that “no enterprise shall abuse its dominant position”. It may be noted that 'dominant position' itself is not prohibited. What is prohibited is its misuse.

‘Dominant position’ means a position of strength, enjoyed by an enterprise, in the relevant market, in India, which enables it to (i) operate independently of competitive forces prevailing in the relevant market; or (ii) affect its competitors or consumers or the relevant market in its favour.

**3. Regulation of Combinations.** Section 5 of the Act defines combination while Section 6 is concerned with regulation of combinations. According to Section 5, the acquisition of one or more enterprises by one or more persons or merger or amalgamation of enterprises shall be treated as 'combination' of such enterprises and persons or enterprises in the following cases: (a) acquisition by large enterprises; (b) acquisition by group; (c) acquisition of enterprises having similar goods/services; (d) acquiring enterprises having similar goods/services by a group; (e) merger of enterprises; and (f) merger in group company;

Section 6 of the Act relates to 'regulation of combinations.' According to Section 6 (1), no person or enterprise shall enter into a combination which causes or is likely to cause an appreciable adverse effect on competition, within the relevant market in India and such a combination shall be void.

The definition and heading of the section itself means that it is 'regulation of combination'. Thus, combination, in itself, is not prohibited. It will be held void only if adversely affects competition.

## **Competition Act, 2002 vs. MRTP Act 1969**

While the focus of MRTP Act, 1969 was on controlling, the concentration of economic power, the focus competition Act, 2002 is on ensuring free and fair competition the markets. The spirit behind the competition Act is that big is no more bad, hurting competition and consumer interest is.

For instance, S. Chakravarthy (a member of the Raghavan Committee) has pointed out that “size is no longer the issue. It could become when consumer interest is compromised”. Moreover while MRTP Act, 1969 frowned upon dominance, competition Act, 2002 frowns upon abuse of dominance, ‘dominance’ is not prohibited in Competition Act. Only ‘abuse of dominance’ is prohibited.

### **Competition (Amendment) Bill, 2007**

The Competition (Amendment) Bill 2007 was introduced and passed in August-September 2007. The bill, piloted by corporate Affairs Minister P.C. Gupta, said the Competition of India (CCI) would eventually replace the monopolies and Restrictive Trade Practices Commission (MRTPC). MRTPC would continue to deal with pending cases even two years after the establishment of CCI and it would be dissolved thereafter. However, MRTPC would entertain any new cases after the CCI is constituted, main features of Competition (Amendment) Bill, 2007 as follows:

1. The Supreme Court had held that if an expert body is to be created by the government, it might be appropriate to Create two separate bodies one with expertise for advisory and regulatory functions (CCI) and the other for adjudicatory functions (Competition Appellate Tribunal or CAT). Accordingly, the Competition (Amendment) Bill, 2007 provides for constitution of both CCI and CAT. The CCI will be an expert body, which would function as a market regulator to prevent and regulate anticompetitive practices in the country. It would also have advisory and advocacy functions in its role as regulator. It would have four members, with the chairman being the Chief Justice of India or his nominee. The CCI will exercise its powers through various benches, including those designated for mergers. CAT would be a three-member quasi-judicial body. It would be headed by a person who is or has been a justice of the Supreme Court or the Chief Justice of a High Court and would hear appeals against any direction issued by the commission.

2. The new law has sought to make mergers and acquisitions (M&A) deals more transparent. Companies will have to inform the CCI about the deal within 30 days. Companies could be penalised if they fail to do so.

3. If any agreement between companies results in a cartel, they might have to pay hefty financial penalties upto thrice the value of profits earned. This has been done to prevent corporations from building dominant market positions artificially.

4. The new law seeks to empower the CCI to impose penalty of upto Rs. 25 crore or upto three year imprisonment or both in cases of continued contravention of its orders if the chief metropolitan magistrate deems fit.

5. While earlier it was voluntary for an enterprise proposing to enter into a combination to intimate the competition commission, the new law makes such intimation of the combination to the commission mandatory. In fact, such a coupling shall not take effect until 210 days from the date of notification or approval from the commission, whichever is earlier.

### **A Critical Review**

1. The new law focuses on the provision of a domestic nexus (a nexus with assets and operations in India) in connection with the limits applicable to acquisitions in which a foreign entity and an Indian entity are involved. According to critics, this would narrow down the scope for an acquisition being covered under combinations to be regulated by the commission. Thus, if the acquirer is a foreign company without any Indian presence, the competition act trigger will not apply due to the provision of the Indian nexus.”
2. As stated above, coupling shall not take effect until 210 days from the date of notification or approval from the commission. Whichever is earlier. This is likely to result in a long gestation period of about seven to eight months from the date of approval of the proposal. This long gestation period will add a significant element of uncertainty and can be a drag on ‘big-ticket’ M&A activities in india.

According to Dalal, the uncertainty has several implications, including the following.

- Perception among customers.
- Uncertainty as regards the identity of the enterprise could create reluctance among customers who could choose to shift to a more stable competitor.
- Inability to make strategic and operational decisions. Strategic and operational business issues could remain in limbo.
- Human resources : in any acquisition or merger, the human resources element is crucial. This has dimensions relating to alignment of titles, roles and responsibilities. A long period of uncertainty could seriously dent morale and heighten attrition.
- Enterprise value (s) : as a result of the uncertainty, including the above factors, the market value of both enterprises could be severely dented due to the long period of uncertainty.

While reference to a regulatory body is mandatory in a number of countries, the time limit prescribed by most of them is much shorter, ranging from 25-35 days for an initial investigation. Only when there are serious doubts regarding the effects of the combination on competition, the next level investigation is required within a time limit of 90-180 days.<sup>11</sup>

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<sup>11</sup> The MRTP Act, 1969, and competition Act, 2002

## **2.6 Conclusion**

The message is loud yet clear that a well planned exhaustive competition compliance programme can be of great benefit to all enterprises irrespective of their size, area of operation, jurisdiction involved, nature of products supplied or services rendered and the same is essential for companies, its directors and the delegate key corporate executives to avoid insurmountable hardships of monetary fines, civil imprisonment, beside loss of hard-earned reputation when the Competition Authorities, the media and others reveal the misdeeds in public.

In the changed scenario, India do needs a fresh law for competition and a new regulatory authority, which under this policy is the Competition Commission of India.' The law will serve the purpose only if it is made independently, runs independently and is less expensive.

## **Chapter-3**

### **Indian Capital Market**

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### **3.1 History of Indian Capital Market**

The history of the capital market in India dates back to the eighteenth century when East India Company securities were traded in the country. Until the end of the nineteenth century, securities trading was unorganized and the main trading centres were Bombay(now Mumbai) and Calcutta (now Kolkata). Of the two, Bombay was the chief trading centre wherein bank shares were the major trading stock. During the American Civil War (1860-61). Bombay was an important source of supply for cotton. Hence, trading activities flourished during the period, resulting in a boom in share prices. This boom, the first in the history of the Indian capital market, lasted for a half a decade. The first joint stock company was established on 1850. The bubble burst on July 1, 1865, when there was tremendous slump in share prices.

Trading was at that time limited to a dozen brokers, their trading place was under a banyan tree in front of the Town Hall in Bombay. These stockbrokers organized an informal association in 1875-Native Shares and Stock Brokers Association. Bombay. The stock exchanges in Calcutta and Ahmedabad, also industrial and trading centres; came up later. The Bombay Stock Exchange was recognized in May 1927 under the Bombay Securities Contracts Control Act, 1925.

The capital market was not well organized and developed during the British rule because the British government was not interested in the economic growth of the country. As a result, many foreign companies companies depended on the London capital market for funds rather than on the Indian capital market.

In the post-independence period also, the size of the capital market remained small. During the first and second five-year plans, the government's emphasis was on the development of the agricultural sector and public sector undertakings. The public sector undertakings were healthier than the private undertakings in terms of paid-up capital but their shares were not listed on the stock exchanges. Moreover, the Controller of Capital Issues (CCI) closely supervised and controlled the timing composition, interest rates, pricing,

allotment, and floatation costs of new issues. These strict regulations demotivated many companies from going public for almost four and a half decades.

In the 1950s, Century Textiles, Tata Steel, Bombay Dyeing, National Rayon, and Kohinoor Mills were the favorite scrips of speculators. As speculation became rampant, the stock market came to be known as 'Satta Bazaar'. Despite speculation, non-payment or defaults were not very frequent. The government enacted the Securities Contracts (Regulation) Act in 1956 which was also characterized by the establishment of a network for the development of financial institutions and state financial corporations.

The 1960s was characterized by wars and droughts in the country which led to bearish trends. These trends were aggravated by the ban in 1969 on forward trading and 'badla', technically called 'contracts for clearing.' 'Badla' provided a mechanism for carrying forward positions as well as borrowing funds. Financial institutions such as LIC and GIC helped to revive the sentiment by emerging as the most important group of investors. The first mutual fund of India, the Unit Trust of India (UTI) came into existence in 1964.

In the 1970s, badla trading was resumed under the disguised form of 'hand-delivery contracts-A group.' This revived the market. However, the capital market received another severe setback on July 6, 1974. When the government promulgated the

In the 1970s, badla trading was resumed under the disguised form of 'hand-delivery contracts - A group'. This revived the market. However, the capital market received another severe setback on July 6, 1974, when the government promulgated the Dividend Restriction Ordinance, restricting the payment of dividend by companies to 12 per cent of the face value or one-third of the profits of the companies that can be distributed as computed under section 369 of the Companies Act, whichever was lower. This led to a slump in market capitalization at the BSE by about 20 per cent overnight and the stock market did not open for nearly a fortnight. Later came a buoyancy in the stock markets when the multinational companies (MNCs) were forced to dilute

their majority stocks in their Indian ventures in favour of the Indian public under FERA, 1973. Several MNCs opted out of India. One under and twenty-three MNCs offered shares were lower than their intrinsic worth. Hence, for the first time, the FERA dilution created an equity cult in India. It was the spate of FERA issues that gave a real fillip to the Indian stock markets. For the first time, many investors got an opportunity to invest in the stocks of such MNCs as Colgate, and Hindustan Liver Limited. Then, in 1977, a little – known entrepreneur, Dhirubhai Ambani, tapped the capital market. The scrip, reliance textiles, is still a hot favourite and dominates trading at all stock exchanges.

The 1980s witnessed an explosive growth of the securities market in India. with millions of investors suddenly discovering lucrative opportunities. Many investors jumped into the stock markets for the first time. The government's liberalisation process initiated during the mid-1980s, spurred this growth. Participation by small investors, speculation, defaults ban on badla, and resumption of badla continued. Convertible debentures emerged an a popular instrument of resource mobilization in the primary market. The introduction of public sector bonds and the successful mega issues of Reliance Petrochemicals and Larsen and Toubro gave a new lease of life to the primary market. This, in turn, enlarged volumes in the secondary market. The decade of the 1980s was characterized by an increase in the number of stock exchanges, listed companies, paid up-capital, and market capitalization.

The 1990s will go down as the most important decade in the history of the capital market of India. Liberalisation and globalization were the new terms coined and marketed during the decade this decade. The Capital Issues (Control) Act, 1947 was repealed in May 1992. The decade was characterized by a new industrial policy, emergence of SEBI as a regulator of capital market, advent of foreign institutional investors, euro-issues, free pricing, new trading practices, new stock exchanges, entry of new players

such as private sector mutual funds and private sector banks, and primary market boom and bust.<sup>12</sup>

Major capital market scams took place in the 1990s. These shook the capital market and drove away small investors from the market. The securities scam of March, 1992 involving brokers as well as bankers was one of the biggest scams in the history of the capital market. In the subsequent years owing to free pricing, many unscrupulous promoters, who raised money from the capital market, proved to be fly-by-night operators. This led to an erosion in the investors' confidence. The M S Shoes case, one such scam which took place in March 1995, put a break on new issue activity.

The 1991-1992 securities scam revealed the inadequacies of and inefficiencies in the financial system. It was the scam, which prompted a reform of the equity market. The Indian stock market witnessed a sea change in terms of technology and market prices. Technology brought radical changes in the trading mechanism. The Bombay Stock Exchange was subject to nationwide competition by two new stock exchanges—the National Stock Exchange, set up in 1994, and Over the Counter Exchange of India, set up in 1992. The National Securities Clearing Corporation (NSCC) and National Securities Depository Limited (NSDL) were set up in April 1995 and November 1996 respectively from improved clearing and settlement and dematerialized trading. The Securities Contracts (Regulation) Act, 1956 was amended in 1995-96 for introduction of options trading. Moreover, rolling settlement was introduced in January 1998 for the dematerialized segment of all companies. With automation and geographical spread, stock market participation increased.

In the late 1990s, the Information Technology (IT) scrips were dominant on the Indian bourses. These scrips included Infosys, Wipro, and Satyam. They were a part of the favourite scrips of the period, also known as 'New Economy' scrips, along with telecommunications and media scrips. The new economy companies are knowledge intensive unlike the old economy companies that were asset intensive.

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<sup>12</sup> The Capital Issues (Control) Act, 1947

The Indian capital market entered the twenty-first century with the Ketan Paresh scam. As a result of this scam, badla was discontinued from July 2001 and rolling settlement was introduced in all scrips. Trading of futures commenced from June 2000, and Internet trading was permitted in February 2000. On July 2, 2001, the Unit Trust of India announced suspension of the sale and repurchase of its flagship US-64 scheme due to heavy redemption leading to panic on the bourses. The government's decision to privatize oil PSUs in 2003 fuelled stock prices. One big divestment of international telephony major VSNL took place in early February 2002. Foreign institutional investors have emerged as major players on the Indian bourses. NSE has an upper hand over its rival BSE in terms of volumes not only in the equity markets but also in the derivatives market.

It has been a long journey for the Indian capital market. Now the capital market is organized, fairly integrated, mature, more global and modernized. The Indian equity market is one of the best in the world in terms of technology. Advances in computer and communications technology coming together on Internet are shattering geographic boundaries and enlarging the investor class. Internet trading has become a global phenomenon. The Indian stock markets are now getting integrated with global markets.

## **3.2 A Historical Perspective of the Securities Market Reforms in India**

### **3.2.1 First, the Appetiser**

Which is the most televised structure in India ? I am told that a study has revealed that it is not the Rastrapati Bhawan or Parliament House : it is not even the abode of Lord Tirupati; it is the Pheroze Jeejeebhoy Towers which houses the oldest securities market participant in India, i.e. The stock Exchange, Mumbai. This indicates our intimate relationship with the securities market. In today's rational world, it really means the immense contribution of the securities market to the our life and economy.

Which is the most reformed sector / segment / market in the Indian economy ? Which sector / segment / market of the economy has witnessed as much as nine special legislative interventions during the last decade ? Which market / segment / sector acquired the first ever autonomous regulator (which in course time became the model regulator) in India ? Which sector / segment / market of the economy consumes 3/4<sup>th</sup> space of the pink newspaper everyday ? Which sector / segment / market of the economy most promptly reflects the feel good factor ? The answer to all these questions is the securities market. It expresses the significance of the securities market in our life.

Now a few figures to illustrate the importance of the securities market in our life. While the corporate and governments raise resources from the securities market to meet their obligations and / or make investments, the households representing investors invest their savings in securities. The corporate sector and governments together raised a sum of Rs.2,52,018 crore from the securities market during 2002-03. The household sector invested Rs.21,000 crore in the securities (shares, debentures, public sector bonds and units of UTI and other mutual funds and government securities) during 2001-02. Though form data are not yet available these figures have gone up substantially in the years 2002-2003 and 2003-04. About 20 million investors have invested in securities.

Two years down the line, I have a view questions to ask, even though I may appear like a quiz master. Which is the securities market first to use satellite communication technology for securities transactions ? Which is the securities market first to introduce the straight through processing in securities transactions ? Which major securities market has implemented T+2 rolling settlement ? Which is the largest market for stock futures ? Which securities market started real time on line position monitoring of brokers ? Which is the securities market where trading terminals go off automatically when the margins are exhausted ? Probably answer to all of these is the Indian securities market. This has earned a place of respect amongst the comity of securities markets in the World.

### **3.2.2 Now, the Side Dish – A Brief History**

The importance of the securities market in our life and our economy, as stated so far, did not happen overnight. Countless people have slogged for over two centuries to bring the market to the centre stage.

Though the historical records relating to securities market in India is meager and obscure, there is evidence to indicate that the loan securities of the East Indian Company used to be traded towards close of the 18<sup>th</sup> century. By 1830's, the trading in shares of banks started. The trader by the name of broker emerged in 1830 when 6 persons called themselves as share brokers. This number grew gradually. Till 1850, they traded in shares of banks and securities of the East India Company in Mumbai under a sprawling Banyan Tree are located at the Horniman Circle. In 1850, the Joint Stock Companies Act introducing limited liability was enacted heralding the era of modern joint stock company which propelled trading volumes.

The American Civil War broke out in 1861 which cut off supply of cotton from the USA to Europe. This heightened the demand for cotton from India. Cotton prices increased. Exports of cotton grew, payments were received in bullion. The great and sudden spurt in wealth produced by cotton price propelled setting up companies for every conceivable purpose. Between 1863 and 1865, the new ventures raised nearly Rs.30 crore in the form of paid

up capital and nearly Rs.38 crore of the premia. Rarely was a share which did not command a premium between 1861 and 1865. The Back Bay Reclamation share with Rs.5,000 paid up was at Rs.50,000 premium, the Port Canning share with Rs.1,000 paid up was at Rs.11,000 premium, etc. There was share mania and every body was after a piece of paper, variously called 'allotments', 'scrips' and 'shares'. The people woke up only when the American Civil war ended. Then all rushed to sell their securities but there were no buyers. They were left with huge mass of unsalable paper. This occurred then. This also occurs today at regular intervals. I think, little seems to have changed since then; the bubbles and burst continue to be a perennial feature of the securities market world over.

The depression was so severe that it paved way for setting up of a formal market. The number of brokers, which had increased during the civil war to about 250. During the civil war, they had become so influential and powerful that even the police had only salams for them. But after the end of the civil war, they were driven from pillar to post by the police. They moved from place to place till 1874 when they found a convenient place, which is now appropriately called Dalal Street after their name. They organized an informal association on or about 9<sup>th</sup> July 1875 for protecting their interests. On 3<sup>rd</sup> December 1887, they established a stock exchange called 'Native Share and Stock Brokers' Association.' This laid the foundation of the oldest stock exchange in India. The word 'native' indicated that only natives of India could be brokers of the Exchange.

In 1880s a number textile mills came up in Ahmedabad. This created a need for trading of shares of these mills. In 1894, the borkers of Ahmedabad formed 'The Ahmedabad Share and Stock Brokers' Association."

The 1870s saw a boom in jute prices, 1880s saw boom in tea prices, then followed coal boom. When the booms ended, there were endless differences and disputes among brokers in astern India which was home to production of jute, tea and coal. This provoked the establishment of "The Calcutta Stock Exchange Association" on June 15, 1908.



Then followed the proliferation of exchanges, many of them even do not exist today. The rest is history.

Let us look at the legal developments. Control of capital issues was introduced through the Defence of India Rules in 1943 under the Defence of India Act, 1939 to channel resources to support the war effort. The control was retained after the war with some modifications as a means of controlling the raising of capital by companies and to ensure that national resources were channeled to serve the goals and priorities of the government, and to protect the interest of investors. The relevant provisions in the Defence of India Rules were replaced by the Capital Issues (Continuance of Control) Act in April 1947.

Though the stock exchanges were in operation, there was no legislation for their regulation till the Bombay Securities Contracts Control Act was enacted in 1925. This was, however, deficient in many respects. Under the constitution which came into force on January 26, 1950, stock exchanges and forward markets came under the exclusive authority of the central government. Following the recommendations of the A. D. Gorwala Committee in 1951, the Securities Contracts (Regulation) Act, 1956 was enacted to provide for direct and indirect control of virtually all aspects of securities trading and the running of stock exchanges and to prevent undesirable transactions in securities.

### **3.2.3 Main Course – Fast Forward to 1990s**

In 1980s and 1990s. it was increasingly realized that an efficient and well developed securities market is essential for sustained economic growth. Without venturing into a detailed discussion, it would suffice if I just say that the securities market fosters economic growth to the extent it augments the quantities of real savings and capital formation from a given level of national income and it raises productivity of investment by improving allocation of investible funds. The extent depends on the quality of the securities market. In order to improve the quality of the market, that is, to improve market efficiency, enhance transparency, prevent.

unfair trade practices and bring the Indian market up to international standards, a package of reforms consisting of measures to liberalise, regulate and develop the securities market is being implemented since early 1990s. Let me sound a little academic, in presence of Sir Davies, to explain why the package included liberalization, regulation and development ?

**Why Liberalization ?** I strongly believe that the more liberalised a securities market is, the better is its impact on economic growth. Interventions in the securities market were originally designed to help governments expropriate much and control and direct the flow of funds for favored uses. These helped governments to tap savings on a low or even no-cost basis. Besides, government used to allocate funds from the securities market to competing enterprises and decide the terms of allocation. The result was channelization of resources to favored uses rather than sound projects. In such circumstances accumulation of capital per se meant little, where rate of return on some investments were negative while extremely remunerative investment opportunities were foregone. This kept the average rate of return from investment lower than it would otherwise have been and, given the cost of savings, the resulting investment was less than optimum. Hence, it was necessary to do away interventions hindering optimum allocation of resources.

**Why Regulation ?** Do you know what a 'security' is ? Our laws provide an inclusive definition of 'securities'. It says that 'securities' include shares, bonds, debentures, units of CIS, etc. It does not define in terms of ingredients an instrument must have to be considered as 'securities'. I have not seen an ingredient type definition of 'securities' in any other jurisdiction. It is precisely because 'securities' are most insecure instruments. The only ingredient common to all types of securities is its associated 'insecurity'. It is like a blind man named padmalochan. If it is a market for such insecure instruments, market would collapse if some body does not regulate away the insecurities.

We need regulations to correct for identified market imperfections which produce sub-optimal outcomes and to prevent market failures. In the absence of regulation by a specialized agency, each participant would do its own due diligence before undertaking any transaction in the market. This imposes huge social costs. Besides, regulations signal minimum standards of quality and hence enhance confidence in market. With a known asymmetric information problem, risk averse investors may exit the market altogether if such minimum standards are not signaled. In its extreme form the market breaks down completely.

There is an apparent contradiction that the reforms aim at liberalization while regulations appear that restrict liberalization. Liberalisation does not mean scrapping of all code and statutes, as some market participants may wish. It rather means replacement of one set by another set of more liberal code / statute, which allow full freedom to economic agents, but influence or prescribe the way they should carry out their activities, so that the liberalized markets operate in an efficient and fair manner and the risks of systemic failure are minimized. It is, however, desirable to keep in mind the contradiction to ensure that we do not resort to excessive regulation and regulations are designed and implemented properly. Otherwise the costs of regulation would exceed the benefits from regulation are introduced as a part of general program for economic and political development. The macro economic policies relating to interest rate, prices, etc. can have salubrious effect on the growth and development of the securities market. Other developmental measures include provision of reliable payment system and clearing mechanism, standardized accounting procedure, good corporate governance, skilled manpower etc. which improve the efficiency and transparency of the market.

Though it is incidental that reforms in true sense happened since early 1990s, that is, since the establishment of SEBI, I, by no means, propose to suggest that SEBI is the agency exclusively responsible for all the reform. These reforms have been designed and implemented jointly by all stakeholders, including the government, the regulator, and the regulated.

It would do justice with your time and attention if I make a dhobi list of reforms undertaken since early 1990s. In stead let me discuss only a few major reforms.

- a. **Control over Issue of Capital** : A major initiative of liberalisation was the repeal of the Capital Issues (Control) Act, 1947 in May 1992. With this, Government's control over issue of capital, pricing of the issues, fixing of premia and rates of interest of debentures etc. ceased and the market was allowed to allocate resources to competing uses. In the interest of investors, SEBI issued Disclosure and Investor Protection (DIP) guidelines. The guidelines allow issuers, complying with the eligibility criteria, to issue securities the securities at market determined rates. The market moved from merit based to disclosure based regulation.
- b. **Establishment of Regulator** : A major initiative of regulation was establishment of a statutory autonomous agency, called SEBI, to provide reassurance that it is safe to undertake transactions in securities. It was empowered adequately and assigned the responsibility to (a) protect the interests of investors in securities. (b) promote the development of the securities market, and (c) regulate the securities market. Its regulatory jurisdiction extends over corporate in the issuance of capital and transfer of securities, in addition to all intermediaries and persons associated with securities market. All market intermediaries are registered and regulated by SEBI. They are also required to appoint a compliance officer who is responsible form monitoring compliance with securities laws and for redressal of investor grievances.
- c. **Screen Based Trading** : A major developmental initiative was a nation-wide on-line fully-automated screen based trading system (SBTS) where a member can punch into the computer quantities of securities and the prices at which he likes to

transact and the transaction is executed as soon as it finds a matching sale or buy order from a counter party. SBTS electronically matches orders on a strict price/time priority and hence cut down on time, cost and risk of error, as well as on fraud resulting in improved operational efficiency. It allowed faster incorporation of price sensitive information into prevailing prices, thus increasing the informational efficiency of markets. It enabled market participants to see the full market on real-time, making the market transparent. It allowed a large number of participants, irrespective of their geographical locations, to trade with one another simultaneously, improving the depth and liquidity of the market – over 10,000 terminals creating waves by clicks from over 400 towns / cities in India. It provided fully anonymity by accepting orders, big or small, from members without revealing their identity, thus providing equal access to everybody. It also provided a perfect audit trail, which helps to resolve disputes by logging in the trade execution process in entirety.

The SBTS shifted the trading platform from the trading hall of an exchange to brokers' premises. It was then shifted to the PCs in the residences of investors through the Internet and to hand-held devices through WAP for convenience of mobile investors. This made a huge difference in terms of equal access to investors in a geographically vast country like India.

- d. **Risk management** : A number of measures were taken to manage the risks in the market so that the participants are safe and market integrity is protected. These include :
  - i. **Trading Cycle** : The trading cycle varied from 14 days for others and settlement took another fortnight. Often this cycle was not adhered to. This was euphemistically often described as T+ anything. Many things could happen between entering into a trade and its performance providing incentives for either of the parties to go back on

its promise. This had on several occasions led to defaults and risks in settlement. In order to reduce large open position, the trading cycle was reduced over a period of time to a week initially. Rolling settlement on T+5 basis was introduced in phases. All scrips moved to rolling settlement from December 2001. T+5 gave way to T+3 from April 2002 and T+2 from April 2003.

- ii. **Dematerialisation** : Settlement system on Indian stock exchanges gave rise to settlement risk due to the time that elapsed before trades are settled. Trades were settled by physical movement of paper. This had two aspects. First, the settlement of trade in stock exchanged by delivery of shares by the seller and payment by the purchaser. The process of physically moving the securities from the seller to the ultimate buyer through the seller's broker and buyer's broker took time with the risk of delay somewhere along the chain. The second aspect related to transfer of shares in favour of the purchaser by the company. The system of transfer of ownership was grossly inefficient as every transfer involved physical movement of paper securities to the issuer for registration, with the change of ownership being evidenced by an endorsement on the security certificate. In many cases the process of transfer took much longer, and a significant proportion of transactions ended up as bad delivery delivery due to faulty compliance of paper work. Theft, forgery, mutilation of certificates and other irregularities were rampant, and in addition the issuer had the right to refuse the transfer of a security. All this added to costs, and delays in settlement, restricted liquidity and made investor grievance redressal time consuming and at times intractable.

To obviate these problems, the Depositories Act, 1996 was passed to provide for the establishment of

- iii. **Derivatives** : To assist market participants to manage risks better through hedging, speculation and arbitrage, SC(R)A was amended in 1995 to lift the ban on options in securities. The SC(R)A was amended further in December 1999 to expand the definition of securities to include derivatives so that the whole regulatory framework governing trading of securities could apply to trading of derivatives also. A three-decade old ban on forward trading, better known as BADLA, which had lost its relevance and was hindering introduction of derivatives trading, was withdrawn. Derivative trading took off in June 2000 on two exchanges.
- iv. **Settlement Guarantee** : A variety of measures were taken to address the risk in the market. Clearing corporations emerged to assume counter party risk. Trade and settlement guarantee funds were set up to guarantee settlement of trades irrespective of default by brokers. These funds provide full novation and work as central counter party. The Exchanges / clearing corporations monitor the positions of the brokers on real times basis.

Various measures taken over last decade or so have yielded considerable benefits to the market, as evidenced by the growth in number of market participants, growth in volumes in securities transactions, increasing globalization of the Indian market, reduction in transaction costs, and compliance with international standards. In terms of number of trades, NSE is the third largest exchange in the world. I am not going in to these details, as my objective is not to boost our performance here except to quote from the Economic Intelligence Unit 2003 study: "Top of the Country class, as might be expected is Singapore followed by Hongkong and, somewhat surprisingly, India where overall disclosure standards

have improved dramatically, accounting differences between local and US standards have been minimized and the number of companies with a majority of independent director has risen significantly.”

### **Recent Initiatives**

Let me now present a list of our recent initiatives. We have, only on 19<sup>th</sup> March 2004, rationalized the margin trading and securities lending mechanism. This should promote liquidity in the market. We have also done away with the auctions. The clearing corporations / houses have been authorized to borrow securities to complete settlement without resorting to auctions. Hence there would be no short delivery in settlement. We have assigned NSDL the responsibility to construct and maintain a central registry of securities market participants and professionals. This would come very handy in market surveillance. We have recently set up the Central List Authority to bynames listing requirements and to issue a gate pass for entry into trading platform. We are in the process of appointing ombudsman to redress the grievances of investors expeditiously. We have introduced limited STP in the securities leg for institutional investors. We have implemented market wide T+2 rolling settlement. We have expanded the availability of products for trading by making a variety of derivatives; including interest rate derivatives, corporate debt securities, retail government securities, available on exchanges. We have significantly improved disclosure and corporate governance standards.



### **3.2.4 Deserts – Road Ahead**

SEBI is working continuously and in close co-ordination with the regulated and the government, to improve market design to bring in further efficiency and transparency to market and make available newer and newer products to meet the varying needs of market participants, while protecting investors in securities. The aim is to make Indian securities market a model for other jurisdictions to follow and make SEBI the most dynamic and respected regulator globally. Some of the initiatives on which SEBI is working are :

- a. set up a national institute to build a cadre of professionals to man the specialized functions in the securities market. We are also working on a nationwide certification to ensure that any person or agent working with a market intermediary has the necessary knowledge and skill to render quality intermediation.
- b. Corporatise and demutualise exchanges where the ownership, management and trading rights would be with three different sets of people in order to avoid conflict of interest.
- c. Introduce market wide straight through processing from trade initiation to settlement.
- d. Migrate to T+1 rolling settlement.
- e. Continuously review and upgrade accounting standards, disclosures, corporate governance practices in the interest of investors.
- f. Continuously review and amend the various regulations to bring them in tune with dynamics of market requirements.
- g. Introduce new products in the market to meet all kinds of needs of market participants.

We will continue to work to improve the functioning of the securities market to meet the challenges of the changing environment. We will do so because we are fully convinced that securities market allows people to do more with their savings and to do more with their ideas and talents than would otherwise be possible. In the process, we would ensure that every citizen of the country participates in the securities market in some form or other and shares the prosperity.<sup>13</sup>

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<sup>13</sup> [www.indiancapitalmarket.com](http://www.indiancapitalmarket.com).

## Chapter - 4

### Privatization in Indian Economic

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## **4.1 Public Sector in the Indian Economy<sup>14</sup>**

The present Indian economic structure is often characterised as 'mixed economy. There are two fields of production in the structure — the private sector and the : sector. The present chapter is devoted to a discussion of issues pertaining to the public sector. In particular, we discuss:

- Division of the economy-into public and private sectors
- Role and performance of the public sector
- Problems of public sector enterprises
- Policy towards public sector since 1991.

### **4.1.1 Division of the Economy into Public and Private Sectors**

At the time of Independence, activities of the public or were restricted to a limited field like irrigation, power, railways, ports, communications and some departmental undertakings. After Independence, the area of activities of the public sector expanded at a very rapid speed. To assure the private sector that its activities will not unduly curbed, two industrial policy resolutions were issued in 1948 and 1956 respectively. These policy resolutions divided the industries into different categories. Some fields were left, entirely for. the public sector, some fields were divided between the public and the private sector and some others were left totally to the private sector. A cursory glance at the division of fields of industrial activity into the public and private sectors clearly brings out, that while heavy and basic industries were kept for the public sector, the entire field of consumer goods industries (having high and early returns) was left to the private sector. Outside the industrial field, while most of the banks, financial corporations, railways, air transport, etc., are in the public sector, the entire agricultural sector (which is the largest sector of the economy) has been left for the private sector.

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<sup>14</sup> Mishra & Puri, Indian Economy, 2010, Himalaya Publication. Pg.391

The important point that arises at this juncture, is — why were the heavy and basic industries like iron and steel, heavy engineering, heavy electrical plant, etc., selected for development in the public sector while quick-yielding consumer goods industries were left for the private sector?

The answer to this question has been attempted by R. K. Hazari according to whom the industrial programmes of government that emerged after 1955 were built around two hypotheses:

(i) private investment in relatively simple goods would be promoted by shutting out imports as well as through excess capacity at home, with a consequent boost to profits; and

(ii) public investment, being autonomous of profits, would take place in basic areas which had long gestation periods, low or no profits, a large foreign exchange component, complex technology and equally complex problems of co-ordination.

The logic of the first hypothesis was that private investment was in the nature of 'induced investment' and could be promoted by adopting a policy of protection against imported substitutes. The logic of the second hypothesis was that investments in low profit yielding and heavy investment requiring industries were in the nature of 'autonomous investment' and could, accordingly, be undertaken only by the State.

#### **4.1.2 Role of Public Sector in the Indian Economy**

Public sector in India has been criticized vehemently by a number of supporters of the private sector who have chosen to shut their eyes towards the achievements of the public sector. Following description should be sufficient to convince one that public sector has played a definite positive role in the economy.

**1. Public sector and capital formation.** The role of public sector in collecting savings and investing them during the planning era has been very important. During the first and second plans of the total investment, 54 per

cent was in the public sector and the remaining in the private sector. The share of public sector and the remaining in the private sector. The share of public sector rose to 60 per cent in the third plan but fell thereafter. However, even then it was as high as 45.7 per cent in the seventh plan. With increasing trends of liberalization in 1990s, the share of public sector in total investment fell drastically to 34.3 per cent in the eighth plan (i.e., only one-third) and further to 29.5 per cent in the Ninth Plan. This reflects the increasing importance that is now being accorded to the private sector. The nationalized banks, State Bank of India, Industrial Development Bank of India, Industrial Finance Corporation of India, State Financial Corporations, LIC, UTI etc., have played an important role in collecting savings and mobilisation of resources.

However, savings in the public sector itself are not much. In fact, there has been a precipitous fall in the share of public sector in gross domestic savings. During the period of Sixth Plan as a whole, public saving was 23.7 per cent of total domestic saving and this fell to 14.8 per cent during the period of the Seventh Plan and just 9.2 per cent in the Eighth Plan (at 1999-2000 prices). During the first year of the Ninth Plan, 1997-98, share of public sector in total savings was just 7.5 per cent. Savings in the public sector were negative in all other years of the Ninth Plan. The first year of the Tenth Plan, i.e., 2002-03 also recorded negative savings in the public sector. However, things have distinctly improved since. In 2003-04, savings in the public sector were Rs. 29,521 crore which rose significantly to Rs. 1,37,926 crore in 2006-07 and Rs. 2,12,543 crore in 2007-08. The share of public sector in total savings was 3.6 per cent in 2003-04 which rose significantly to 9.3 per cent in 2006-07 and further to 11.9 per cent in 2007-08. The share of public sector in gross domestic capital formation (GDCF) which was 44.6 per cent during Sixth Plan fell to 31.7 per cent during Eighth Plan. It is estimated to have declined further to 27.3 per cent in the Ninth Plan and 22.2 per cent during the Tenth Plan.

**2. Development of infrastructure.** The primary condition of economic development in any underdeveloped country is that the infrastructure should

develop at a rapid pace. Without a sufficient expansion of irrigation facilities and power and energy, one cannot even conceive of agricultural development. In the same way without an adequate development of transportation and communication facilities, fuel and energy, and basic and heavy industries, the process of industrialization cannot be sustained. India had inherited an undeveloped basic infrastructure from the colonial period. After Independence, the private sector neither showed any inclination to develop it nor did it have any resources to make this possible. It was comparatively weak both financially and technically, and was incapable of establishing a heavy industry immediately. These factors made the State's participation in industrialization essential since only the 'government could enforce' a large-scale mobilization of capital, the co-ordination of industrial construction, and training of technicians. The government has not only improved the road, rail, air and sea transport system, it has also expanded them manifold. Thus the public sector has enabled the economy to develop a strong infrastructure for the future economic growth. The private sector also has benefited immensely from these investments undertaken by the public sector.

**3. Strong industrial base.** The share of the industrial sector (comprising manufacturing, construction, electricity, gas and water supply) in Gross Domestic Product at factor cost has increased slowly but steadily during the period of planning. The share of the industrial sector in GDP at factor cost rose from 15.1 per cent in 1950-51 to 24.0 per cent in 1980-81 and further to 25.8 per cent in 2008-09 (at 1999-2000 prices). This shows the increasing importance of the industrial sector in the Indian economy. Not only this, the industrial base of the Indian economy is now much stronger than what it was in 1950-51. There has been significant growth in the defense industries and industries of strategic importance. The government has strengthened the industrial base considerably by placing due emphasis on the setting up of industries in the following fields — iron and steel, heavy engineering, coal, heavy electrical machinery, petroleum and natural gas, chemicals and drugs, fertilizers, etc. Because of their low profitability potential in the short run, these industries do not find favour with the private sector. However, unless these

industries are set up, the consumer goods industries cannot progress at a sufficiently rapid pace. Therefore, the production of consumer goods industries in the private sector is also likely to suffer if the State does not invest in heavy and basic industries. As noted by A.H. Hanson, "Even the view that ; it is the function of the State to provide only basic 'services' leaves room for a great deal of public enterprise in manufacturing industry, as well as in power, transport, communications, etc. For consumer-goods industries, which; are usually capable of attracting; some private capital, depend on the 'services' of the producer-goods industries in which private capital is — at least initially — less interested. Hence one can argue, without any 'socialistic' overtones, that as — for instance — textile or food-processing industries; need the support of native metallurgical and engineering industries (the necessary equipment not being available; from abroad owing to foreign exchange difficulties, delivery; delays, etc.) and as no private entrepreneurs show any; inclination to pioneer the latter, the State must step in arid;; do the pioneering itself.

**4. Economies of scale.** In the case of those industries where for technological reasons, the plants have to be large! requiring huge investments, setting up of these industries in the public sector can prevent the concentration of economic; and industrial power in private hands. It is a known fact that; in the presence of significant economies of scale, the free market does not produce the best results. Accordingly, considerations of economic efficiency require some form of government regulation or public ownership. Even in the U.S.A. firms in electric power, natural gas, telephone and some other industries are being regulated by Federal and State regulatory commissions. Countries like France and le United Kingdom have explicitly preferred public ownership in these fields.

**5. Removal of regional disparities.** The government in India has sought to use its power of setting up of industries as a means of removing regional disparities in industrial development; In the pre-Independence period, lost of the industrial progress of the country was limited in and around the port towns of Mumbai, Kolkata and Chennai. Other parts of the country lagged far



behind. After the, initiation of the planning process in the country in 1951, the government paid particular attention to the problem and set up industries in a number of areas neglected by the private sector. Thus, a major proportion of public sector investment was directed towards backward States. All the four major steel plants in the public sector—Bhilai Steel plant, Rourkela Steel Plant, Durgapur Steel Plant and Bokaro steel Plant were set up in the backward States. It was believed that the setting up of large-scale public sector projects. in the backward areas would unleash a propulsive mechanism in them and cause economic development of tie hinterland. These considerations also guided the location if machinery and machine tools factories, aircraft, transport equipment, fertiliser plants etc.

**6. Import substitution and export promotion.** the foreign exchange problem often emerges as a serious constraint on the programmes of industrialization in a developing economy. This constraint appeared in a rather strong way in India during the Second Plan and the subsequent plans. Because of these considerations, all such industries hat help in import substitution are of crucial importance for the economy. Bharat Heavy Electricals Limited, Bharat electronics Ltd., Hindustan Antibiotics Ltd., Indian Oil Corporation, Oil and Natural Gas Commission, etc., in the public sector are of special importance from this point of view.

Several public sector enterprises have also played an important role in expanding the exports of the country. Specific reference of Hindustan Steel Limited, Hindustan Machine Tools Limited, Bharat Electronics Ltd., State Trading Corporation and Metals and Minerals Trading Corporation can be made in this context.

**7. Check over concentration of economic power.** In a capitalist economy where the public sector is practically non-existent or is of a very small size, economic power gets increasingly concentrated in a few hands and inequalities of income and wealth increase. During the four and a half decades of planning in this country, it has been said time and again that the

expansion of public sector will help in putting a brake on the tendency towards concentration of wealth and economic power in the private sector.

Public sector can help in reducing inequalities in the economy in a number of ways. For instance (i) profits of the public sector can be used directly by the government on the welfare programmes of the poorer sections of community; (ii) public sector can adopt a discriminatory policy by supplying materials to small industrialists at low prices and big industrialists at high prices; (iii) public sector can give better wages to the lower staff as compared to the private sector and can also implement programmes of labour welfare, construction of colonies and townships for labourers, slum clearance, etc.; and (iv) public sector can orient production machinery towards the production of mass consumption goods.

### **Performance of the Public Sector**

It is usual to judge the performance of private sector units by the yardstick of net profit or loss since in their case, maximization of profit is the sole aim. This yardstick fails miserably in the case of public sector undertakings. Such units are frequently started in those sectors where profitability is low and gestation period long. For instance, investment in infrastructure and basic industries is not likely to yield early returns and, accordingly, profits in the beginning are likely to be very low and in some instances, may even be negative. Yet these investments serve important ends since they create the basis for expansion of industrial activities in the future. Investments made by the public sector in the steel industry, fertilizers, power projects, mining, etc., come under this category. Then, in some cases, public sector provides inputs to the private sector (for example, iron and steel to machine building, tools, automobile industry, etc.) It is very easy for it to earn huge profits by merely hiking the prices of its output. However, this is likely to have an adverse impact on the industrial activity in the private sector on the one hand, and push up prices on the other. Accordingly, prices are intentionally kept low even though this cuts into the profits of the public sector seriously. Also, as noted by Hazari and Oza, private sector has invested mostly in consumer and lighter goods which have been granted far greater

protection against external competition as compared to capital goods which were mostly produced by the public sector and which faced stiff competition from imports financed by aid and foreign private investment. Another point that needs specific mention is that the public sector is not merely capital-intensive and characterised by longer gestation periods; in steel, which accounts for the bulk of investment, it is also material intensive, and to that extent its value added component is smaller than in items like, say, chemicals.

Because of considerations such as these, it is often maintained that the performance of the public sector units should not be judged by what they earn in the form of profits but by the total additions they make to the flow of goods and services in the economy. Thus, instead of profits, the yardstick should be the total value of the sales of an enterprise. For instance, if an iron and steel plant produces steel worth Rs. 5,000 crore in a certain specified period but makes no profit because its aim is to provide steel at low prices to the industries using steel as an input, it would be wrong to say that its performance is disappointing on this count alone. What is important from the point of view of the industrial development of the country is the fact that this plant has added steel worth Rs. 5,000 crore to the social pool of goods and services obtaining in the country.

### **Expansion of the Public Sector and its Share in National Production**

There has been massive expansion in the public sector after Independence. At the commencement of the First Five Year Plan in 1951, there were only 5 central public sector enterprises with investment amounting to Rs. 29 crore. As on March 31, 2009, there were 246 public sector enterprises with an investment of Rs. 5,28,951 crore. The turnover was Rs. 3,89,199 crore in 1999-2000 which rose to Rs. 10,81,925 crore in 2007-08. According to Economic Survey, 2009-10, the turnover rose further to Rs. 12,63,405 crore in 2008-09. Of the total Rs. 5,28,951 crore investment in the public sector as on March 31, 2009, as much as 46.1 per cent belonged to the service sector, 26.2 per cent to electricity, 18.1 per cent to manufacturing and 8.8 per cent to mining.

As far as the share in national production is concerned, Central PSEs play a pivotal role in the production of coal and lignite, petroleum and in non-ferrous metals such as primary lead and zinc. The PSEs have also been making substantial contribution to augment the resources of the Central government through payment of dividend, interest, corporate taxes, excise duties, etc. During 2008-09, contribution to the Central Exchequer by the Central PSEs amounted to Rs. 1,51,728 crore.

### **The Question of Profitability**

Though we have pointed out earlier that profits are not the criterion for examining the performance of public sector enterprises their financial performance is of wide interest and concern as they are set up at a huge cost to the national exchequer. As is clear from Table 30.1, profit before interest and tax increased from Rs. 42,720 crore in 1999-2000 to Rs. 1,55,000 crore in 2007-08 while net profit after tax increased from Rs. 14,331 crore to Rs. 79,736 crore over the same period. The ratio of profit after tax to turnover rose from 3.7 per cent in 1999-2000 to 7.4 per cent in 2007-08 while the ratio of profit after tax to capital employed rose from 4.7 per cent to 10.4 per cent over the same period.

What is more, the reliance of public sector enterprises on budgetary resources declined while their gross internal resource generation increased. Gross internal resource generation in 1999-2000 was Rs. 35,933 crore which rose to Rs. 96,551 crore in 2006-07. Despite all this, the fact of the matter is that the ratio of net profit to capital employed remained highly inadequate for many years looking at the colossal investments that have been made in the public sector (in a number of years this ratio has been in the range 2.0 to 2.5 per cent). Bimal Jalan has alleged that it is this 'low return on investment' in the public sector enterprises that is, to a large extent, responsible for the fiscal crisis of the Central government.

## **Employment and Labour Welfare**

As far as this criterion of the performance is concerned, the public sector seems to have done exceedingly well. It has contributed to a significant extent in improving the overall employment situation in the country and has acted as a model employer by providing the workers with better wages and other facilities as compared to the private sector, the number of persons employed in the Central public sector enterprises as on March 31, 2009 was 15.35 lakh (excluding casual workers and contract labour). The average per capita emoluments in central public sector enterprises stood at about Rs. 5,45,500 per annum. The industrial sectors which have a sizable number of employees in the public sector include coal, steel, textiles, heavy engineering, and medium and light engineering.

The public sector enterprises have also spent a considerable amount on the development of townships around them. These townships were provided with facilities like schools, hospitals, shopping complexes, etc. A substantial sum of money is spent annually on the maintenance and administration of these townships and social overheads. For instance, gross expenditure worth Rs. 3,581 crore was incurred by public sector units as on March 1, 2007 on township maintenance, administration and social overheads. The employees of the public sector enterprises also enjoy medical amenities, subsidized canteen facilities, transport and, educational facilities, etc.

## **Public Sector and Foreign Exchange Earnings**

Enterprises in the public sector have helped the economy in earning substantial amount of foreign exchange and also in saving the foreign exchange and expenditure via their efforts at import substitution. Capital goods, industrial machinery, and other equipment which were totally imported about four decades back are, now being mostly manufactured in the country itself. This has saved valuable foreign exchange. The ONGC and Indian Oil Corporation have helped the country in reducing the dependence on foreign imports. The Hindustan Antibiotics Ltd. and the Indian Drugs and Pharmaceuticals Ltd. have entered the field of manufacture of drugs and

pharmaceuticals in a big way. While this has helped in saving foreign exchange on the one hand, it has also enabled the country to break the stranglehold of foreign companies in this field. As far as foreign exchange earnings are concerned, the public sector has contributed in three ways: (i) through direct export of items produced in the public sector, (ii) through services rendered by the public-sector undertakings, and (iii) through trading and marketing services of the undertakings through which exports are canalized. The public sector accounted for 11.5 per cent of export earnings in 2006-07 (Rs. 65,620 crore out of Rs. 5,71,779 crore).

### **The Question of Efficiency**

Though there is no dispute regarding the role of the public sector undertakings in country's economic development, yet the feeling widely prevalent is that the rate of profit in these undertakings is either too low or is negative. Accordingly, they are inefficient.

However, it is not so easy to decide about the efficiency of the public sector undertakings. As noted by us earlier, the rate of profit might be a good criterion to judge the efficiency of a private sector enterprise but cannot be deemed so for a public sector enterprise. To judge the efficiency of a public sector undertaking, A.E. Khan and Hollis B. Chenery have recommended the criterion of social marginal productivity. According to Chenery, the utility of investment in any project should be judged by its impact on the national income, balance of payments and distribution of income. According to Walter Galensen and Harvey Libenstein, the evaluation of investment in the public sector should be done on the basis of "marginal per capita reinvestment quotient". According to this criterion, we must examine whether investment of capital in any project will lead to maximization of national income at any point in the future or riot. Without entering into the controversy regarding determination of investment in the public sector at this juncture, we would like to emphasize that evaluation of any State enterprise should be done on the basis of social benefit and social cost and not on the basis of rate of profit.

According to G.K. Shirokov, efficiency of a public enterprise should not be judged on the basis of profitability alone. "The economic efficiency of a public sector industry manifests itself alone in the transformation of the industrial structure, modernisation, higher labour productivity on a country-wide scale etc." The fact is that a higher proportion of the value produced by the public sector industries is realised outside this sector, and it is, therefore, very difficult to estimate the efficiency of public sector enterprises in terms of cost and profitability. Most of the critics of the public sector enterprises fail to take social costs and benefits into account and consider only net profits or losses. They are thus guilty of ignoring the right criteria for judging the performance of public sector enterprises.

Not only this. Even the losses incurred by public-sector enterprises are, to a considerable extent, due to the take over of sick units from the private sector to protect the interests of the working class. For instance, of the 102 loss making enterprises in 1991-92, about 40 per cent constituted sick units taken over by the government from the private sector. Thus, the losses of the private sector 'spilled over' to the public sector.

Before we conclude this section, the following comments from Arif Sharif are in order: "Now that decrying public sector performance has become fashionable, many seem to have forgotten the crucial role it has played in India's development since the Second Plan, which cannot be measured against the value of its output. The private sector never had to bear such responsibilities. Instead, it relied on the public sector to meet much of its technology and skilled manpower requirements."

### **4.1.3 Problem of Public Sector Enterprise**

The most important criticism levied against the public sector has been that, in relation to the capital employed, the level of profits has been too low. Even the government has criticised the public sector enterprises on this count. For instance, the Eighth Five Year Plan notes that the public sector has been unable to generate adequate resources for sustaining the growth process. Of

the various factors responsible for low profits in the public sector, the following are particularly important:

### **Price Policy of Public Enterprises**

Private sector enterprises are operated with the sole aim of maximising profits. Accordingly, prices are determined at a level that would cover total cost (including taxes) and provide a sufficient net return over and above this. As against this, the purposes of setting up and operating public sector enterprises are varied and price policy is determined by the objectives which they are expected to serve. Even under conditions of monopoly, the objective of the pricing policy of a particular public sector enterprise may not be profit maximisation. Indian Railways, Indian Airlines Corporation, State Electricity Boards are examples of public monopolies. Public enterprises like Steel Authority of India and the Fertilizer Corporation of India also operate in seller's market. It is very easy for these enterprises to earn huge profits simply by increasing their prices. But since their object was not profit maximisation but fulfilment of some social objective, they opted for losses in some cases while in some instances they just tried to equate total revenues to total costs.

As an illustration of this statement one may consider the pricing policy for fertilizers and pesticides being produced by the public sector in India. The main aim in this case was to provide fertilizers and pesticides at cheap prices so that even average farmers can easily purchase them. This was rendered essential because of the contribution that fertilizers and pesticides make towards increasing agricultural production and productivity. On account of this reason, Fertilizer Corporation of India and Hindustan Insecticides intentionally kept their selling prices low. Even in regard to the pricing of steel, the government's policy was not to earn high profits. Till May 1967, prices of steel were kept so low that they either yielded losses or very low profits.

As regards the pricing policy of public sector enterprises, we can find two different approaches- (i) the public utility approach and (ii) the rate of return approach. The former implies a pricing policy that yields a no-profit-no-loss situation. This pricing policy was followed for a long period by many public



sector enterprises. It obtained support from the fact that many public sector units were in the area of basic industries and unduly high prices of their products could cause cost increases over a large segment of the economy. Thus, the pressure to adopt in some sense a minimal price policy was strong and persistent. On account of these reasons, administered prices were intentionally kept very low. For example, the price of steel (as already mentioned earlier) was kept deliberately low. Similar practices were followed by Hindustan Machine Tools, Hindustan Shipyard and many other public sector enterprises in the initial stages of their operations.

Because of considerations such as these, it is a folly to regard the observed rates of return, without detailed investigation, as evidence of wasteful investment. In fact, as noted by Bhagwati and Desai, "In a situation where domestic prices are distorted by a variety of endogenous and policy-imposed factors, the observed rates of return cannot be taken to give a proper ranking of the social profitability of alternative investments." However, such a policy of deliberate under-pricing has had two adverse effects: "Firstly, a policy of under-pricing may result in distortion of choice of technique by the user industries. Thus, for example, under-priced steel can result in excessive, and sub-optimal, use of it as against other materials wherever choice is available (e.g., with office furniture). Secondly, even where no such choice is available, the fact that, in many cases, there is no de jure (or de facto) regulation of the prices of the end-products of the user industries (e.g.; the prices of textile machinery) implies that the profits foregone by the public sector enterprises wind up with the users, who eventually tend to be in the private sector. The effect of under-pricing by public sector enterprises is thus substantially to redistribute revenue in favour of the private sector: which, in turn, compromises the effort of the government at raising real savings in so far as this leads to additional consumption in the private sector." Moreover, as pointed out by Krishnaswamy, persistent loss or under achievement had serious effects on the morale of both the management and labour in the public enterprises. Particular examples of this tendency are Coal India Ltd., Mining and Allied Machinery Corporation and Heavy Engineering Corporation. As

against this, positive returns had morale boosting effects in enterprises like Hindustan Machine Tools, Bharat Heavy Electricals and Maruti Udyog Ltd.

Since a large amount of investment has gone into public sector enterprises, it is essential that they yield sizable returns. If this does not happen, the process of economic development will suffer a severe jolt as scarcity of investment resources would appear. Therefore, while some public sector enterprises might adopt a 'public utility approach' in their pricing decisions, others have to yield returns on investment. This brings us to the 'rate of return approach' which has been accepted by the government as the right principle for determining the pricing policy of a number of industries. However, as noted by Krishnaswamy, there has been no consistency in the application of this principle. For instance, in the case of petroleum products, the Oil Prices Committee (1974-76) calculated a retention price for each refinery on the basis of a gross return of 15 per cent on the total capital employed. In the case of fertilisers, the Marathe Committee provided for a post-tax return of 12 per cent of net worth.

In an article published in 2006, R. Nagaraj argued that the real culprit of poor public sector saving is not Central public sector enterprises (that have been the subject of much of reforms) but inadequate pricing of the utilities and infrastructure services, and lack of recovery of user charges for the services rendered. In this context, he has provided data to show that the revenue-cost ratio for SEBs (State Electricity Boards), railways and road transport corporations (RTCs) has deteriorated over time (from 82.2 per cent in 1992-93 to 68.6 per cent a decade later in the case of SEBs, from 91.4 per cent in 1992-93 to 88.7 per cent in 2000-01 in the case of RTCs and from greater than one upto 1990-91 to less than one thereafter in the case of railways). Perhaps a telling evidence of the problem, in the aggregate, is the movement of the public sector price deflator, relative to the GDP deflator since 1960-61. Over the last 40 years public sector prices never exceeded the overall price level, and in 2003-04 the relative price stood just 83 per cent of what it was in 1960-61. This shows that public sector prices have risen at a slower rate than the overall prices in the economy over the long run, adversely affecting its

financial position. In other words, the crux of the poor financial returns lies in incorrect pricing of these services and poor collection of user charges.

In an attempt to tackle the above problem, the government has announced changes in the pricing policy of public sector enterprises in recent years. The new policy relies less on command and control type mechanisms and more on market-based instruments of regulation. Price controls on a number of consumer goods have been lifted. Cement and steel prices have been decontrolled. In fertilisers, only nitrogenous fertilisers are now subject to price control. The new policy favours a more transparent policy for fixing prices and the government has already recommended the adoption of Long Run Marginal Cost (LRMC) based prices for public enterprises. However, adequate steps to levy user charges in public utility and infrastructure services like power, railways, and RTCs have not been undertaken as their pricing is a politically sensitive issue.

### **Under-utilization of Capacity**

Under-utilization of installed capacity is another reason for the low level of profitability in public sector enterprises. A large number of these enterprises have operated at less than 50 per cent of their capacity for a number of years. We must ponder seriously why investments worth thousands of crores of rupees in the public sector were not utilized properly and resulted in substantial under-utilization of capacity. Some people have attributed this to the lack of foresightedness on the part of the government. However, the facts are somewhat different. As pointed out by Vijay Kelkar, after the Third Plan, public investments which till then were decided mostly on the basis of plan priorities, were influenced by various other pressures. The public sector enterprises “became increasingly instruments for meeting immediate or ad hoc demands such as producing mass consumption goods, stimulating growth in economically backward areas or using locally available raw materials which were in some cases, like Khetri copper ore, of poor quality. Furthermore, a large number of industries which became sick under private sector management were taken over by the government with a view to maintaining production and protecting employment.” Other factors that

accounted for under-utilization of capacity in public sector enterprises include inefficient operation and poor management of some enterprises, political interference in day-to-day working, labour disputes etc.

### **Problems Related to Planning and Construction of Projects**

As far as the phase of planning and construction of projects is concerned, following problems had to be faced:

(i) selection of site was not based on detailed soil investigation; (ii) there were serious omissions and understatements of several elements of the projects; (iii) the actual costs of projects far exceeded the original estimates; (iv) the projects took much longer time to complete than originally envisaged; and (v) the projects often embodied inappropriate technology or product mix. For instance, Bhagwati and Desai have argued that the site for Heavy Electricals Limited was selected without any explicit calculation of, the cost of alternative locations and later was changed, when found unsuitable. Similarly, a decision was made to locate a fertilizer plant within each State. This led to corresponding decisions to initiate construction at places which were unsuitable from the viewpoint of either demand or raw materials. In addition, as noted by Bhagwati and Desai: "A careful scrutiny of the methods adopted to plan for the projects, as revealed by the reports of several governmental committees appointed for the purpose as also to evaluate the reasons for subsequent increasing costs, underlines the extremely poor quality in general of the work, both from a technical viewpoint, and even more so from the point of view of economic cost and benefit analysis. These reports have not followed any uniform format varying in their coverage and inquiry underlining that no systematic thought was given to questions of project appraisal and that rough, sketchy, and haphazardly incomplete records were often considered adequate for embarking upon quite expensive investments."

As far as completion of projects is concerned, several of them were completed 18 months to 2 years behind schedule. Cost escalation has often been of the order of 10-15 to 80-90 per cent of the original estimate. According to Chaudhury, cost escalation was due to the following two major

causes: (i) last minute changes in project design sometimes due to a belated recognition that the product mix that was chosen originally was inappropriate to Indian market conditions. This required expensive modifications to plant. Sometimes changes were induced by the need to add vital parts of the plant which had not been included in the original contract; and (ii) lag in starting or finishing a project, which landed the projects with higher costs due to inflation in supplier countries. Very often aid contracts took much longer to complete than originally envisaged. In some cases, the donor countries took advantage of the practices of tied-aid to increase prices charged for plant and equipment. As noted by A.K. Bagchi, foreign aid was normally tied to purchases of equipment and materials from the countries giving loans and grants. The government made only halting and ineffective attempts to insulate the choices of technology and product-mix against pressures exerted by foreign firms and their agents. As a result, foreign suppliers often got away with misspecifying the capacity of the plants set up and their operating characteristics. In fact, alleges Bagchi, a considerable amount of the excess costs and dynamic inefficiencies of the public sector projects was due to the failure of the government to break out of dependence on foreign sources of funds which were tied to sales of particular types of technology for setting up the installations. This shows that while some problems regarding escalation of costs rose from the Indian side, blame for some others has to be placed entirely at the door of the aid relationship India entered into with other countries.

Also, because of the decision to locate large-sized industrial projects in hitherto backward areas the cost and execution of the project depended heavily on the creation of adequate infrastructure facilities. Delays in completion also occurred due to the interlinking of projects steel plants with heavy engineering plants or with coal mines or with railway facilities; electricity generation with the manufacture of electricity machinery, cables, transmission towers and so on by other public sector units; port development with the production of cranes and other berthing equipment by public sector enterprises: Though there was nothing inherently wrong in this practice, it enhanced the transmission of delays and high cost in one unit to the other.

Moreover^ huge townships were constructed around many public sector enterprises to house the employees. Naturally, the costs increased.

### **Problems of Labour, Personnel and Management**

Public sector enterprises are often plagued with undue political interference in their day-to-day working and this has demoralising effect on the management and other personnel of these enterprises. Many appointments at the top are not made on grounds of professional competence or suitability but are determined by various political considerations. Often the management at the top is constituted of the traditional administrative services of I.C.S. and I.A.S. These non-specialised, non-technical people are often unequal to the task of providing the requisite managerial competence in the complex, capital-intensive industrial projects in the public sector. Also, as noted by Bhagwati and Desai,; with their civil service background, these officials inevitably tended to act with bureaucratic caution and unimaginativeness rather than in bold and inventive ways. The actual management was also hampered in by traditional audit procedures and scrutiny of whether the expenditures incurred were within the framework of the authorizations. "Since this scrutiny is intensive and departure from its exacting standards can lead to censure and disgrace, the scope for imaginative and quick action in the interest of better economic performance is inevitably jeopardized." The work ethic of a public enterprise is very much like that of a government office over occupation with file work, rules-oriented practices, and keeping within the framework of prescribed rules and norms. The costs of this lengthy procedure or delays in decision often do not matter. More emphasis is laid on precedence and interpretation of rules than on results. It has not been duly recognised that the work ethic of a public sector enterprise has to be different from the work ethic of a government office and practices and procedures that make the latter efficient may not be suitable for the former.

Political considerations have also contributed to overstaffing of unskilled labour and payment of higher wages to such labour than in the private sector. As far as skilled personnel are concerned, the public sector enterprises required an imaginative management policy. It was necessary to

provide incentive to skilled personnel in the form of better wages and better, promotion prospects than in the private sector. However, in actual practice it was exactly the opposite. The private sector bosses weaned away the skilled personnel from the public sector through various incentives.

It is frequent to discuss the problem of 'control vs. autonomy' in the context of managerial problems. 'Control' of government undertakings refers to their 'accountability' to Parliament for their work. This accountability is justified on the plea that the public sector enterprises are run with the help of tax-payers money and the latter have: every right to know whether these enterprises are being run efficiently or not. Since the will of the people is expressed through Parliament, it is the latter that exercises control over the public sector undertakings. For this purpose, Parliament constituted a separate committee known as the Committee on Public Enterprises in 1964. In addition to this Committee, Bureau of Public Enterprises, Public Accounts Committee, the Estimates Committee, etc. also evaluate the performance of public sector enterprises from time to time.

'Autonomy' refers to the freedom granted to the management of a public enterprise to run it without interference of outside agencies. Autonomy is especially important in the context of day-to-day operations of a public enterprise where many on-the-spot decisions have to be taken on a variety of issues that crop up before the management. Interference in such daily work is neither feasible nor necessary. In fact, it can only create impediments on the one hand and demoralise the management on the other.

The line between 'control' and 'autonomy' is very thin and has not been properly spelt out. Managements of many public enterprises feel that controls on their operations are too much and too frequent inhibiting the possibilities of independent action unduly. Even in routine matters, interference persists. This leads to a sense of insecurity and indecision in top management circles and a lot of time that could be utilised more productively is wasted on drawing up explanations to convince 'persons who matter'.

To solve these problems, it is necessary to define clearly and explicitly the limits of control, i.e., the spheres where control is to be exercised and the activities that are to be left entirely to the management. Once the limits of control are specifically laid down and the spheres for freedom of action for the management are explicitly recognised; scope for conflict and suspicion will be considerably narrowed down. It would also be a wise policy to involve the management of State enterprises in the process of policy-formulation, target-setting, delineation of functional limits, organising efficient working, etc.

#### **4.1.4 Policy Towards Public Sector Since 1991**

The new industrial policy announced by the government in July 1991 emphasised the following four major measures to 'reform' the public sector enterprises: (i) reduction in the number of industries reserved for the public sector from 17 to 8 (reduced still further to 3 later on) and the introduction of selective competition in the reserved area; (ii) the disinvestment of shares of a select set of public sector enterprises in order to raise resources and to encourage wider participation of general public and workers in the ownership of public sector enterprises; (iii) the policy towards sick public sector enterprises to be the same as that for the private sector; and (iv) an improvement of performance through an MOU (memorandum of understanding) system by which managements are to be granted greater autonomy but held accountable for specified results. In addition, there was a drastic reduction in the budgetary support to sick or potentially sick public sector enterprises.

#### **Dereservations**

As stated in the Chapter on 'Industrial Policy', the 1956 Resolution had reserved 17 industries for the public sector. The 1991 industrial policy reduced this number to 8: (1) arms and ammunition, (2) atomic energy, (3) coal and lignite, (4) mineral oils, (5) mining of iron ore, manganese ore, chrome ore, gypsum, sulphur, gold and diamond, (6) mining of copper, lead, zinc, tin, molybdenum and wolfram, (7) minerals specified in the schedule to the atomic energy (control of production and use order), 1953, and (8) rail



transport. In 1993, items 5 and 6 were deleted from the reserved list. In-1998-99, items 3 and 4 were also taken out from the reserved list. On May 9, 2001, the government opened up arms and ammunition sector also to the private sector. Thus, now only 3 industries are reserved exclusively for the public sector. These are atomic energy, minerals specified in the schedule to the atomic energy (control of production and use order) 1953, and rail transport.

### **Policy Regarding Sick Units**

The 1991 industrial policy brought the public sector units at par with the private sector units. As a result, the public sector units were also brought within the jurisdiction of the Board for Industrial and Financial Reconstruction (BIFR). Thus, BIFR was given the responsibility to decide whether a sick public sector unit can be effectively restructured or whether it has to be closed down. As on March 31, 2008, 66 PSEs were registered with BIFR, out of which revival schemes were sanctioned in respect of 9 enterprises, 3 cases were dismissed as non-maintainable, 5 companies were declared as no longer sick, and 5 other cases were dropped on account of net worth becoming positive.

In the process of restructuring of the sick and loss making enterprises, the government has liberalised the Voluntary Retirement Scheme (VRS) to enable the Central public sector enterprises to shed their excess manpower. Cumulatively around 5.90 lakh employees have opted for VRS from Central public sector enterprises since October 1998 till March 2007.<sup>19</sup>

### **Memorandum of Understanding**

One of the major initiatives towards the public sector as outlined in the new industrial policy of July 1991 was to bring all public sector enterprises under the system of Memorandum of Understanding (MOU). The system of MOU envisages an arm's length relationship between the PSU and the administrative ministries. It gives clear targets to PSUs and ensures operational autonomy to them for achieving those targets. The MOU system was started in 1987-88 with four PSUs signing MOUs. This number went upto

144 CPSEs in 2008-09. The government has now decided that all CPSEs including risk and loss-making and CPSEs under construction will be covered under the MOU system.

### **Policy for ‘Navratnas’**

The government has identified 18 public sector enterprises as Navratnas and decided to give enhanced powers to the Board of Directors of these enterprises to facilitate their becoming global players. The Boards of these Navratna enterprises have been professionalised by induction of non-official part-time professional Directors. These PSUs have been delegated substantial enhanced autonomy and operational freedom which include (i) incurring capital expenditure, (ii) entering into joint ventures, (iii) effecting organisational restructuring, (iv) creation and winding up of posts below Board level, (v) to raise capital from the domestic and international markets, and (vi) to establish financial joint ventures subject to equity investments with special limits.

The government has also granted financial and operational autonomy to some of the other profit making PSUs subject to fulfilling certain conditions. These enterprises are categorised as Miniratnas. The enterprises which have made profits continuously for the last three years and have earned a net profit of Rs. 30 crore or more in one of the three years, with positive networth are categorised as Miniratnas I. Category II Miniratnas should have made profits for the last three years continuously and should have a positive networth. Both these categories of public sector enterprises are granted certain autonomy like incurring capital expenditure without government approval upto Rs. 300 crore or equal to their networth whichever is lower (for category I Miniratna companies) and upto Rs. 150 crore or upto 50 per cent of their networth whichever is lower (for category II Miniratna companies). These enterprises can also enter into joint ventures subject to certain conditions, set up subsidiary companies and overseas offices, enter into technology joint ventures, etc. The total number of Miniratna Central Public sector enterprises is presently 62.

## **Disinvestment of Shares**

The Government of India has decided to withdraw from the industrial sector and, in accordance with this decision, it is privatising the public sector enterprises in a phased manner. The main approach of the government in this regard is to bring down its equity in all non-strategic public sector undertakings to 26 per cent (or lower) and close down those public sector undertakings which cannot be revived. For purposes of privatisation, the government has adopted the route of disinvestment which involves the sale of the public sector equity to the private sector and the public at large. All through the period of economic reforms, successive governments at the Centre have advocated the sale of public sector equity as a means of public sector 'reform.' Equity sale, as the industrial policy statement of July 1991 argued, was a means of ensuring financial discipline and improving performance. However, as correctly pointed out by CP. Chandrasekhar and Jayati Ghosh, the experience suggests that fiscal convenience was the prime mover of such disinvestments. The proceeds from disinvestments were used to finance budget deficits and thus to 'window-dress' budgets, "This meant that while there has been much talk of managerial reform, voluntary retrenchment, and greater public sector autonomy for meeting the new market environment, the thrust of public sector reform was almost entirely concentrated: on the sale of equity." The disinvestment programme is discussed in detail in the next chapter on "Privatisation of Public Sector Enterprises: The Disinvestment Programme in India."

## **Setting up of BRPSE**

The government in December 2004 set up a Board for Reconstruction of Public Sector Enterprises (BRPSE) to recommend measures for restructuring/reviving Central PSUs referred to them. The BRPSE also recommends cases where disinvestment or closure or sale are justified. BRPSE made recommendations in respect of 58 cases until December 31, 2009. The government has approved proposals for the revival of 37 public sector enterprise and closure of two.

## NOTES

1. For details, please refer to the Chapter on 'Industrial Policy'.
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3. Computed from Government of India. *Economic Survey, 2004-05* (Delhi, 2005). Statement 1.4. p. S-6, and *Economic Survey, 2008-09* (Delhi, 2009), Appendix Table 1.5.
4. A.H. Hanson, *Public Enterprises and Economic Development* (London, 1965). p. 188.
5. Bimal Jalan, *India's Economic Policy* (New Delhi, 1996), p. 21.
6. G.K. Shirokov, *Industrialization of India* (Moscow, 1973), p. 139.
7. Arif Sharif, "Planning a Dishonourable Exit," *The Economic Times*, April 4, 1993, p. 7.
8. Eighth Five Year Plan, *op.cit.*, Vol. II, p. 108.
9. K.S. Krishnaswamy, 'Public Sector Undertakings,' *The Economic Times*, 8,9 & 10 January, 1981.
10. Jagdish N. Bhagwati and Padma Desai, *India Planning for Industrialisation*, (London, 1970), p. 155.
11. *Ibid*, pp. 156-7.
12. R. Nagaraj, "Public Sector Performance Since 1950: A Fresh Look", *Economic and Political Weekly*, June 24, 2006. p. 2554.
13. Vijay Kelkar, "Public Sector: Measures to Impart Efficiency." *The Economic Times*, January 3, 1991, p. 11.
14. Bhagwati and Desai, *op.cit*, p. 158.
15. Primit Chaudhury, *The Indian Economy* (Delhi, 1979). pp. 157-8.
16. Amiya Kumar Bagchi, "Public Sector Industry and the Political Economy of Indian Development," in Terence J. Byres (ed.) *The State, Development Planning and Liberalisation in India* (New Delhi. 1997), p. 308 and p. 310.

17. Bhagwati and Desai, *op.cit.*, p. 165.
18. Government of India, *Economic Survey, 1992-93*. pp. 143-5.
19. Government of India, *India 2010 - A Reference Annual* (Delhi, 2010), p. 657.
20. CP. Chandrashekhar and Jayati Ghosh, *The Market that Failed: A Decade of Neoliberal Economic Reforms in India* (New Delhi, 2002), p. 88.

## **4.2 Private Sector in the Indian Economy<sup>15</sup>**

As stated in the chapters on 'Industrial Policy' and 'Public Sector in the Indian Economy', the Government of India opted for a mixed economy in which both public and private sectors were allowed to operate. For example, the 1948 Industrial Policy Resolution divided industries into four categories: (i) three industries in which State was given a monopoly; (ii) six industries where State was to have the exclusive right to set up new units but existing private sector units were allowed to operate; (iii) eighteen industries where regulation and direction was necessary; and (iv) all other industries (not included in the above three categories) where private sector was allowed the freedom to operate. The 1956 Industrial Policy Resolution divided industries into three categories: (i) seventeen industries (listed in Schedule A) whose future development was to be the exclusive responsibility of the State; (ii) twelve industries where the State would increasingly establish new units and increase its participation but would not deny the private sector opportunities to set up units or expand existing units; and (iii) all other industries (not listed in Schedules A and B) where the private sector was given freedom to operate. However, the private sector had to operate within the provisions of the Industries (Development and Regulation) Act, 1951 and other relevant legislations. In this context, the Industrial Policy Resolution 1956 stated, "Industrial undertakings in the private sector have necessarily to fit into the framework of the social and economic policy of the State and will be subject to control and regulation in terms of the Industries (Development and

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<sup>15</sup> Mishra & Puri, *Indian Economy, 2010*, Himalaya Publication, Pg.412

Regulation) Act and other relevant legislation. The Government of India, however, recognizes that it would, in general, be desirable to allow such undertakings to develop with as much freedom as possible, consistent with the targets and objectives of the national plan. When there exist in the same industry both privately and publicly owned units, it would continue to be the policy of the State to give fair and nondiscriminatory treatment to both of them.” The Resolution also emphasized the mutual dependence of public and private sectors. While State could start any industry not included in Schedule A and Schedule B, the private sector could be allowed to produce an item falling within schedule A. In fact, the 1956 Resolution emphasized not only the mutual co-existence of private and public sectors but also provided for their mutual co-operation and help.

The private sector took full advantage of the loopholes and exceptions in the legislation and the ‘elbow room’ allowed by the 1956 Resolution to set up industries even in areas exclusively reserved for the State sector. In fact, with the passage of time, more and more concessions were granted to the private sector to expand its business activities. The working of the Industries (Development and Regulation) Act, 1951, was also full of flaws as the licensing committee worked in a very haphazard and ad hoc manner and there were no definite criteria adopted for acceptance or rejection of applications. Because of widespread criticism of the working of the Act, the government considerably liberalised the industrial licensing policy as well. The New Industrial Policy, 1991, ushered in a new era of liberalisation as industrial licensing was abolished, role of public sector diluted, doors to foreign investment considerably opened, and numerous incentives and initiatives granted to the private sector to expand its business activities. The 1991 policy was therefore welcomed with unbridled enthusiasm by the private sector initially. It welcomed the thought of lower taxes, less red tape, less paperwork, more ‘space’ to work and less government interference. However, the 1991 policy had also opened the doors to multinationals and increased competition from abroad as tariffs were reduced substantially. Consequently, many domestic producers suddenly discovered their market shares shrinking drastically as their goods failed to meet foreign competition both on grounds

of quality and price. The corporate world also saw significant changes with many old businessmen being knocked out from their top positions and a number of new entrants making their mark.

## **Role of the private sector in Indian economy**

- Private sector in the post-liberalisation phase
- Problems of the private sector
- MRTP Act, 1969 which was designed to control monopolistic and restrictive trade practices of the private sector entrepreneurs and the Competition Act, 2002 (alongwith its amendment in September 2007) which has now replaced the MRTP Act, 1969.

### **4.2.1 Role of the Private Sector**

**1. The dominant sector.** Despite the rapid progress of the public sector in the period of planning, private sector is the dominant sector in the Indian economy as would be clear from a glance at Table 32.1. Since government data on the industrial sector are available with some time-lag, the latest data are for the year 2005-06.

• As is clear from Table 32.1, the number of private sector companies in 2005-06 was 1,21,113 out of 1,40,161 total companies. Thus as many as 86.4 per cent of the total companies were in the private sector, the share of public sector being only 9.4 per cent. However, in terms of fixed capital, gross output and value added, private sector's share was much lower. For instance, its share in fixed capital was only 28.1 per cent in 2005-06. Its share in gross output and value added was only 38.9 per cent and 33.8 per cent respectively in that year. In terms of employment, private sector's share was greater in 2005-06. It employed 61.5 per cent of workers as against 34.1 per cent employed by the public sector.

**2. Importance for development.** In western countries, private entrepreneurs have played an important role in economic development so

much so that Schumpeter has characterised them as the initiator and moving force behind the industrialisation process. The private entrepreneur is guided by the profit motive. He is responsible for the introduction of new commodities, new techniques of production, assembling the necessary plant and equipment, labour force and management and organising them into a going concern. The private entrepreneur acts as an innovator who revolutionises the entire method of production. Such activities help the process of industrialisation and economic development. It was because of this reason that the industrial policy resolutions of 1948 and 1956 of the government gave immense opportunities to the private sector to expand its activities. In the new liberalised scenario that has emerged after the announcement of the new industrial policy in 1991, private sector has been assigned the dominant role in industrial development.

**3. Extensive modern industrial Sector.** A number of modern industries have been set up in the private sector. Important consumer goods industries were set up in the pre-Independence period itself. Particular mention in this regard can be made of the cotton textile industry, sugar industry, paper industry and edible oil industry. These industries were set up in response to the opportunities offered by the market forces. They were highly suitable for private sector since they ensured early returns and required less capital for establishment. Though the engineering industries did not make an appearance in the pre-Independence period yet a start was made by Tata in the field of iron and steel industry at Jamshedpur. After Independence, a number of consumer goods industries were set up in the private sector. Today India is practically self reliant in its requirements for consumer goods. According to the 1956 resolution, "industries producing intermediate goods and machines can be set up in the private sector." As a consequence, chemical industries like paints, varnishes, plastics etc. and industries manufacturing machine tools, machinery and plants, ferrous and non-ferrous metals, rubber, paper, etc. have been set up in the private sector.

**4. Potentialities due to personal incentive in the small sector.** Small and cottage industries have an important role to play in the industrial



field. These industries employ labour intensive techniques and are, accordingly, important from the point of view of providing employment opportunities. In India, all small and cottage industries are in the private sector. Personal initiative plays a decisive role in small-scale industries. With the help of a small capital, the small entrepreneur uses his resources efficiently to earn maximum profit. Such management is not available to public sector enterprises. The government has reserved a large number of items for production in the small-scale sector. This sector is granted loans at concessional rates of interest and marketing outlets are also provided. In addition, industrial estates have been established at various places where all facilities are provided under one roof to the small scale industries.

#### **4.2.2 Private Sector in the Post in the Post Liberalisation Phase**

As stated earlier, the new industrial policy enunciated in 1991 abolished industrial licensing and opened up the economy considerably. As a result, the private sector registered a fast growth in the post liberalization phase. 'Opening up' the economy to foreign competition has also forced considerable restructuring of the private corporate sector via consolidation, mergers and acquisitions as many business houses are concentrating on their core competencies and exiting from unrelated and diversified fields.

#### **Performance of the Corporate Sector**

Table 1 provides information on the performance of the corporate sector in the post-liberalisation period. As is clear from this Table, the average rate of growth of sales was 14.0 per cent per annum during 1990s (1990-91 to 1999-2000) and 14.2 per cent per annum during the period 2000-01 to 2006-07. Gross profits increased at an average

**Table 1**  
**Financial performance of the corporate sector.**

	1990-91 to 1999-2000	2000-01 to 2006-07	2003-04	2004-05	2005-06	2006-07	2007-08
1	2	3	4	5	6	7	8
Growth Rates	(Average)	(Average)					
Sales	14.0	14.2	16.0	24.1	16.3	26.2	18.3
Expenditure	14.1	13.6	14.9	23.6	16.7	23.4	18.4
Depreciation provision	17.3	8.9	6.0	11.2	8.1	15.4	14.8
Gross profits	12.5	20.4	25.0	32.5	24.6	41.9	22.8
Interest payments	15.8	-1.4	-11.9	-5.8	-2.0	1.7.4	28.8
Profits after tax	11.8	36.5	59.8	51.2	32.8	45.2	26.2
Select Ratios	(Min-Max.)	(Min-Max.)					
Gross Profits to Sales	(10.5-14.2)	(10.1-15.5)	11.1	11.9	12.2	15.5	16.3
Profits After Tax to Sales	(3.3-7.8)	(2.6-10.7)	5.9	7.2	8.2	10.7	11.8
Debt to Equity	(58.7-99.5)	(43.0-70.5)*	58.6	52.7	43.0	n.a.	n.a.
Internal Sources of Funds to Total Sources of Funds	(26.1-40.3)	(43.6-65.3)*	53.5	55.5	43.6	n.a...	n.a.
Memo:	(Amount in Rupees Crores)						
Number of Companies			2,214	2,214	2,730	2,388	2,359
Sales			4,42,743	5,49,449	7,35,216	10,41,894	11,41,711
Expenditure			3,86,559	4,77,609	6,43,824	8,78,645	9,56,930
Depreciation Provision			20,406	22,697	28,961	37,095	40,664
Gross Profits			49,278	65,301	90,179	1,61,006	1,86,665
Interest Payments			15,143	14,268	16,302	21,500	25,677
Profits after tax			26,182	39,599	60,236	1,11,107	1,34,291

rate of 12.5 per cent per annum during 1990s and at 20.4 per cent per annum during 2000-01 to 2006-07. What is most significant is the fact that the rate of growth of profits after tax which was 11.8 per cent per annum during 1990s increased to 36.5, per cent per annum during the period 2000-01 to 2006-07. Performance during the year 2006-07 has been particularly good. Growth in sales in this year was 26.2 per cent as against an average of 19.0 per cent during the preceding three-year period (2003-04 to 2005-06). Growth in gross profits at 41.9 per cent during 2006-07 was also higher than the average of 27.3 per cent during 2003-04 to 2005-06, and outpaced the growth in sales by

a large margin. Profits after tax increased by 45.2 per cent during 2006-07 on top of 48 per cent average growth during the three year period 2003-04 to 2005-06. Concomitantly, profit-margin the ratio of profits after tax to sales that fluctuated between 3:3 per cent and 7.8 per cent in the 1990s, improved from 5.9 per cent in 2003-04 to 10.7 per cent in 2006-07; Reflecting the sustained high profitability, internal sources now constitute a major source of funds. This has partly led to a reduced reliance on debt, and a decline in the debt-equity ratio to around 43 per cent by 2005-06 from more than 59 per cent during the 1990s.

However, as is clear from Table 32.2, the performance of the corporate sector in 2007-08 showed some deterioration vis-a-vis 2006-07. For instance, growth in sales and net profits during this year decelerated to 18.3 per cent and 26.2 per cent from 26.2 per cent and 45.2 per cent respectively in 2006-07. Growth in gross profits of the corporate sector also decelerated from 41.9 per cent in 2006-07 to 22.8 per cent in 2007-08;

### **Private Sector Corporate Giants — Ranking in Terms of Net Sales**

Table 2 presents data on top 10 private sector companies in India in 2009 (ranked according to net sales). As is clear from this table, the largest private sector company in terms of net sales in 2009 was Reliance Industries with its net sales touching Rs. 1,51,336 crore. In terms of assets also, the company ranks first with its assets placed at Rs. 2,34,800 crore in 2009. Reliance Industries also ranks first in terms of operating profits and net profits. Its operating profits stood at Rs. 25,336 crore in 2009 and net profits at Rs. 14,969 crore. The second ranked company in terms of net sales is Tata Steel. Its net sales in 2009 amounted to Rs. 1,47,365 crore. The third ranked company in terms of net sales in 2009 was Tata Motors with its net sales placed at Rs. 70,429 crore. Operating profits of this company were Rs. 2,548 crore and net profits were negative at - Rs. 2,505 crore. With net sales at Rs. 65,415 crore in 2009, Hindalco occupied the fourth position in 2009. The fifth position in terms of net sales in 2009 was occupied by Larsen & Toubro with its net sales placed at Rs. 40,371 crore. In terms of assets, Tata Steel was the

second largest company in 2009 after Reliance Industries with its assets at Rs. 1,24,239 crore.

In terms of Table 2, the three top companies in terms of assets in 2009 were Reliance Industries, Tata Steel and Tata Motors. In terms of net profits, the top three companies in 2009 were Reliance Industries, Bharti Airtel and Tata Consultancy Services.

**Table 2**

**Top ten private sector companies (Ranked According to net sales), 2009**

Company	Net Sales		Operating Profit		Net Profit		Assets	
	2009	Percentage change over previous year	2009	Percentage change over previous year	2009	Percentage change over previous year	2009	Percentage change over previous year
1.Reliance Industries	151336	10.1	25336	-12.90	14969	-23.3	234800	37.7
2.Tata Steel	147365	12.1	14799	-40.90	4951	-59.9	124239	-2.9
3.Tata Motors	70429	98.8	2548	-46.7	-2.505	**	74165	109.6
4.Hindalco	65415	9.6	3665	-49.7	485	-47.9	66906	-9.2
5.Larsen & Tourbo	40371	37.7	6844	53.8	3790	62.0	55722	42.5
6.Essar Oil	38106	5745.2	1317		-483	***	23151	6.0
7.Bharti Airtel	37352	38.3	15570	36.7	7859	22.9	62502	33.3
8.Tata Consultancy Service	27813	23.0	6743	4.7	5256	4.6	22430	29.1
9.Adani Enterprises	26189	33.7	1224	36.1	505	36.5	19657	63.0
10.Suzlon Energy	26082	90.7	2344	13.4	236	-77.0	35568	38.9

Since 2008-09 was the year of economic slowdown in the country as a result of global recession, operating profits and net profits of many companies fell. Even the top private sector companies could not buck the trend and registered a fall in profits. As is clear from Table 32.3, the net profit of Tata Steel declined by as much as 59.9 per cent and that of Hindalco by 77.9 per cent in 2008-09 vis-a-vis 2007-08.

## **Private Sector Corporate Giants — Ranking in Terms of Market Capitalisation**

In recent years, the attention of many corporate sector observers has been shifting from sales recorded by a corporate enterprise to its market capitalisation. Market capitalisation is simply the value assigned by the stock market to a firm. On any particular day, market capitalisation is obtained by multiplying the number of outstanding shares of a company to the stock price on that particular day. However, since stock prices fluctuate from day-to-day and are manipulated by speculators, it is generally average market capitalisation for a period that is taken into account. For instance, a six-monthly average could be considered or an annual average could be considered. Information on top 10 private sector companies on the basis of market capitalisation is provided in Table-3.

As is clear from this Table, the largest private sector company in terms of market capitalisation is Reliance Industries. The average market capitalisation of this company stood at Rs. 2,68,448 crore in 2008-09. Bharti Airtel occupies the second position in terms of market capitalisation with its market capitalisation in 2008-09 at Rs. 1,39,238 crore. Infosys Technologies occupies the third position followed by ITC and TCS. What is significant is the fact that the three top IT companies of the country — Infosys, TCS and Wipro are among the top ten companies in terms of market capitalisation.

Conditions of slowdown in the economy during the year 2008-09 affected the investor psychology adversely and, as a result, market capitalisation of most of the companies fell in this year vis-a-vis the previous year. Of the top ten private sector companies in 2008-09 listed in terms of market capitalisation, the most adverse effect can be seen in the case of ICICI Bank whose market capitalisation fell by as much as 42.7 per cent in 2008-09 over 2007-08.

### 4.2.3 Problems of the Private Sector

**1. Profit generation is the main motive.** Industrialists in the private sector operate with the sole motive of maximizing profits. Consequently, they are interested in investing only in those industrial sectors where quick profit generation is possible. Therefore, they tend to invest in consumer goods industries and ignore investments that are crucial for building up a proper industrial infrastructure. Since lack of infrastructure and capital goods industries plagued the Indian economy after Independence, while private sector was reluctant to invest in these areas, the public sector had to step in. Thus, for a considerable period of planning, while the public sector bore the responsibility of developing the capital goods and basic industries and industrial infrastructure (electricity and power, transportation, communications etc.), the private sector concentrated on consumer goods industries; where investments were low and profits high. Thus, a-number of economists allege that in the initial phase of

**Table 3**  
**Top ten private sector companies – ranked on the basis of market capitalization**

Rank	Company	Average Market Cap. 2008-09	Average Market Cap. 2007-08	Average Market Cap. 2006-07
1.	Reliance Industries	2,68,448	3,14,124	1,60,393
2.	Bharti Airtel	1,39,238	1,66,593	97,891
3.	Infosys Technologies	84,595	1,02,417	1,04,532
4.	ITC	69,928	67,223	66,904
5.	TCS	67,808	1,03,535	1,03,974
6.	ICICI Bank	62,775	1,09,586	63,486
7.	Larsen & Toubro	61,349	84,890	36,884
8.	Housing Development Finance Corp. 55,380		62,672	35,065
9.	Wipro	50,400	70,712	77,669
10.	HDFC Bank	45,171	46,296	28,658

industrial development lasting for about three decades, the private sector was not willing to shoulder the responsibility of a prime mover of economic development processes.

**2. Focus on consumer durables sector.** Even in the consumer goods sector, the focus of the private sector is on the elite consumer groups since it is these groups that have ample purchasing power. Thus, the production pattern is skewed in favour of the relatively small richer sections of the society. As a result, while production of elite consumer durable goods like consumer electronics and automobiles is encouraged, the production of mass consumption goods is neglected. Some economists allege that this implies the wastage of the economic surplus of the country on unnecessary industrial activities while the 'core' economic activities suffer. This leads to, what they call, 'distortions in production structure.' However, if the increasing trends of liberalisation in the Indian economy during the last two decades are any indication, the Government of India now regards such investments as 'prime movers of growth' rather than distortions.

**3. Monopoly and concentration.** It is the general pattern of capitalist development that, as the economy progresses, the monopoly organisations is strengthened and concentration of wealth and economic power in a few hands increases. This has happened in India also. In the pre-Independent India, this was encouraged by the managing agency system. After Independence, with the initiation of economic planning in the country, it was expected that this tendency would be effectively controlled. However, this was not to be. The Mahalariobis Committee pointed out in 1964 that the operation of the system had actually resulted in increase in the concentration of wealth and economic power. Similar conclusions were arrived at by the Monopolies Enquiry Commission in 1965. These tendencies have been further strengthened by the substantial liberalisation of industrial policy in the last two decades which has enabled the large business houses to amass considerable wealth with the result that concentration of economic power has further increased.

**4. Declining share of net value added in total output.** Net value added is defined as the amount generated over and above the cost of raw materials which go to the production system after allowing for the depreciation charges. It, thus, indicates the efficiency of the production process. Many industries in the private sector have reported a fall in the share of net value added in output in a number of years. This fall means that the same amount of raw materials has generated less output. It, thus, implies a decline in efficiency.

**5. Infrastructure bottlenecks.** Severe capacity shortfalls, poor quality and high “cost of infrastructure continues to constrain Indian businesses. The most important infrastructural constraint is power. Industry surveys have found that acute power shortfalls, unscheduled power cuts, erratic power quality (low voltage coupled with fluctuation), delays and informal payments required to obtain new connections, and very high industrial energy costs, hurt industry performance and competitiveness. Frequent and substantial power cuts (mostly unscheduled) have forced many units to operate their own (captive) generators, further increasing the cost of power for industry and reducing firm competitiveness. A World Bank - CII survey conducted in 2002 found that 69 per cent of the manufacturing firms surveyed across India had their own power generator, far more than the” 30 per cent in China. For garments and electronics, energy costs in Indian firms were found to be twice those in Indonesia, the Philippines, and Thailand. In fact, industrial tariffs for larger firms in India are 8-9 cents/ kWh, among the highest in the world (typical rates in Western Europe are in the range 6-7 cents/kWh while in China they are in the range 3-4 cents/kWh). Moreover, the ‘quality’ of power is also poor. Some 40 per cent of the industries surveyed in Andhra Pradesh reported damage to equipment due to the poor quality of power with damage much more costly for industries with sensitive equipment, and process and quality heavily dependent on motor speed.

The second most important infrastructural constraint is transport. While India has one of the most extensive transport systems in the world, there are severe capacity and quality constraints. It has currently no inter-State



expressways linking the major economic centres, and only 3,000 kilometers of four-lane highways (China has built 25,000 kilometers of four-to-six-lane, access controlled expressways in the last 10 years). Poor riding quality and congestion result in truck and bus speeds on Indian highways that average 30-40 kilometers an hour, about half the expected average. India's high-density rail corridors also face severe capacity constraints, compounded by poor maintenance.

**6. Contribution to trade deficit.** A large number of private sector companies have been resorting to massive imports in the post-liberalisation phase to upgrade their technology in a bid to brace up to global competition. As a result, their import expenditures have increased at a much faster rate than their export earnings. This has pushed up the country's trade deficit.

**7. Industrial disputes.** As compared to public sector enterprises, the private sector enterprises suffer from more industrial disputes. Differences and conflicts between the owners and employees regarding wages, bonus, retrenchment and other issues frequently emerge. Although there is a provision for Works Committees, Arbitration Boards, etc. for settlement of industrial disputes, the employers have better bargaining strength. Taking advantage of this, they often refuse to accede even the genuine demands of workers and the conflicts assume the shape of long drawn out struggles. Industrial disputes often result in strikes, lockouts, gherao, etc. Valuable man-days are lost and productive activity suffers.

**8. Industrial sickness.** This is a serious problem confronting the small, medium and large units in the private sector. Substantial amount of loanable funds of the financial institutions is locked up in sick industrial units causing not only wastage of resources but also affecting the healthy growth of the industrial economy adversely. As at the end of March 2007, the total number of sick/weak units in the portfolio of scheduled commercial banks stood at 1.18 lakh involving a bank credit of Rs. 30,333 crore. Causes of industrial sickness are many and are generally divided into two categories: (i) external and (ii) internal. The former include factors which originate outside the unit

and are, therefore, not under the control of the unit such as power cuts, demand (or market) recession, erratic availability of inputs, government policies etc. The latter include factors which originate within the unit and can, therefore, be said to be under the control of the unit such as production, management, finance etc.

**9. Problems relating to finance and credit.** Since the rate of capital formation in the economy is low and the capital market is in an underdeveloped state, the private sector enterprises have to encounter serious difficulties in arranging finances. Because of high inflationary tendencies in the economy, people are attracted towards purchasing land, gold and jewellery and are not willing to invest in industries. Inflationary conditions have also given birth to black marketing and a large parallel economy which weans away funds from productive activities. The industrial finance institutions have filled up this gap to some extent but the problem continues to be enormous.

**10. Threat from foreign competition.** The process of liberalisation unleashed in 1991 has opened up the gates to foreign investors and the government has progressively introduced measures to 'open up' the economy to foreign competition. This process of globalization and 'integration' of the Indian economy with the world economy has led to an unequal competition a competition between 'giant MNCs (multinational corporations)' and 'dwarf Indian enterprises'. In the early euphoria of liberalisation, the private sector welcomed the measures of the government, but it soon came to realise that opening up the Indian economy to foreign competition meant not only more and cheaper imports and more foreign investment but also opportunities to the MNCs to raid and takeover their enterprises. Even the large Indian enterprises are just pygmies compared to the. Multinational corporations and while some of them have already been gobbled up by the latter, some others are awaiting their turn with bated breath. As once noted by an MP from West Bengal, the globalization of the Indian economy is like integrating a mouse into a herd of elephants.

### **4.3 Privatisation of Public Sector Enterprises : The Disinvestment Programme in India<sup>16</sup>**

- Meaning and rationale of privatisation
- Methods of privatisation
- Evolution of privatisation policy in India
- The disinvestment programme in India as it is in this form that privatisation has been carried out in India
- A critical evaluation of the privatisation and disinvestment programme adopted in India.

#### **4.3.1 Meaning and Rationale of Privatisation**

Privatisation is a process by which the government transfers the productive activity from the public sector to the private sector. Many countries of the world—industrial market economies, the former socialist economies (belonging to Central and Eastern Europe and Soviet Union), and a large number of developing countries belonging to Asia, Africa and Latin America — have launched massive programmes of privatisation during the period of last two-three decades or so. While many industrial market economies (particularly OECD member countries) have carried out the programme of privatisation on their own accord, former communist countries and many developing countries were forced by the IMF and World Bank to carry out privatisation as a condition for assistance under the economic stabilisation and structural adjustment programmes.

According to the supporters of privatisation, the rationale for privatisation and disinvestment is as follows:

1. The private sector introduces the 'profit-oriented' decision making process in the working of the enterprise leading to improved efficiency

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<sup>16</sup> Misra & Puri, Indian Economy, 2011, Himalaya Publication, Pg.402.

and performance. Moreover, private ownership establishes a market for managers, which improves the quality of management.

2. While personnel in the public enterprises cannot be held responsible (or accountable) for any lapse, the areas of responsibility in the private sector are clearly defined. This makes it possible to take people to task in the private sector units for any blunders committed by them whereas in public sector units, it is easy to pass the buck. Even when responsibility is defined in the public enterprises, there, are too many pressures and forces operating to reduce its effective implementation.
3. Private sector firms are subject to capital market disciplines and scrutiny by financial experts. In fact, the ability to raise funds in the capital market is crucially dependent on performance. Not so in the case of public enterprises. On account of government ownership of these enterprises, they have easy access to credit and budgetary support irrespective of their performance. Thus there is no compulsion for these enterprises to perform well.
4. According to Bimal Jalan, political interference is unavoidable in public corporations and is a major cause of decline in operational efficiency. "Such political decision-making reflects itself in the less than optimal choice of technology or location, overstaffing, inefficient use of input, and purchase or price preferences for certain suppliers."<sup>1</sup> Most governments also impose non-economic objectives on public enterprises.
5. Many public sector enterprises remain 'headless' for long periods of time. This causes confusion and delay in decision-making as nobody is sure how the new incumbent will act (or react) on the policy decision being undertaken. Such a situation does not exist in private sector enterprises as the heir-apparent is identified early on and groomed to take over the reins when the time actually arrives.
6. In a quick changing business environment it often becomes necessary to take spot decisions without having to worry too much about not

having consulted others. In fact, 'delayed decision-making is often equivalent to making no decision at all.' In public enterprises, the concept of response time is almost totally absent as no one is willing to disturb the status quo. Not so in the case of private sector enterprises. Because of the very nature of management in these units,; it becomes easier to react to changing situations fast.

7. Private sector firms are more subject to liquidation threat of takeover, and loss of assets for owners than public sector enterprises. When owners stand to lose control over assets, there is greater likelihood of remedial measures being taken earlier.
8. According to Bimal Jalan, efforts to improve managerial efficiency in public enterprises by administrative measures are generally short-lived and, unsustainable as, sooner or later, political considerations take precedence over economic or commercial considerations. This has happened in many countries including Italy, France, Korea, India and Pakistan.
9. The very survival of private sector enterprises depends on customer satisfaction since only such satisfaction can ensure more widespread and repeat buying. As against this, so the argument goes, caring for the customer is generally not a priority with public sector enterprises. Once privatisation occurs, the need to create and sustain markets Will lead to a sea change in the attitude of these enterprises towards customers. Hence, quality of services will improve.

#### **4.3.2 Methods of Privatisation**

The first major programme of privatisation was adopted in U.K. by the conservative government of Margaret Thatcher during 1980s. In this swift and widespread programme, a large number of public sector companies that dominated a wide swathe of industry and services in UK. including railways, aerospace, oil, telecommunications mining, and bus: services were sold off. This was followed by privatisation in France and many other OECD countries,

former communist Countries, and developing nations. The methods of privatisation used by these countries were frequently one or a combination of the following methods.

**1. Initial Public Offering (IPO).** This is the most important method used for privatisation in UK and OECD countries. Under this method, the shares of public sector undertakings (PSUs) are sold to the retail investors and institutions. The government may, in some cases, sell shares of a PSU in international market also. The IPO method is the best method in the case of those countries which have a strong capital market. In fact, OECD countries raised as much as two-thirds of all their privatisations proceed in 1990s through IPOs. The main advantage of the IPO method are as follows: (i) it ensures wide participation of retail investors and thus helps in a broad-based control of the public sector entity at the same time as it helps in the widening and deepening of the capital market; (ii) it is likely to face less resistance from the PSU employees as there is a continuity in the management; (iii) it can be used to offer shares to the employees; and (iv) it can be employed usefully in those cases where the government wants to raise resources but does not want to lose control of the enterprise. However, the main problem in this method is the problem of 'valuation' - i.e., what should be the 'price' of the share? Since in most countries shares of public sector undertakings are not traded on the stock exchanges, it is not possible to find out the right price at which the government should sell the shares of a PSU. As we shall point out later in this chapter, as a result of this problem, the Government of India actually obtained much less through disinvestment as it could have had (because in many cases the shares were undervalued). Moreover, this method cannot be adopted in small countries with weak capital markets and institutions.

**2. Strategic Sale.** In this method, the government sells its share in the PSU to a strategic partner. As a result, the management passes over to the buyer. The advantages claimed for this method are as follows: (i) the performance and efficiency of the enterprise is expected to improve as the private partner introduces better management practices on the one hand, and

the unit is freed from government shackles on the other hand; (ii) the government may realise a better price as the strategic partner may be willing to pay more because of the synergy he perceives in combining the PSU business with his own existing business; (iii) the strategic partner would be willing to inject more capital into the PSU and modernise its business operations as he would be keen in generating profits; (iv) loss-making PSUs will be unattractive to the public whereas a strategic acquirer can have the skills to turnaround the business even after paying a reasonable price; and (v) this method is the most important method of disinvestment in small countries with weak capital markets and in those countries where shares of PSUs are not traded (and hence it is not possible to know the 'share price'). However, this method has a number of disadvantages: (i) this method is 'unfair' as many ordinary citizens cannot participate in it; (ii) the whole process of selecting a strategic partner and setting the terms of sale depends on the ministers and officials. Thus, the whole process is non-transparent and arbitrary. Since it is very difficult to assess the 'actual' value of the enterprise, the strategic partner often connives with government officials to get control over the company at a value far less than the actual value of the enterprise. As a result, the government gets a far less realisation from the sale vis-a-vis the actual value; (iii) the acquisition of a PSU with a significant market share by a partner in a similar business can lead to a monopolistic or oligopolistic situation, which could be harmful to consumer interests; (iv) there is a serious risk of employees losing their job as the strategic partner is likely to restructure the PSU business to align with his existing business; and (v) once even a small part of the equity is sold to a strategic partner, other potential bidders will be put off, thereby lowering the value of the rest of the PSU's shares.

Smaller countries, especially those in the former Soviet Union and Eastern Europe (the so-called 'transition economies') have often relied more on the method of strategic sales to privatise their PSUs. This is due to the reason that most of these countries did not have well developed capital markets and shares of PSUs were not traded. Therefore, it was not possible to find the correct share price of a company. This method has also been followed by some OECD countries during the last few years. In some cases, a

combination of IPO method and strategic sales method is adopted. Two approaches are followed in these instances: (i) first a controlling stake is sold to a strategic buyer through a direct sale in order to provide the company with a good management and then subsequent stakes are sold through a public offering to retail and institutional investors as a means of developing the equity market; or (ii) first a share in the company is sold on the stock markets, and once its 'market price' is determined, a controlling stake is sold to a strategic partner. This is closer to what is happening in the case of our oil companies.

In most OECD privatisations, a portion of the shares are allocated for sale to employees, in order to ensure their participation in privatisation and to gain their support. Poland's sale of a stake in telecom company TPSA, for instance, involved a series of steps including a strategic sale, subsequent public offering and a share going to the employees.

**3. Sale to Foreigners.** This is a variant of the strategic sales method where the buyer is not a domestic company but a foreign company. In small countries, the amount of domestic private capital is often limited. Therefore the government sells its stakes to a foreign company. At times, sales to a foreign company are preferred as the expectation is that the foreign company will bring with it world-class technology and expertise to run the PSU. For instance, Hungary received \$ 12 billion through privatisation over the period 1990 and 1998 and, of this, as much as 60 per cent was contributed by foreign investors. The countries of South America have also seen many key companies, including two water companies in Chile, pass into foreign hands in the 1990s. In cases where the government has set up a PSU in collaboration with a foreign company, it may simply sell its stake to the latter. This is what the Government of India has done in the case of Maruti Udyog Ltd. where it has sold its stake to the foreign collaborator Suzuki company of Japan.

**4. Equal-Access Voucher Programmes.** This form of privatisation involves distribution of vouchers across the population and attempts to allocate assets approximately evenly among voucher holders. Such



programmes excel in speed and fairness. However, they raise no revenue for the government and have unclear implications for corporate governance. Mongolia, Lithuania, the former Czechoslovakia, Albania, Armenia, Kazakstan, Poland and Romania (in its 1995 programme) followed this method of privatisation. The Czech Republic's equal-access voucher programme has been the most successful to date. In two successive waves, the Czech transferred more than half the assets of public enterprises into private hands. Citizens were free to invest their vouchers directly in the firms being auctioned. However, to encourage more concentrated ownership and to create incentives for more active corporate governance, the programme allowed the free entry of intermediary investment funds to pool vouchers and invest them on the original holders' behalf. More than two-thirds of the voucher-holders chose to place their vouchers with these competing funds. This led to concentrated ownership of the Czech industrial sector in these large funds. These funds are now participating actively in monitoring managerial performance, imposing financial discipline on the firms they own, trading large blocks of shares among themselves or selling them to new strategic investors, etc. Thus, the Czech experience shows how a well designed voucher-programme can overcome many problems. "It can depoliticize restructuring, stimulate development of capital markets, and quickly create new stakeholders with an interest in reform." However, as correctly pointed out by the World Development Report, while funds monitor the functioning of firms, the question is who will monitor them? Supervising financial agents is difficult even in established market economies and is even more problematic in transition economies, where norms of disclosure and fiduciary responsibility are weak and watchdog institutions are still in a highly underdeveloped state.

**5. Management - Employee Buyouts.** In this route to privatisation, managements and employees themselves buy major stakes in their firms. This method has been; widely used in Croatia, Poland, Romania, and Slovenia. In addition, several voucher-based programmes, such as those of Georgia and Russia, gave such large preferences to insiders that most privatised firms were initially owned! mainly by managers and employees. The

advantage of this method is that it is easy to implement, both politically and / technically. It might also be better for corporate governance; if insiders have better access than outsiders to the information; needed to monitor managers. However, as pointed out by the World Development Report, the risks and disadvantages.; of the method are many, particularly in large-scale buyout; programmes that include many unprofitable firms in need? of restructuring. One important disadvantage is that benefits? are unevenly distributed: employees in good firms get valuable; assets while those in money-losers get little or nothing of value. The second disadvantage is that government tends to charge low prices to insiders and thus realizes little revenue? Finally, managers or employees can connive to block entry of outsiders. At times, outsiders may hesitate to investing firms with significant insider ownership legally or illegally acquired because of potential conflicts of interest between insiders and outside owners. In Russia's mass privatization programme of 1992-94 (which, despite the use of vouchers, was basically a management-employees buyout programme because of its preferential treatment of "managers and workers), insiders ultimately acquired about two-thirds of the shares in the 15,000 privatised firms (accounting for 60 percent of industrial assets) while outsiders obtained only 20 to 30 per cent (about 10 to 15 per cent each went to investment funds and industrial investors), and rest remained in government hands. This exercise soon became politically unpopular as the masses felt that they had been left with the dregs while managers engaged in 'asset stripping', and effective control of the best companies passed into the hand of a chosen few.

#### **4.3.3. Evolution of Privatization Policy in India**

As stated in the chapters on 'Industrial Policy' and 'Public Sector in the Indian Economy', there has been a marked change in the perception towards the role of public sector in the Indian economy since 1991. Some economists argued that the fiscal crisis of 1991 was a result of the public sector's inability to generate adequate returns on investment. The government's attitude also changed markedly as is clearly demonstrated in the following "statement made in the New Industrial Policy, 1991: "After the initial exuberance of the public sector entering new areas of industrial and technical competence, a

number of problems have begun to manifest themselves in many of the public enterprises-. Serious problems are observed in the insufficient growth in productivity, poor project management, over-manning, lack of continuous technological upgradation, and inadequate attention to R & D (Research and Development) and human resource development. In addition, public enterprises have shown a very low rate of return on the capital investment. This has inhibited their ability to re-generate themselves in terms of new investments as well as in technology development/The result is that many of the public enterprises have become a burden rather than being an asset to the Government". Consequently, the New Industrial Policy, 1991, advocated privatisation of public sector enterprises. For purposes of privatisation, the government has adopted the route of disinvestment which involves the sale of the public sector equity to the private sector and the public at large.

The evolution of privatisation policy in India since the start of economic liberalisation since 1991-92 can be outlined as below:

1. Interim Budget and Budget Speech, 1991-92. The Government of India enunciated a policy to divest upto 20 per cent of its equity in selected public sector undertakings to mutual funds and investment institutions in the public sector, as well as workers in these firms. The stated purpose of the policy was to place equity across a broad base, improve management, increase resources to the enterprises, and to raise funds for the general exchequer. Initially, as shown in Table 31.1, shares of different PSUs were bundled together and sold to domestic financial institutions. Later in 1992-93, to ensure better prices, individual shares were auctioned separately.
2. Report of Rangarajan Committee on Disinvestment of Shares, 1993. The Government appointed a Committee on Disinvestment in Public Sector Enterprises under the Chairmanship of C.Rangarajan in 1993 to suggest the correct method of divestiture. The Committee recommended that the percentage of equity divested could be upto 49 per cent for industries reserved for the public sector, and that, in exceptional cases upto 74 per cent of the equity could be divested. In industries not reserved for the public sector, 100 per cent of the equity could be divested. Only the following 6 industries were reserved for the

public-sector: (i) coal, (ii) minerals and oils, (iii) armaments, (iv) atomic energy, (v) radioactive minerals, and (vi) railways. The Government of India did not act on these recommendations.

3. Divestment Commission Recommendations: February 1997-October 1999. The Government constituted a five member Public Sector Disinvestment Commission under the Chairmanship of G.V. Ramakrishna in August 1996 for drawing a long-term disinvestment programme for the PSUs referred to the Commission. The Commission recommended divestment of 58 different PSUs. Moreover, in a break from a past policy of share public offerings, the Commission recommended strategic sales with transfer of management. By 1996-97, sales were open to NRIs and foreigners, and through global depository receipts (GDRs) in the international markets.
4. Budget Speech, 1998-99. In the Budget Speech, 1998-99, the Finance Minister stated that "Government has decided that in the generality of cases, the government shareholding in public sector enterprises will be brought down to 26 per cent. In cases of public sector enterprises involving strategic considerations, government will continue to retain majority holding. The interests of workers shall be protected in all cases."
5. Strategic and Non-Strategic Classification, 1999. Reflecting the- report of the Rangarajan Committee from some six years earlier, the government announced the classification of industries into strategic and non-strategic areas. Strategic industries were limited to: (i) arms, ammunitions, and related defense industries; (ii) atomic energy; (iii) mining of minerals for the atomic industry; and (iv) railway transport. All other industries were classified as non-strategic. For all PSUs in non-strategic industries, government stakes could be dropped to as low as 26 per cent on a case-by-case basis. Since three-fourths majority is needed to pass certain important board resolutions, for control reasons government set a lower limit of 26 per cent of the equity.
6. Address by President to Joint Session of Parliament, February 2001. In his address to the joint session of Parliament in February 2001, the President stated thus: "The government's approach to PSUs has a

threefold objective: revival of potentially viable enterprises; closing down of those PSUs that cannot be revived; and bringing down government equity in non-strategic PSUs to 26 per cent or lower. Interests of workers will be fully protected through attractive Voluntary Retirement Schemes and other measures.” As Table 31.2 shows, in some cases government's equity stake dropped below 26 per cent.

7. National Common Minimum Programme, 2004. The National Common Minimum Programme (NCMP) of the UPA coalition government was released on May 28, 2004. NCMP confirmed the commitment of the UPA government to a 'strong and effective public sector' and laid down the following guidelines as far as privatisation of Central PSEs is concerned: (i) all privatisations will be considered on a transparent and consultative case-by-case basis; (ii) generally profit making companies will not be privatised; (iii) the government will retain existing 'navratna' companies in the public sector while these companies can raise resources from the capital market; (iv) while every effort will be made to modernise and restructure sick public sector, companies and revive sick industry, chronically loss-making companies will either be sold-off, or closed, after all workers have got their legitimate dues and compensation; and (v) the government believes that privatisation should increase competition, not decrease it. Therefore, it will not support the emergence of any monopoly that only restricts competition.

The government approved the constitution of a National Investment Fund (NIF) from April 1, 2005 comprising of proceeds from disinvestment of public sector undertakings. 75 per cent of the annual income of NIF will be used to finance selected social sector schemes, which promote education, health and employment, The residual 25 per cent of the annual income of NIF will be used to meet the capital investment requirements of profitable and revivable Central PSEs that yield adequate returns, in order to enlarge their capital base to finance expansion/diversification.

On May 26, 2005, the Finance Minister announced the intention to disinvest 10 per cent of government-owned equity in the navratna company BHEL (the residual government-owned equity share exceeded 51 per cent after sale). However, after protests from the Left parties, this move was

dropped. The Minister of Heavy Industries and Public Enterprises announced that he had put on hold the decision regarding disinvestment in BHEL and other proposals (for disinvestment) in his ministry. The Finance Minister also ruled out the strategic sale route of disinvestment while keeping open the offer of sale route in 13 profit-making PSEs identified by the earlier NDA government. In June 2006 another attempt was made, this time for the sale of 10 per cent stake each in two non-navratna profit-making companies — NALCO (National Aluminum Company) in Orissa and NLC (Neyveli Lignite Corporation) in Tamil Nadu. However, following indefinite strike by NLC workers, the move was shelved. On July 6, 2006, the Prime Minister decided to keep all disinvestment decisions and proposals on hold, pending further review. However, in recent times, interest in disinvestment has again revived. During 2009-10, the shares in many PSEs like Oil India Ltd., NHPC, NTPC and REC (Rural Electrification Corporation), NMDC etc., have been sold and the government expressed its intention to raise Rs. 125,000 crore through this means. In the Budget for 2010-11, the Finance Minister has kept a target of Rs. 40,000 crore for disinvestment.

### **Proceeds from Disinvestment and Methodologies Adopted**

As stated earlier, the Government has adopted two methods of disinvestment: (i) selling of shares in select PSUs, and (ii) strategic sale of a PSU to a private sector company. The former method was used over the period 1991-92 to 1998-99 and, as is clear from Table 31.1, the government experimented with various variants of this method. From 1999-2000 to 2003-04, the emphasis shifted to the latter method which involved strategic sale of a PSU to a private sector company through a process of competitive bidding. After 2004-05, disinvestment realisations have been mostly through sale of equity.

Table 4 gives the targets and achievements of disinvestment in different years and the methodologies adopted for the purpose. Initially in 1991-92, the government, offered, shares for sale in 'bundles' involving a combination of equity from poor and good, performers. In practice" rather than help the government divest shares in loss

**Table 4**  
**Disinvestment in PSUs and methodologies adopted, 1991-92 to 30-9-2009**

Year	Target receipt for the year (Rs.in crore)	Actual receipt, (Rs.in crore)	Methodology
1991-92	2,500	3,037.74	Minority shares sold in Dec. 1991 and Feb. 1992 by auction method in bundles of 'very good', 'good' and average companies.
1992-93	2,500	1,912.51	Shares sold separately for each company by auction method.
1993-94	3,500	—	Equity of 6 companies sold by auction method but proceeds received in 1994-95.
1994-95	4,000	4,843.10	Shares sold by auction method.
1995-96	7,000	168.48	Shares sold by auction method.
1996-97	5,000	379.67	GDR –VSNL
1997-98	4,800	910.00	GDR – MTNL
1998-99	5,000	5,371.11	GDR - VSNL; Domestic offerings of CONCOR and GAIL; Cross purchase by 3 Oil sector companies, i.e., GAIL, ONGC and IOC.
1999-2000	10,000	1,860.14	GDR - GAIL; Domestic offering of VSNL; capital reduction and dividend from BALCO; strategic sale of MFIL.
2000-01	10,000	1,871.26	Sale of KRL, CPCL and BRPL to CPSEs; Strategic sale of BALCO and LJMC
2001-02	10,000	5,657.69	Strategic sale of CMC, HTL, VSNL, IBP, PPL, hotel properties of ITDC and HCI, slump sale of Hotel Centaur Juhu Beach Mumbai and leasing of Ashok, Bangalore; Special dividend from VSNL, STC, and MMTC; sale of shares to VSNL, employees.
2002-03	12,000	3,347.98	Strategic sale of HZL, IPCL, properties of ITDC, stump sale of Centaur Hotel Mumbai Airport. Premium for renunciation of rights issues in favour of SMC; Put option of MFIL; sale of shares to employees of HZL and CMC
2003-04	14,500	15,547.41	Strategic sale of JCL; call option of HZL; offer for sale of. MUL, IBP, IPCL, CMC, DCI, GAIL and ONGC; sale of shares of IC1 Ltd.
2004-05	4,000	2,764.87	Offer for sale of NTPC and spillover of ONGC, sale of shares . to IPCL employees.
2005-06	No target fixed.	1,569.6.8	Sale of MUL shares to Indian public sector financial institutions and banks and employees.
2006-07	No target fixed		
2007-08	No target fixed	4,181.39	Sale of MUL shares to public sector financial institutions, public sector banks and Indian mutual funds and sale of PGCIL and REC ... shares through offers for sale.
2008-09	No target fixed		
2009-10	No target fixed	4,259.90	Rs. 2,012.85—NHPC and Rs. 2,247.50—OIL
Total		57,682.93	

making PSUs at reasonable prices, bundling resulted in the government obtaining a very low average price for each bundle, implying: that prime shares were handed over at rock-bottom prices. In 1992-93, the government abandoned the bundling of shares and sold shares of each company separately by the auction method, In 1994-95; NRI and other persons were allowed to participate in the auction. In 1996-97 and 1997-98, GDRs (Global Depository Receipts) of VSNL and MTNL in international markets fetched Rs. 380 crore and Rs. 910 crore respectively. In 1998-99, along with QDR and domestic offerings with the participation of foreign institutional investors, cash-rich PSUs (like ONGC, GAIL and IOC) were forced to 'cross hold' shares in related PSUs by buying them from the government. From 1999-2000 to 2003-04, as stated earlier, the focus of the government shifted to the second method of disinvestment the strategic sale of a PSU to a private sector company. The government resorted to strategic sale of a number of companies — MFIL (Modem Foods India Ltd)., Videsh Sanchar Nigam Ltd. (VSNL), Indian Petrochemicals Corporation Ltd. (IPCL), Bharat Aluminum Company (BALCO), CMC Ltd, HTL Ltd. IBP, Indian Tourism Development Corporation (ITDC) (13 hotels), Hotel Corporation of India Ltd. (HCI Hotels), Paradeep Phosphates Ltd. (PPL), Hindustan Zinc Ltd. (HZL), Maruti Udyog Ltd. (MUL) etc.

As is clear from Table 31.1, the actual realisation from disinvestment over the period 1991-92 to 30-9-2009 was Rs.57,682.93 crore as against the target of Rs.96,800 crore for the period 1991-92 to 2004-05 (no target was set for later years). Thus, achievement has been very much less as compared with the target.

#### **4.3.4 A Critique of Privatisation and Disinvestment**

The policy of privatisation and disinvestment has been criticised on the following counts.



## **Undervaluation of Assets**

A study of the data presented in Table 31.1 shows that the performance on the disinvestment front over the period 1991-92 to 2009-10 has been dismal. Only in four years — 1991-92, 1994-95, 1998-99 and 2003-04, the targets for disinvestment were exceeded. According to CP. Chandrashekhar and Jayati Ghosh, the success in 1991-92 was due to the decision to accept extremely low bids for share 'bundles' which included equity from PSUs which would have otherwise commanded a handsome premium. The average price at which more than 87 crore shares were sold in this year was only Rs. 34.83 as compared with the average price realisation of Rs. 109.61 since then. In 1994-95, success was due to the off-loading of a significant chunk of shares in very attractive and profitable PSUs like BHEL, Bharat Petroleum, Container Corporation of India, Engineers India, GAIL, MTNL etc. And in 1998-99 the success was due to the reason that cash-rich PSUs like ONGC, GAIL and IOC were forced to buy shares of other PSUs. “This amounted to forcing PSUs, that needed further investment themselves so as to be restructured, to face up to the more liberal and competitive environment, to hand over their investible surpluses to finance the fiscal deficit of the government.” The success in 2003-04 was primarily due to sale of 142.60 million shares in ONGC which fetched as much as Rs. 10,695 crore.

In all other years, realisations from disinvestment were much less than the targets. The main reasons for this poor performance were as follows:

1. The government earned out the whole exercise of disinvestment in a hasty, unplanned and hesitant way. Thus it failed to realise not only the best value but also the other objectives of the disinvestment programme.
2. The government launched the disinvestment programme without creating the required conditions for its take-off. This would be clear from the fact that it did not try to list the shares of the public sector enterprises on the stock exchanges. Thus, adequate efforts were not made to build-up the much needed linkage between the public enterprises on the one hand and the capital market on the other.

3. The government did not adopt suitable methods to oversee the disinvestment of public sector shareholding.
4. The Department of Public Enterprise and the Finance Ministry adopted techniques and methods which resulted in far lower realisation than justified.

On account of all these reasons, there was considerable “under-pricing” of public enterprises shares resulting in considerable loss to the government. This is clear from the three reports of CAG (Comptroller and Auditor General of India) that have appeared so far. In his first report (1993), the CAG pointed out that the extent of loss to the government in percentage terms varied from 127 per cent in the case of HPCL (its share having been sold for Rs. 243 against the market price of Rs. 550) to as high as 616 per cent in the case of NLC (its share having been sold for Rs. 11 against the market price, of Rs. 82). The average loss consequent upon the under pricing comes to about 256 per cent. If we apply this percentage to the divestiture proceeds for 1991-92 and 1992-93 we find that the potential proceeds would have been Rs. 12,554 crore as against the actual realization of only Rs. 4,951 crore. The second report of CAG (2005) which covered the sale of two hotels, the Hotel Corporation of India's (HCIs), Juhu Centaur and Airport Centaur, pointed out that the sale was finalised on the basis of a single bid and the methodology adopted for valuation had the effect of lowering the reserve price. The CAG's third and most recent report (2006) focuses on nine PSUs where majority shareholding was passed on to private parties through the strategic sale route. The main findings of CAG are as follows:

**1.Valuation.** In several cases where valuation was done under the asset valuation methodology, core assets like leasehold land, housing, township and plant and machinery and certain other properties were either not valued or ignored. This resulted in an undervaluation of PSUs, consequently fixing of lower reserve prices,

**2.Insufficient competition.** Competition was not generated to secure best price as at the final stage, financial bids were submitted by only one party

in case of MFIL, CMC, PPL and two parties in case of BALCO, HTL, VSNL, HZL, while in case of IPCL, Expression of Interest by three ) international bidders was rejected without assigning any : reason.

**3.The shareholders agreement.** It was entered on terms adverse to government, as the strategic partner has been given right to purchase balance equity of privatised PSUs, in what is known as, call and put option. In case of HZL, the strategic partner used this option to purchase 79.9 million shares at Rs. 40.51 per share when the market price was hovering around Rs, 119.10, giving it a windfall profit, Another company, BALCO has exercised its call option and remitted a sum of Rs. 1,098 crore by cheque to the government, based on some kind of ad hoc valuation of shares. The market value of the shares is several times higher.

**4. Post-clearing adjustment clause.** In the sale of four unlisted companies, MFIL, BALCO, HTL and PPL, an open-ended agreement has been entered, under which the government is required to pay the strategic partner any claims resulting from depletion of current assets of the company, between the date of the last audited balance sheet and the date of purchase of the shares. All the four companies have filed heavy claims against the government and in case of MFIL, the government has already paid Rs. 12.64 crore to the new management. In the case of PPL, while the government realised Rs. 151.70 crore through the sale, the buyers have lodged a claim of Rs. 151.55 crore under this clause.

Undervaluation of assets implies substantial losses for the government and therefore for the tax-paying citizens of the country. There is a basic problem with all privatization of public assets, which means that they tend to be associated ultimately with losses to the State exchequer rather than gains. If the government sells the asset that provides income or profit equal to or more than the prevailing interest on government securities, then the government would lose future income by selling it. On the other hand, from the private sector's point of view, it makes no sense to purchase an asset unless it provides at least a rate of return equal to the rate of interest on

government securities, because that is where the private investor could otherwise put the money. "This means that for such sales to occur, either (a) the private investor must believe that it is capable of generating more profits than the public sector — but that is essentially a management issue and there is no logical reason why the public sector cannot also employ managers to achieve this; or (6) the asset must be undervalued so that the actual rate of return for the private buyer turns out to be higher, which really means that the State exchequer has lost the money."

### **Utilisation of Money from Disinvestment**

As shown above, the public sector equity has been sold for a fraction of what it could actually fetch. However, this is only one part of the story. The entire manner in which the proceeds from disinvestment have been used is objectionable. When the programme of disinvestment was initiated in 1991-92, the Finance Minister had stated that a part of the proceeds would be used for providing resources in the NRF (National Renewal Fund) which can be used for various schemes of assistance to workers to the unorganized sector. Moreover, these "non-inflationary resources would also be used to fund...special employment creating schemes in backward areas". In 1997, the first report of the Disinvestment Commission headed by G. V. Ramkrishna stated that the proceeds of disinvestment should not be used to bridge the budget deficit, but instead should be placed in a separate fund to be used for four purposes: (i) retiring public debt; (ii) restructuring PSUs; (iii) developing the social infrastructure; and (iv) voluntary retirement schemes. Similar sentiments were expressed in various Budget Speeches of the Finance Ministers in various years. For the year 2001-02, the Finance Minister had set the target for disinvestment at Rs. 12,000 crore of which Rs. 7,000 crore was to be used to provide "restructuring assistance to PSUs, a safety net to workers and reduction of (the public) debt burden" while the remaining Rs. 5,000 crore was to be used to provide "additional budgetary support to the Plan primarily in the social and infrastructure sectors". The list of objectives of disinvestment given earlier also expressed such lofty ideals. However, the actual experience with the utilisation of disinvestment proceeds during the last

decade belies all these declarations. The government has used the entire proceeds from disinvestment to offset the shortfalls in revenue receipts and thus reduce the fiscal deficit which it was required to do as part of the IMF stabilisation programme. In this context, the following comments of CP. Chandrasekhar and Jayati Ghosh are pertinent: "The experience suggests that fiscal convenience was the prime mover of such disinvestments. Having internalized the IMF prescription that reducing or doing away with fiscal deficits is the prime indicator of good macroeconomic management, the government found privatisation proceeds of PSUs to be a useful source of revenue to window-dress budgets". Thus, the resources generated from the disinvestment of PSUs have been used to meet current consumption needs. This amounts to frittering away of valuable public assets. It is like selling family silver to support a profligate lifestyle. Moreover, once a PSU is privatised, the government is deprived of the future yields from this enterprise. This could be a large long-term loss in the case of profit generating PSUs. This point to the shortsightedness of the government's disinvestment programme.

### **Others Criticisms of Privatisation**

1. It is often assumed that following privatisation, markets arise quickly to fill up the gap whereas the fact is that many government activities arise because markets have failed to provide essential services. As stated in the previous chapter, many PSUs were set-up in India in the post-Independence period in those fields in which the private sector was either not able to set-up units because of paucity of resources or was simply not interested because of the long gestation period and/or low profit generation possibilities. As argued by CP. Chandrasekhar and Jayati Ghosh, "Public sector enterprises are not pure profit making machines, but instruments used by governments to achieve a range of objectives. These could vary from closing infrastructure gaps that may remain if investment was purely private to ensuring access to products crucial to development at appropriate prices. This would imply that investments are made even in areas where profits are low or non-existent because of the external benefits such projects deliver or

that profits are foregone in order to keep prices down in pursuit of other objectives. To ignore such possibilities and make profits, which contribute non-tax revenues to the government, the sole reason for establishing PSUs, is to conceal the actual grounds on which public capital formation has occurred in post Independent India or elsewhere in the world.”

2. One of the genuine fears of labour is that privatization is bound to result in unemployment. Most of the privatisation experiments around the globe are testimony the fact that this indeed does happen. The Government of India has been repeatedly harping on the tune that as a result of privatisation there has only been a 'marginal' retrenchment of labour. However, the fact of the matter is that there is a strong pressure from the corporate sector to 'reform' labour laws to enable it to hire and fire workers as it wishes and indications are that the government is falling in line. This means that the future employment scenario for labour is a cause of worry. The fear of retrenchment and consequent unemployment is all the more as there is no safety net scheme for labour worth the name. How many workers will be able to get VRS (voluntary retirement scheme) and on what conditions is only a matter of speculation. In any case, VRS is no solution of unemployment. A retrenched, unemployed worker is a frustrated man. Moreover, as argued by Joseph Stiglitz, there are large social costs of unemployment manifested in its worst forms, by urban violence, increased crimes, and social and political unrest. But even in the absence of these problems, there are huge costs of unemployment. “They include widespread anxiety even among workers who have managed to keep their jobs, a broader sense of alienation, additional financial burdens on family members who manage to remain employed, and the withdrawal of children from school to-help support the. family. These kinds of social costs endure long past the immediate loss of a job. Moving people from low-productivity jobs in State enterprises to unemployment does not increase a country's income, and it certainly does not increase the welfare of the workers”.

The above dangers are all the more serious in those cases where a PSU is sold to a foreign company as the latter will be more interested in maximising

the 'stock market value for its, shareholders rather than worrying about the, interest of local labour.

3. At times, sale of a PSU to a private company can only result in the substitution of a public monopoly by a private monopoly. In such cases, inefficiencies and monopoly power will merely be transferred to the private sector, with the costs being borne by the consumers. Or, "monopolistic exploitation by efficient private owners replaces the inefficiencies of public ownership." This danger is particularly present in the case of public utilities. For example, in Cochabamba, Bolivia's third largest city, water supply was privatised and sold to a foreign consortium Aguas del Tunari in 1999. The consortium resorted to huge increases in tariffs and at the same time, put restrictions on the use of water. This caused widespread resentment provoking riots. As a result, the government had no option but to put an end to the contract.

We have already discussed the issue of undervaluation of assets of PSUs earlier. Such undervaluation points to the prevalence of widespread corruption on the one hand, and complicity between sections of the government and particular business groups on the other hand (in the case of strategic sales). In this context, the comments of Joseph Stiglitz are pertinent, "Perhaps the most serious concern with privatisation, as it has so often been practiced, is corruption. The rhetoric of market fundamentalism asserts that privatisation will reduce what economists call the "rent-seeking" activity of government officials who either skim off the profits of government enterprises or award contracts and jobs to their friends. But in contrast to what it was supposed to do, privatisation has made matter so much worse that in many countries today privatisation is jokingly referred to as "briberisation". If a government is corrupt, there is little evidence that privatisation will solve the problem. After all, the same corrupt government that mismanaged the firm will also handle the privatisation.

4. One of the important arguments in favour of privatisation of PSUs is the belief that this would improve their performance. However, some critics have pointed out that there is no positive relationship between ownership and

performance; Therefore according' to them, the belief 'that privatisation, by itself, leads to better performance is questionable. For instance, Pranab Bardhan and John E. Roemer state: "Our claim is that competitive markets are necessary to achieve an efficient and vigorous economy, but that full-scale private ownership is not necessary for the successful operation of competition and markets."<sup>20</sup> This claim is substantiated by the experience of China. The process of economic reforms was initiated in China in 1978; During 1978 and 1992, GNP grew at an annual rate of 8.8 per cent, while the industrial sector grew at a rate exceeding 10 per cent annum. As a result, China's GNP trebled, over the 15 year period 1978-92. This remarkable growth was achieved not as a result of privatisation but by marketisation and opening up new areas for competition between the State owned enterprises and the non-State sector. One source of evidence for this is the positive correlation between total factor productivity in State enterprises and the relative size of the non-State sector. Using provisional level data for China from 1982 to 1990, it has been estimated that a ten percentage point increase in the non-State sector share of industrial output yielded an increase of 2.5 per cent to 4 per cent in total factor productivity in the State industry. As the non-State sector has grown, State enterprises have responded to the increased competitive pressure by becoming more productive.<sup>21</sup> Thus the experience of China shows that to improve the efficiency of inefficient units it is necessary to create competitive market structure. It is a competitive environment, rather than ownership, that promotes allocative efficiency.

#### **NOTES**

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## **Chapter-5**

### **Service Sector in Indian Economy**

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## 5.1 Banking and Finance Sector<sup>17</sup>



The last decade witnessed the maturity of India's financial markets. Since 1991, every governments of India took major steps in reforming the financial sector of the country. The important achievements in the following fields are discussed under separate heads:

- Financial markets
- Regulators
- The banking system
- Non-banking finance companies
- The capital market
- Mutual funds
- Overall approach to reforms
- Deregulation of banking system
- Capital market developments
- Consolidation imperative

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<sup>17</sup> Main articles : Banking in India and Insurance in India web site

Now let us discuss each segment separately.

## **Financial Markets**

In the last decade, Private Sector Institutions played an important role. They grew rapidly in commercial banking and asset management business. With the openings in the insurance sector for these institutions, they started making debt in the market.

Competition among financial intermediaries gradually helped the interest rates to decline. Deregulation added to it. The real interest rate was maintained. The borrowers did not pay high price while depositors had incentives to save. It was something between the nominal rate of interest and the expected rate of inflation.

## **Regulators**

The Finance Ministry continuously formulated major policies in the field of financial sector of the country. The Government accepted the important role of regulators. The Reserve Bank of India (RBI) has become more independent. Securities and Exchange Board of India (SEBI) and the Insurance Regulatory and Development Authority (IRDA) became important institutions. Opinions are also there that there should be a super-regulator for the financial services sector instead of multiplicity of regulators.

## **The banking system**

Almost 80% of the business is still controlled by Public Sector Banks (PSBs). PSBs are still dominating the commercial banking system. Shares of the leading PSBs are already listed on the stock exchanges. The RBI has given licences to new private sector banks as part of the liberalisation process. The RBI has also been granting licences to industrial houses. Many banks are successfully running in the retail and consumer segments but are yet to deliver services to industrial finance, retail trade, small business and agricultural finance.

The PSBs will play an important role in the industry due to its number of branches and foreign banks facing the constraint of limited number of branches. Hence, in order to achieve an efficient banking system, the onus is on the Government to encourage the PSBs to be run on professional lines.

### **Development finance institutions**

FIs's access to SLR funds reduced. Now they have to approach the capital market for debt and equity funds.

Convertibility clause no longer obligatory for assistance to corporate sanctioned by term-lending institutions.

### **Capital adequacy norms extended to financial institutions.**

DFIs such as IDBI and ICICI have entered other segments of financial services such as commercial banking, asset management and insurance through separate ventures. The move to universal banking has started.

### **Non-banking finance companies**

In the case of new NBFCs seeking registration with the RBI, the requirement of minimum net owned funds, has been raised to Rs.2 crores.

Until recently, the money market in India was narrow and circumscribed by tight regulations over interest rates and participants. The secondary market was underdeveloped and lacked liquidity. Several measures have been initiated and include new money market instruments, strengthening of existing instruments and setting up of the Discount and Finance House of India (DFHI).

The RBI conducts its sales of dated securities and treasury bills through its open market operations (OMO) window. Primary dealers bid for these securities and also trade in them. The DFHI is the principal agency for developing a secondary market for money market instruments and Government of India treasury bills. The RBI has introduced a liquidity adjustment facility (LAF) in which liquidity is injected through reverse repo auctions and liquidity is sucked out through repo auctions.

On account of the substantial issue of government debt, the gilt- edged market occupies an important position in the financial set- up. The Securities Trading Corporation of India (STCI), which started operations in June 1994 has a mandate to develop the secondary market in government securities.

Long-term debt market: The development of a long-term debt market is crucial to the financing of infrastructure. After bringing some order to the equity market, the SEBI has now decided to concentrate on the development of the debt market. Stamp duty is being withdrawn at the time of dematerialization of debt instruments in order to encourage paperless trading.

### **The capital market**

The number of shareholders in India is estimated at 25 million. However, only an estimated two lakh persons actively trade in stocks. There has been a dramatic improvement in the country's stock market trading infrastructure during the last few years. Expectations are that India will be an attractive emerging market with tremendous potential. Unfortunately, during recent times the stock markets have been constrained by some unsavory developments, which have led to retail investors deserting the stock markets.

### **Mutual funds**

The mutual funds industry is now regulated under the SEBI (Mutual Funds) Regulations, 1996 and amendments thereto. With the issuance of SEBI guidelines, the industry had a framework for the establishment of many more players, both Indian and foreign players.

The Unit Trust of India remains easily the biggest mutual fund controlling a corpus of nearly Rs.70,000 crores, but its share is going down. The biggest shock to the mutual fund industry during recent times was the insecurity generated in the minds of investors regarding the US 64 scheme. With the growth in the securities markets and tax advantages granted for investment in mutual fund units, mutual funds started becoming popular.

The foreign owned AMCs are the ones which are now setting the pace for the industry. They are introducing new products, setting new standards of customer service, improving disclosure standards and experimenting with new types of distribution.

The insurance industry is the latest to be thrown open to competition from the private sector including foreign players. Foreign companies can only enter joint ventures with Indian companies, with participation restricted to 26 per cent of equity. It is too early to conclude whether the erstwhile public sector monopolies will successfully be able to face up to the competition posed by the new players, but it can be expected that the customer will gain from improved service.

The new players will need to bring in innovative products as well as fresh ideas on marketing and distribution, in order to improve the low per capita insurance coverage. Good regulation will, of course, be essential.

### **Overall approach to reforms**

The last ten years have seen major improvements in the working of various financial market participants. The government and the regulatory authorities have followed a step-by-step approach, not a big bang one. The entry of foreign players has assisted in the introduction of international practices and systems. Technology developments have improved customer service. Some gaps however remain (for example: lack of an inter-bank interest rate benchmark, an active corporate debt market and a developed derivatives market). On the whole, the cumulative effect of the developments since 1991 has been quite encouraging. An indication of the strength of the reformed Indian financial system can be seen from the way India was not affected by the Southeast Asian crisis.

However, financial liberalisation alone will not ensure stable economic growth. Some tough decisions still need to be taken. Without fiscal control, financial stability cannot be ensured. The fate of the Fiscal Responsibility Bill remains unknown and high fiscal deficits continue. In the case of financial



institutions, the political and legal structures have to ensure that borrowers repay on time the loans they have taken. The phenomenon of rich industrialists and bankrupt companies continues. Further, frauds cannot be totally prevented, even with the best of regulation. However, punishment has to follow crime, which is often not the case in India.

### **Deregulation of banking system**

Prudential norms were introduced for income recognition, asset classification, provisioning for delinquent loans and for capital adequacy. In order to reach the stipulated capital adequacy norms, substantial capital were provided by the Government to PSBs.

Government pre-emption of banks' resources through statutory liquidity ratio (SLR) and cash reserve ratio (CRR) brought down in steps. Interest rates on the deposits and lending sides almost entirely were deregulated.

New private sector banks allowed to promote and encourage competition. PSBs were encouraged to approach the public for raising resources. Recovery of debts due to banks and the Financial Institutions Act, 1993 was passed, and special recovery tribunals set up to facilitate quicker recovery of loan arrears.

Bank lending norms liberalised and a loan system to ensure better control over credit introduced. Banks asked to set up asset liability management (ALM) systems. RBI guidelines issued for risk management systems in banks encompassing credit, market and operational risks.

A credit information bureau being established to identify bad risks. Derivative products such as forward rate agreements (FRAs) and interest rate swaps (IRSs) introduced.

### **Capital market developments**

The Capital Issues (Control) Act, 1947, repealed, office of the Controller of Capital Issues was abolished and the initial share pricing were decontrolled. SEBI, the capital market regulator was established in 1992.

Foreign institutional investors (FIIs) were allowed to invest in Indian capital markets after registration with the SEBI. Indian companies were permitted to access international capital markets through euro issues.

The National Stock Exchange (NSE), with nationwide stock trading and electronic display, clearing and settlement facilities was established. Several local stock exchanges changed over from floor based trading to screen based trading.

### **Private mutual funds permitted**

The Depositories Act had given a legal framework for the establishment of depositories to record ownership deals in book entry form. Dematerialisation of stocks encouraged paperless trading. Companies were required to disclose all material facts and specific risk factors associated with their projects while making public issues.

To reduce the cost of issue, underwriting by the issuer were made optional, subject to conditions. The practice of making preferential allotment of shares at prices unrelated to the prevailing market prices stopped and fresh guidelines were issued by SEBI.

SEBI reconstituted governing boards of the stock exchanges, introduced capital adequacy norms for brokers, and made rules for making client or broker relationship more transparent which included separation of client and broker accounts.

### **Buy back of shares allowed**

The SEBI started insisting on greater corporate disclosures. Steps were taken to improve corporate governance based on the report of a committee.

SEBI issued detailed employee stock option scheme and employee stock purchase scheme for listed companies.

Standard denomination for equity shares of Rs. 10 and Rs. 100 were abolished. Companies given the freedom to issue dematerialised shares in any denomination.

Derivatives trading starts with index options and futures. A system of rolling settlements introduced. SEBI empowered to register and regulate venture capital funds.

The SEBI (Credit Rating Agencies) Regulations, 1999 issued for regulating new credit rating agencies as well as introducing a code of conduct for all credit rating agencies operating in India.

### **Consolidation imperative**

Another aspect of the financial sector reforms in India is the consolidation of existing institutions which is especially applicable to the commercial banks. In India the banks are in huge quantity. First, there is no need for 27 PSBs with branches all over India. A number of them can be merged. The merger of Punjab National Bank and New Bank of India was a difficult one, but the situation is different now. No one expected so many employees to take voluntary retirement from PSBs, which at one time were much sought after jobs. Private sector banks will be self consolidated while co-operative and rural banks will be encouraged for consolidation, and anyway play only a niche role.

In the case of insurance, the Life Insurance Corporation of India is a behemoth, while the four public sector general insurance companies will probably move towards consolidation with a bit of nudging. The UTI is yet again a big institution, even though facing difficult times, and most other public sector players are already exiting the mutual fund business. There are a number of small mutual fund players in the private sector, but the business being comparatively new for the private players, it will take some time.

We finally come to convergence in the financial sector, the new buzzword internationally. Hi-tech and the need to meet increasing consumer needs is encouraging convergence, even though it has not always been a

success till date. In India organisations such as IDBI, ICICI, HDFC and SBI are already trying to offer various services to the customer under one umbrella. This phenomenon is expected to grow rapidly in the coming years. Where mergers may not be possible, alliances between organisations may be effective. Various forms of banc assurance are being introduced, with the RBI having already come out with detailed guidelines for entry of banks into insurance. The LIC has bought into Corporation Bank in order to spread its insurance distribution network. Both banks and insurance companies have started entering the asset management business, as there is a great deal of synergy among these businesses. The pensions market is expected to open up fresh opportunities for insurance companies and mutual funds.

It is not possible to play the role of the Oracle of Delphi when a vast nation like India is involved. However, a few trends are evident, and the coming decade should be as interesting as the last one.

## 5.2 Insurance sector

The insurance industry has grown by 83 per cent since the opening up of the sector. Remarking on the performance of the insurance industry, C S Rao, chairman, Insurance Regulatory & Development Authority, said public sector players have not suffered with the opening up of the sector.

Insurance premium income has risen to Rs 82,415 crore (Rs 824.15 billion) in 2003-04, against Rs 45,000 crore (Rs 450 billion) in 2000-01. Rao expects premium income in the life insurance sector to rise further by 15-16 per cent and non-life insurance premium by 14 per cent in 2005-06. The growth comes on the back of healthy demand from the manufacturing sector.

"There has been no reduction in growth rates as seen in the case of the Life Insurance Corporation of India . It is able to hold on to its existing share in terms of business growth. Market share is bound to stand reduced as some business goes to the private players," said Rao.

The health and personal line segments are expected to see maximum growth during the current financial year.

"The health insurance sector is expected to grow by 10-15 per cent," Rao said at a one-day seminar on 'Growth of Insurance Industry in India' organised by the Indian Merchants' Chamber in Mumbai on Friday.

If the cap on foreign direct investment is increased to 49 per cent from the current 26 per cent, the industry can expect greater entry of players. But this, said Rao, should not be seen as a threat to public sector players.

Insurance has always been a politically sensitive subject in India. Within less than 10 years of independence, the Indian government nationalized private insurance companies in 1956 to bring this vital sector under government control to raise much needed development funds.

Since then, state-owned insurance companies have grown into monoliths, lumbering and often inefficient but the only alternative. They have been

criticized for their huge bureaucracies, but still have millions of policy holders as there is no alternative.

Any attempt to even suggest letting private players into this vital sector has met with resistance and agitation from the powerful insurance employees unions. The Narasimha Rao government (1991-96) which unleashed liberal changes in India's rigid economic structure could not handle this political hot potato. Ironically, it is the coalition government in power today which has declared its intention of opening up insurance to the private sector. Ironical because this government is at the mercy of support from the left groups which have been the most vociferous opponents of any such move.

No policy initiatives have yet been announced, but the government has already clarified it will not privatize the existing insurance companies. But while the decision has been welcomed by the big companies who were planning to make a foray into this lucrative business, the move has been criticized by trade unions and even some left supporters of the government.

In some ways it was inevitable—all segments of the financial sector had been opened to private players and it was only a matter of time before insurance followed. The bigger private players claim that opening up insurance will give policy holders better products and service; the opponents of privatization argue that in a poor country like India insurance needs to have social objectives and newcomers will not have that commitment.

Many international players are eyeing the vast potential of the Indian market and are already making plans to come in. But it will take some time before the intent translates into policy—the unions are not going to give up without a fight and in that they will get the support of some elements of the coalition government

### 5.3 Which Services have Grown Rapidly ?<sup>18</sup>

Table-1 provides information on growth rate in different segments of the services sector. Some segments grew at a rate much faster than their past average growth rates, while for some other segments, growth rates were similar to the past trend. Gordon and Gupta term the former as fast growers and the latter as trend growers.

**Table 1**  
**Sectoral share of GDP in per cent**

	1950/51	1960/61	1970/71	1980/81	1990/91	2000/2001	2007/08	2008/09
<b>Agriculture</b>	55.3	50.8	44.3	37.9	31.4	23.9	17.8	17.0
<b>Industry</b>	15.1	18.8	22.1	24.1	25.9	25.8	26.5	25.8
<b>Services</b>	29.6	30.4	33.6	38.0	42.7	50.3	55.7	57.3

**Table 2**  
**Contribution of different sectors to GDP growth**

<b>Sector</b>	1951/52	1960/61	1990/91	1991-97	1996-2002	2001-08
<b>(1)</b>	(2)	(3)	(4)	(5)	(6)	(7)
Agriculture	34.9	48.2	23.8	21.1	11.5	7.0
Industry	35.5	29.2	35.2	29.0	20.2	29.3
Services	29.6	22.6	41.0	49.8	68.3	63.6
GDP at factor cost	100.0	100.0	100.0	100.0	100.0	100.0

**Source: (i)** For columns (2), (3) and (4), Sunil Jain and T. N. Ninan "Servicing India's GDP Growth", Table 10.2, p. 335 and **(ii)** For columns (5), (6) and (7) Shankar Acharya, "Macroeconomic Performance and Policies, 2000-08", in Shankar Acharya and Rakesh Mohan (ed.), India's Economy - Performance and Challenges (New Delhi, 2010), Table 4.2, p. 120.

<sup>18</sup> Mishra & Puri, Indian Economy, 2010, Himalaya Publication, Pg. No.441

**Table 3**  
**Growth rates and shares of service sub-sectors in GDP**

Sector	Average growth in 1950s-1970s (Share in GDP in 1980)	Average growth in 1980s (Share in GDP in 1990)	Average growth in 1990s (Share in GDP in 2000)	Average growth in 2005-04 to 2007-08 (Share in GDP in 2007-08)
<u>Trade Hotels and Restaurant</u>				
Trade	4.8 (11.7)	5.9 (11.9)	7.3 (13.7)	9.3 (14.3)
Hotels and Restaurants	4.8 (0.7)	6.5 (0.7)	9.3 (1-0)	13.4 (1.6)
<u>Transport, Storage and Communication</u>				
Railways	4.2 (1.5)	4.5 (1.4)	3.6 (1.1)	8.8 (1.2)
Transport by other means	6.3 (3.6)	6.3 (3.8)	6.9 (4.3)	9.3 (5.2)
Storage	5.5 (0.1)	2.7 (0.1)	2.0 (0.1)	4.2 (0.1)
Communication	6.7 (1.0)	6.1 (1.0)	13.6 (2.0)	26.1 (5.7)
<u>Financing, Insurance, Real Estate and Business Services</u>				
Banking	7.2 (1-9)	11.9 (3-4)	12.7 (6.3)	14.6 (6.0)
Insurance	7.1 (0.5)	10.9 (0-8)	6.7 (0.7)	15.5 (1-1)
Dwellings, real estate	2.6 (4.0)	7.7 (4.8)	5.0 (4.5)	2.5 (3.7)
Business Services	4.2 (0.2)	13.5 (0.3)	19.8 (1.1)	17.7 (3.7)
Legal Services	2.6 (0.6)	8.6 (0.0)	5.8 (0.0)	3.7 (0.1)
<u>Community Social and Personal Services</u>				
Public administration, defence	.6.1 (5.3)	7.0 (6.0)	6.0 (6.1)	4.9 (5.2)
Personal services	1.7 (1.6)	2.4 (1.1)	5.0- (1.1)	7.0 (1.4)
Community services	4.8 (4.0)	6.5 (4.3)	8.4 (5.5)	8.4 (6.2)
Oilier services	3.4 (1.1)	5.3 (1.0)	7.1 (0.7)	2.5 (0.4)

- Note:** 1. 'Personal services' include domestic, laundry, barber, beauty shops, tailoring, others.  
2. 'Community services' include education, research, scientific, medical, health, religious and other community.  
3. 'Other services' include recreation, entertainment, radio, TV broadcast, sanitary services.

**Source:** Information in the last column has been computed from CSO, **National Accounts Statistics** 2009, information contained in earlier columns is from Jim Gordon and Poonam Gupta, "Understanding India's Services Revolution", **IMF Working Paper**, 2003, Table 5, p. 13.



1980s), while the contribution made by the fast growing activities was only about half the size. As against this, fast growing activities made about the same contribution to services growth in the 1990s as the trend growing sectors. In fact, argue Gordon and Gupta, "Since the trend growing sectors grew at about the same rate in both decades, the fast growers collectively accounted for almost all the higher growth in the 1990s." one of the important reasons for this is that a number of new activities and industries have sprung up in the fast growth sub-sectors but not in the trend growth ones.

### **What Explains Rapid Services Growth ?**

The main reasons for rapid services growth in the Indian economy in recent years are generally discussed under the following headings :

#### **Splintering**

It is argued that as an economy matures, increasing specialization takes place. Industrial units tend to outsource some activities which were previously undertaken by themselves. For example, they may use greater services of specialist sub-contractors to provide accounting, research and development, legal and security services, etc., which were earlier undertaken by themselves. Bhagwati (1994) calls this process of specialization splintering. Kravis (1982) has argued that splintering leads to a growth in the share of services in GDP. Even when the GDP itself is not growing. This is due to the reason that the jobs outsourced will now be counted as service sector contribution to GDP, rather than being subsumed in manufacturing value-added.

However, Gordon and Gupta (2003) have argued on the basis of admittedly limited data. That the impact of splintering has been overstated. They use input-output coefficients to measure the increase in the use of outsourced services. Their study considers the input-output matrix for 1993-94. With the help of this matrix, they find that splintering added around 0.5 percentage point to services sector growth during the decades of 1990s, Nirvikar Singh (2006) repeated the analysis for 1990s using input-output

coefficients constructed from 1998-99 data and obtained the result that splintering essentially made no contribution to growth during the 1990s. no study for the period after 1990s is available. However, since the biggest rise in services after 2000 was in sectors like communications and IT, neither of which is related to Indian industries outsourcing their work to independent service units, it can perhaps be said that the role of splintering is insignificant.

However, as correctly pointed out by Nirvikar Singh, the above method of measuring the effect of splintering does not permit an analysis of the extent to which cross country splintering, which became important during 1990s and afterward (as through offshore outsourcing of business services), would explain the observed patterns of services sector growth. This is due to the reason that cross-country splintering implies a real shift in economic activity to India, whereas domestic splintering is more of an accounting change. Even in the case of domestic splintering, opines Singh, when specialization leads to efficiency improvements, it may well reflect a positive economic change.

### **Demand side impetus to Growth**

During recent period, the demand side impetus to services growth is clearly visible. Till the liberalization of the early 1990s, the trend in private final consumption expenditure was a straightforward one – the share of services in the total consumption basket (at 1999-2000 prices) increased by about 3 percentage points each decade: that is, from around 8 per cent in 1950-51 to 11 percent in 1960-61; 14 percent in 1970-71; 17 percent in 1980-81; and 20 percent in 1990-91. However, thereafter, this trend changed significantly and by 2000-01, the share of services in private consumption rose to as much as 31 percent that is up by 10 percentage points. By 2006-07, it rose by another 8 percent points, indicating that the pace had quickened up further in the 2000s. These data clearly indicate a demand side impetus to growth of services. Sunil Jain and T. N. Ninan are of the view that this demand side impetus will not only continue in future but will also become stronger. They specifically mention increasing private expenditure on education, communications, medical care and health services.

The demand side impetus has also come from foreign sources particularly the IT/ITES (information technology and information technology enabled services) sector as, due to cost advantages in India, many companies in the developed world have started outsourcing certain services to Indian companies on a large scale. This has enabled exports of services from India to increase from only \$4.9 billion in 1992 to as high as \$ 101.2 billion in 2008-09.

### **Role of Policy Liberalization**

The post-reform period (the period since 1991) has considerably liberalised the industrial and trade policies and opened up the banking, insurance, transport and communication sectors to private participation. Many economists have argued that this liberalization has boosted the growth of the services sector significantly. Sunil Jain and T. N. Ninan have shown that the fast-growth areas in services in the post reforms period have been those that have witnessed significant liberalisation. Even in the technology-driven sectors (such as IT and communication), the removal of government-imposed constraints has been important, if not vital, for growth.<sup>13</sup> In this context, the examples of communication services, banking services, insurance services, and computer related services clearly stand out. As is clear from Table 35.4, the share of communication services in GDP rose considerably from 1.0 per cent in 1991 to as high as 5.7 per cent in 2007-08. This was primarily due to telecom liberalisation which began in 1994 when the private sector was allowed entry. In 1999, the share of the private sector in total telephone connections was a meagre 5 per cent. By December 2009, this had increased to as much 82.3 per cent. A revolution of sorts has taken place in the field of mobile telephony with the number of wireless connections increasing at a compound annual growth rate (CAGR) of 60 per cent per annum since 2004. This has been primarily due to increased role of private players. With 525.1 million wireless connections, Indian telecom has become the second largest wireless network in the world.

As far as the banking sector is concerned, its share in GDP almost doubled in the post reform period (its share was 3.4 per cent in 1990, 6.3 per

cent in 2000 and 6.0 per cent in 2007-08). As a result of the policy of liberalisation, the private banks have started playing an important role in the spread of banking facilities and this has given an impetus to the growth of the banking sector. While private banks accounted for just over 5 per cent of all bank incomes in 1995, their share rose to almost 25 percent in 2007. In insurance, within just seven years of the sector opening up, there were 24 private firms in 2006-07 who brought in Rs. 9,625 crore as capital.<sup>14</sup> Liberalisation had a positive influence on computer related services (broadly the IT/ITES sector) whose share in GDP rose from 0.96 per cent in 1999-2000 to 3.04 per cent in 2006-07, while its contribution to growth was around 7.0 per cent.

### **Technological Advances**

Services sector growth can also be stimulated by technological advances, whereby new activities or products emerge as a result of technological breakthrough. Such technological advances that appear to have had a positive impact on growth in India are the increasing use of internet in the case of the IT sector, expansion of cellular phone services in the telecom sector and use of credit cards, ATMs, etc., in the case of the banking sector. Gordon and Gupta have used a growth-accounting exercise to estimate a 1.25 percentage points contribution of policy liberalisation and technology progress to services sector growth in India.

### **Mutual Dependence of Industrial and Services Growth**

Gordon and Gupta also find positive impact of industrial growth on services growth. The reverse direction examines the impact of services on manufacturing production and productivity. In this context, Nirvikar Singh quotes a study of Banga and Goldar (2003) which estimates that, although service inputs contributed little to the production of the registered manufacturing sector during the 1980s (only 1 per cent of output growth), the contribution of services increased substantially in the 1990s (to about 25 per cent of output growth). This, in turn, implies that excluding services inputs overstates the extent of manufacturing total factor productivity (TFP) growth in

the 1990s. These results suggest that the increasing use of services in manufacturing in the 1990s favourably affected TFP.

### **Share of Services in Employment**

Although the services sector has grown at a fast rate during recent times and accounts for more than half of GDP (presently it accounts for around 57-58 per cent of GDP), its share in overall employment continues to be very low and is less than one-fourth of the total. In fact, during 1990s while the share of services in GDP rose from 42.0 per cent to 48.0 per cent, the share of services in employment actually declined by about one percentage point (from 24.4 per cent in total employment in 1990-91, the share of services fell to 23.5 per cent in 1999-2000). This indicates that India witnessed a relatively jobless services sector growth during 1990s. According to Gordon and Gupta, this is unlike the experience of other countries, where the services sector has also tended to gain a larger share of employment over time. When compared with other countries, India has an exceptionally low share of services employment.

In order to focus upon the differences in growth rate of employment and gross value added in services sector since 1970-71, a difference of means test was employed by the Report on Currency and Finance, 2001-02, with the following null hypothesis (i) there is no difference in the growth rate of employment in services sector and growth rate of gross value added in services sector; (ii) there is no difference between labour productivity growth and employment growth in services sector. Labour productivity was defined as value added in services sector divided by total labour in services sector.

The results show that hypothesis (i) can be rejected; i.e., growth rates of employment and value added in services sector are statistically different from each other during 1971-72 to 1999-2000. As the mean difference is negative decade and a half, large number of export and import items have been decanalised. Decanalisation of imports and exports is an important step towards opening of more areas of the external sector to the private sector. The government has also introduced a number of export promotion measures in recent years. These include establishment of Export Oriented Units for

promoting exports from the agricultural and allied sectors, simplification of Export Promotion Capital Goods Scheme, introduction of Export Promotion Capital Goods scheme for the services sector, adoption of a more rational and convenient criterion for recognition of export houses/Trading houses/Star Trading houses, broadening of areas of activity in Export Processing Zones, duty free import for exports under the advance licensing scheme, setting up of Special Economic Zones (SEZs), and creation of an exporters' grievance cell in the Ministry of Commerce to facilitate action on problems being faced by exporters. Besides these, some more schemes/ measures have been introduced to accelerate the country's transition to a globally-oriented economy, to stimulate growth by providing access to capital goods, intermediates and raw materials, and to enhance technological strengths of the economy thereby improving the global competitiveness of Indian exports.

The government has also liberalised capital flows in the form of foreign direct investment (FDI) as a part of the package of external sector reforms. Foreign companies are now allowed to use their trade marks, accept appointment as technical or management advisers, borrow and accept deposits from the public and repatriate profits etc.

## **5.4 Financial Sector Reforms**

A vibrant, efficient and competitive financial system is necessary to support the structural reforms in the real economy. As pointed out by the Tenth Five Year Plan, “An important outcome of financial sector reforms is that it contributes to greater flexibility in the factor and product markets. With the real sector becoming increasingly market driven and engulfed by a competitive environment there is need for a matching and dynamic response from the financial sector.” This is possible only if the productivity and efficiency of the financial system improves. Keeping this in view, the government set up Committee on the Financial System in 1991 and on Banking Sector Reforms in 1998 (Narasimham Committees).

The Committee on Financial System was asked to examine the country's financial system and its various components and to make recommendations in respect of the following:

1. For improving the efficiency and effectiveness of the Financial System, with special reference to economy of operations, accountability and profitability.

2. For infusing greater competition into the financial system so as to enable the banks and other financial institutions to respond more effectively to the credit needs of the economy.

3. For ensuring appropriate and effective supervision over the various entities in the financial sector, in particular the commercial banks and term lending institutions.

The Committee was also required to review the existing legislative framework and to suggest necessary amendments for implementing the recommendations.

The report of the Narasimham Committee on Financial System was placed before the Parliament in December 1991, and since then it has

become a basis for introducing reforms in the banking sector. The major reform measures undertaken during the past few years are as follows:

1. The level of the statutory liquidity ratio (SLR) and the cash reserve ratio (CRR) were progressively raised during the 1980s for combating inflationary pressures generated by large budgetary deficits. This, however, adversely affected the profitability of banks and pressurised them to charge high interest rates on their commercial sector advances. The government has over the years brought down both statutory liquidity ratio and cash reserve ratio in a phased manner. The effective statutory liquidity ratio has been lowered down to 24 per cent with effect from November 8, 2008. The cash reserve ratio was also brought down to 4.5 per cent with effect from June 14, 2003. However, to check liquidity overhang in the system the RBI hiked the CRR to 5 per cent in October 2005. It was raised in phases and stood at 9 per cent on August 30, 2008. However, because of slowdown in the economy during the latter half of the financial year 2008-09 following global recession, CRR was lowered in stages and brought down to 5.0 per cent with effect from January 17, 2009 in a bid to increase credit growth. To check inflationary pressures in the economy, the CRR was again raised in phases to 6.0 per cent from April 24, 2010.

2. The RBI introduced new prudential norms in respect of income recognition, classification of assets, provisioning of bad debts and capital adequacy. The minimum capital standards were prescribed in accordance with the Basel Committee norms under which banks were required to maintain unimpaired capital funds equivalent to 8 per cent of the aggregate of the risk weighted assets. Banks were expected to touch 8 per cent capital to risk weighted asset ratio (CRAR) by March 1996.



## Chapter – 6

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Foreign Direct Investment

Foreign Technology Agreement

Imports

Exports

Constitution of Pharmaceutical Export Promotion Council  
(Pharmexil)

Research & Development

Product Patent in Pharmaceuticals

Schedule M of Drugs and Cosmetics Act, 1940.

Introduction of value added tax (VAT)

Excise duty payable at MRP (Maximum Retail)

Key Policy Objectives

The National Common Minimum programme,  
as adopted by the government aims as follows.

New Policy initiatives

1. Strengthening of Drug Regulatory System
2. Intellectual property rights including g data protection.
3. Clinical Trials and Drug development.
4. Public-Private Partnership Programme for Anti-  
Cancer and Anti-HIV/AIDS Drugs :
  - = Anti Caner Drugs
  - = Anti-HIV/AIDs Medicines
  - = Pricess o drugs for other life Threatening Diseases

6.3.5 Drugs (Price Control) Order, 1995

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## **6.1 FOOD AND DRUG INDUSTRY IN INDIA “AN OVERVIEW”**

The present Government policy, regulatory and business trends in food and pharmaceuticals Industry in India. These sectors of industry provide multifarious opportunities to potential investors in this Sector, both domestic and foreign. As several policy initiatives are undertaken by the Government of India since liberalization in August 1991, the industry sectors have witnessed unprecedented growth in most of the segments.

## **6.2 Introducing India’s Food Industry**

The food industry is the complex, global collective of diverse businesses that together supply much of the food energy consumed by the world population.

The food processing industry is one of the largest industries in India. It is ranked fifth in terms of production, consumption, export and expected growth. Food Processing Industry is widely recognized as a ‘sunrise industry’ in India having huge potential for uplifting agricultural economy, creation of large scale processed food manufacturing and food chain facilities, and the resultant generation of employment and export earnings. India has enormous growth potential from its current status of being the world’s second largest food producer to be the world’s number one producer.

Food Processing Industry is of enormous significance for India’s development because of the vital linkages and synergies that it promotes between the two pillars of the economy, namely Industry and Agriculture. Food processing covers a spectrum of products from sub-sector comprising agriculture, horticulture, Plantation, animal husbandry and fisheries. Essentially, the food industry involves the commercial movement of food from field to fork.

While India has an abundant supply of food, the food processing industry is still nascent: only two per cent of fruit and vegetables; and 15 per

cent of milk produced are processed. Despite, of this the processed food industry ranks fifth in size in the country, representing 6.3 per cent of GDP. It accounts for 13 per cent of the country's exports and 6 per cent of total industrial investment. The industry size is estimated at US\$ 70 billion, including US\$ 22 billion of value added products. This sector has been attracting FDI across different categories.

- One of the world's largest food producers, India produces 600 million tonnes of food grains every year. Its granaries had a buffer stock of nearly 50 million tonnes of food grains (wheat and rice) in 2003-2004.
- The second largest exporter of rice and fifth largest exporter of wheat in the world, its agricultural exports account for nearly 14.2 percent of its total export figures.
- India ranks first in the world in production of cereals and milk. It is the second largest fruit and vegetable producer and is among the top five producers of rice, wheat, groundnuts, tea, coffee, tobacco, spices, sugar, and oilseeds.
- India is the seventh largest producer of fish in the world and is ranked second in inland fish production.

With the overwhelming success of the Green and White Revolution, India is now fervently poised for the Food Revolution that will ensure agricultural diversification and large investments in food processing. The entries of multinationals, aggressive rise of commodity branding and low cost of technology are changing the economics of the Indian food industry. The rise of aggressive regional players making forays into categories where entry barriers are low and a boom in Indian Fast Moving Consumer Goods (FMCG) markets and the rising need for these products are the key reasons for this growth in food business.

In Store...The Indian food market is approximately Rs 2, 50,000 crore (\$69.4 billion), of which value-added food products comprise Rs 80,000 crore (\$22.2 billion). Despite food production in the country is expected to double by

the year 2020. With food production expected to double by 2020, large investments are already going into food and food processing technologies, skills and equipment.

The Confederation of Indian Industry (CII) has estimated that the food processing sector has the potential of attracting Rs 1,50,000 crore (US\$ 33 billion) of investment in 10 years and generate employment of 9 million persons. The Government has formulated and implemented several Plans and Schemes to provide financial assistance for setting up and modernizing of food processing units, creation of infrastructure, support for research and development and human resource development in addition to other promotional measures to encourage the growth of the processed food sector.

A Goldman Sachs report ('Dreaming with BRICs: The Path to 2050') states that among Brazil, Russia, India and China, India will grow the fastest over the next 30 to 50 years by leveraging its demographic advantages and through continued development. At its present rates of growth, the burgeoning market in the country "would be adding nearly one France every 3.5 years and one Australia every year".

### **6.2.1 Food processing industries in India-Regulatory Framework**

Different laws govern the food processing sector in India. The prevailing laws and standards adopted by the Government to verify the quality of food and drugs is one of the best in the world.

Multiple laws/regulations prescribe varied standards regarding food additives, contaminants, food colours, preservatives and labelling. In order to rationalize the multiplicity of food laws, a Group of Ministers (hereinafter referred as "GoM") was recently set up to suggest legislative and other changes to formulate a modern, integrated food law, which will be a single reference point in relation to the regulation of food products. The food laws in India are enforced by the Director General of Health Services, Ministry of Health and Family Welfare, Government of India (GOI).

## **6.2.2 There are various food laws applicable to food and related products in India**

- Prevention of Food Adulteration Act (PFA), 1954 and Rules (Ministry of Health & Family Welfare).
- The Standards of Weights and Measures Act, 1976, and Standards of Weights and Measures (Packaged Commodities) Rules, 1977
- Agriculture Produce (Grading & Marking) Act (Ministry of Rural Development).
- Essential Commodities Act, 1955(Ministry of Food & Consumer Affairs).
- Fruit Products Order (FPO), 1995.
- Meat Food Products Order, 1973 (MFPO).
- Milk and Milk Products Order, 1992.
- The Infant Milk Substitutes, Feeding Bottles and Infant Foods (Regulation of Production, Supply and Distribution) Act, 1992 and Rules 1993.
- The Insecticide Act, 1968.
- Export (Quality Control and Inspection) Act, 1963.
- Environment Protection Act, 1986.
- Pollution Control (Ministry of Environment and Forests).
- Industrial Licenses.
- BIS Act, 1986.
- VOP (Control) Order – 1947.
- SEO (Control) Order -1967.

The Prevention of Food Adulteration Act (PFA), 1954 focuses primarily on the establishment of regulatory standards for primary food products, which constitute the bulk of the Indian diet. The Central Committee for Food Standards, chaired by the Director General of Health Services, is the decision making entity. The appeals process, however, is cumbersome and time consuming. All imported products must adhere to the rules as specified in the regulation, including the labeling and marking requirements.

The Standards of Weights and Measures Act, 1976 and Standards of Weights and Measures (Packaged Commodities) Rules, 1977 are legislative measures designed to establish fair trade practices with respect to packaged commodities. The rules prescribe that the basic rights of consumers regarding vital information about the nature of the commodity, the name and address of the manufacturer, the net quantity, date of manufacture, and sale price are provided on the label. There are additional mandatory labeling requirements for food items covered under the PFA. The Department of Consumer Affairs in the Ministry of Consumer Affairs, Food, and Public Distribution is the regulatory authority and enforcement agency.

The fruit and vegetable processing sector is regulated by the Fruit Products Order, 1955 (FPO), which is administered by the Department of Food Processing Industries. The FPO contains specifications and quality control requirements on the production and marketing of processed fruits and vegetables, sweetened aerated water, vinegar, and synthetic syrups. All such processing units are required to obtain a licence under the FPO and periodic inspections are carried out. Processed fruit and vegetable products imported into the country must meet the FPO standards.

Meat Food Products Order, 1992 administers the permissible quantity of heavy metals, preservatives, and insecticide residues for meat products. This order is equally applicable to the domestic processors and importers of meat products. However, its implementation is weak due to unorganized production in the domestic market and fewer imports.

Milk and Milk Products Order, 1992 order regulates the production, distribution, and supply of milk products; establishes sanitary requirements for dairies, machinery, premises; and sets quality control standards for milk and milk products. Standards specified in the order are also equally applicable to imported milk products.

The Destructive Insects and Pests Act, 1914, and Plants, Fruits, and Seeds (Regulation of Import in India) Order, 1989 regulate imports of planting seeds into India, and prohibit imports of seeds for sowing and planting materials without a valid permit. The implementing agency is the Directorate of Plant Protection, Quarantine, and Storage under the Department of Agriculture and Cooperation, Ministry of Agriculture.

After the enactment of the proposed Food Safety and Standards Bill, 2005 in India, the food processing sector would be governed by only one law and one regulator, instead of presently applicable 15 different laws. With the simplified mechanism growth in the food-processing sector would kick-start, which is needed to ensure higher growth for the agriculture sector.

### **6.2.3 Policies and Regulations**

Since liberalization several policy measures have been taken with regard to regulation & control, fiscal policy, export & import laws, taxation, exchange & interest rate control, export promotion and incentives to high priority industries. Food processing and agro industries have been accorded high priority with a number of important reliefs and incentives.

At present, no industrial license is required for almost all of the food & agro processing industries except for some items like: beer, potable alcohol & wines, cane sugar, hydrogenated animal fats & oils etc. and items reserved for exclusive manufacture in the small scale sector. Items reserved for Small Scale Industry (hereinafter referred as "SSI") include pickles & chutneys, bread, confectionery (excluding chocolate, toffees and chewing-gum etc.), rapeseed, mustard, sesame & groundnut oils (except solvent extracted),



ground and processed spices other than spice oil and oleoresins, sweetened cashew nut products, tapioca sago and tapioca flour.

In order to boost the food processing sector, the Centre has permitted under the Income Tax Act a deduction of 100 per cent of profit for five years and 25 per cent of profit in the next five years in case of new agro processing industries set up to package and preserve fruits and vegetables. Excise Duty of 16 per cent on dairy machinery has been fully waived off and excise duty on meat, poultry and fish products has been reduced from 16 per cent to 8 per cent.

#### **6.2.4 Food Parks**

In a bid to boost the food sector, the Government is working on agrizones and the concept of mega food parks. Twenty such mega parks will come up across the country in various cities to attract Foreign Direct Investment (FDI) in the food processing sector. The Government approved 105 proposals between January 2002 and May 2005 from foreign industrialists to set up food processing industries in India involving Rs.643.47 crore (US\$ 144 million). The ministry has released a total assistance of Rs.105.22 crore (US\$ 23 million) to implement the Food Parks Scheme. It has so far approved 50 food parks for assistance across the country. The Centre also plans Rs.100 crore (US\$ 22 billion) subsidy for mega food processing parks.

#### **6.2.5 FDI in Food Sector**

Actual FDI inflow in food processing sector in 2004-05 and 2005-06 (till November, 2005) was Rs.332.00 crore. Automatic approval is granted for foreign investment upto 51% in high priority industries which include all food processing industries (except milk food, malted foods and flour) and all items of packaging for food processing industries. Investors need to file an application with the Reserve Bank of India (RBI) in the prescribed format and approval is ordinarily granted within 15 days. For foreign investment higher than 51% and for investments in industries outside the high priority industries,

clearance has to be obtained from SIA. Applications are processed on a case by case basis on merit and usually SIA takes about 2 months for the process. Applications for setting up a 100% Export Oriented Unit is also required to be filed with the SIA. For setting up a unit in an Export Processing Zone (EPZ), application has to be filed with the Development Commissioner of the concerned EPZ. Foreign equity of upto 24% of the total shareholding is also being permitted in the small scale sector.

Under automatic procedures, foreign technology agreements are being permitted in respect of industries that are designated as high priority industries. The use of foreign brand names and / or trade mark of goods is also now being permitted freely. To provide access to international markets, majority foreign equity holding upto 51% equity is being permitted for international trading companies that are primarily engaged in export activities.

FDI in a company engaged in “cash and carry wholesale trading” is now permitted up to 100 % under automatic route. The present policy only permit FDI up to 100 % in Cash and carry wholesale trading, which is distinct from retail trading, involving sale to individual customers through normal retail outlets. Recently Government of India has allowed retail trading in single brand items. FDI is not allowed in any other agricultural sector / activity.

### **6.2.6 Fiscal Policy & Taxation**

Wide ranging fiscal policy changes have been introduced progressively. Excise & Import duty rates have been reduced substantially. Many processed food items are totally exempt from excise duty. Custom duty rates have been substantially reduced on plant & equipments, as well as on raw materials and intermediates, especially for export Production. Corporate taxes have been reduced and there is a shift towards market related interest rates.

There are tax incentives for new manufacturing units for certain years, except for industries like: beer, wine, aerated water using flavouring concentrates, confectionery & chocolates etc. Indian currency (rupee) is now

fully convertible on current account and convertibility on capital account with unified exchange rate mechanism is foreseen in coming years. Repatriation of profits is freely permitted in many industries except for some, where there is an additional requirement of balancing the dividend payments through export earnings.

### **6.2.7 Export Promotion**

- Food processing industry is one of the thrust areas identified for exports. Free trade zones (FTZ) and export processing zones (EPZ) have been set up with all necessary infrastructure. Also, setting up of 100% Export oriented units (EOU) is encouraged in other areas. They may import free of duty all types of goods, including capital goods.
- Capital goods, including spares upto 20% of the CIF value of the Capital goods may be imported at a concessional rate of Customs duty subject to certain export obligations under the EPCG scheme. Export linked duty free imports are also allowed.
- Units in EPZ/FTZ and 100% Export oriented units can retain 50% of foreign exchange receipts in foreign currency accounts.
- 50% of the production of EPZ/FTZ and 100% EOU units are saleable in domestic tariff area.
- All profits from export sales are completely free from corporate taxes. Profits from such exports are also exempt from Minimum Alternate Tax (MAT).

### **6.2.8 Custom clearance: Food items**

Customs Department in India follows certain guidelines for custom clearance of food items which includes checks on the condition of the hold in which the products were transported, ensuring whether they meet the requirement of storage as per the nature of the products, and does not in any way cause deterioration or contamination of the products. Customs Department is also required to check the physical/visual appearance of goods

in terms of possible damage and its compliance with labeling requirements under the Prevention of Food Adulteration Rules and the Packaged Commodities Rules. In addition, any imported food item, at the time of its import, should have a valid shelf life of not less than 60 % of original shelf life. The Customs Department ensures that the articles which do not meet this condition are not allowed clearance for home consumption.

Apart from the checks on all the consignments of edible/food products imported through Ports, Inland container Depots, Air Cargo Complexes, Container Freight Stations and Land Customs Station the samples of imported food products are required to be referred to the Port Health Officer for testing. For alleviating the difficulties of importers, it has been decided that pending receipt of the test report, such consignments be allowed to be stored in warehouses under Section 49 of the Customs Act, 1962.

### **6.2.9 New Opportunities: In India**

In India the Food Processing Industry is relatively nascent and offers opportunities for FDI. It accounts for Rs 1,280 billion (US\$29.4 billion), in a total estimated market of Rs 3,990 billion (US\$91.66 billion). There is a rapidly increasing demand for processed food caused by rising urbanization and income levels. To meet this demand, the investment required is about US\$28 billion. Food processing has been declared a priority sector.

The outlay in the Food Processing Sector has been increased from US\$19.5 million in 2004-05 to US\$41.35 million the next year, more than twice the earlier amount. The government is also considering investing US\$22.97 million in at least 10 mega food parks in the country besides working towards offering 100 per cent foreign direct investment and income tax benefits in the sector.

The Government has recently established Special Economic Zones with the purpose of promoting exports and attracting FDI. These SEZs do not impose duty on imports of inputs and they enjoy simplified fiscal and foreign exchange procedures and allow 100% FDI.

The Government is also moving towards introducing an integrated food law, which is expected to help meet the requirements of international trade and make the Indian food industry competitive in the global market. To harness the value-creating potential of agro processing, superior market mechanism and infrastructure are required to be created. State governments have already begun to actively encourage the creation of aggregators by encouraging companies to engage in agriculture marketing. It is believed that this may provide the basis to jumpstart private investment into cold chain and other supply chain infrastructure.

### **6.3 Pharmaceutical Industry**

The pharmaceutical industry has shown tremendous progress in terms of infrastructure development, technology base creation and a wide range of production. The country ranks fourth worldwide accounting for 8% of world's production by volume and 1.5% by value. It ranks 17th in terms of export value of bulk actives and dosage forms. Indian exports are destined to more than 200 countries around the globe including highly regulated markets of US, Europe, Japan and Australia. During 1999-2000, production of bulk actives (APIs) is estimated at US \$ 860 million and value of Dosage forms is estimated around \$ 3 billion (growth + 15%). The country is also showing excellent performance on the export front with the exports touching \$ 1.5 billion during 1999-2000 as per provisional statistics. In the process, the pharmaceutical industry in India has achieved global recognition as a low cost producer and supplier of quality bulk drugs and formulations to the world.

India Patents Act of 1970 provided patenting of all processes and products in all areas excepting food, drugs and chemicals. Introduction of product patents in these three crucial areas indicates the sign of confidence and maturity of Indian industry particularly the emerging pharmaceutical industry. In fact, the new patent regime will help Indian pharma industry which has made large investments in drug research. It gives a chance to drug development by frontline companies with adequate safeguards to protect the interests of society.

#### **6.3.1 Regulatory Framework-Drugs Sector**

Under the current Indian legal and regulatory regime, the manufacture, sale, import, exports and clinical research of drugs and cosmetics is governed by the following laws

1. The Drugs and Cosmetics Act, 1940
2. The Pharmacy Act, 1948

3. The Drugs and Magic Remedies (Objectionable Advertisement) Act, 1954
4. The Narcotic Drugs and Psychotropic Substances Act, 1985
5. The Medicinal and Toilet Preparations (Excise Duties) Act, 1956
6. The Drugs (Prices Control) Order 1995 (under the Essential Commodities Act).

There are some other laws which have a bearing on the manufacture, distribution and sale of pharmaceutical products in India. The important ones being:

- The Industries (Development and Regulation) Act, 1951
- The Trade and Merchandise Marks Act, 1958.
- The Indian Patent and Design Act, 1970
- The Factories Act.

The Drugs and Cosmetics Act, 1940 is legislation brought in force to protect consumers interests. Provisions under this Act include punishments & fines for misbranding drugs, confiscating of such drugs (sec 14), prevention of the import of such drugs (sec10) etc. It prohibits the sale of such drugs under section 18. It also provides for the setting up of Central Drugs Laboratory for testing batches of drugs. The Act also prescribes strict standards that are to be followed by drug manufacturers and importers. It also clearly defines a misbranded drug under section 17. Section 13 clearly states that whoever contravenes any part of this Act will be punishable with imprisonment which may extend to one year, or with fine which may extend to five hundred rupees, or with both. If convicted again of the same offence then, in addition he shall be punishable with imprisonment, which may extend to two years, or with fine which may extend to one thousand rupees, or with both.

### **6.3.2 Opportunities in Drugs Sector**

The Indian pharmaceutical market has been forecast to grow to as much as US\$ 25 billion by 2010 as per Organization of Pharmaceutical

Producers of India (OPPI) estimates. However, Espicom's market projections forecast more modest but stable annual market growth of around 7.2 per cent, putting the market at US\$ 11.6 billion by 2009.

With such a large number of drugs going out of patent by 2005, the opportunity of Indian industry is becoming bigger and bigger and the future is certain.

As per Drugs policy – 1994, only five drugs have been reserved for public sector. Some drugs which involve use of recombinant DNA technology and those formulations which are targeted specifically at cells and tissues will require licence. Other drugs will not require any licence. Foreign companies will be allowed to hold upto 51% Shares. Existing companies will also be allowed to increase the foreign share-holding to 51%. Permission for holding above 51% will have to be obtained from “Foreign Investment Promotion board.” This will be decided on case to case. Basis on merits of each case.

Thus, the list covers only items which are sensitive either from defence point of view, security point of view or scarcity point of view.

Exemption from licensing to other industries – No industrial licensing is required if following conditions are fulfilled.

- (a) Industry is not in Annexure I or II
- (b) Product is not reserved for SSI.
- (c) The project is not located within 25 kms. of the standard urban area limit of city having population of more than 10 lakhs as per 1991 census. There are now 30 such cities in India, having population over 10 lakhs. This restriction of location is not applicable to electronics, computer software printing and other non-polluting industries as may be notified.
- (d) These provisions are applicable to “substantial, expansion” as, which means increase in capacity by more than 25% of existing capacity.
- (e) The location will, however, be subject to environment as restrictions and other regulation, if any



### **6.3.3 Manufacturing: Innovation**

- Pharmaceutical Companies: High performers
- 1/3 of 2002 production of 5.2B exported.
- 1996-2001: 3 pharma companies in top 10 highest US patents by Indian company
- Average R&D intensity is 2%
- Joint R&D with MNCs, licensing, sponsored research, intl marketing
- Dr. Reddy's Laboratory
- R&D firm launched in 1992
- Invested Rs 1.12B over 8 yrs
- Filed 55 US patents, 19 granted, Total Revenue of \$8M upto June 2001
- Licensed 3 molecules to foreign drug firms
- Others: Ranbaxy, Cipla, Wockhardt, Sun Pharma

### **6.3.4 National Pharmaceuticals Policy 2006**

#### **1.0 Introduction**

Driven by the knowledge skills, growing enterprise, low costs, improved quality and demand (domestic and international) the pharmaceuticals sector has witnessed a tremendous growth over the past few years – from a turnover of Rs. 5000 crores in 1990 to over Rs.50,000 crores during 2004-2005. Exports have also grown very significantly to over Rs. 16700 crores during this period. India is today recognized as one of the leading global players in the manufacture of pharmaceuticals – it holds 4<sup>th</sup> position in terms of volume and 13<sup>th</sup> in terms of value of production. It is also recognized that the cost of drugs produced in India is amongst the lowest in the world. It is estimated that by the year 2010 industry has the potential to achieve Rs. 1,00,000 crores in formulations with bulk drug production going up from Rs. 8000 crores to Rs. 25,000 crores. India's rich human capital is believed to be the strongest asset

for this knowledge-led industry. Various studies show that the scientific talent pool of 4 million Indians is the second largest English speaking group worldwide, after the US. However despite the impressive growth of the sector and low costs there are several concerns which need to be addressed. Some to these concerns pertain to accessibility and affordability of medicines by the common man particularly the vast segment of poor population, instituting standards of quality, particularly for units not conforming to standards of regulated markets, strengthening the fragmented regulatory system, sustaining growth of generics – the main forte of Indian Industry, meeting the challenge of product patent regime and so on. In order to find the right solutions and the right balance between various viewpoints almost a continuous debate goes on regarding some of these issues both within and outside Government.

In the year 2002 Government had formulated a new Drug Policy but the same could not be implemented due to litigation involving it, hence the policy of 1994 still continues to be in force. The present Policy known as the National Pharmaceuticals Policy, 2005 has been necessitated due to several developments that have taken place during the course of last few years as well as to address some of the major concerns as highlighted above. Price regulation of the essential medicines is an important component of this policy. However several other matters having a close bearing on the pharmaceuticals sector have also been included in the policy.

## **2.0 Past Approach**

For meeting the requirements of medicines at reasonable prices as also for strengthening of the indigenous manufacturing capacity and capability, the Government has, over the years, formulated policies and issued drug price control orders from time to time. The first price control order was issued under the Defence of India Act in 1963. Thereafter from 1970 onwards price control orders were issued under the Essential Commodities Act, 1955. Presently the Policy of 1994 is in existence and price control is being exercised through the Drugs Price Control Order, 1995 under which prices of 74 bulk drugs and their formulations are controlled. Under the 2002

policy a new price control criteria was approved. However before the same could be implemented it was stayed by Karnataka High Court. An SLP was filed in the Supreme Court against the order of Karnataka High Court. Supreme court vide its interim order on 10th March, 2003 stayed the order of Karnataka High Court. However it also ordered that –”— the petitioner shall consider the formulate appropriate criteria for ensuring essential and life saving drugs not to fall out of price control and to review the drugs which are essential and life saving in nature till 2nd May, 2003.” Accordingly the Central Government reviewed the National Essential Drug List, 1996 and brought out a new Department of Chemicals and Petrochemicals, Government of India, December 28, 2005 Health Administrator Vol : XX Number 1& 2 : 1- 8 Pg. list called the National List of Essential Medicines 2003 which was made available to the Supreme Court. Under this list as many as 354 drugs have been categorized as essential medicines. Another important development that has recently taken place in India is the introduction of product patent regime in pharmaceuticals with effect from 1st January, 2005. Earlier with the enactment of The Patent Act, 1970 (which came into force in the year 1972) only process patent was made applicable for pharmaceuticals which played a very significant role in the development of the pharmaceutical industry in India. India emerged as a major producer and exporter of pharmaceuticals in the world. After India became a signatory to the WTO and TRIPS agreements it was obliged to introduce product patent on pharmaceuticals with effect from 1st January, 2005. Our patent law has now been made TRIPS compliant by fulfilling various commitments under the TRIPS agreement. This has brought a new challenge to the Indian pharmaceutical industry as it would no longer be able to freely continue with the production of generics of the new patented molecules without licence/payment of royalty to the innovator company. With this paradigm shift the Indian industry would now be required to focus much more on research and development.

## **2.1 Experience Drawn from Past**

### **Pharmaceutical Policies**

The first comprehensive Drug Policy of 1978 and thereafter the Drug Policy of 1986 together with the application of process patent under the Patent Act of 1970 successfully paved the way for development of indigenous pharmaceutical industry which went into the production of generic drugs in a big way. A conducive environment for success was provided by the then prevailing trade and economic policies. During the period from 1978 to 1990 indigenous industry acquired a respectable status in terms of product range and market share. R&D was confined to process development/innovation of existing molecules.

As regards pricing, the span of control, inclusion/exclusion of drugs under price control, methodologies adopted etc continued to be debated. The Government developed principles of selectivity, from time to time, to keep the price control manageable and focused, as would be observed from declining trend in number of drugs under price control. In 1970, almost all bulk drugs and their formulations were under price control. In keeping with the economic policies of the country the number got reduced to 347 bulk drugs in 1979, 142 in 1987 and finally to 74 in 1995. It would have got reduced further under the criteria adopted in the Pharmaceutical Policy 2002, however, the same could not be implemented due to litigation involving it.

## **3.0 Important Developments after liberalization process in 1991**

Following are some of the important developments that have taken place in pharmaceutical sector after the process of liberalization of the Indian economy was initiated by the Government in the year 1991—

### **1. Industrial Licensing**

Industrial licensing for all kinds of drugs has been abolished (it has recently been done for the last remaining bulk drugs produced by the use of recombinant DNA technology, bulk drugs requiring in-vivo use of nucleic acids

and specific cell-tissue targeted formulations). However the need for obtaining manufacturing licence under Drugs and Cosmetics Act, 1940 continues for all units whether organized or small scale. The State Drug Controllers are authorized to issue such licences in most cases.

## **2. Foreign Direct Investment**

FDI up to 100% is permitted, subject to stipulations laid down from time to time in the Industrial Policy, through the automatic route in case of all bulk drugs cleared by the Drug Controller General (India), all their intermediates and formulations. Recently bulk drugs produced by the use of recombinant DNA technology, bulk drugs requiring in-vivo use of nucleic acids as the active principles and special cell/tissue targeted formulations have also been allowed this facility.

## **3. Foreign Technology Agreement**

Automatic approval for Foreign Technology Agreement (FTA) is already available in the case of all the bulk drugs cleared by Drug Controller General (India), all their intermediates and formulations, except bulk drugs produced by the use of recombinant DNA technology, bulk drugs requiring in-vivo use of nucleic acids as the active principles, and specific cell/tissue targeted formulations.

## **4. Imports**

Imports of drugs and pharmaceuticals are regulated through EXIM Policy in force and presently all items except those requiring clearance under The Narcotics and Psychotropic Substances Act, 1985 are allowed under OGL. Further, a centralized system of registration has been introduced under the Drugs & Cosmetics Act and Rules made there under, administered by Ministry of Health and Family Welfare. These arrangements may continue to regulate imports of Drugs and Pharmaceuticals.

## **5. Exports**

Exports are permitted in accordance with the Exim Policy and relevant procedures/rules formulated for the purpose by the Directorate General of Foreign Trade. Exports are also subject to laws prevalent in importing countries. Also, the exporters are allowed imports of inputs on duty free basis for export production. The industry has shown commendable export performance, the trade balance being positive. Over the last few years the compounded annual growth rate in exports has been 22.7 percent.

## **6. Constitution of Pharmaceutical Export Promotion Council (Pharmexil)**

In order to provide a boost a pharma exports Government constituted a separate Export Promotion Council for Pharmaceuticals (Pharmexil) in the year 2004-05. This Council works closely with the Department of Commerce and the Export Promotion Cell in the Department of Chemicals and Petrochemicals to undertake activities such as promoting exports, preparing country-profiles, assessing export potential across the countries and to have greater degree of interaction internationally.

## **7. Research & Development**

As recommended by the Mashelkar Committee in 1999 a Pharmaceutical Research and Development Support Fund (PRDSF) with the corpus of Rs. 150 crores has been set up under the administrative control of the Department of Science and Technology. A Drug Development Promotion Board (DDPB) to administer the utilization of PRDSF has also been set up.

## **8. Product Patent in Pharmaceuticals**

Product patent in pharmaceuticals has been introduced in the country with effect from 1<sup>st</sup> January, 2005 by amending the Patents Act, 1970 in conformity with the TRIPS agreement. The physical infrastructure in the four patent offices in the country (Kolkata, Delhi, Chennai and Mumbai) has been substantially strengthened and computerization has been introduced. Steps

are now being taken to further augment and improve the software and human resources in these offices to enable them to deal with the new responsibilities.

## **9. Schedule M of Drugs and Cosmetics Act, 1940**

The revised Schedule M of the Drugs and Cosmetics Act, 1940 related to Good Manufacturing Practices (GMP) has come into effect from 1st July 2005. This would in the long run strengthen the pharma industry as a producer of quality medicines.

## **10. Introduction of Value Added Tax (VAT)**

VAT has been introduced in India with effect from 1st April, 2005. Already 22 States have implemented it. The remaining States are likely to implement it in the near future. VAT on medicines has been kept at 4%

## **11. Excise Duty payable at MRP (Maximum Retail Price)**

A Notification was issued on 7th January, 2005 under which Excise duty became leviable on MRP with an abatement of 40%.

## **4.0 Key Policy Objectives**

Following are the key objectives of the policy –

(a) To ensure availability at reasonable prices of good quality medicines within the country.

(b) To improve accessibility of essential medicines for common man particularly the poorer sections of the population.

(c) To facilitate higher investment for increased production of good quality medicines

(d) To promote greater research and development in the pharmaceuticals sector by providing suitable incentives in this regard

(e) To enable domestic pharma companies to become internationally competitive by implementing CGMP, GLP GCP and other established international guidelines

(f) To facilitate higher growth in exports of APIs and formulations by reducing the barriers to internationally trade in pharmaceuticals sector To develop India as the preferred global destination for pharma R&D and manufacturing To facilitate implementation of the Health Policy of the country

#### **4.1 The National Common Minimum Programme, as adopted by the Government aims as follows**

a) UPA Government will raise public spending on health to at least 2-3% of GDP over the next five years with focus on primary health care.

b) A national scheme for health insurance for poor families will be introduced.

c) The UPA will step up public investment in programmes to control all communicable diseases and also provide leadership to the national AIDS control effort.

d) The UPA Government will take all steps to ensure availability of life savings drugs at reasonable prices.

e) Special attention will be paid to the poorer sections in the matter of health care.

f) The feasibility of reviving public sector units set up for the manufacture of critical bulk drugs will be re-examined so as to bring down and keep a check on prices of drugs.

An issue of paramount importance in the Indian context is to increase the accessibility of drugs to the common man and in particular to the vulnerable and poorer segments of the population. Even though the prices of drugs as compared to most other countries and particularly the neighboring countries are one of the lowest yet these are important issued relevant to



India. A Committee set up by Government under the chairmanship of Joint Secretary (Pharmaceuticals) popularly known as the Sandhu Committee had made several recommendations in this regard. Thereafter the Task Force headed by Dr. Pronab Sen, Principal Adviser (PP), Planning Commission popularly known as the Sen Committee made several other wide ranging recommendations.

Some important recommendations were made by the National Manufacturing Competitiveness Council (NMCC). National Commission on Macroeconomics and Health Constituted by the Ministry of Health and Family Welfare in its report on 'Access To Drugs and Medicine ' also made some valuable recommendations on issues relevant to the drug industry. The recommendations made by all these Committees have been examined by Government and there is a broad agreement on the implementation of several of the recommendations. Several suggestions were received from industry associations, voluntary bodies, States and other organizations. A Core Committee consisting of representatives of Department of Chemicals and Petrochemicals, NPPA, NIPER and Chief Executives of various public sector pharma undertakings was constituted to facilitate drafting of the policy based on the various/suggestions.

## **New Policy Initiatives**

The new initiatives except for price control are enumerated in Part A of the report while Price control system is enumerated in Part B of the report (Part B has been prepared separately)

### **1. Strengthening of Drug Regulatory System**

Drug regulatory system has a close bearing on the prices, availability and quality of drugs. Under the Drugs and Cosmetics Act, 1940 there is dual regulatory control over the drugs by Central and State governments. While regulation of manufacture, sale and distribution of drugs is primarily the responsibility of the State Authorities, the Central Authorities are responsible for approval of new drugs, clinical trials, laying down standards for drugs,

control over imported drugs, coordination of the activities of state drug control organizations. The Expert Committee set up by Government under the chairmanship of Dr R A Mashelkar, Director CSIR in its report submitted in 2003 has made comprehensive recommendations for strengthening the drug regulatory system including the problem of spurious drugs. It has made detailed recommendations to strengthen the existing regulatory organizations both at the Centre and the States.

The Task Force set up by Government to 'Explore options other than Price control for achieving the objective of making available life saving drugs at reasonable level' has recommended that in the long run both the functions of drug regulation and price control should be performed by the same agency and there should be an integrated regulatory system.

Keeping in view the recommendations of the two Committees it has been decided that –

a) As an immediate step an independent and autonomous body by the name of National Drug Authority would be constituted in place of the present Central Drugs Standard Control Organisation (CDSCO).

b) Several of the existing provisions of the Drugs and Cosmetics Act, 1940 would be amended to make the penalties more deterrent for various offences and in particular for spurious and sub-standard drugs. A bill in this regard has been introduced in the Parliament

c) In the long run the proposal of Task Force regarding merger of NPPA and NDA would be considered in the form of National Authority on Drugs and Therapeutics (NADT) which will lead to an integrated regulatory system in the country.

## **2. Intellectual Property Rights including Data Protection**

Government is committed to making the Indian laws and policies pertaining to Intellectual Property Rights fully compliant with the provisions of TRIPS. Significant progress has already been made in this regard. Product

patent in case of pharmaceuticals has been introduced with effect from 1st April, 2005 by amending the Patents Act, 1970. Under this Act both product as well as process patents can now be granted for pharmaceuticals. New Rules are being framed under this Act and would be notified soon. Under these rules it would be endeavour of the Government to simplify procedures and shorten the timelines for various approvals. Modernisation of Patent Offices in the country has been undertaken and the number of patent examiners has been augmented in these offices. Following action is contemplated towards further improving the working of the patent offices. Proper training to be imparted to the personal working in the four patent offices. Trainers from India and abroad would be utilized for this purpose.

a) The number of patent examiners to be further increased to match the increased workload

b) Full computerization would be undertaken so as to bring about greater transparency and convenience in the functioning of these offices.

c) All the pending patent applications to be made available on the website of the patent office

d) Electronic filing of patent applications to be introduced

e) An IP Cell to be set up in the Department of Chemicals and Petrochemicals to support innovator pharma SMEs in the patenting process, training in documentation and other areas of intellectual property. This would enable them to take advantage of the patent regime and in the process encourage greater R&D in their enterprises.

f) A Technical Expert Group has been constituted under the chairmanship of Dr R.A. Mashelkar, Director General, Council of Scientific and Industrial Research with the following terms of reference-

\* Whether it would be TRIPS compatible to limit the grant of patent for pharmaceutical substance to new chemical entity or to new medical entity involving one or more inventive steps,

\* Whether it would be TRIPS compatible to exclude micro-organisms from patenting As regards Data Protection various options are being examined by the Inter-Ministerial Committee headed by Secretary, Department of Chemicals and Petrochemicals. The Committee has heard various viewpoints on the subject and is likely to submit its report soon. Suitable policy decision/action would be taken after receipt of the report of the Committee on this matter.

#### **4. Clinical Trials and Drug Development**

Clinical Trials are essential for drug development. Schedule Y of the Drugs and Cosmetics Rules, 1945 has been amended to allow for multicentric concurrent clinical trials in India. Under these rules clinical trials have been defined and it has been made mandatory to take approval for conducting any type of clinical trials in the country. Also Good Clinical Practices (GCP) guidelines have been published and made mandatory. It also addresses the protection of study subjects (patients/volunteers) and integration and quality and data. Following action is contemplated to facilitate and encourage clinical trials in India) An early decision on data protection

a) As improved regulatory infrastructure and some form of protection to undisclosed test data will increase the activity in this field.

b) In order to facilitate pre-clinical trials National Toxicology Centre set up in NIPER to be made fully compliant with GLP norms

c) Tax benefits available to R&D to be made applicable to for Clinical trials also

d) Clinical trial samples being imported into India to be exempted from payment of import duty on the basis of authorization/licence issued by Drug Controller General of India

f) To promote direct investment in the field of clinical development and data management exemption from service tax for a period of 10 years upto 2015

## **5. Public-Private Partnership Programme for Anti-Cancer and Anti-HIV/AIDS Drugs**

For making available anti-cancer and anti-HIV/AIDS drug at reasonable prices to a much larger section of the population Government would evolve a public-private partnership programme with the concerned manufacturers and cancer hospitals in the country. All medicines pertaining to these categories whether under National List of Essential Medicines, 2003 or outside would be brought under this programme. Some of the steps proposed to be taken are as under

### **a) Anti Cancer Drugs**

At any given point of time there are about 20 to 25 lac people suffering from cancer in the country who are affected by various types of cancer (lung cancer, blood cancer ect.) It is estimated that every year about 7 lac people are detected with different types of cancer. Most of them are unable to afford the cost of expensive anti-cancer medicines. Going by a conservative estimate of average cost of anticancer medicines per patient as Rs. 25,000 it would require medicines worth of Rs. 5,000 crores. As against this, the present turnover of this segment of medicines in India is estimated to be only Rs. 150 crores. The big gap indicates the near non-accessibility of the medicines to a vast majority of the affected population mainly because of the high cost of these medicines. In order to reach out to a larger number of cancer patients following steps would be taken –

1. Government would completely exempt anticancer drugs (bulk and formulations) from all types of Central taxes – excise duty, import duty etc and the benefit would be passed on to the consumers.
2. States would also be asked to exempt these medicines from all types of state and local levies

3. Industry and trade would be asked to reduce their margins – both profit and trade margins to the barest minimum level and pass on the benefit to the consumers.
4. A subsidy scheme for making cancer drugs affordable to the common man would be worked out with the help of concerned manufacturers and the Cancer hospitals. Under this scheme a subsidy on the sale of anti-cancer drugs would be made available to all the cancer hospitals who register under the scheme.
5. Subsidized anti-cancer medicines would be provided to all the cancer patients from the retail outlets of the cancer hospitals on the recommendations of the doctors of such hospitals. In order to take advantage of lower rates from bulk purchase a Rate Contract for the anticancer drugs would be worked out with the manufacturers for all the hospitals which join this scheme. All Government run hospitals with facilities for treatment of cancer would be eligible to become members of the scheme as also the private cancer hospitals. Efforts would be made to create drug banks in major cities where manufacturers would be encouraged to contribute to these drug banks which may be managed by hospitals and NGOs

**b) Anti-HIV/AIDS Medicines**

India has the highest number of reported HIV/AIDS cases in the entire SOUTH Asian region. There are as many 5.1 million people affected by HIV/AIDS in India, about 85% of the South Asian total. In the world India has the second highest reported cases of HIV/AIDS, just below South Africa's total of 5.3 million There are presently 39 Anti-Retroviral Therapy (ART) Centres in the country located mostly in the medical colleges and major tertiary hospitals. These are located mostly in the six high prevalence states namely Karnataka, Tamil Nadu, Andhra Pradesh, Maharashtra, Manipur and Nagaland. 100 new centres have been identified to be opened in the near future and the number would go to 188 by the year 2010. It would be the endeavour of the Government to open atleast one or two centers in each state. The number of patients being provided free treatment through the ART centers is 16000.

(another 16000 patients are being treated by Railways and ESIC and 10000 by the private sector). The number of patients treated would be taken to 500,000 by the year 2010. Apart from the assistance available under the Global Fund for Aids, TB and Malaria-Round 4, additional funds would be provided to cover the entire AIDS affected population.

Presently anti-HIV/AIDS drugs that are being manufactured in India are mostly first generation which have developed resistance in many cases. Production of second generation drugs would be ensured in the country so as to provide an effective treatment on a continuous basis. Some of the measures envisaged to reduce the cost of ARV drugs and increase their availability are as follows:

a) Complete exemption of anti-HIV/AIDS drugs (bulk drugs as well as formulations) from the payment of excise duty, customs duty and other levies, if any. This benefit would be passed on to the patients.

b) Manufacturers and Trade to charge lower profit and trade margins on these drugs.

c) Most of the first generation drugs and some of the second generation drugs are presently being manufactured in India. All efforts would be made to ensure production of second generation drugs in the country in consonance with the provisions of Patent Act, 1970.

d) In case of second generation drugs which are not manufactured in India these would be procured at prices which are negotiated with the concerned manufacturers. (In the case of AIDS cheaper and more easily available drugs have led to 80% decline in deaths between the period 1997 and 2003 – as reported by researchers from India and Rhode Island in the November 15 issue of Clinical Infectious Diseases. Government is running 39 testing and treatment centers where over 14400 patients are being treated – only those with CD 4 count below 200 per cubic ml of blood are treated. Railways and industry is treating another about 30,000 patients. At the same time the fact is that there are over 5 million HIV-positive cases in India which is 10% of the world's population of people with HIV. Estimates of population

affected by HIV varies between 5 million to 7 million. Presently NACO is purchasing medicines and distributing these free of cost through its Centers and State Aids Control Societies Government would allocate larger funds for the purchase of these medicines particularly anti-AIDS through a centralized system)

#### **4. Prices of Drugs for other Life Threatening Diseases**

Drugs for other life threatening diseases requiring life long treatment, whether part of National List of Essential Medicines, 2003 or outside it, would also be identified and brought under the public private partnership model.

##### **6.3.5 Drugs (Price Control) Order, 1995**

As per Drugs policy 1994, control over prices of drugs will be retained only if its total turnover exceeds Rs.4 crore per annum. However, if there are at least five bulk drug producer or 10 formulators with none of them having more than 40% market share, these will be out of price, control, even if turnover exceeds Rs.4 crore (5% drugs are covered under this criteria). Further, if there is only a single manufacturer with 90% market share in bulk drug, it will be considered as a monopoly situation. Such drugs will be brought under price control even if its turnover exceeds Rs.1 crore per annum (19 bulk drugs have been covered as per this criteria).

Sugar – Manufacturers of Sugar have to surrender fixed percentage of their production to Government for 'public distribution system' (PDS). Remaining sugar can be sold in open market. There is also control over movement of sugar, sugarcane etc.



## Chapter-7

### Essential Commodities Regulation & Industries Promotion

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## 7.1 Essential Commodities Regulation<sup>19</sup>

It is responsibility of any Government to ensure equitable supply of essential commodities to people at reasonable prices. Need for such control is necessary in cases of inadequate supply and lack of competition. India started facing severe shortages of many commodities particularly before and during 2<sup>nd</sup> World War. Government of India, therefore, made certain rules to India Act, in 1939. This provision continued upto 1946, when Essential Supplies (Temporary Powers) Act, 1946 was passed. This Act continued upto 26.1.1955. Since shortages continued, it was felt that a permanent measure for control of Essential Commodities is necessary. Constitution was amended in 1954 by adding entry No.33 to list 3 of the 7<sup>th</sup> Schedule to the Constitution. After this, Essential Commodities Act, 1955 (ECA) was passed, which came into force on 1.4.1955. The Act has been amended from time to time. Under Essential commodities Act, Government has power to control production, supply and distribution of and trade and commerce in certain commodities. Essential Commodities (Special provisions) Act, 1981 was passed which contains provisions of special court to try the offences. These Special provisions have been extended by an ordinance but have now lapsed.

### **Controls beyond limit are counter – productive :**

Government has realized that controls over prices and distribution do not help in the long run. Most glaring example is that of cement. Severe distribution and price control was established on cement. The result was that in view of an-remunerative prices, new units were not being set-up and existing cement manufacturing units were not taking steps to expand, renovate or replace old machinery. The result was that shortage of cement persisted and increased. Government introduced partial decontrol over cement in February 1982 cement was fully decontrolled on March 1989. After removal of controls, production of cement picked up and now availability of

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<sup>19</sup> Taxmans Economics Laws 2003

cement is adequate and in fact, customer can choose brand and quality they require.

Severe price control on bulk drugs is leading to a situation where drug manufacturers are not investing in basic research as they are unable to generate enough surplus. This in long range will affect supply and quality.<sup>20</sup>

## **7.2 Essential Commodities Act, 1955**

The Essential Commodities Act, 1955 was enacted to ensure the easy availability of essential commodities to consumers and to protect them from exploitation by unscrupulous traders. The Act provides for the regulation and control of production, distribution and pricing of commodities which are declared as essential for maintaining or increasing supplies or for securing their equitable distribution and availability at fair prices. Exercising powers under the Act, various Ministries/Departments of the Central Government and under the delegated powers, the State Governments/UT Administrations have issued orders for regulating production, distribution, pricing and other aspects of trading in respect of the commodities declared as essential. The enforcement/ implementation of the provisions of the Essential Commodities Act, 1955 lies with the State Governments and UT Administrations.

As per the decisions of the Conference of Chief Ministers held on 21 May 2001, a Group of Ministers and Chief Ministers had been constituted which recommended that the regulatory mechanism under the Essential Commodities Act, 1955 should be phased out. Accordingly, the restrictions like licensing requirement, stock limits and movement restrictions have been removed from almost all agricultural commodities. Wheat, pulses and edible oils, edible oilseeds and rice being exceptions, where States have been permitted to impose some temporary restrictions in order to contain price increase of these commodities.

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<sup>20</sup> Taxmann's Students guide to economic laws 1999 – Essential Commodities Act, 1955.

The list of essential commodities has been reviewed from time to time with reference to the production and supply of these commodities and in the light of economic liberalisation in consultation with the concerned Ministries/Departments administering these commodities. The Central Government is consistently following the policy of removing all unnecessary restrictions on movement of goods across the State boundaries as part of the process of globalisation simultaneously with the pruning of the list of essential commodities under the said Act to promote consumer interest and free trade. The number of essential commodities which stood at 70 in the year 1989 has been brought down to 7 at present through such periodic reviews.

In conformity with the policy of the Government towards economic liberalisation, Department of Consumer Affairs is committed to the development of agriculture and trade by removing unnecessary controls and restrictions to achieve a single Indian Common Market across the country for both manufactured and agricultural produce and to encourage linkage between agriculture and industry. With this object in view, this Department introduced the Essential Commodities (Amendment) Bill, 2005 in the Parliament in the winter session of 2005 to enable the Central Government to prune the list of essential commodities to the minimum by deleting all such commodities which have no relevance in the context of present improved demand and supply position and to facilitate free trade and commerce. Only those commodities considered essential to protect the interest of the farmers and the large section of the people "below the poverty line" are proposed to be retained under the Essential Commodities Act, 1955.

The Prevention of Black-marketing and Maintenance of Supplies of Essential Commodities Act, 1980 is being implemented by the State Governments/UT Administrations for the prevention of unethical trade practices like hoarding and black-marketing. The Act empowers the Central and State Governments to detain persons whose activities are found to be prejudicial to the maintenance of supplies of commodities essential to the community. Detentions are made by the States/UTs in selective cases to prevent hoarding and black-marketing of the essential commodities. As per

reports received from the State Governments, 119 detention orders were issued under the Act during the year 2007. The Central Government and the State Governments also have the power to modify or revoke the detention orders. The representations made by or on behalf of the persons ordered for detention are considered and decided by the Central Government.

In the context of unprecedented rise in prices of some essential commodities in the mid 2006, there had been wide spread concern from various corners for taking immediate steps to mitigate the rising trend of prices of essential commodities. Representations from the Chief Ministers of Punjab and Delhi and also from the Governments of Andhra Pradesh, Rajasthan and Maharashtra were received for restoration of powers under the Essential Commodities Act, 1955 for undertaking dehoarding operations in view of the assumption that there is speculative holding back of stocks particularly of wheat and pulses in anticipation of further rise in prices. Central Government has already taken a number of steps to control the price rise in essential commodities by trying to augment supply including through imports by reducing the duty level on import of both wheat and pulses to zero.

The situation was further reviewed by the Government and it was decided with the approval of the Cabinet to keep in abeyance some provisions in the Central Order dated 15.2.2002 for a period of six months with respect to wheat and pulses (whole and split), so as to tackle the crises on availability and prices of these commodities. Accordingly, the Government order No.1373 (E) dated 29.8.2006 by virtue of which the words or expressions made in respect of purchase, movement, sale, supply, distribution or storage for sale in the "Removal of (Licensing requirements, Stock limits and Movement Restrictions) on Specified Foodstuffs Order, 2002" notified on 15.02.2002 have been kept in abeyance for commodities namely wheat and pulses for a period of six months. The transport, distribution or disposal of wheat and pulses (whole or split) to places outside the State as well as import of these commodities have been kept outside the purview of the aforesaid Order of 29.08.2006. The Order of 29.08.2006 was initially in force for a period of 6 months, which was extended thrice for a period of 6 months each by Central

Notifications dated 27.02.2007, 31.8.2007 and 28.02.2006. The Order permitted State/UT Governments to fix stock limits in respect of wheat and pulses.

To enable the State Governments/UT Administrations to continue to take effective action for undertaking de-hoarding operations under the Essential Commodities Act, 1955, the price situation was further reviewed by the Government and it has been decided with the approval of the Cabinet to further impose similar restrictions by keeping in abeyance some provisions of the Central Order dated 15.02.2002 for a period of one year with respect to edible oils, oilseeds and rice, so as to tackle the rising trend of prices as well as to ensure availability of these commodities to the common people. However, it has also been decided that there shall not be any restriction on the inter-state movement of these items and that imports of these items would also be kept out of the purview of any controls by the State Governments.

**(a) What is essential commodity** – see 2(a) of Essential Commodities Act, 1955 states that “Essential Commodity means any of the following classes of commodities.

- i. Cattle fodder including oil cakes and other concentrates.
- ii. Coal including coke and other derivatives.
- iii. Component parts and accessories of automobiles (Omitted)
- iv. Cotton and Woolen textiles.
- v. Drugs (As defined in Drugs and Cosmetics Act.
- vi. Foodstuffs, including edible oil-seeds and oil.
- vii. Iron and steel, including manufactured products of iron and steel.
- viii. Paper, including newsprint, paperboard and straw board.
- ix. raw cotton, whether ginned or unginned, and cotton seed.
- x. raw jute.
- xi. any other class of commodity which the control Government may be notified order, declare to be an essential commodity for the purpose of this Act, being a commodity with respect to which

Parliament has power to make laws by virtue of entry 33 in list – III in the seventh schedule of the constitution.

**(b) “Food Crops”** include crops of Sugarcane

**(c) “Sugar” Means :**

- i. any form of sugar certaining more than ninety per cent of sucrose, including sugar candy.
- ii. Khandsari Sugar or bura Sugar or crushed sugar or any sugar in crystalline or powdered from; or
- iii. Sugar in process in vaccum pan sugar factory or raw sugar produced thereon.

### **7.3 Govt removes 12 items from Essential Commodities list; decontrols sugar**

The government on Tuesday gave permission to the removal of 12 items from the purview of Essential Commodities Act 1955 in order to lift controls pertaining to their processing, movement, storage and marketing.

Of the 29 items at present governed by the ECA, 12 will be removed from its purview and a notification to this effect will be issued shortly, an official spokesperson said in New Delhi after the meeting of the Union Cabinet.

The 12 items include textile machinery, textiles made from silk, textiles made wholly or in part from man-made cellulosic and non-cellulosic filament yarn.

Other items to be removed are man-made cellulosic and non cellulosic staple fibers and yarn made from four materials namely wool, man made cellulosic spun and non-spun fiber and silk.

However, food stuffs, cotton and woolen textiles, raw cotton, either ginned or unginned and cotton seed, raw jute, jute textiles and yarn wholly made from cotton will continue to be in the list of the essential commodities.

The government by a notified order can declare any commodity as 'essential' for the purpose of ECA 1955. Section 3 of the Act empowers the government to control production, supply, distribution, trade and commerce of such commodities.

This gives controlling powers to the state for trading and marketing these commodities in the country.

Under the Act government controls production and price, regulates storage, transport, distribution, disposal and consumption of the commodities.

### **Government approves full decontrol of sugar**

The government also cleared giving full effect to decontrol of sugar during the coming financial year beginning April 1, 2002.

Stating this after a meeting of the Union Cabinet, an official spokesperson said the sugar decontrol would be effected after futures trading in the commodity becomes operational.

Sugar at present is a controlled commodity on account of which 15 per cent of the release in the market is channeled through the Public Distribution System.

In the event of the full decontrol, to be effected in the next fiscal, millers will be able to unload the entire quantity in the open market.

There is a three monthly release mechanism under which each factory is allotted a quantum it can unload in the market and the aggregate nationwide quota is also fixed. This will, however, stay even after full decontrol.

In the previous Union Budget, Finance Minister Yashwant Sinha had described the full sugar decontrol process as irreversible and linked it with the futures trading in the commodity.

The two are intertwined as full decontrol ensures greater volumes for futures trading and better chances of price discovery.



The government has given in-principle clearance to three companies for sugar futures, E-Commodities Ltd and E-Sugar India of Bombay and Hyderabad-based NCS InfoTech who have 10 months to put the process in place from December 2001.

As part of the phased decontrol, government has also switched over to three monthly release mechanism, however, mills can only sell one half of their quota in the first 45 days of a quarter to avoid any crash in prices.

### **Curbs on movement of grains to go**

The Cabinet also decided to remove the requirement of licensing of dealers as also restrictions on storage and movement of wheat, paddy and rice, coarse grains, sugar, edible oilseeds and edible oil.

A central order would be issued under Section 3 of the Essential Commodities Act (ECA), 1955 removing the requirement of licensing and restrictions on storage and movement of these commodities, an official spokesperson told reporters.

In view of the relatively more comfortable food situation, it was felt that restrictions like licensing of dealers, limits on stock and control on movement are no longer needed, she said.

The government felt restrictions only hampered the growth of the agricultural sector and promotion of food processing industries in rapidly changing economic scenario and liberalisation.

Facilitating free trade and movement of foodgrains would enable farmers to get best prices for their produce, achieve price stability and ensure availability of foodgrains in deficit areas, the spokesperson said.

Removal of hurdles would also be in the interest of the consumers all over the country, specially for those in the lower income group, she said.

The Essential Commodities Act, 1955 provides for the control of the production, supply and distribution of essential commodities.

Powers to issue control orders under the Act have been delegated by the Centre to the state governments.

### **Onion out of essential commodities list**



In a thanks giving of sorts to the rural electorate of Maharashtra that paved the way for its recent assembly elections victory, the Centre on Wednesday approved deletion of onion from the purview of the Essential Commodities Act, 1955 (ECA).

The decision, taken at a meeting of the Union Cabinet here, would mean that onion would no longer be considered an 'essential commodity' and neither the Centre nor the State Governments will be able to issue orders under the Act to regulate production, supply, pricing and distribution of onion.

Today's decision would also remove restrictions on movement and exports of the commodity. Export of onion is presently canalised through the National Agricultural Marketing Federation of India (Nafed) and other State/cooperative agencies, whereas from now onwards, private players would also be allowed to export on their own account.

Onion was placed under the ECA list in early-1999, following a decline in domestic production and skyrocketing of prices that led to the defeat of the then-ruling Bharatiya Janata Party (BJP) in three States. Production fell from 4.18 million tonnes (mt) in 1996-97 to 3.62 mt in 1997-98, after which it recovered to 5.33 mt in 1998-99. Since then, output has been hovering in the 4.5 mt - 4.9-mt range, except in 2002-03, when it declined again to 4.21 mt.

But the 2003-04 crop has been a bumper one of well over 5 mt, leading to a glut and piling up of huge stocks, particularly in Maharashtra, which accounts a third of the country's total onion production. "The production and availability of onion during the last five years has, by and large, been satisfactory. The price trend of onion has also not shown any abnormality during this period. The removal of unnecessary restrictions and relaxation of controls on onion will give fair returns to growers, promote consumer interest and free trade," an official release said.

The release added that onion being a perishable commodity, storage problems coupled with controls/interventions had led to distress sales by farmers at very low prices, causing them economic hardship. Moreover, no Control Order has been issued for regulating production, distribution of onion since 1999.

Following onion's deletion, the ECA's purview is now limited to 15 items, which includes foodstuffs (including edible oilseeds and oil), petroleum products, drugs, fertilisers, cotton (including yarn and textiles), raw jute (including textiles), iron & steel, coal, fertilisers and cattle fodder.

## **7.4 Industry Promotion**

### **Industry**

Industries (Development and Regulation) Act, 1951 (IDRA) was passed in early stages after independence. India and ideal of socialistic model for development and growth. “Planned Economy” was the goal. It was envisaged to introduce licensing for proper industrial growth. Many industries were nationalized upto 1984.

However, it was observed later that policy of compulsory industrial licensing was stifling industrial growth instead of promoting it. Many industries taken over by Government (now called Public Sector Undertakings) continue to be sick and are causing a great drain on our economy. It was expected that public sector undertakings (PSU) will command the heights and will lead the industrial growth. Unfortunately, banning a few undertakings, other have become models of inefficiency poor productivity and corruption. Realising this government has not taken over any unit almost for 25 years. New Industrial Policy (NIP) announced in July 1991 has made radical departure from earlier policies. Most of the industries (barring a few) are delicensed. The IDRA Act has lost most of its relevance in the present situation.



### **Purpose of the IDR Act**

Industry refers to the people or companies engaged in a particular kind of commercial enterprise. It is described it as the manufacturing of a good or

service within a category. It is the secondary sector in economics, also coming under the private sector.

Economies tend to follow a developmental progress that takes them from a heavy reliance to agriculture and mining to manufacturing industry, and then move on to a more service based economy.

1. **Primary sector:** mainly includes raw material extraction industries such as mining and farming. It is mainly the conversion of natural resources into primary products that are used as raw material by other industries. The manufacturing industries that aggregate, package, purify or process the raw material near the primary producers are normally considered part of this sector, especially if the raw material is unsuitable for use in its original form, or if it is difficult to transport it to long distances. Developing countries are more dependent on this sector. In developed the same sector becomes more mechanized and high-tech, requiring smaller manpower. Hence, while developing countries have a major part of the workforce involved in this industry, the developed countries have a higher percentage involved in secondary and tertiary sectors as compared to the primary sector.

2. **Secondary sector:** involves refining, construction, and manufacturing. This sector creates a finished and useable product. The sector is divided into light and heavy industry. The sector consumes large amount of energy and needs factories and often heavy machinery to convert raw material into a finished product. These also produce large amount of waste product in the process, often environmentally hazardous. However, manufacturing is an important part of economic growth and development. It increases export possibilities, thus improving GDP of the country. This in turn funds infrastructure in the economy and health facilities, among other life initiatives. This sector is more open to international trade and competition than service.

3. **Tertiary sector:** deals with services (such as law and medicine) and distribution of manufactured goods. When contrasted to the wealth producing sectors like secondary and primary sectors, tertiary sector is a wealth consuming sector. When the wealth consuming and wealth producing sectors

are balanced, the economy grows, but if the tertiary sector grows bigger than the first two, the economy declines. Service sector, as it is called, offers services or 'intangible goods'. The services are provided to businesses and final consumers. It may involve distribution or transport and sales of goods from producer to consumer. This sector also includes the soft parts of the economy such as the insurance, tourism, banking, education, retail. Typically, the output is in the form of content (info), advice, service, attention experience or discussion. Service economy refers to a model where as much economic activity as possible is treated as service.

4. **Quaternary sector:** knowledge industry focusing on technological research, design and development such as computer programming, and biochemistry. It is a comparatively new division. It is an extension of the three-sector hypothesis of industrial evolution. It principally concerns the intellectual services: information generation, information sharing, consultation, education and research and development. It is sometimes incorporated into the tertiary sector but many argue that intellectual services are distinct enough to warrant a separate sector. Entertainment is also an important part of this sector.

The purpose of the IDR Act was to implement the industrial policy. It provides for The development and regulation of major industries IDR Act envisages balanced industrial growth all over India and optimum use of available resources and infrastructure. IDR Act also sees that the industries do not suffer due to financial mismanagement or technical inefficiency or operational defects. In certain cases Act provides for investigation by Union Government in cases of mismanagement and misadministration.

## **Industrialization: A New Era**



Though agriculture has been the main preoccupation of the bulk of the Indian population, the founding fathers saw India becoming a prosperous and Modern State with a good industrial base. Programs were formulated to build an adequate infrastructure for rapid industrialization.

Since independence, India has achieved a good measure of self-sufficiency in manufacturing a variety of basic and capital goods. The output of the major industries includes aircraft, ships, cars, locomotives, heavy electrical machinery, construction equipment, power generation and transmission equipment, chemicals, precision instruments, communication equipment and computers. Early planners in free India had to keep in mind two aims: all-round development and generation of large-scale job opportunities. Economic development strategies were evolved with an eye on these twin objectives.

## **New International Economic Order**

As a responsible and progressive member of the international community, India is continuing her untiring efforts to bring about a constructive dialogue between the developed and developing countries in their quest for a cooperative approach towards a new International Economic Order. India is convinced that the establishment of an equitable International Economic Order involving structural and other, change is the only answer to the various economic ills and problems of development confronting the world today.

## **Economic Restructuring**

The international confidence in India's economy has been fully restored.

The reforms launched have made India an attractive place for investment. Duties have been lowered, repatriation of profit made liberal and levels of foreign equity raised considerably, and 100% in case of export oriented industry.

While several multinational companies have entered the Indian market, some Indian companies have also begun to gain international recognition. In the field of computer software, India is among the major exporting nations with an overflow of scientists in the field.

With the conclusion of the Uruguay Round of Multilateral Trade Negotiations, India decided to join the new World Trade Organization, successor to GATT. India hopes that developing countries will not suffer on account of any protectionism.

On its part, India has opened several sectors hitherto restricted to the public sector. The rupee is convertible on the trade account. In 1994, exports grew by 17%. Figures for 1995-96 show that exports grew at a rate of 28.8%. About 90% of India's import are financed by export earnings. The Non-Resident Indian (NRI) enjoys special incentives to invest in India like tax exemption and higher interest rates on deposits.

### **NRI's**

The government acknowledges the great role that the vast number of Indians living and working abroad, the Non-Resident Indians can play in accelerating the pace of development in the country. In the 1980s, the NRIs contribution through their remittances was instrumental to a large extent in stabilizing the balance of payment situation. Several initiatives have been taken to attract NRI investments - in industry, shares and debentures. The NRIs are allowed 100% investment in 34 priority and infrastructure facilities on



non-repatriation basis. Approval is given automatically on investment in certain technical collaborations. They can buy Indian Development Bonds and acquire or transfer any property in India without waiting for government approval. The Foreign Exchange Regulation Act has been amended to permit NRIs to deal in foreign currency and they can also bring in five kg of gold. There are programs to utilize the scientific and technical talents of the NRIs with the help of the Council of Scientific and Industrial Research.

## **Infrastructure**

In view of their crucial importance, power, transport and other infrastructure industries are owned by the State. As a result of special attention given to the area in recent years, the infrastructure industries have been growing at the rate of 9 to 10 per cent annually.

**Power:** The generation of power has increased impressively in recent years. In 1990-51, India generated 6.6 billion-kilowatt hour of electricity, in 1995-96 the figure was 380.1 billion-kilowatt hour. The installed capacity, which was 1400 MW at Independence in 1947, has crossed 83,288 MW. The policy of inviting private sector has been well received; about 140 offers that can generate over 60,000 MW of power have come in.

**Coal:** Coal is the primary source for power generation in India. The country has huge reserves of coal approximately 197 billion tons. A sufficient amount of lignite (brown coal used in thermal power stations) is also available.

India produced about 270 million tons of coal in 1995-96. The government now welcomes private investment in the coal sector, allowing companies to operate captive mines.

**Petroleum and Natural Gas:** The recent exploration and production activities in the country have led to a dramatic increase in the output of oil. The country currently produces 35 million tons of crude oil, two thirds of which is from offshore areas, and imports another 27 million tons. Refinery production in terms of crude throughput of the existing refineries is about 54 million tons.

Natural gas production has also increased substantially in recent years, with the country producing over 22,000 million cubic meters. Natural gas is rapidly becoming an important source of energy and feedstock for major industries. By the end of the Eighth Five-Year Plan, production was likely to reach 30 billion cubic meters.

**Railways:** With a total route length of 63,000 Km and a fleet of 7000 passenger and 4000 goods trains, the Indian Railways is the second largest network in the world. It carries more than 4000 million passengers per year and transports over 382 million tons of freight every year. It is well equipped to meet its demands for locomotives, coaches and other components.

Lately, the Railways have launched a massive gauge conversion drive as about a third of the track is meter or narrow gauge. With improvement in tracks, plans are afoot to introduce faster trains. Very soon, certain prestigious long distance trains will be running at 160 Km per hour.

The Railways have also started a scheme to privatize several services that will include maintenance of railway stations, meals, drinking water and cleaning of trains.

**Road Transport :** The roadways have grown rapidly in independent India. Ranging from the cross-country link of the national highways to the roads in the deepest interiors, the country has a road network of 2.1 million-km. India also manufactures most of its motorized vehicles -cars, jeeps, trucks, vans, buses and a wide range of two-wheelers of various capacities. While Indian scooters have established a good foreign market, the car industry is also looking up with several foreign companies setting up plants in India.

**Shipping :** The natural advantage of a vast coastline requires India to use sea transport for the bulk of cargo transport. Following the policy of liberalization, the Indian shipping industry, major ports, as also national highways and water transport have been thrown open to the private sector.

Shipping activity is buoyant and the number of ships registered under the Indian flag has reached 471. The average age of the shipping fleet in India is 13 years, compared to 17 years of the international shipping fleet. India is also among the few countries that offer fair and free competition to all shipping companies for obtaining cargo. There is no cargo reservation policy in India.

**Aviation** : India has an aviation infrastructure, which caters to every aspect of this industry. Hindustan Aeronautics Limited (HAL) is India's gigantic aeronautical organization and one of the major aerospace complexes in the world.

India's international carrier, Air India, is well known for its quality service spanning the world. Within the country, five international airports and more than 88 other airports are linked by Indian Airlines. Vayudoot, an intermediate feeder airline, already links more than 80 stations with its fleet of turboprop aircraft and it plans to build and expand its network to over 140 airports in the far-flung and remote areas of the country. Pawan Hans, a helicopter service, provides services in difficult terrain.

The Government has adopted a liberal civil aviation policy with a view to improving domestic services. Many private airlines are already operating in the country.

**Pipelines** : Oil and natural gas pipelines form an important transportation network in the country. The country completed recently, on schedule, one of its most ambitious projects, the 1700 km Hazira-Bijaipu Jagdishpur pipeline. Costing nearly Rs. 17 billion, the pipeline transports liquid gas from the South Bassein offshore field off Mumbai to Jagdishpur and Aonla, deep in the mainland in Uttar Pradesh. Besides, India has nearly 7,000 km of pipeline mainly for the transportation of crude oil and its products.

**Telecommunications** : With rapid advances in technology, India now uses digital technology in telecommunications, which derives advantage from its ability to interface with computers. The present strategy focuses on a balanced growth of the network rapid modernization, a quantum jump in key

technologies, increased productivity, and innovation in organization and management. Moving towards self-reliance, besides establishing indigenous R&D in digital technology, India has established manufacturing capabilities in both the Government and private sectors.

The private sector is expected to play a major role in the future growth of telephone services in India after the opening of the economy. The recent growth in telecommunications has also been impressive. Till September 1996, the number of telephone connections had reached 126.1 lakh (12.6 million). Soon every village panchayat will have a telephone. By 1997, cellular services in most major urban areas were functional, and telephone connections were available on demand. India is linked to most parts of the world by E-mail and the Internet.

### **Key Industries**

**Steel** : The iron and steel industry in India is over 122 years old. However, a concerted effort to increase the steel output was made only in the early years of planning. Three integrated steel plants were set up at Bhilai, Durgapur and Rourkela. Later two more steel plants, at Bokaro and Vishakhapatnam, were set up. Private sector plants, of which the Tata Iron and Steel Company (TISCO) is the biggest, have been allowed to raise their capacity. The Steel Authority of India (SAIL), which manages the public sector plants, has undertaken a Rs. 40,500 crore program to modernize them. During 1995,96, production of salable steel in the country was about 21.4 million tons. The five SAIL plants accounted for over half of this: The export of iron and steel jumped from 9.10 lakh tons in 1992-93 (valued at Rs.'708 crore) to over 20 lakh tons (Rs. 1940 crore).

TISCO and a large number of mini steel plants in the country contribute about 40% of the steel production in the country. The Government has given a push to sponge iron plants to meet the secondary sector's requirement of steel scrap.

**Engineering and Machine Tools :** Among the Third World countries, India is a major exporter of heavy and light engineering goods, producing a wide range of items. The bulk of capital goods required for power projects, fertilizer, cement, steel and petrochemical plants and mining equipment are made in India. The country also makes construction machinery, equipment for irrigation projects, diesel engines, tractors, transport vehicles, cotton textile and sugar mill machinery. The engineering industry has shown its capacity to manufacture large-size plants and equipment for various sectors like power, fertilizer and cement. Lately, air pollution control equipment is also being made in the country. The heavy electrical industry meets the entire domestic demand.

**Electronics :** The electronics industry in India has made rapid strides in recent years. The country produces electronics items worth over Rs. 200 billion annually. Exports are also rising; in 1995-96 they reached Rs. 4.5 billion. The software export during the same year reached Rs 2.5 billion. Compared to 1994-95, the software export growth in 1995-96 rose by an impressive 70%. The Software Technology Park scheme for attracting investments has proved successful. The relative low cost of production in India makes items made in India competitive in the world market.

Some of the major items manufactured in India are computers, communication equipment, broadcasting and strategic electronics, television sets, microwave ovens and washing machines.

The compound growth of the computer industry has been 50% during the last five years. Almost the entire demand for floppy disk drives, dot matrix printers, CRT terminals, keyboards, line printers and plotters is met from indigenous production. With the availability of trained technical manpower, computers have been identified as a major thrust area. Special emphasis has been given to software export.

The Indian software industry has developed skill and expertise in areas like design and implementation of management information and decision

support systems, banking, insurance and financial applications, artificial intelligence and fifth generation systems.

Recognition for the Indian computer software industry has been global. Indian software enterprises have completed projects for reputed international organizations in 43 countries.

**Textiles :** Textiles, the largest industry in the country employing about 20 million people, account for one third of India's total exports. During 1995-96, textile exports were estimated at Rs. 35,504.6 crore which was 13.3% more than the 1994-95 figure. In recent years, several controls have been removed and in October 1996, a new long-term Quota policy was announced to boost exports over the next three years, till 1999. Per person production of cloth is 20 meters after adopting liberalisation as a part of economy.

**Public Sector :** The public sector contributed to the initial development of infrastructure and diversification of industrial base. It is now being exposed to competition. Part equity of some units is being disinvested. But many core and strategic areas, important for economy and self-reliance, will remain in the public sector.

## **Research and Development**

Research and Development activities are supported by the governments at the Center and the states as well as by public and private sector undertakings. The Department of Scientific and Industrial Research recognizes over 1200 in-house R & D units. About 200 research laboratories exist in government departments and agencies. The benefits of the R & D works are reaching various fields like industry, agriculture and commerce.

## **Planning for Development**

The Planning Commission headed by the Prime Minister, draws up five-year plans under the guidance of the National Development Council to ensure growth, self-reliance, modernization and social justice. Its role has been redefined in the eighth plan document: from a centralized planning

system, India is moving towards indicative planning which will outline the priorities and encourage a higher growth rate. The Rs. 4,000 billion eighth plan envisaged a growth rate of 5.6%.

### **Traditional Industry**

Indian handicrafts have withstood competition from machines over the years. The skills are passed on from one generation to the next. The handicraft and handloom sector is a major source of rural employment and earns substantial foreign exchange. Traditional textiles are as popular abroad as they are within the country. The major export items include hand-knotted carpets, art metalware, hand-printed textiles and leather, wood and cane wares.

### **Exemption from Industrial Licensing**

See 29B(i) authorises Union Government to exempt any industry or class of industries from any of provisions of the Act. Presently, Union Government has exempted most of the industries from the provisions of licensing. There are only few industries (like paper, drugs and pharmaceuticals, etc.) which require licence. Licence is not required for other industry. Five industries (arms and ammunition) atomic energy, mineral oils, minerals for atomic energy and railway transport) are reserved for public sector. No licence is required for any other industry. However, the conditions are (a) prescribed locational restrictions are explained below should be observed (b) the product should not be reserved for small scale sector.

### **Information by de-licensed Industries**

Industries which are exempt from licensing provisions or registration procedure, have to only submit information in prescribed form – called “Industrial Entrepreneurs Memorandum. (From IEM).

**Regulating Supply and Prices :** Union Government can provide for regulating supply and distribution any industrial article by issuing a notified order sec 189 (1) of IDRA. Such order can before (a) price control (b)

regulating distribution, transport, possession, use or consumption (c) prohibiting the withholding from sale of any article (d) requiring a person to sell industrial product to a particular class of persons. The sale can be at controlled price or mutually agreed price, at price prevalent in market (e) regulating or prohibiting, any class of commercial or financial transactions respect of the industrial product. (f) requiring that product should be marked with price, display, stock and display prices (g) collecting information or statistics for regulating above matters. (h) incidental or supplementary matters in respect of above like licences, permits, records etc.

De-licensing of many industries – New Industrial Policy envisages that some industries will be reserved exclusively for public sector. Excluding these industries, no industry will require licence, subject to certain conditions.

### **Items Reserve Exclusively for Public Sector**

Annexure-I of policy statement gives list of 5 industries reserved for public sector. These are: Arms and Ammunition and allied defence equipment. Atomic Energy, Mineral. Oils, Minerals and Railway Transport. As per National Mineral Policy, 1993, minerals and minerals bearing areas have been de-reserved in respect of 13 minerals namely iron ore, manganese ore, chrome ore, gypsum, sulphur, gold, diamond, copper, lead, zinc, tin, molybdenum and wolfram. Out of 'mineral oils', petroleum (other than crude) and its distillation products are no more reserved for public sector.

### **Products Requiring Licensing**

Annexure – II contains list of 6 industries for which industrial licensing is compulsory – after deletion of items upto 14.07.1997. These are alcoholic drinks, cigars and cigarettes, electronic aerospace and defence equipment industrial explosives, hazardous chemicals and drugs and pharmaceuticals as announced in Drugs Policy – Original list contained 18 limits – white goods, motor cars, paper and news print except biogases based units, plywood, veneer and other wood based products, animals fats and oils, asbestos and asbestos based products, tanned or dressed furskin and chamois leather and



plywood products appearing in that list have been subsequently removed. Coal & Lignite and petroleum (other than crude) and its distillation products have been removed from the list w.e.f. 8<sup>th</sup> June, 1998. Sugar has been delicensed in August 1998. The only condition is that distance between 2 sugar mills should be minimum 15 kms.

## **Industrial Policy**

After Independence, the Government of India spelt out its approach to the development of the industrial sector in the Industrial Policy Resolution 1948. This was followed by the Industrial Policy Resolution, 1956. In between, the government introduced the Industries (Development and Regulation) Act, 1951 to regulate and control the development of the private sector. In 1969, MRTP Act (Monopolies and Restrictive Trade Practices Act) was adopted to prevent concentration of economic power and control monopolies. Another legislation that had considerable implications for industrial policy (as far as the participation of foreign companies in industrial sector of India is concerned) was the Foreign Exchange Regulation Act (FERA) adopted in 1973. However, all these measures which guided and determined the State intervention in the field of industrial development failed in achieving the objectives laid down for them. They also created a number of inefficiencies, distortions and rigidities in the system. Therefore, the government started liberalizing the industrial policy in 1970s and 1980s. The most drastic liberalisation was carried out in 1991 when a New Industrial Policy was announced.

We shall discuss the MRTP, Act in chapter 32 on 'Private Sector in the Indian Economy' and the FERA in chapter 40 on 'Multinational Corporations, FERA and FEMA.' Other constituents of industrial policy are discussed in this chapter. The focus of discussion in this chapter, therefore is on:

- Industrial Policy Resolutions of 1948 and 1956
- Industries (Development and Regulation) Act, 1951
- Critical review of pre-1991 industrial policy and liberalisation trends
- New industrial Policy, 1991 and its critical appraisal.

## 7.4.1 Industrial Policy Prior to 1991<sup>21</sup>

### Industrial Policy Resolution, 1948

The first important industrial policy statement was made in the Industrial Policy Resolution, 1948. The Resolution accepted the importance of both private and public sectors in the industrial economy of India. It divided the industries into the following four categories:

**1. Industries where State had a monopoly.** In this category, three fields of activity were specified – arms and ammunition, atomic energy and rail transport.

**2. Mixed sector.** In this category, the following 6 industries were specified – coal, iron and steel, aircraft manufacture, ship building, manufacture of telephone, telegraph and wireless apparatus (excluding radio sets) and mineral oils. New undertakings in this category were to be set up by the State but existing private undertakings were allowed to continue for 10 years after which the government was to review the situation and acquire any existing undertaking after paying compensation on a fair and equitable basis.

**3. The field of government control.** 18 industries of national importance were included in this category. The government did not undertake the responsibility of developing these industries but considered them of such importance that their regulation and direction was necessary. Some of the industries included were – automobiles, heavy chemicals, heavy machinery, machine tools, fertilizers, electrical engineering, sugar, paper, cement, cotton and woolen textiles.

**4. The field of private enterprise.** All other industries (not included in the above three categories) were left open to the private sector. However, the State could take over any industry in this sector also if its progress was unsatisfactory.

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<sup>21</sup> Misra & Puri, Indian Economy, 2010, Himalaya Publication. Pg.381

The 1948 Resolution also accepted the importance of small and cottage industries as they are particularly suited for the utilization of local resources and for creation of employment opportunities.

### **Industries (Development and Regulation) Act, 1951**

To control and regulate the process of industrial development in the country, an Act was passed by the Parliament in October 1951. Known as the Industries (Development and Regulation) Act, 1951, the Act came into force on May 8, 1952. Though it aimed at both, development and regulation of private sector, its main task over the years has been to concentrate more on the 'regulation' aspect. The objectives that the Act sought to accomplish were : (i) the regulation of industrial investment and production according to plan priorities and targets; (ii) protection of small entrepreneurs against competition from large industries; (iii) prevention of monopoly and concentration of ownership of industries; and (iv) balanced regional development with a view to reducing disparities in the levels of development of different regions of the economy. It was hoped that through the instrument of industrial licensing, the State would be able to (i) direct investment into the most important branches, (ii) correlate supply and demand in the domestic market, (iii) eliminate competition and (iv) ensure the optimum utilization of social capital.

**1. Restrictive Provisions.** Under this category come all measures designed to curb unfair practices adopted by industries. These provisions were as follows: (i) Registration and licensing of industrial undertakings – Undertaking of all those industries which were included in the schedule of the Industries (Development and Regulation) Act, 1951 were required to be registered whether they come under the private sector or the public sector. Even in the existing undertakings intended expanding the activities, they required prior permission of the government; (ii) Enquiry of industries listed in the schedule – The responsibility of the State does not end with the registration or granting of licences to the undertakings. If the working of a particular industrial unit was not satisfactory (say, for example, there was substantial underutilization of capacity or product was not up to the mark or cost of production and price were excessive), the government could set up an

enquiry into the affairs of the particular undertaking; and (iii) Cancellation of registration and licence – If a particular industrial undertaking had succeeded in obtaining industrial licence and registration by submitting wrong information the government could cancel the registration under article 10(A) of the Act. In the same way, the government could cancel the licence if the undertaking was not set up within the stipulated period.

**2. Reformative Provisions.** In this category, following provisions were considered: (i) Direct regulation or control by the government – If the government felt that a particular industry was not being run satisfactorily, it could issue directions for carrying out reforms. If these directions were not heeded to, the government could take over the management and control of that unit in its hands; (ii) Control on price, distribution, supply, etc. – The government was empowered in the Act to regulate or control the supply, distribution and price of the product manufactured by units belonging to the industries listed in the schedule of the Act, if it so wished; and (iii) Constructive measures – To inspire mutual confidence and elicit co-operation from the workers, the government established Central Advisory Council and a number of Development Councils for different products.

In the initial stages 37 industries (specified under the Act) were brought under the purview of the Act which was later extended to include 70 industries. Of these specified industries only those units were brought under the Act where the capital employed was Rs. 1 lakh or more. Since the net of coverage was too small, it was decided to cover all units (irrespective of size) under the Act in 1953 but the excessive administrative strain brought upon the authorities as a consequence of this decision, compelled them to scrap this decision in 1956. It was stated that henceforth the Act would be applicable only to enterprises employing 50 or more workers if worked with the aid of power or employing 100 or more workers if worked without the aid of power. In 1960 another change was made and all enterprises with fixed capital of Rs.10 lakh or less were exempted from the licensing procedure. The exemption limit was raised to Rs.25 lakh in 1963 and (subject to certain conditions) to Rs. 1 crore in 1970. The March 1978 industrial policy statement

liberalised the licensing policy further by raising the exemption limit from Rs.1 crore to Rs. 3 crore. It was later raised to Rs.5 crore. The government announced a major package of industrial delicensing during the year 1988-89. This package provided that henceforth, only projects involving an investment in fixed assets of more than Rs.50 crore, if they are located in backward areas, or more than Rs.15 crore if they are located in non-backward areas would require industrial licences.

### **Industrial Policy Resolution, 1956**

The 1956 Resolution laid down the following objectives for the industrial policy : (i) to accelerate the rate of growth and to speed up industrialization; (ii) to develop heavy industries and machine making industries; (iii) to expand public sector; (iv) to reduce disparities in income and wealth; (v) to build up a large and growing cooperative sector; and (vi) to prevent monopolies and the concentration of wealth and income in the hands of a small number of individuals.

These objectives, it was thought, would help in generating more employment opportunities and in raising the standard of living of the masses. For this purpose, stress was laid on cooperation between public and private sectors but an increasing role was envisaged for the former so that, in due course of time, it could gain 'commanding heights' of the economy.

The 1956 Resolution divided the industries into the following three categories:

**1. Monopoly of the State.** In this category, 17 industries were included whose future development was to be the exclusive responsibility of the State. These were listed in Schedule-A appended to the Resolution. Of the 17 industries, 4 industries – arms and ammunition, atomic energy, railway and air transport – were to be government monopolies. In the remaining 13 industries, new units were to be established by the State but existing private units were allowed to subsist and expand. New units in the private sector could also be allowed 'when the national interest so required.'

**2. Mixed sector of public and private enterprise.** In this section 12 industries listed in Schedule B (appended to the Resolution) were included. These were: all other minerals (except minor minerals), road transport, sea transport, machine tools, ferro-alloys and tool steels, basic and intermediate products required by chemical industries such as manufacture of drugs dyestuffs and plastics, antibiotics and other essential drugs, fertilizers, synthetic rubber, chemical pulp, carbonization of coal, and aluminum and other non-ferrous metals not included in the first category. In these industries, State would increasingly establish new units and increase its participation but would not deny the private sector opportunities to set up units or expand existing units.

**3. Industries left for private sector.** All industries not listed in schedules 'A' or 'B' were included in the third category. These industries were left open to the private sector. Their development was to depend on the initiative and enterprise of the private sector, though even here the State could start any industry in which it was interested.

The 1956 Resolution emphasized the mutual dependence of public and private sectors. The only 4 industries in which private sector was not allowed to function were arms and ammunition, atomic energy, railways and air transport. In all other industries, either the private sector was allowed to operate freely or its help could be obtained if the government deemed fit. However, the private sector was to remain subject to various government regulations and controls as specified in Industries (Development and Regulation) Act, 1951 and other related regulations.

The 1956 Resolution recognized the importance of small-scale and cottage industries just as the 1948. Resolution had done. It also called for the reduction in regional imbalances and inequalities. For this purpose, it advocated that transport facilities, power and other facilities should be provided in backward regions.

As compared to the 1948 Resolution, the 1956 Resolution considerably enlarged the area of operation of the public sector as the exclusive

responsibility of the State was enlarged from 6 to 17 industries (Schedule A). In addition, another category including 12 industries (Schedule B) was defined where the State could participate on an increasing scale. However, the 1956 Resolution dropped the 'threat' of nationalization that the 1948 Resolution contained and the division of industries in different categories was more flexible in the former as compared to the latter. The fact is that the basic objective of both the Resolutions was the same-strengthening the mixed economy structure of the country.

#### **7.4.2 Review of Pre-1991 Industrial Policy and Liberalisation Trends**

The actual operation of the industrial policy (particularly the industrial licensing policy) has been a subject of much debate and criticism. Several studies on the implementation of the licensing policies and the functioning of the industrial approval system pointed out a number of flaws and deficiencies. Reports of the various Committees and Commissions appointed by the government itself (Monopolies Enquiry Commission in April 1964, Dr. R. K. Hazari in 1965 and Dutt Committee in 1967) pointed out that the licensing policy had failed to achieve its objectives. In many cases, the results were just the opposite of what the government had planned. The main points of criticism have been as follows:

**1. Licensing and underutilization of capacity.** Licensing was supposed to ensure creation of capacities according to plan priorities and targets. However, no clear priorities for private sector were laid down in plans and therefore the private sector chose those industries which appeared more profitable. In many cases, these industries happened to be luxury industries and frequently they also satisfied the technical curiosity of the D.G.T.D. (Directorate General of Technical Development) and were, therefore, granted licenses in defiance of the needs of essential industries producing commodities for mass consumption.

The grant of a licence to an enterprise was no guarantee that the production capacity permitted would actually be installed. The government had the right to take away a licence only several years later. Because of this

fact, capacity created, in some cases, was less than allowed. Many industries (especially those belonging to the large monopoly houses) indulged in such practices to restrict output and raise prices. Since the government had no guarantee that the licensed capacity would actually be installed within the stipulated time, it adopted the practice of granting licences for capacities far in excess of the plan targets, from the end of the Second Plan. In those cases where actual implementation was larger than expected (as, for example, in the case of paper industry, cement industry and ceramic production) a sizable unutilized capacity appeared. In some cases, overlicensing of an industry deterred the licencees from implementing their full licensed capacities for fear of excessive capacity creation in the industry. As a consequence of this, industries over-licensed in the Third Plan were marked by under fulfillment of capacity.

**2. Licensing and concentration of economic power.** As noted by Aurobindo Ghosh, in India: "It is industrial licensing which limits the areas of private investment and also determines entry into specific industries. The total volume of licensable private investment is normally (though not always) fixed in relation to the total Plan target of private investment in industry. This generally holds true of licensing in particular industries also; i.e., in correspondence with Plan targets of capacity in specific industries. In such a situation, oligopolistic rivalry proceeds principally through competition for investment opportunities at the stage of entry into the industry itself.' This explains the behavior of the large industrial houses in India who sought "Pre-emption of investment opportunities" though acquiring as much industrial licences as possible thereby ensuring an increasing share of new capacities created on the one hand, and on the other hand keeping out potential rivals. Since a major objective of the Industries (Development and regulation) Act was the prevention of monopoly and concentration of the ownership of industries, it was expected to foil the attempt of the large industrial houses. However, as all Enquiry Committees have noted, the operation of licensing policy actually helped the large houses in achieving their ends in a number of ways. As noted by the Dutt Committee, the licensing authorities many times used their discretionary powers in favour of the large houses. This "has been



revealed through their different practices, e.g., their early intimation of impending licensing to an applicant, inadequate scrutiny and/or expeditious disposal of licence applications, 'on file decisions' without going through the Licensing Committee, reversal of earlier decisions, etc.”

**3. Discretionary powers of licensing authorities.** Martinussen has pointed out that because of the considerable discretionary powers vested in the regulatory agencies, the whole system tended to promote corruption, rent-seeking and discrimination based on personality relationships.

In this context, Martinussen emphasizes two features of the formal bureaucratic institutions functioning in India: First, “although separated from the rest of society by effective socialization processes and specific rules which govern their behavior, government officials often remain loyal to outside social networks. They are inclined in general to favour members of their own social network.” Second, “the individual government official at higher levels of the hierarchy is vested with considerable discretionary powers in his discharging of administrative functions. This has increased the scope for outside influence and for discrimination based on personalistic relationships.”

Because of the loyalty to outside social networks and personalistic relationships, a strong nexus between high government officials and managers of large industrial houses emerged in this country. As a result, the actual functioning of the industrial approval system in India favoured large industrial houses. In his empirical study, Martinussen found that none of the large industrial houses included in his sample had sustained severe setbacks due to government regulations. On the contrary, the managers or the board members of large industrial houses told him that they had received all the licences they wanted, although with some delay in most of the cases. Even with regard to industries explicitly reserved for the public sector, several of the respondents cited instances where their companies had obtained permissions to set up units or expand production. The whole system of operational controls simply favoured large business houses as only they had enough resources to cope with the bureaucracy in Delhi. Newcomers and smaller enterprises could rarely exploit personalistic relationships with the government

officials and were therefore left out. Thus, the industrial approval system impeded entry of new promoters and entrepreneurs, contrary to official objectives.

**4. Licensing and regional imbalances.** One of the avowed objectives of industrial licensing policy was the reduction in regional inequalities and imbalances. However, the actual operation of this policy has accomplished just the opposite – it tended to increase regional inequalities. As noted by the Dutt Committee, the four industrially advanced States of Maharashtra, Gujarat, West Bengal and Tamil Nadu benefited the most from the operation of this policy. For example, in the decade 1955-65, these four industrially advanced States accounted for 59.3 per cent of the applications and 62.42 per cent of the licences approved. On the other hand, the poor States of Bihar, Orissa, Uttar Pradesh and Madhya Pradesh received only 15.5 per cent of total licences approved. These trends continued in later years also. For instance, during the thirteen years period 1979 to 1992, the four industrially advanced States of Maharashtra, Gujarat, Tamil Nadu and West Bengal received 46.4 per cent of total licences issued whereas the combined share of Bihar, Orissa, Madhya Pradesh and Uttar Pradesh was only 16.2 per cent.

Because of this discrimination against the backward regions, the government decided to issue more licences to such regions. However, even here the developed States benefited more as it were their backward areas that got more licences as compared to the backward areas of the poor States. For instance, of the total 2,321 licences issued to backward areas during 1982 to 1992, backward areas of the four developed States of Maharashtra, Gujarat, Tamil Nadu and West Bengal got 37.6 per cent licences while the backward areas of Bihar, Orissa and Madhya Pradesh got only 9.8 per cent of the total licences.

**5. Delays in processing of applications.** Two developments added significantly to the burden on both the regulatory authorities and the private entrepreneurs. On the one hand, the coverage and degree of detail of the regulations was increased significantly (for instance an amendment to IDR Act in 1953 made it compulsory for companies to obtain a licence for the

production of any 'new article' while in 1956 industrial activity and products were defined in much greater detail, thus adding to the number of permissions required), while on the other hand, industrial growth and diversification increased the scarcity of resources allocated administratively. The outcome was increasing delays in the processing of applications. Moreover, the Licensing Committee worked in a very haphazard and adhoc manner and there were no definite criteria adopted for acceptance or rejection of applications. This lack of explicit economic criteria was accompanied by the generally poor quality of techno-economic examinations conducted by the Directorate General of Technical Development (D.G.T.D.) which also took an unnecessarily long time for disposing of cases and submitting its recommendations to the Licensing Committee. All these factors impeded industrial growth.

### **The Liberalisation Trends**

Because of the above criticisms indicating the failure of the industrial licensing policy in achieving its objectives, the Government of India announced a number of liberalisation measures in the Industrial Licensing Policy announced in 1970, 1973 and 1978. In 1980, the government came forward with an Industrial Policy Statement which served as a guideline to various liberalisation measures undertaken all through the 1980s. Some of these measures were as follows:

**1. Exemption from Licensing.** The limit of exemption from licensing was continuously raised upwards. In March 1978 the limit was fixed at Rs.3 crore. During 1980s it was first raised to Rs.5 crore in 1983 and then to a whopping Rs.15 crore for projects located in non-backward areas and Rs.50 crore for projects located in backward areas in 1988-89 (under certain conditions).

**2. Relaxations to MRTP and FERA Companies.** Under the pretext of expanding industrial production and promoting exports, various concessions were provided to companies falling under the MRTP Act (Monopolies and Restrictive Trade Practices Act) and FERA (Foreign Exchange Regulation

Act). The most important relaxation related to the raising of the limit for MRTP companies from rs.20 crore to Rs.100 crore (i.e., by five time) at one stroke in March 1985. In May 1983, the government notified that MRTP companies are eligible to set up, without the approval of the government, new capacities in industries of high national importance or industries with import substitution potential or those using sophisticated technology. On December 24, 1985, the government permitted the unrestricted entry of large industrial houses and companies governed by FERA into 21 high-technology items of manufacture. With this permission, the large industrial houses falling within the purview of the MRTP Act and FERA companies were allowed to freely take up the manufacture of 83 items. The government specified a list of 33 broad groups of industries under Appendix I in which MRTP and FERA companies were permitted to set up capacities provided the concerned items are not reserved for the small-scale or public sectors. Various other concessions like regulation of excess capacity and capacity re-endorsement, facilities to set up industries in backward areas etc. were also granted to MRTP and FERA companies.

**3. Delicensing.** With a view to encouraging production, the government delicensed 28 broad categories of industries and 82 bulk drugs and their formulations. For these industries only registration with the Secretariat for Industrial Approvals was now required: no licence had to be obtained under the Industries (Development and Regulation) Act. This was subject to the conditions that the undertakings concerned do not fall within the purview of the Monopolies and Restrictive Trade Practices (MRTP) Act or the Foreign Exchange Regulation Act (FERA), that the article of manufacture was not reserved for the small-scale sector and that the undertaking concerned was not located within specified urban locales. During 1989-90, some more industries were delicensed.

**4. Re-endorsement of Capacity.** With a view to improving capacity utilization in industries, the government announced a scheme of capacity re-endorsement in April, 1982. During 1986, this scheme was liberalised to allow undertakings which had achieved 80 per cent capacity utilization (as against 94 per cent earlier) to avail of the facility. The re-endorsed capacity was to be

calculated by taking the highest production achieved during any of the previous five years plus one-third thereof. The undertakings which were able to achieve capacity utilization equal to the re-endorsed level were to get further re-endorsement according to the highest production achieved in subsequent years. The number of industries for which automatic re-endorsement of capacity was not available was reduced from 77 to 26. With a view to encourage modernization, renovation, replacement, etc., the government announced in 1986 exemption from licensing requirements of increases up to 49 per cent over licensed capacity.

**5. Broad Banding of Industries.** The scheme of broad banding of industries was introduced in 1984. This implied classification under broad categories – of two wheelers, four-wheelers, as well as machinery for fertilizers, pharmaceuticals, and paper and pulp etc., into generic categories. Thus, to take one example, cars, jeeps, light, medium and heavy commercial vehicles, etc., were clubbed together into the generic category of “four wheelers”. This measure was intended to enable the manufacturers to change their product-mix rapidly to match changes in demand patterns without incurring procedural delays and other costs associated with seeking amendments to their industrial licences. Broad-banding was extended in stages to cover 45 broad industry groups.

**6. Minimum Economic Scales of Operation.** Another important concept introduced in the field of industrial licensing was that of minimum economic level of operation. This was introduced in 1986. The idea was to encourage realization of economies of scale by expansion of existing installed capacities of undertakings to minimum economic levels of operation. With this end in view, minimum economic capacities (MECs) were specified for 108 industries till 1989. Expansion of existing installed capacities was encouraged upto these MECs if they fell short of the latter. During 1989-90, MECs were specified for some more industries.

**7. Development of Backward Areas.** For promoting the development of backward areas, the government extended the scheme of delicensing in March 1986 to MRTP/FERA companies in respect of 20 industries in

Appendix I for location in centrally declared backward areas. The scheme was later extended to 49 industries for location in any centrally declared backward area and to 23 non-Appendix – I industries for location in category 'A' backward districts. The conditions permitting MRTP and FERA companies to establish non-Appendix I industries in backward districts were also liberalised.

Recognizing that one of the impediments blocking the industrialization of backward areas of the country is the absence of infrastructural facilities, the government announced the decision in 1988-89 to set up 100 growth centres spread across the country over a period of five years or so. It was decided to provide funds of the order of Rs.25 crore to Rs.30 crore to each growth centre for creating infrastructural facilities of a high order.

**8. Incentives for Export Production.** Various concessions were announced by the government in its industrial policy and export-import policy from time to time to promote the expansion of exports. As mentioned earlier, MRTP and FERA companies were permitted (outside the Appendix I industries) if the product is predominantly for export. With a view to providing fillip to production in industries of high national priority and/or those meant exclusively for export, the government introduced Section 22-A in the MRTP act whereby it could notify industries or services to which Section 21 and 22 of the Act will not apply. In October 1982, all 100 per cent export oriented industries set up in the Free Trade Zones were exempted from Sections 21 and 22 of the Act. In addition, the government identified some industries which were especially important from export angle. These industries were allowed 5 per cent automatic growth per annum, upto a limit of 25 per cent in a plan period over and above the normal permissible limit for 25 per cent excess production over the authorized capacity.

**9. Enhancement of Investment Limit for SSI Units and Ancillary Units.** As stated earlier, the July 1980 Statement fixed the investment limit for small-scale industries at Rs. 20 lakh and for ancillary units at Rs.25 lakh. In March 1985 these limits were enhanced to Rs.25 lakh and Rs.45 lakh respectively. For tiny units, the investment limit stood at Rs.2 lakh. A government notification issued in April 1991 raised the investment limit for

small-scale industry from Rs.35 lakh to rs.60 lakh. In August 1991, the investment limit for tiny units was raised to Rs.5 lakh. In February 1997, the investment limit for small-scale units and ancillary units was raised to Rs.3 crore. The investment limit for tiny units was raised from Rs.5 lakh to Rs.25 lakh. The investment limit for small-scale industry was reduced to Rs.1 crore in 1999. Now MSMED Act, 2006, has raised this investment limit to Rs.5 crore for manufacturing enterprises and Rs.2 crore for service enterprises.

#### **7.4.3 New Industrial Policy, 1991**

In line with the liberalisation measures announce during the 1980s, the government announced a New Industries Policy on July 24, 1991. This new policy de-regulates the industrial economy in a substantial manner. The major objectives of the new policy are “to build on the gain already made, correct the distortions or weaknesses the might have crept in, maintain a sustained growth in productivity and gainful employment, and attain international competitiveness.” In pursuit of these objectives, the government announced a series of initiatives in respect the policies relating to the following areas:

- A. Industrial Licensing
- B. Public Sector Policy
- C. MRTP Act
- D. Foreign Investment and Technology

A package for the small and Tiny Sectors of industry was announced separately in August 1991.

#### **Abolition of Industrial Licensing**

Industrial licensing policy in India has been governed by the Industries (Development and Regulation) Act, 1951. As we have discussed above, industrial licensing policy and procedures have been liberalised considerably from time to time. Yet, the industrial licensing policy has all along been resented to by the entrepreneurs as it led to unnecessary governmental

interference, delays in investment decisions and bureaucratic red-tapism, corruption etc. Not only this, the industrial licensing policy was also unable to achieve the objectives laid down for it by the government. On account of these considerations, and in order to liberalise the economy and to enable the entrepreneurs to make investment decisions on the basis of their own commercial judgment, the 1991 industrial policy abolished industrial licensing for all but 18 industries. The 18 industries for which licensing was kept necessary were as under – coal and lignite; petroleum (other than crude) and its distillation and brewing of alcoholic drinks; sugar; animal fats and oils; cigars and cigarettes; asbestos and asbestos-based products; plywood and other wood based products; raw hides and skins and leather; tanned or dressed furskins; motor cars; paper and newsprint; electronic aerospace and defence equipment; industrial explosives; hazardous chemicals; drugs and pharmaceuticals; entertainment electronics; and white goods (domestic refrigerators, washing machines, airconditioners, etc.). With the passage of time, most of these industries have also been delicensed. As of now, licensing is compulsory for only 5 industries. These are alcohol, cigarettes, hazardous chemicals, electronics aerospace and defence equipment, and industrial explosives.

In respect of delicensed industry, no approval is required from the government. However, entrepreneurs are required to file an Industrial Entrepreneur Memorandum (IEM) to the Secretariat for Industrial Approvals (SIA) provided the value of investment on plant and machinery of such unit is above Rs.10 crore.

### **Public Sector's Role Diluted**

The 1956 Resolution had reserved 17 industries for the public sector. The 1991 industrial policy reduced this number to 8: (1) arms and ammunition, (2) atomic energy (3) coal and lignite, (4) mineral oils, (5) mining of iron ore, manganese ore, chrome ore, gypsum, sulphur, gold and diamond, (6) mining of copper, lead, zinc, tin, molybdenum and wolfram, (7) minerals specified in the schedule to the atomic energy (control of production and use order), 1953, and (8) rail transport. In 1993, items 5 and 6 were deleted from



the reserved list. In 1998-99, items 3 and 4 were also taken out from the reserved list. On May 9, 2001, the government opened up arms and ammunition sector also to the private sector. This now leaves only 3 industries reserved exclusively for the public sector – atomic energy, minerals specified in the schedule to the atomic energy (control of production and use order) 1953, and rail transport.

The new industrial policy also states that the government will undertake review of the existing public enterprises in low technology, small-scale and non-strategic areas as also when there is low or nil social consideration or public purpose. Sick units will be referred to the Board for Industrial and Financial Reconstruction (or a similar body) for advice about rehabilitation and reconstruction. For enterprises remaining in the public sector, it is stated that they will be provided a much greater degree of management autonomy through the system of MOU (memorandum of understanding).

The government has also announced its intention to offer a part of government shareholding in the public sector enterprises to mutual funds, financial institutions, the general public enterprises to mutual funds, financial institutions, the general public and the workers. A beginning in this direction was made in 1991-92 itself by divesting part of the equities of selected public sector enterprises. Over the period 1991-92 upto 2009-10, the government has raised Rs.57,683 crore through this means. The new industrial policy indicates the government's intention to invite a greater degree of participation by the private sector in important areas of the economy.

## **Other Liberalisation Measures**

**1. Industrial location policy liberalised.** In a departure from the earlier locational policy for industries, the new industrial policy provided that in locations other than cities of more than 1 million population, there will be no requirement of obtaining industrial approvals from the Centre, except for industries subject to compulsory licensing. In cities with a population of more than 1 million, industries other than those of a non-polluting nature were required to be located outside 25 kms. of the periphery.

Major amendment in the industrial location policy was effected during 1997-98. The requirement of obtaining industrial approvals from the Central government (except for the industries under compulsory licensing) for establishing units at locations not falling within 25 kms. of the periphery of cities having a population of more than 1 million was dispensed with. However, notified industries of a non-polluting nature such as electronics, computer software and printing, may be located within 25 kms of the periphery of cities with more than 1 million population. Other industries are permitted only if they are located in designated industrial areas set up prior to July 25, 1991. Zoning and Land Use Regulations as well as Environment legislation continue to regulate industrial locations.

**2. Abolition of Phased Manufacturing Programmes for new projects.** To increase the pace of in-digenisation in manufacturing, Phased Manufacturing Programmes have been in force in a number of engineering and electronic industries. The new industrial policy has abolished such programmes in future as the government feels that due to substantial reforms made in the trade policy and the devaluation of the rupee, there is no longer any need for enforcing the local content requirements on a case-by-case, administrative basis. Various incentives that are currently available to manufacturing units with existing Phased Manufacturing Programmes will continue.

**3. Removal of mandatory convertibility clause.** A large part of industrial investment in India is financed by loans from banks and financial institutions. These institutions have followed a mandatory practice of including a convertibility clause in their lending operations for new projects. This has provided them an option of converting part of their loans into equity if felt necessary by their management. Although this option has not generally been exercised, it has often been interpreted as an unwarranted threat to private firms of takeover by financial institutions. The new industrial policy has provided that hence forth financial institutions will not impose this mandatory convertibility clause.

## **Appraisal of New Industrial Policy**

According to J. C. Sandesara, the new industrial policy seeks to raise efficiency and accelerate industrial production in five different ways:

(1) A number of changes in industrial licensing policy, foreign investment, foreign technology agreements and MRTP. Acts are such as to do away with the prior clearance of the government. In such cases, project time and, therefore, project cost will be reduced. Material and human resources engaged in cultivating contacts and 'getting things done' will be released for more productive uses. Thus, efficiency will improve.

(2) The changes in respect of foreign investment and foreign technology agreements are also designed to attract capital, technology and managerial expertise from abroad. This will raise the availability of such scarce resources in the country on the one hand, and will improve the level of efficiency of production on the other hand.

(3) Some changes as regards public sector may enhance the 'allocative efficiency'. Opening up of the areas so far reserved for the public sector to the private sector implies an opening for the sector which has, by and large, given a better account of itself. Closure, liquidation or rehabilitation etc. of sick/weak public sector units will free resources for more productive use. Similarly, privatization may make for improved efficiency of the public sector, through its being subjected to the stock market discipline.

(4) Other measures in this area such as purposeful formulation and implementation of Memorandum of Understanding and its monitoring, professionalization and greater autonomy may be expected to improve the performance of the enterprises that will remain in the public sector.

(5) Greater emphasis in controlling and regulating monopolistic, restrictive and unfair trade practices and the strengthening of the powers of the MRTP Commission will curb anti-competitive behavior of firms in the monopolistic, oligopolistic and ineffectively competitive markets and thus promote competition and efficiency.

However, the new industrial policy 1991 has invited scathing criticism from a number of quarters. The main points of criticism are as follows:

**1. Erratic and fluctuating industrial growth.** As noted above, the new industrial policy considerably reduced the interventionist barriers to the entry of domestic and foreign investors, resulting in what has been proclaimed as a much more competitive environment in the industrial sector. It was hoped that this 'much more competitive environment' would, in itself, induce higher growth rates in the industrial sector. However, as discussed in Chapter 26, this has not happened. In fact, the rate of growth in the industrial sector declined in the post-reform period (particularly during the latter half of 1990s). For instance, the rate of growth of industrial production was only 5.0 per cent per annum during the period of the Ninth Plan (1997-98 to 2001-02) whereas it was 7.8 per cent per annum in the pre-reform decade (1980-81 to 1991-92). During 1990s as a whole (1990-91 to 1999-2000), the rate of growth of industry was only 5.7 per cent per annum. What is more, the decade of 1990s witnessed erratic and fluctuating industrial growth rates in different years leading to conditions of instability and uncertainty. However, the industrial sector registered strong positive growth of 8.2 per cent per annum during the period of the Tenth Plan (2002-03 to 2006-07).

The suggests that "liberalisation per se has not been enough to ensure high rates of growth of investment and productive activity, and that other strategies may be necessary to encourage the 'animal spirits' of entrepreneurs."

**2. Distortions in production structure.** From the point of view of long run industrial development, the most important group of industries is the group of capital goods industries. However, the rate of growth of this group of industries fell drastically from 9.4 per cent per annum during 1980s to only 4.7 per cent per annum over the Ninth Plan period. This points to the distortions in production structure during 1990s.

**3. Threat from foreign competition.** In the early euphoria of liberalisation, the private sector industrialists welcomes the new industrial

policy 1991 but they soon came to realize that opening up the Indian economy to foreign competition meant more and cheaper imports, more foreign investment, opportunities to the MNCs (multinational corporations) to raid and takeover their enterprises, and worse, their inability to meet the challenge from MNCs due to their weak economic strength vis-à-vis the MNCs. In the new liberalised scenario that has emerged in the post-1991 reform phase, the Indian businessmen are facing unequal competition from MNCs. The unequal competition stems from a number of reasons discussed in detail in the section on 'Effects of Globalisation' on "Globalisation and its Impact on the Indian Economy." As stated therein, the Indian enterprises suffer from 'size disadvantages' as they are just minuscules in comparison with MNCs' they have for long operated in a protectionist environment which promoted inefficiencies in production; the cost of capital to Indian business is much higher than for MNCs; they are very weak financially in comparison with MNCs; high multiple and cascading indirect taxes – especially at the local level, where they are not applicable to foreign imports – result in making Indian goods uncompetitive; etc. On account of these reasons, the Indian industry associations (particularly the Confederation of Indian Industry) have recently adopted a very critical attitude to the government's new industrial policy. The basic position of CII is the India has moved from too much protection to too little protection, which may eventually result in policy-induced de-industrialisation. The overall business demand is for a level playing field.

**4. Dangers of business colonisation.** The various measures to promote foreign investment contained in the new industrial policy and the various concessions to such investment announced in recent years have provided opportunities to MNCs to penetrate the Indian economy and gobble up Indian enterprises. Baldev Raj Nayar has pointed out three strategies adopted by the MNCs to penetrate the Indian economy through FDI (foreign direct investment). One, some foreign investors have bought off existing local brands alongwith the branded products with the aim of replacing such products with their own internationally known products, eliminating in the process the possibility of competition from the local products. Two, some foreign investors initially opted for joint ventures with Indian partners to gain

easy foothold in the domestic industry but, once having consolidated their position, reduced the Indian partner to a subordinate position or simply ousted him. Thus, many Indian businessmen feel that MNCs simply use them as a 'door mat' for entry and spread risk only to be dumped later. Three, some foreign investors, even as they started out with local partners in a joint venture, then went on to set up parallel 100 per cent subsidiaries of their own in the same field, which were then favoured with greater resources and more modern technology, rendering the joint venture uncompetitive and useless. The aggression which MNCs have shown to devour domestic enterprise has raised the dangers of business colonisation.

**5. Misplaced faith in foreign investment.** Various policy pronouncements of the government in recent years indicate that it expects foreign investment to help in technological up gradation of the industrial sector and push up export earnings. However, this faith in foreign investment is misplaced. As pointed out by H. K. Paranjape, none of the MNCs operating in this country has attempted to develop India as an important base for a significant part of its world-wide research and development work. Despite various tax concessions and incentives none of the multinationals tried to expand export markets. They undertook export activities only to the extent they were compelled to do so under export obligations, or when it was found necessary to do so in order to be able to earn foreign exchange for importing some of their essential requirements.

Coming to the import of foreign technology, Paranjape again expresses some reservations. According to him, in the whole eagerness to import foreign technology, little attention seems to have been paid to the possibility that production and managerial technologies found more suitable in other countries may not necessarily prove to be the best in our circumstances. As correctly pointed out by him, one of the very purposes of India's industrialization is to ensure that our very large manpower resources are effectively utilized. This implies the adoption of labour-intensive and capital saving technologies in whichever areas it is feasible to do so. This may imply

major readjustments in technologies that have developed in the labour scarce and capital abundant rich countries. This will not be an easy task.

**6. Personalistic relationships and corrupt practices continue to prevail.** As stated earlier, the 'licence permit raj' of the pre-1991 period provided ample scope for rent seeking as the entire operations of the industrial licensing policy were governed by personalistic relationships. According to John Dengbol-Martinussen while delicensing and de-regulation has undoubtedly discouraged rent seeking and corruption at the Central government level, these practices have continued and may have even increased at the State government level. This is due to the reason that while the number of interaction points between government officials and entrepreneurs have declined at 'the Union level, they have generally increased at the State level providing ample scope for continued interaction on a personalistic basis.

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## **7.5 Evaluation of Some Major Industries of India**

### **7.5.1 Sugar Industry**

India is the largest producer and consumer of sugar in the world. Sugar industry is the second largest agro-based industry in the country next only to textiles. About 45 million sugarcane farmers, their dependents and a large agricultural force, constituting 7.5 per cent of the rural population, is involved in sugarcane cultivation, harvesting and ancillary activities. Besides, about 0.5 million skilled and semi-skilled workers, mostly from rural areas, are engaged in the sugar industry. The sugar industry in India has been a focal point for socio-economic development in the rural areas by mobilizing rural resources, generating employment and higher income, transport and communication facilities.

The history of sugar industry in India begins in 1903 when a sugar factory was set up in Bihar and U.P. each. In 1932 there were 32 factories operating in the country. In that year tariff protection was granted to the industry and, as a result, the number of factories shot up to 137 by 1937 and India became self-sufficient in sugar. Because of the extensive cultivation of sugarcane as a commercial crop in northern India, the sugar industry was localized for quite some time in U.P. and Bihar. For instance, in 1936-37, 85 per cent of the sugar production came from these two States. Their share in 1960-61 also stood at about 60 per cent. However, in the last four decades, the industry has developed at a fast rate in Maharashtra, Andhra Pradesh, Karnataka and Tamil Nadu. Since the sugar mills in these States have been set up in recent decades, their production efficiency is greater and costs of production lower as compared to the mills in U.P. and Bihar. At present, there are 582 sugar factories in the country (as against 138 during 1950-51). The aggregate capacity of these factories is 197.97 lakh tones.

Production of sugar has increased by leaps and bounds in the planning period. From 11.34 lakh tones in 1950-51, production of sugar shot up to 51.48 lakh tones in 1980-81 and further to the record level of 132.77 lakh tones in 1991-92. This enabled India to become the largest producer of

sugarcane and sugar in the world leaving the other major producers – Brazil and Cuba – way behind. Sugar production touched an all-time high of 201.32 lakh tones in 2002-03 but fell to 139.58 lakh tones in 2003-04 due to drought in major sugar producing States like Maharashtra, Karnataka and Tamil Nadu and Woolly Aphids pest infestation.<sup>15</sup> Sugar production in 2007-08 sugar season (October-September) stood at 263 lakh tones and this fell steeply to only 146.80 lakh tones in 2008-09 forcing the government to allow imports to augment domestic availability and cool prices.

### **Sugar Policy of the Government**

The sugar economy in the country has traditionally been a highly controlled one and the industry was delicensed only recently in September 1998. The Janata Government way back in 1977 did try to decontrol sugar but this decontrol proved to be short-lived as sugar prices crashed in the absence of a monthly quota release mechanism. Therefore, controls were reimposed soon. Since 1979, the government has been following a policy of dual prices through which a specified percentage of total production of each sugar factory is procured as levy sugar at notified prices for distribution through the PDS (public distribution system). The ratio of levy sugar and free sale sugar from 1992-93 to the end of December 1999 was 40:60. The levy to free sale ratio was reduced from 40:60 to 30:70 from January 2000 and subsequently to 15:85 and 10:90 with effect from February 1, 2001 and March 1, 2002 respectively. The levy share has been reduced to 10 per cent because families above poverty line are now not to be provided sugar from the PDS (excepting North East States, hill States and island territories) with the result that the government would now require much less levy sugar for distribution through the PDS.

In January 1997, the sugar industry was brought under a regime of free licensing, which entitled the time-bound grant of licences without a due-diligence exercise or a ministerial revaluation of the project. As a result of this policy, there was a scramble for the creation of additional capacity. On the eve of delicensing in September 1998, the number of licences granted for new mills stood at 236 while those for capacity expansion stood at 1800. Additional

capacity sanctioned was as much as 150 lakh tones in just two years against the then prevailing total capacity of 134 lakh tones. The biggest draw for the setting up new capacity was the incentives offered with the licences: exemption from the supply of levy sugar for a period ranging from 5 to 10 years (i.e., the new units could sell 100 per cent of their production in open market for a number of years) and preferential treatment from the financial institutions, the primary lenders. "This meant that a mill could recover its cost in 5 years, make profits in the remaining 5, and conveniently, turn sick once the incentives expired. What the government was offering was a sweet haven for fly-by-night operators. Not surprisingly, a few existing mills also snapped up licences to pre-empt competition."<sup>16</sup>

### **Sugar Development Fund**

Under the Sugar Cess Act 1982, a cess of Rs.14.00 per quintal is collected on all sugar produced in the country and an amount equal to the same is credited in the Sugar Development Fund (SDF) created under the SDF Act 1982. The Fund has benefited the domestic industry by providing loans at concessional rates to sugar factories for modernization and expansion of capacities, rehabilitation development of sugarcane, providing grants for industrial research etc.

### **Problems of Sugar Industry**

**1. Problem of mounting losses.** Sugarcane prices have been increasing over the years as the costs of production have been rising on the one hand, and on the other hand, the government feels that a remunerative price policy is a must for growers so that the incentive to grow more remains. Since cane prices account for as much as 60 per cent of the cost of producing sugar this, in turn, implies that the cost of producing sugar has been increasing year after years. However, the realizations from the sale of sugar are not rising adequately to meet these increasing costs resulting in heavy losses to sugar units. Naturally, the arrears of sugarcane due to farmers are rising.

## **2. Fixation of high sugarcane prices by the State governments.**

The pricing of sugarcane is affected by a number of factors, the most important being the Statutory Minimum Price (SMP) and the State Advised Price (SAP), SMP is the price for sugarcane fixed by the Central government on the basis of cost of production of sugarcane. SAP is the price fixed by the State government taking into account the specific recoveries and conditions in that particular State. Sugarcane pricing has become a highly politicized issue and it has been observed that the basis of fixing SAP is quite arbitrary and has no bearing with the increase in the cost of production. As a result, the difference between SAP and SMP has been growing.

**3. The question of minimum economic size.** The minimum economic size, as it exists in India, is 2,500 tonnes of cane crushed per day . This is much less than the minimum economic size in other countries. For instance, in Thailand the average plant size is of 10,000 against the average of 1,400 in this country. According to some experts, the sheer size makes us lose out on the economies of scale. Also, the small MEs makes efficient use of by-products impossible.

**4. Old machinery.** Like jute and cotton textiles, some sugar factories also require replacement of old machinery and modernization of production techniques. The need is particularly great for the sugar factories located in U.P. and Bihar.

**5. Low sugar recovery.** The sugar recovery from the canes, as also the yield of cane crop, has been stagnant for a long time for want of any major breakthrough in breeding better varieties of sugarcane. The average recovery (extraction) rate for the Indian sugar mills is just 9.5 to 10 per cent, against 13 to 14 per cent in some other sugar producing countries.

**6. Failure to follow a consistent policy.** The government has not followed a consistent long-term policy for sugar. It has varied between complete control, partial controls and total decontrol. In 1967-68, the sugar factories were required to supply 60 per cent of output to government at 'levy' or control prices while there remaining output could be sold in the market at

market price. The proportion of levy sugar was later raised to 70 per cent. The Janata government removed all controls in 1978 but with the return of the Congress government to power, partial controls with dual pricing were again imposed. Presently, the sugar producers are required to supply 10 per cent in the form of 'levy' sugar while the remaining 90 per cent is the free sale quota.

### **7.5.2 Textile Industries**

Textile industry is the largest industry of modern India. It contributes about 4.0 per cent of GDP, 14 per cent of total industrial output and provides employment to over 35 million people. Together with allied agriculture sector, it provides employment to over 82 million people. The contribution of this industry to export earnings of the country is about 13.5 per cent. It is the only industry which is self-reliant, from raw material to the highest value added products, viz., garments/made-ups. The first cotton mill was set up in Kolkata in 1818. However, the industry made a real beginning in 1854 when a cotton mill was set up in Mumbai. In fact, the industry got localized in Mumbai and Ahmedabad as would be clear from the fact that in 1911 Mumbai City had 33 per cent of the total number of mills and provided employment to 45 per cent of the total workers of the industry. Ahmedabad had 19 per cent of the mills and provided employment to 13.6 per cent of the workers. Outside Mumbai City, some mills were located in Sholapur, Baroda and other minor local centres in Mumbai State. In the United Provinces (Uttar Pradesh), Kanpur had 5 large mills and dominated the industry of U.P. In the post-Independence period, important centres of this industry have been Mumbai, Ahmedabad, Sholapur, Kanpur, Kolkata, Indore and Coimbatore. India's textile industry continues to be predominantly cotton based, more than 56 per cent of fabric consumption in the country being accounted for by cotton (as against the world average of 46 per cent).

### **Expansion of the Textile Industry**

There are four sectors in the textile industry – mill sector, power loom sector, handloom sector and hosiery. The latter three are jointly considered under the heading 'decentralized sector'. Over the years, the government has

granted many concessions and incentives to the decentralized sector with the result that the share of this sector in total production has increased considerably. For example, while the share of the mill sector in total fabric production was 76 per cent in 1950-51, it fell to 38 per cent in 1980-81 and further to 0.8 per cent in 2008-09. The share of the decentralized sector correspondingly rose from 24 per cent in 1950-51 to 99.2 per cent in 2008-09. Of the total output of 54,966 million square metres of textiles in 2008-09, the share of the mill sector was only 1,796 million square metres – the rest 53,170 million square metres being contributed by the decentralized sector.

Of the three sub-sectors – handlooms, powerlooms and hosiery – in the decentralised sector, it is the powerlooms sub sector that has grown at a faster pace. For instance, in 2008-09, the share of powerlooms in total textile production was as large as 63.1 per cent while hosiery contributed 22.0 per cent and handloom 12.1 per cent. There are many reasons for the fast development of the powerloom sub-sector : (i) government's favourable policies on synthetic fabric industry; (ii) ability of this sub-sector to introduce flexibility in the product mix in line with the market situation; (iii) low labour costs achieved indirectly through the flexible use of labour itself resulting in lower cost of production, and providing an edge in the market; and (iv) increase in exports from the powerloom sub-sector.

With the aim of developing the four sectors of the industry viz., mills, powerlooms, hosiery and handlooms in an integrated manner, the government announced a new Textile Policy in June 1985. The main objective of this policy was to enable the industry to increase production of cloth of good quality at reasonable prices for the vast population of the country as well as for export purposes. A Textile Modernisation Fund of Rs.750 crore was created in 1986 to meet the modernization requirements of the textile industry. A Textiles Workers' Rehabilitation Fund was set up to provide interim relief to workers rendered unemployed as a consequence of permanent closure of the textile units. Another measure of significant importance has been the delicensing of the textile industry as per the Textile (Development and Regulation) Order 1993. Under the new policy, prior approval of the

government is not necessary to set up textile units including powerlooms. The technology Upgradation Fund Scheme (TUFS) was launched in 1999 to enable textile units to take up modernization projects, by providing an interest subsidy on borrowings. Under TUFS, loans worth Rs.66,284 crore were disbursed to 25,777 applicants upto June 30, 2009. National Textile Policy 2000 targeted increase in textile and apparel exports from \$11 billion to \$50 billion by 2010 with the share of garments at \$25 billion. Scheme for Integrated Textile Parks (SITP) was launched in 2005. Under this scheme, 40 integrated textile parks of international standards, covering weaving, knitting, processing and garmenting sectors with project proposals worth Rs.4, 149 crore have been sanctioned.

## **Problems of Textile Industry**

**1. Availability of raw materials.** The Indian textile industry continues to be predominantly cotton based. This would be clear from the fact that cotton accounts for more than 73 per cent of the total fibre consumption in the spinning mills and 56 per cent of the total fibre consumption in the textile sector. Naturally in those years when the production of raw cotton is small, the cotton textile industry faces a serious problem. The target of raw cotton was kept at 7 million bales in the Third Plan but the achievement was merely 4.9 million bales. There were extreme shortfalls in some other plans as well. Such shortfalls in the production of raw cotton as compared to the targets affected the expansion programmes of the textile industry adversely. However, things have now changed. From period of low level of output and shortages, raw cotton has now reached an era of self-sufficiency with production touching the level of 23.2 million bales in 2008-09. The cause for concern now is the fluctuating and highly volatile prices of cotton month after month. Such large fluctuations adversely affect the decentralized sector and handloom weavers in particular.

**2. Poor quality and low productivity of cotton.** Productivity of cotton in India is very low. In fact, cotton yield is only around half of the world average (in comparison with China, the productivity is just one-third). Not only this. Cotton cultivation is done in India by small farmers with very small farms

and with improper technology and methodology. Outdated farm practices and poor maintenance of the market yards have earned Indian cotton the label of the world's most contaminated cotton. This poor quality of cotton is creating difficulties for the spinning industry.

**3. Outdated plant and machinery.** Since the cotton textile industry is fairly old in India and a number of mills were set up long back, the machinery and equipment have grown old and outdated and need fast replacement. Production with the help of such outdated machinery results in higher costs and poor quality of product. According to a study by Doraisamy, out of 35 million spindles installed in the country, as many as 9 million need to be scrapped while another 16 million need modernization of varying degrees.<sup>11</sup>

**4. Fiscal structure skewed against modern, integrated mills.** The fiscal structure in India has been biased against the modern, integrated mills with the result that the organised textile industry has not been able to attract much investment in modernization in the last three – four decades. Both in weaving and processing we have small and tiny units dominating the sector with outmoded technology and sub-optimal scales. In the process of trying to protect what should be marginal segments of an expanding industry in which India traditionally has had competitive advantage, fiscal policy has been killing the industry itself. The net result is that India is left without domestic production of quality textiles needed by the largest and most lucrative segments of the garment trade.

**5. Interest burden and NPAs.** With steady erosion in their profits, most mills find it difficult to repay their loans. Most of these loans date back to early 1990s when interest rates ranged from 16 to 18 per cent. Today, the textile industry accounts for a significant portion of the NPAs (non-performing assets) of the banking sector in the country (in fact, it has the dubious distinction of having made the maximum contribution to the NPAs of the banking sectors). For a large number of technically viable mills, the pressure of unbearable interest burden has been the limiting factor to growth (expansion and modernization) and even to survival.



**6. Labour problems.** The cotton textile industry has been faced with frequent labour problems. While some problems of labour are genuine it is no doubt true that the cotton textile mills have become the playground for personal rivalries and the testing ground for some political groups. Protests from labour have also come in way of modernization of textile mills due to fear of displacement and unemployment. For instance, according to one estimate, a single worker can oversee 48 automatic looms while he can manage only 6 non-automatic looms. The problem is aggravated by the fact that due to stagnant demand conditions, there is little possibility of the displaced labour being employed elsewhere in the sector.

**7. Eroding cost competitiveness.** India suffers from a competitive disadvantage vis-à-vis its competitors like China, Pakistan and Taiwan. For example, compared with China and Pakistan, Indian salaries and wages are higher by 30 to 60 per cent. It is also estimated that Indian spinners pay 100-150 per cent more than their competitors for their power, making power cost 12 per cent of the production cost as against 5-7 per cent of the competition.

**8. Dismantling of MFA and India's export prospects.** Since January 1, 1974 the textile and clothing industry came to be governed by MFA (multi-fibre arrangement). The MFA handed countrywide quotas for exports of textiles. India had bilateral arrangement under MFA with USA, Canada, Australia, countries of the European Union, etc. More than 70 per cent of India's clothing exports were to quota countries of USA and EU. However, in accordance with the Agreement of Textiles and Clothing (ATC), 1995 (which is a part of WTO agreements), the MFA was dismantled with effect from January 1, 2005. This opened up the textile industry to free competition at the international level from January 1, 2005 for the first time in 30 years. There was a wide consensus among many economists that China and India will gain from this. Garment shops set up in small countries to take advantage of quotas will die; India and China – with their investment capacity, cotton and synthetic fibres, and economies of scale – will sweep the board. Within one year of the MFA regime coming to an end, Indian textile exports grew at a rate of 22 per cent. However, Indian textiles and clothing exports faced many ups

and downs after that, initially due to appreciation of Indian Rupee in 2007-08 and subsequently on account of global meltdown. Moreover, the performance of India's textile continues to lag substantially behind that of China in terms of rate of growth of exports and share in world textile exports. While China has created huge capacities and capitalized on economics of scale, India has an incredibly fragmented industry which is simply not geared to meet the challenges of a rapidly changing global industry. There are hundreds of thousands of powerloom units producing most of the fabrics in the country with the share of the organized mill industry being negligible. How can this miniscule mill sector pull up the entire industry ? It is also to be noted that while China is moving aggressively towards modernization and upgradation and pumping in large sums of money in building up its textiles and clothing industry, the Indian industry has shown complacency and distinct lack of enterprise. China's industry also has a cost advantage and better infrastructure. Therefore, many experts have argued that India will lose out the race to China.

### **Repeal of Cotton Ginning and Pressing Factories Act-1925**

1. The Cotton Ginning and Pressing factories Act, 1925 enacted on the 8th day of August, 1925 provided for periodical filing of returns, maintenance of registers, marking of bales and other rule making powers for the Central and State Governments for the purpose of regulating the ginning and pressing factories.

2. There have been changes in the pattern of processing, marketing and consumption of cotton since the enactment of the act. In the market driven economy needing quality products modernisation of ginning and pressing factories is essential. Further, in the present liberalized industrial scenario the restrictions laid down in the Cotton Ginning and Pressing Factories Act, 1925 are not required any longer and the Cotton control Order, 1986 issued under the Essential Commodities Act, 1955 would cover provisions considered essential to regulate working of ginning and pressing factories in future so long as cotton remains as an essential commodity. Hence it was considered that the said Act be repealed.

3. The repeal will also provide a thrust and incentive to the modernisation efforts in the cotton ginning and pressing sector to ensure quality processing of cotton and charging remunerative price for the service provided for.

### **7.5.3 Jute Industries**

The jute industry is one of the oldest in the country. The first power-driven jute mill was established in the country at Rishra near Kolkata in 1859 and since then the industry has made rapid progress. Most of the development of the jute industry has taken place in Bengal. The partition of the country gave a set-back to the industry as major jute growing areas went over to Bangladesh. In fact, only 25 per cent of jute growing areas were left within the country. Therefore, the government made concerted efforts to increase the production of raw jute within the country. As a result, area under jute increased from 6.52 lakh acres in 1947-48 to 1.4 million acres by 1950-51 and the output of raw jute rose from 1.6 million bales to 3.3 million bales over the same period. Production of mesta was also encouraged to be used in mixture with jute. The total area under jute and mesta stood at 0.9 million hectares in 2008-09 and their production stood at 10.4 million bales. The production of jute and mesta textiles increased from 837 thousand tones in 1950-51 to 1,074 thousand tones in 1981-82 and further to 1,369 thousand tones in 2008-09. Globally, India is the largest producer and second largest exporter of jute goods and this sector provides employment to 40 lakh farm families, as well as direct and indirect employment to 4 lakh workers. There are 77 jute mills in the country of which 60 are in West Bengal.

### **Problems of Jute Industry**

**1. The emergence of substitutes.** Perhaps the most important problem plaguing the jute industry is the demand recession emanating mainly from the emergence of substitutes. Jute bags have been rapidly losing their place to synthetic bags both at home and abroad. At home, the packaging of foodgrains, fertilizers, cement and sugar is increasingly being done in synthetic bags in place of jute bags. For instance, domestic consumption of jute products reached its peak in 2001-02, when it touched 1.5 million reached

its peak in 2001-02, which it touched 1.5 million tones, tones. Subsequently it kept falling in the next five years to 1.1 million tones basically due to the use of synthetic products. In the international market, adoption of new techniques of transportation and discovery of synthetic substitutes has reduced the demand for jute goods.

**2. Use of outmoded plant and equipment.** A number of jute mills in India are very old and carry out production with obsolete machinery. Such production is uneconomic since costs of production are very high. Naturally these mills require replacement of machinery and modernization. This is all the more necessary because India's main competitors in international market, Bangladesh and China, have new mills possessing modern machinery and are accordingly posing a serious threat to India's jute exports.. If India is to face this challenge it must scrap and replace the 100 year old looms. With the new sophisticated looms that are now being produced in the developed countries, per man production can be raised as much as 12 times more than the present per man production.

**3. Irregular power supply.** There has been severe power crisis in west Bengal in a number of years resulting in the imposition of power cuts on jute industry. Naturally the production of jute manufactures suffered seriously in these years.

**4. Competition from imports.** The government has removed duty on imports of raw jute and jute products from Bangladesh, Pakistan, Nepal and China. With zero duty, imported materials are Rs.250-300 a tone cheaper than the domestic products. This has increased imports of jute creating difficulties for domestic producers.<sup>8</sup>

**5. Other Problems.** The jute industry is plagued by many other problems also like historically high an-machine ratio, burgeoning wage and input costs, and a mismatch between the installed capacity and actual production.

Saddled with these problems, a number of units in the jute industry have turned sick and many are being run under arrangements reached with

the approval of the BIFR (Board for Industrial and Financial Reconstruction). Faced with this peculiar situation, the jute industry has no resources to undertake large-scale modernization and rehabilitation programmes. In fact, as noted by A.V.Krishnan, the industry is carrying a large surplus labour force of which a substantial number has already reached the retirement age but the industry is finding itself unable to retire them due to paucity of funds.<sup>9</sup>

### **The Emerging Opportunities**

The above discussion indeed presents a dismal picture of the jute industry but the future seems to be good. This is on account of the following factors :

1. There is ample scope of diversification and production of value added products. A large area for non-traditional jute items, jute decorative and other jute specialties (like tea bags, jute reinforced plastic, geo-textiles, decorative including furnishing, soft luggage, shopping bags, carpets and matting, apparels, blankets and non-woven's) remains to be explored. This can open upon tremendous possibilities for expansion of demand for jute goods in future. The advantages of the new and value added products have generated considerable interest in the commercial use of jute on a large scale. Krishnan notes that the textile manufacturers, particularly in the South, are directing their attention now towards cotton-jute blended yarn due to high cost of cotton yarn for some uses. In years to high cost of cotton yarn for some uses. In years to come, the South might well emerge as the largest manufacturing base for value added jute products in the country.

2. The development of the market for new value-added jute products is an excellent opportunity for the industry to direct its attention, penetrate and create new export markets with brand name 'Indian Jute'. Whatever efforts at diversification have been undertaken so far, have reaped rich dividends as would be clear from the fact that the share of diversified products in total jute exports has increased considerably over the years. Moreover, notes Krishnan, as jute fibre is not only environment friendly and fire retardant but also bio-degradable with capacity to promote safety

standards, some top car manufacturers in Germany have plants to use it. Jute is also being used increasingly as a soil saver. This can help jute in recapturing the export markets.

Keeping in view the immense possibilities for diversified products, the government set up the National Centre for Jute Diversification (NCJD) in 1995 as a body under the Ministry of Textiles. NCJD is playing an important role in the commercialization of technologies for the manufacture of jute-diversified products and creating awareness about the uses of this natural fibre in non-conventional application. The government formulated the first ever National Jute Policy 2005 with an objective of increasing production, improving quality, ensuring remunerative prices to the jute farmers and enhancing per hectare yield. On June 2, 2006 the government approved the implementation of the Jute Technology Mission (JTM) at an estimated cost of Rs.355.55 crore. JTM comprises four mini-mission: (1) Minimission I – Strengthening of Research and Development; (2) Mini-mission II – transfer of technology; (3) Mini-mission III – development of marketing infrastructure; and (4) Mini-mission IV – modernization / upgradation of technology of jute sector, and initiation of activities for promotion of jute diversified products.<sup>10</sup>

#### **7.5.4 Cement Industry**

Manufacture of cement was first started in Madras in 1904. A real beginning was, however, made in 192-13 when three companies were formed. By the time the plans started, there were 21 factories with an annual capacity of 3.28 million tones. The government had a complete control on the production, distribution and price of cement and this dampened the growth of the cement industry. In 1977, the government announced that 12 per cent post-tax return on net worth was fair enough and retention prices would be fixed to ensure it. This provided an initial momentum for investment in the industry. The real impetus was provided when partial decontrol was announced in 1982. Under this policy, all existing cement units were required to give up to 66.6 per cent of their installed capacity as levy at controlled price (for new units and sick units the requirement was kept at 50 per cent of installed capacity). The balance production was treated as 'non-levy cement'

and was allowed to be sold in the market at the ruling prices. The most important objective of the new policy of partial decontrol was to eliminate black marketing and bring down the price in the free market. The government intended to fully dismantle the controls and, keeping this end in view, liquidated the levy system in a phased manner. The 1989 Budget announced total decontrol of cement. Thus, from a phase of total controls, the cement industry passed through a phase of total decontrol in March 1989. The cement industry was delicensed in 1991. The industry responded favorably to the government initiatives and the production capacity increased from 29 million tones in 1982 to 113 million tones in 1999-2000 – an expansion of 84 million tones in just 18 years. At present, there are 159 large cement plants in the country with an installed capacity of 163.45 million tones per annum. Besides, there are about 332 mini-cement plants with an estimated installed capacity of 11.10 million tones per annum. The production of cement was 21 million tones in 1981-82. This rose to 45.8 million tones in 1989-90 and 181.4 million tones in 2008-09 – a substantial expansion by all means. Now India is the second largest producer of cement in the world after China. However, it is distant second.

An event of significant importance from the long-term point of view has been the process of consolidation and 'mergers and acquisitions' witnessed in the cement industry during recent period (particularly since 1997-98). The leaders are now finding it economical to acquire an existing under utilized/ill-managed company rather than to float a new company.

### **Mini Cement Plants**

In order to exploit smaller deposits of limestones scattered all over the country and in remote and inaccessible areas, the government announced guidelines for the setting up of mini cement plants (having a capacity ranging between 50 tonnes and 200 tonnes a day). The major advantages of mini cement plants are increased employment opportunities in rural areas, dispersal of industrial activity and reducing strain on the transportation infrastructure. As stated above, there are about 332 mini cement plants in the country with an aggregate capacity of about 11.10 million tones. Most of the

mini cement plants in India are located in Andhra Pradesh, Karnataka, Madhya Pradesh, Gujarat and Rajasthan.

### **The Regional Distribution**

Capacity-wise, the western region dominates the rest of the country with 40.5 per cent followed by the southern region (28.9 per cent), northern region (20.6 per cent) and lastly, the eastern region contributing 10 per cent to the total capacity. Since the industry is 'location-specific', it has resulted in formation of clusters of companies at suitable limestone reserves. At present, there are seven clusters manufacturing a total of 55.3 per cent of the total production while the remaining plants, which are scattered, manufacture the remaining 44.7 per cent. As emphasized by N. Srinivasan, addition to cement capacity in clusters in coming years should be so planned that they match the growing demand of the States in the region concerned. A quantum jump in addition to capacity in a cluster could lead to market distortions. "While it is important to assess 'what' capacity is to be created it is more important to know 'where' to create it."<sup>17</sup>

### **Problems of Cement Industry**

The above brief discussion shows that the cement scenario has undergone a sea change – from that of shortages and premiums just a few years ago to that of surplus production now. However, this surplus production has brought in its wake new problems like cut-throat competition, unremunerative prices and deepening financial crisis. The main problems of the cement industry are outlined below.

**1. Burden of high tariffs.** The cement industry is facing high tariffs – high excise duty, sales tax, royalty on limestone and coal etc. The excise duty on cement has been steadily rising. According to the development council for cement industry, the total levies on cement per tone amount to as much as Rs.66.8 per tone. The effective burden on cement amounts to as much as Rs.35 per cent of the retail price of cement and 47 per cent of the ex-factory price excluding excise, sales tax and freight. This is much higher as compared



to the burden in other countries making the Indian cement industry internationally uncompetitive.

**2. Poor quality of coal.** Coal is an important input in the cement industry and accounts for 15 to 20 per cent of cash expenses in the manufacture of cement. On an average 250 kg. of coal is required to produce one tone of cement. Coal in India has to be moved over long distances of 1,000 to 1,200 km to some plants in North, South and West India. There is a severe shortage of coal for the cement industry. Moreover, with the capacity addition in the cement industry projected for the Eleventh Plan, the annual requirement of coal would substantially go up from the current level of 28.68 million tones to 57.97 million tones by the end of the Eleventh Plan.<sup>18</sup> The quality of coal supplied to cement units is also highly unsatisfactory as only D, E and F grades of coal are supplied to these units. The ash content in Indian coal is very high and this restricts production. To meet the twin problems of (i) shortage of coal and (ii) poor quality of coal (due to high ash content), the emphasis on imports of coal is now increasing. However, this option, in addition to involving expenditure of foreign exchange resources, also places those cement plants at a disadvantage which are located far from ports as they have to incur extra costs for double handling and freight.

**3. The power shortage.** Power is another important requirement and alongwith coal forms 40 per cent of the total cost. Power cuts, unsteady and inadequate power supply from State Electricity Boards have created serious problems for cement units. This is all the more so as the production of cement is a continuous process requiring uninterrupted power supply to operate efficiently. To cope with the problem for cement units. This is all the more so as the production of cement is a continuous process requiring uninterrupted power supply to operate efficiently. To cope with the problem of power shortage, cement companies have been obliged to make heavy investments in captive power generation and also auxiliary generation in wind farms, particularly in plants located in coastal areas.

**4. Transportation problem.** Transportation costs make up around 20 per cement of the total cement price. The industry predominately depends on

railways, but due to shortage of wagons, cement dispatches by rail have declined over the years. The Indian Railways has introduced an 'Own Your Wagon (OYW) Scheme' wherein cement companies have been allowed to purchase wagons. This has led to some marginal improvement and has enabled the cement companies to tide over distribution bottlenecks. However, the increased distribution cost is forcing companies to pass the costs to the customers.

**5. Demand constraints.** Till the year 1990-91, the demand for cement was mainly dependent on government spending as the government with a 40 per cent off take was the single largest consumer of cement. However, due to financial constraints, the government was forced to cut down on a wide range of developmental activities. This resulted in a demand constraint. In recent years, the policy of liberalisation and the opening up of the infrastructure sector to the private sector and the foreign sector, have given a push to the demand for cement. NHDP (National Highway Development Programme) alone has been estimated to generate demand for 10 million tones of cement. The growth of the housing sector, which has been assisted by lower interest rates, and a favorable tax treatment of home loans, has also helped assist cement demand. As a consequence, massive investments in the setting up of new units and expansion of existing units in the cement industry have taken place in recent years pushing up the production capacity and actual production level of cement considerably.

#### **6. Underutilization of capacity.**

Underutilisation of capacity is a recurrent feature of cement industry. Underutilisation is particularly marked in the cement plants located in the Eastern region. One of the main factors accounting for low capacity utilization in this region has been the demand constraint. Because of underutilization of capacity, the cement plants are not able to reap the benefits of economies of scale. Thus, they are not able to minimize costs of production at their prevailing levels of production. They also waste scarce resources like power, skills, and so on which hurt the bottomline in the long run.

## 7. Cement Technology

For a long period of time, many cement plants have used the uneconomical wet process technology. Due to the high labour and maintenance costs and smaller size, these plants had a high cost of production. Their obsolete technology also resulted in a lot of wastage of coal and electricity. In recent years, there has been a gradual shift from wet to modern, fuel efficient dry process plants. Most of the new plants have adopted state-of-the-art technology and have been implementing modernization programmes to improve the performance of existing plants. This has resulted in better capacity utilization, higher productivity, reduced energy consumption and better quality of cement (comparable to the best in the world).

The Eleventh Five Year Plan targets a capacity addition of 118 million tones during the Plan period (2007-12) This would require a total investment of rs.52,400 crore.<sup>19</sup>

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### 7.5.5 Iron and Steel



Steel industry reforms - particularly in 1991 and 1992 - have led to strong and sustainable growth in India's steel industry.

Since its independence, India has experienced steady growth in the steel industry, thanks in part to the successive governments that have supported the industry and pushed for its robust development.

Further illustrating this plan is the fact that a number of steel plants were established in India, with technological assistance and investments by foreign countries.

In 1991, a substantial number of economic reforms were introduced by the Indian government. These reforms boosted the development process of a number of industries - the steel industry in India in particular - which has subsequently developed quite rapidly.

The 1991 reforms allowed for no licenses to be required for capacity creation, except for some locations. Also, once India's steel industry was moved from the listing of the industries that were reserved exclusively for the public sector, huge foreign investments were made in this industry.

Yet another reform for India's steel industry came in 1992, when every type of control over the pricing and distribution system was removed, making the modern Indian Steel Industry extremely efficient, as well as competitive.

Additionally, numbers of other government measures have stimulated the growth of the steel industry, coming in the form of an unrestricted external trade, low import duties, and an easy tax structure.

India continually posts phenomenal growth records in steel production. In 1992, India produced 14.33 million tones of finished carbon steels and 1.59 million tones of pig iron. Furthermore, the steel production capacity of the country has increased rapidly since 1991 - in 2008, India produced nearly 46.575 million tones of finished steels and 4.393 million tones of pig iron.

Both primary and secondary producers contributed their share to this phenomenal development, while these increases have pushed up the demand for finished steel at a very stable rate.

In 1992, the total consumption of finished steel was 14.84 million tones. In 2008, the total amount of domestic steel consumption was 43.925 million tones. With the increased demand in the national market, a huge part of the international market is also served by this industry. Today, India is in seventh position among all the crude steel producing countries.

The following are the premier steel plants operating in India:

- Salem Steel Plant at Tamil Nadu
- Bhilai Steel Plant at Chattisgarh
- Durgapur Steel Plant at West Bengal
- Alloy Steel Plants at West Bengal
- Visvesvaraya Iron and Steel Plant in Karnataka
- Rourkela Steel Plant at Orissa
- Bokaro Steel Plant at Jharkhand

The earliest successful attempt to manufacture iron and steel by modern methods was made in the country at Barakar in 1875 for the production of pig iron. This was taken over by the Bengal Iron Company in 1889. However, the first effort at large scale production was made when Tata Iron & Steel Company (TISCO) was set up in Jamshedpur in 1907. The Indian Iron and Steel Company (IISCO) were set up at Burnpur in 1919. The first unit

in the public sector, now known as the Visveswaraya Iron and Steel Works Ltd., started functioning at Bhadravati in 1923.

### **Progress in the Post-Independence Period**

After Independence, special attention was paid to the development of the iron and steel industry. The Second Plan which aimed at laying strong foundations of industrial development naturally gave top priority to the development of the iron and steel industry. This would be clear from the fact that the investment on steel programme in the Second Plan alone was about 2.5 times the combined new investment undertaken by the public and private sector on the industrial programmes in the First Plan. Three steel plants of one million tones ingot capacity each were set up in the public sector at Bhilai, Rourkela and Durgapur. Besides, expansion programme to double the capacity of the two private sector plants, namely, TISCO and IISCO to 2 million tones and 1 million tones respectively were also taken into hand.

The three steel plants set up in the public sector came into operation in stages between 1959 and 1962. The Third Plan placed emphasis on expansion of these plants and the setting up on a new steel works at Bokaro. The Fourth Plan steel programme was based on the maximum utilization of steel capacity and preparation of plans to set up three new steel plants at Salem in Tamil Nadu, Vijaynagar in Karnataka and Visakhapatnam in Andhra Pradesh. The Bokaro Steel Plant was commissioned on February 26, 1978. With this the total installed ingot capacity which stood at 8.9 million tones on March 31, 1974, increased to 11.6 million tones as on March 31, 1980. The government also took over the management of IISCO in 1972 and acquired its ownership in 1976 to improve its working.

Prior to 1973, of the four steel plants in the public sector, the plants at Bhilai, Rourkela and Durgapur were owned and managed by the Hindustan steel Limited (HSL) and the Bokaro Steel Plant by Bokaro Steel Limited (BSL), In 1973, the government set up the Steel Authority of India Ltd. (SAIL). HSL and BSL became the wholly owned subsidiaries of SAIL. The management of IISCO is also under SAIL. Visveswaraya Iron and Steel Ltd.

was taken over by SAIL in August 1989. Thus SAIL is now the main integrated steel company. Vishakhapatnam Steel Plant of Rashtriya Ispat Nigam Ltd. (RINL), was commissioned in July 1992. It is the best laid out steel plant in the country with a capacity of three million tones. In the private sector, Tata Iron and steel Company (TISCO) is the first integrated steel plant. It is located at Jamshedpur. Other important players in the private sector are Essar, Mukand (having the biggest mini steel plant in the country), Lloyds, Jindal, Nippon Denro Ispat Ltd., Mahindra UGINE Steel Company Ltd., FACOR, Mardia Steel Ltd., etc. India is now the fifth largest crude steel producing country in the world. This sector represents around Rs.90,000 crore of capital and directly provided employment to over five lakh people.

### **Liberalisation of Steel Policy**

Iron and steel industry was reserved for the public sector in the 1956 Industrial Policy Resolution which had stated that while existing units in the private sector would be allowed to continue and expand, new units will be set up in the public sector only. However, due to acute shortage of steel in 1960s and 1970s and increase in the demand of steel by the re-rolling and engineering industries, the government liberalised the steel policy. The process of liberalisation initiated in 1983 has been progressively extended. In 1986 private sector was allowed to produce steel using EAF (Electric Arc Furnace) process. Small blast furnaces were allowed only if they used optimum energy. In February 1988, expansion of units was permitted within an overall capacity ceiling of upto 250,000 tonnes per annum. The enhancement of capacity upto 150 per cent of the existing licensed capacity was allowed within the overall ceiling limit. However, certain conditions were imposed.

To liberalise and rationalize the manufacture of steel and steel-based products, remove unnecessary restrictions, and promote minimum economic scales of production, the government issued a new set of guidelines on June 6, 1990. Under the new policy, the private sector was allowed to set up steel plants with a capacity of up to one million tones per annum and, for this purpose, they were allowed the freedom to choose between the electric arc furnace and blast furnace processes. Subsequent to the announcement of the



substantial liberalisation measures in July 1991, the government removed the iron and steel industry from the list of industries reserved for the public sector and also exempted it from the provision of compulsory licensing. The government also abolished price and distribution controls on iron and steel manufactured by integrated steel plants with effect from January 16, 1992. The Freight Equalization Scheme was also withdrawn. The iron and steel sector is now almost entirely open with no sectoral reservations, with no licensing, pricing, distribution and import controls. This is a radical departure for an industry which has experienced near exclusive public sector monopoly, canalized imports, protective import tariffs and government regulated domestic prices.

### **Production, Consumption and Exports of Steel**

The production of finished steel (including secondary producers) rose from 1.04 million tones in 1950-51 to 6.82 million tonnes in 1980-81 and 57.2 million tones in 2008-09. The production of pig iron was 5.3 million tones in 2007-08 and 6.2 million tones in 2008-09. The consumption of finished steel in 2005-06 was 41.4 million tones which rose to 52.4 million tones in 2008-09 was 5.08 million tones and 4.44 million tones respectively.

### **Problems of Iron and Steel Industry**

The development and expansion of the industrialization programmes of a country depends crucially on the development and expansion of the iron and steel industry. It is mainly due to the emphasis laid on the development of this industry in the post-Independence period and the progress registered by it that India's industrial base has now become strong enough to meet the requirements of rapidly expanding engineering goods industries, machine building industries, machine tools industries and a number of other capital goods, intermediate goods and consumer goods industries. Naturally, a setback in the iron and steel industry due to any reasons whatsoever has to be viewed with concern since it has adverse repercussions on the numerous industries associated with it. Let us now consider some of the problems that the steel industry has had to face:

**1. Rise in input costs.** Raw materials such as iron ore and coal constitute on average 70 per cent of the total costs of steel companies. In 2005-06, prices of iron ore costs of steel companies. In 2005-06, prices of iron ore shot up by 71 per cent and coal by 50 per cent. As a result, a third of the large steel players' profits were wiped out.<sup>1</sup> In 2008-09, the Indian iron and steel industry was hit hard by the spiraling cost of imported coking coal/metcoke.

**2. Shortage of coal and power.** The steel plants frequently face problems in obtaining adequate quantities of the desired quality of coking coal. This has often forced the steel plants to restrict the pushing of coke ovens. In addition, Indian coking coal has a high ash content mainly because of the sedimentary nature of their origin. In the 1950s the steel plants were designed for using coal with 17 per cent ash content. Over the years, as mining proceeded deeper and to lower seams, the ash content increased to 25 per cent. Every one per cent increase in ash brings down the production of blast furnaces by 2-3 per cent. In addition, coke rate goes up and quality of the product goes down. To keep the ash content of the blend at around 15 per cent, the dependence on imported coal has to be increased which is obtained at a considerably higher cost as compared with domestic coal (while price of domestic coal is in the range of \$40-45 per tonne, that of imported coal is in the range of \$70 per tonne). Power shortages also affect the functioning of steel plants adversely. For instance, inadequate power availability from Damodar Valley Corporation (DVC) has adversely affected the performance of SAIL.

**3. Technologically obsolescence.** Some public sector steel plants are today victims of technological obsolescence. In respect of blast furnace productivity, consumption of coke and tap-to-tap time in convertors, most of the integrated steel plants are half as efficient as the steel plants in the rest of the world. For example, in terms of hot metal output per cubic metre of working volume per day, the performance has been 1.11-1.33 for Bokaro, 1.21 – 1.26 for Vishakhapatnam Steel Plant and 1.87 for the G-furnace (new furnace) for TISCO while the same has been in the order 2.3-2.8 on a typical

Japanese Furnace. Similarly, the tap-to-tap time in the blast furnace in the TISCO plant has been in the range of 70-136 minutes while the same is 20-30 minutes in a Japanese firm. Not only in material value productivity, even in terms of labour productivity, has Indian steel industry lagged considerably behind the developed countries. While labour productivity in Indian steel industry ranges between 39 tonnes per man year to 228 tonnes per man year, it ranges between 300-500 tonnes per man year in the steel industry of industrialized countries.<sup>3</sup> It is also due to technological obsolescence that energy consumption in Indian steel mills still continues to be considerably higher than in steel mills of the developed countries. For instance, while energy constitutes about 20 per cent or one-fifth of the total cost of steel making in the latter, it is as high as 33 per cent (almost one-third) of the total cost of steel making in India.

**4. Inefficient management.** The management and control of steel plants leaves much to be desired. The top management often comprises non-specialised, non-technical people who are often unequal to the task of providing the requisite managerial competence in the complex and capital intensive projects as the steel plants, in fact, are. The management also works under severe constraints like undue political interference, frequent labour disputes etc.

**5. The demand constraint.** The steel industry has faced rough time during a number of recent years due to a slump in demand following reduction in government's planned expenditure, lack of investment in the housing and infrastructure sectors, and additional capacity creation based on assumed growth in consumption which did not materialize. As a result, there was huge piling up of inventories resulting in downward pressure on prices and deep erosion in the profitability of the steel producers. The latest instance of this was the latter half of the year 2008-09 when the domestic demand for steel was adversely impacted by economic slowdown and, in particular, by slackening demand in some of its leading end-use segments. As a result, domestic steel prices started declining from September 2008 and the pace of growth of production slowed down considerably.

**6. Menace of dumping.** Already in distress over the failure of domestic demand to increase, the misery of the Indian steel industry was compounded by the alarming downtrend in international price during the late 1990s. In respect of certain steel products, the decline in prices was as much as 40 to 40 per cent. This led to unhealthy practices like dumping which pulled down domestic prices and eroded the bottom-line of the local steel makers. The lower tariff regime in the current era of liberalisation and the unrestricted import of all iron and steel material under the new export-import policy made things worse for the domestic producers of steel. What is more worrying is the fact that seconds and defective grades of steel were dumped into the economy. These were no match to the quality products turned out by the Indian steel mills but spoiled the market of domestic steel makers.

The Eleventh Five Year Plan has listed the problems faced by the steel industry as follows : “depleting iron ore resources, inadequate availability of coal, inadequate sintering and pelletization capacities and poor transport infrastructure for movement of raw materials.” Outlay for the steel sector in the Eleventh Plan has been kept at Rs.37,318 crore.

### **Facing the Challenges**

To face the problems mentioned above, the Indian steel industry has adopted a multi-pronged strategy consisting of the following steps;

**1. Control raw materials.** To tackle the problem of rising costs of raw materials, the Indian steel companies are devising strategies to ‘control’ raw materials. For example, companies are acquiring captive iron ore mines to control iron ore supplies. For instance, Jindal South West (JSW) is making efforts to source at least 50 per cent of its iron ore requirements from its captive mines in Karnataka. As for coke, companies are now setting up their own coke oven batteries where they can manufacture it from raw coal.

**2. Intergrate.** India’s companies are also engaged in backward integration to mitigate risks. For instance, Bhushan Steel and Strips buys hot-rolled steel – used to manufacture high-end cold rolled and galvanized steel-

from the market. Now it is setting up a 3 million-tonne hot-rolled steel manufacturing plant in Orissa. Another area of backward integration is power. For example, in 2005-06 JSW commissioned a 100-MW captive power plant in Vijayanagar which helped reduced power costs by nearly 25 per cent.

**3. Engineer the finances.** Steel is a capital intensive industry and many companies resort to long-term loans. The recent upturn in the sector enabled many companies to pay off their long-term debts early and in general, interest payments have also come down. Thus, companies are saving through debt restructuring.

**4. Expand.** The massive expenditure on infrastructure development has created extensive opportunities for the steel companies (for example, Phase I of National Highways Development Programme alone led to a demand for 1 million tone of steel). To benefit from these opportunities, companies have started expanding capacities. For example, SAIL has embarked upon a Rs.35,000 crore expansion plan. Similar expansions are being undertaken by Tata Steel (which recently acquired Corus), JSW, Mukand, Bhushan Steel etc.

Since India has significant resources of iron ore and coal, India is an attractive destination for global steel companies such as Posco and Mittal Steel. Therefore, smaller Indian companies can be subject to hostile bids from these global players. To stave off this danger, it is expected that consolidation in India will happen among the domestic players in the near future.

The Government of India approved the National Steel Policy (NSP) 2005 in October 2005. The long-term goal of NSP is to ensure that India has a modern and efficient steel industry, capable of standing up to international competition and catering to the growing domestic demand for steel. The NSP envisages a threefold role for the State in the now deregulated Indian steel industry – (1) as a catalyst for “triggering” domestic demand, (2) as a facilitator to do away with supply side constraints, including the finance constraint, and (3) as a co-coordinator to “manage” the external environment

effectively, However, as correctly pointed out by Economic and Political Weekly, success on all these fronts is suspect. For example, it is not clear how the government can boost the domestic demand for steel with the FRBM (Fiscal Responsibility and Budget Management) Act in place and neo-liberal ideology dictating fiscal conservatism. As far as doing away with supply side constraints is concerned, this would imply heavy financial assistance and commitments to private sector capitalists who decide to invest (particularly due to the capital intensive nature of the steel industry). This would put pressure on the resources of financial institutions and push up their non-performing assets (this is what happened in the first half of 1990s when initial deregulation of the steel industry had led to a surge of investments in the sector). As far as “managing” the external environment is concerned, the NSP has no strategy in place. It has nothing concrete to say about how India plans to deal with steel-industry related subsidies, dumping, and the filing of anti-dumping and countervailing duty cases. Overall the NSP simply lacks substance.

#### **7.5.6 Oil & Gas Industry in India<sup>22</sup>**



The origin of oil & gas industry in India can be traced back to 1867 when oil was struck at Makum near Margherita in Assam. At the time of Independence in 1947, the Oil & Gas industry was controlled by international

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<sup>22</sup> [www.petroleum.nic.com](http://www.petroleum.nic.com).

companies. India's domestic oil production was just 250,000 tonnes per annum and the entire production was from one state - Assam.

The foundation of the Oil & Gas Industry in India was laid by the Industrial Policy Resolution, 1954, when the government announced that petroleum would be the core sector industry. In pursuance of the Industrial Policy Resolution, 1954, Government-owned National Oil Companies ONGC (Oil & Natural Gas Commission), IOC (Indian Oil Corporation), and OIL (Oil India Ltd.) were formed. ONGC was formed as a Directorate in 1955, and became a Commission in 1956. In 1958, Indian Refineries Ltd, a government company was set up. In 1959, for marketing of petroleum products, the government set up another company called Indian Refineries Ltd. In 1964, Indian Refineries Ltd was merged with Indian Oil Company Ltd. to form Indian Oil Corporation Ltd.

During 1960s, a number of oil and gas-bearing structures were discovered by ONGC in Gujarat and Assam. Discovery of oil in significant quantities in Bombay High in February, 1974 opened up new avenues of oil exploration in offshore areas. During 1970s and till mid 1980s exploratory efforts by ONGC and OIL India yielded discoveries of oil and gas in a number of structures in Bassein, Tapti, Krishna-Godavari-Cauvery basins, Cachar (Assam), Nagaland, and Tripura. In 1984-85, India achieved a self-sufficiency level of 70% in petroleum products.

In 1984, Gas Authority of India Ltd. (GAIL) was set up to look after transportation, processing and marketing of natural gas and natural gas liquids. GAIL has been instrumental in the laying of a 1700 km-long gas pipeline (HBJ pipeline) from Hazira in Gujarat to Jagdishpur in Uttar Pradesh, passing through Rajasthan and Madhya Pradesh.

After Independence, India also made significant additions to its refining capacity. In the first decade after independence, three coastal refineries were established by multinational oil companies operating in India at that time. These included refineries by Burma Shell, and Esso Stanvac at Mumbai, and by Caltex at Visakhapatnam. Today, there are a total of 18 refineries in the

country comprising 17 in the Public Sector, one in the private sector. The 17 Public sector refineries are located at Guwahati, Barauni, Koyali, Haldia, Mathura, Digboi, Panipat, Vishakapatnam, Chennai, Nagapatinam, Kochi, Bongaigaon, Numaligarh, Mangalore, Tatipaka, and two refineries in Mumbai. The private sector refinery built by Reliance Petroleum Ltd is in Jamnagar. It is the biggest oil refinery in Asia.

By the end of 1980s, the petroleum sector was in the doldrums. Oil production had begun to decline whereas there was a steady increase in consumption and domestic oil production was able to meet only about 35% of the domestic requirement. The situation was further compounded by the resource crunch in early 1990s. The Government had no money for the development of some of the then newly discovered fields (Gandhar, Heera Phase-II and III, Neelam, Ravva, Panna, Mukta, Tapti, Lakwa Phase-II, Geleki, Bombay High Final Development schemes etc. This forced the Government to go for the petroleum sector reforms which had become inevitable if India had to attract funds and technology from abroad into the petroleum sector.

The government in order to increase exploration activity, approved the New Exploration Licensing Policy (NELP) in March 1997 to ensure level playing field in the upstream sector between private and public sector companies in all fiscal, financial and contractual matters. This ensured there was no mandatory state participation through ONGC/OIL nor there was any carried interest of the government.

To meet its growing petroleum demand, India is investing heavily in oil fields abroad. India's state-owned oil firms already have stakes in oil and gas fields in Russia, Sudan, Iraq, Libya, Egypt, Qatar, Ivory Coast, Australia, Vietnam and Myanmar. Oil and Gas Industry has a vital role to play in India's energy security and if India has to sustain its high economic growth rate.



## **Liberalisation Of Indian Economy Its Impact On Indian Oil & Gas Sector**

1. Liberalisation of Indian Economy & Its Impact On Indian Oil & Gas Sector.
2. For four decades following Independence , the Indian economy was under a socialist, dirigiste leash. The laws of demand and supply took a backseat to the diktats of faceless bureaucrats.
3. Unsurprisingly, the economy could only crawl along, plagued by high rates of inflation, unemployment and inefficiency - the consistently meagre rates of growth produced by it coming to be contemptuously termed the "Hindu rate of growth" the world over.
4. The central pillar of the policy was import substitution, the belief that India needed to rely on internal markets for development, not international trade — a belief generated by a mixture of socialism and the experience of colonial exploitation.
5. The problems steadily mounted and in 1991, the economy stood on the verge of collapse due to an acute foreign exchange shortage crisis.
6. In 1991, after the International Monetary Fund (IMF) had bailed out the bankrupt state, the government of P.V. NarasimhaRao and his finance minister Manmohan Singh started breakthrough reforms.
7. The new policies included opening for international trade and investment, deregulation, initiation of privatisation, tax reforms, and inflation-controlling measures.
8. Energy Policy & Regulation
9. Various agencies within Indian government oversee energy policy in India and include the Ministry of Petroleum and Natural Gas, the Ministry of Coal, the Ministry of Non-Conventional Energy Sources, the

Ministry of Environment and Forests, the Department of Atomic Energy, and the Ministry of Power.

10. Under the Ministry of Petroleum and Natural Gas are the Directorate General of Hydrocarbons (DGH) and the Oil Coordination Committee.
11. The DGH was set up in 1993 to oversee petroleum exploration programs, develop plans for the state-owned oil enterprises and private companies, and oversee efficient utilization of gas fields.
12. The Oil Coordination Committee oversees, plans, regulates, and advises on the downstream sector.
13. The Gas Authority of India Limited (GAIL) is responsible for transportation and marketing of natural gas.
14. State-owned companies like the Oil and Natural Gas Corporation (ONGC) and Oil India Limited (OIL), which manage exploration and production activities, and the Indian Oil Corporation (IOC), which secures oil from abroad, also help shape the direction of energy policy.
15. Hydrocarbon Vision 2025
16. Lack of a comprehensive energy policy is a barrier to foreign investment in long-term energy projects in India.
17. To address the absence of a policy, the government released in early 2000 Hydrocarbon Vision 2025, a study whose recommendations may become official policy.
18. The study suggests, among other things, that India revise foreign ownership regulations for refinery operations to allow 100% foreign ownership.
19. The study calls for elimination of government subsidies for petroleum over the course of the next 3-5 years.

20. The government is being encouraged to allow domestic gas prices to float to international levels which would affect the 25% of the gas market that is protected by government price controls.
21. Furthermore, the study set down a goal to supply 90% of India's petroleum and diesel needs from domestic sources.
22. India suffers from low drilling recovery rates. Recovery rates in Indian fields average only about 30%, well below the world average. The government hopes one of the benefits to opening up the energy industry to foreign companies will be access to better technology which will help improve recovery rates.
23. Wary of a growing reliance on imported oil, the government announced the New Exploration Licensing Policy (NELP) in 1997, which opened the door to involvement by foreign energy companies.
24. Foreign firms were initially hesitant to bid on oil exploration rights, and as a result no bids were received from foreign energy companies in 1999. However, by early 2000 India had awarded 25 oil exploration blocks. The largest contract went to Reliance Industries of India, which together with Niko Resources of Canada, won 12 oil exploration blocks.
25. Additionally, the government is encouraging Indian energy companies to get involved in exploration and production projects in other Asian countries to make them more competitive in the international arena and develop their technical prowess.
26. Indian companies have become active in other oil projects in Asia, Sudan, Australia, and Russia. In early 1999, IOC and ONGC formed a strategic alliance designed to improve the international competitiveness of both firms.
27. Refining & Petrochemicals

28. India is becoming a major global market for petroleum products. Consumption of petroleum products rose from 57 million tons in 1991-1992 to 107 million tons in 2000.
29. The India Hydrocarbon Vision 2025 report estimates future refinery demand at 368 million tons by 2025.
30. For India to meet its ambitious refinery expansion goals it will need help from multinationals and private Indian companies.
31. The main focus of a liberalization program that began in the mid-nineties has been greater access to the refinery sector for private companies and a green light for joint ventures with state-run enterprises.
32. One approach has been tax breaks such as granting plants completed by 2003 a five-year tax holiday.
33. Regulatory reform has entered into the picture, allowing foreign firms that invest in excess of \$400 million in refinery operations to sell refined products.
34. Natural Gas
- 35.** Natural gas now supplies about 7% of India's energy. Consumption of natural gas rose from 628 billion cubic feet (bcf) per year in 1995, to 752 bcf in 1999. Power generation, fertilizers, and petrochemicals production are industries that have been turning to natural gas as an energy feedstock. Natural gas will become a bigger part of the energy picture for India, primarily as a way to reduce dependence on foreign oil.

## **Petrol and Diesel prices deregulated in India**

The Government of India has taken a bold decision to deregulate petrol and diesel (partially) prices in India and also come up with a price hike.



As usual the vote bank politicians on the UPA alliance, opposition leaders and the left have voiced their protest. They claim that they are 'with the people of India' and whole lot of other crap. Two of the most politically spoiled states in India – The West Bengal and Kerala – have readily jumped on to 'celebrate' the situation with a 'Hartal' (strike). But do they even know how pampered the people of India already are how much they are misusing one of the most limited natural resources such as petrol (LPG and diesel as well)?

### **What does deregulation means ?**

Decontrolling or deregulating the petrol prices mean that, the government will no longer be subsidizing petrol prices and the prices will be purely linked to the international crude prices. In the case of diesel, though, it will be only partially regulated – the reason being an attempt to avoid sudden spike in inflation.

### **Why should Petrol cost more ?**

As all of us know, petrol (or Gasoline) is produced out of crude oil which is a natural resource that's available in limited quantity. It is a matter of a few years before the crude gets totally exhausted. Although, there have been several crude discoveries in India, we are still dependent on the **OPEC**

(Oil Producing and Exporting Countries) to import crude and refine it to produce petrol, LPG, diesel, aviation fuel, kerosene etc.

### **Petrol production cost**

The crude oil costs \$79 a barrel (159 Litres). Since this has to be transported to India via the marine route, there is a shipping cost. Let's say it's something like 10%. Since the import duty on crude oil was waived sometime back, let us not count that part. Hence by the time the crude arrives in India, it is already costing something like \$85 per 159L.

So the petrol refining calculation goes as follows :

**Cost of 1 barrel crude: \$85 or Rs. 3910.00** (exchange rate of 46)

**Quantity of petrol produced** from 1 barrel crude: 72L (45.4%)

Since almost 100% of the crude is refined into some product or other, we can calculate the raw material cost of producing 72L or petrol as 45.4% of the price of crude barrel.

Hence 72L petrol's material cost alone is  $3910 * 45.4 / 100 = \text{Rs. } 1775.00$

**Raw material cost of 1L of Petrol =  $1775.00 / 72 = @25$  rupees**

Obviously, the raw materials alone do not contribute to a product. You need electric power, thousands of paid employees, machinery, maintenance etc to finally produce petrol. So finally when it's of consumable form, it is costing around 30 rupees in the oil refining spot itself.

### **Taxes, marketing and distribution cost**

The following are the other additional expense before you can consume the petrol at your favorite gas station:

Excise duty

Education tax

VAT

Distribution and transportation cost

Dealer commission

As I understand, all the above added up comes to around 27 rupees per litre of petrol the majority of the cost is towards excise duty, transportation cost and VAT (Isn't it a pity you have to spend more petrol or diesel to distribute petrol?)

Essentially, one litre of petrol, by the time it reaches the petrol filling stations, is costing you already Rs. 57/- without any profit added to the petroleum marketing companies. Obviously most of these companies are state run companies and hence cannot afford to reap 100% profit. Let's turn our back on them and tell them that you can make say 20% profit. And if you add that your 1L of petrol should actually cost you around Rs. 68/-

Now, aren't you really lucky that it's available below Rs.60/- even with the latest hike in petrol prices?

### **Subsidy woes**

The story is not over yet. One needs to do similar calculations for other products such as diesel, aviation fuel, kerosene and LPG. Unfortunately diesel is the primary thing that fuel public transport and distribution system in India and kerosene – LPG are house hold lifesavers when it comes to cooking purposes. In order to curb the inflation and protect the below poverty line people, the government has to subsidize it big time. A part of this subsidy cost is absorbed by the government while the oil marketing companies bear the other half. This puts some pressure on the government to increase taxes on luxury consumption sectors such as airlines by increasing aviation or jet fuel prices. They are also taxed heavily which is mainly borne by the rich or upper middle class people in India.

## **Why deregulation of petrol prices is good?**

The deregulation of petrol prices will definitely increase the rate of inflation in short term. Virtually there will be immediate price rise in commodities and other consumables. However, for long term I think it is a good move because at the end it will definitely reduce our long term debt and fiscal deficit. Our overall economy will get stabler in this case.

Secondly, this measure will be a boost to the oil producing and marketing companies to recover their losses immediately. Remember, lakhs of people work in these huge companies and they need a life too. Moreover, the government run oil companies will be candidates for disinvestment which means that the government can lower their fiscal deficits further with additional income.

The other advantage is that the inflation, at the moment, is a fake figure. You will get to know the actual inflation and variation of commodity prices only when the petrol prices move according to the international crude prices.

This will also bring in big private players (e.g. Reliance) into the petrol marketing game. Remember that companies like Shell and Reliance used to provide excellent quality of petrol and service until Reliance pumps were forced to close down due to government regulations. This kind of competition will eventually bring in good service, good quality and in the future competitive pricing as well. The immediate woes will be compensated in the mid term – that's my strong belief.

The government, in the meantime, should try to reduce the excise duties and restructure the VAT to minimize the impact of immediate fuel price rise on inflation and the poor people.

## **Long term solutions to curb petrol prices**

In the long term, there are several viable solutions that needs to be done from the sourcing point to distribution and consumption.



There are possibilities of under sea pipes (just like the one we were planning with Iran for gas sourcing) from the vendor nation to India to reduce shipping cost. This has a very good long term positive impact though initial cost of incorporation is high.

The oil refining companies sourcing and storing mechanism needs to be optimized in a way that when the crude prices are low, we are able to store more. I am not sure, how much of optimization is done in this regard. Since we keep getting new and new governments every few years, they may not go for a long term plan for the same. Please remember that not too long back, the crude prices were at \$35 or so per barrel.

There is a scope for improving the internal distribution system as well. Though, India has a huge geographical region, we can still have oil distribution pipes from refineries directly to the regional distribution centers. This needs long term planning.

## **Oil**

India had about 5.6 billion barrels (890,000,000 m<sup>3</sup>) of proven oil reserves as of January 2007, which is the second-largest amount in the Asia-Pacific region behind China. Most of India's crude oil reserves are located in the western coast (Mumbai High) and in the northeastern parts of the country, although considerable undeveloped reserves are also located in the offshore Bay of Bengal and in the state of Rajasthan.

The combination of rising oil consumption and fairly unwavering production levels leaves India highly dependent on imports to meet the consumption needs. In 2006, India produced an average of about 846,000 barrels per day (bbl/d) of total oil liquids, of which 77%, or 648,000 bbl/d (103,000 m<sup>3</sup>/d), was crude oil. During 2006, India consumed an estimated 2.63 Mbbbl/d (418,000 m<sup>3</sup>/d) of oil. The Energy Information Administration (EIA) estimates that India registered oil demand growth of 100,000 bbl/d (16,000 m<sup>3</sup>/d) during 2006. EIA forecasts suggest that country is likely to experience similar gains during 2007 and 2008.

## **Sector organisation**

India's oil sector is dominated by state-owned enterprises, although the government has taken steps in past recent years to deregulate the hydrocarbons industry and support greater foreign involvement. India's state-owned Oil and Natural Gas Corporation (**ONGC**) is the largest oil company, and also the country's largest company overall by market capitalization. ONGC is the leading player in India's upstream sector, accounting for roughly 75% of the country's oil output during 2006, as per Indian government estimates.

As a net importer of oil, the Government of India has introduced policies aimed at growing domestic oil production and oil exploration activities. As part of the effort, the Ministry of Petroleum and Natural Gas crafted the New Exploration License Policy (NELP) in 2000, which permits foreign companies to hold 100% equity possession in oil and natural gas projects. However, to date, only a handful of oil fields are controlled by foreign firms. India's downstream sector is also dominated by state-owned entities, though private companies have enlarged their market share in past recent years.

## **Natural gas**

As per the Oil and Gas Journal, India had 38 trillion cubic feet (Tcf) of confirmed natural gas reserves as of January 2007. A huge mass of India's natural gas production comes from the western offshore regions, particularly the Mumbai High complex. The onshore fields in Assam, Andhra Pradesh, and Gujarat states are also major producers of natural gas. As per EIA data, India produced 996 billion cubic feet (**Bcf**) of natural gas in 2004.

India imports small amounts of natural gas. In 2004, India consumed about  $1,089 \times 10^9$  cu ft ( $3.08 \times 10^{10}$  m<sup>3</sup>) of natural gas, the first year in which the country showed net natural gas imports. During 2004, India imported  $93 \times 10^9$  cu ft ( $2.6 \times 10^9$  m<sup>3</sup>) of liquefied natural gas (LNG) from Qatar.

## **Sector Organization**

As in the oil sector, India's state-owned companies account for the bulk of natural gas production. ONGC and Oil India Ltd. (OIL) are the leading

companies with respect to production volume, while some foreign companies take part in upstream developments in joint-ventures and production sharing contracts (**PSCs**). Reliance Industries, a privately-owned Indian company, will also have a bigger role in the natural gas sector as a result of a large natural gas find in 2002 in the Krishna Godavari basin.

The Gas Authority of India Ltd. (GAIL) holds an effective control on natural gas transmission and allocation activities. In December 2006, the Minister of Petroleum and Natural Gas issued a new policy that allows foreign investors, private domestic companies, and national oil companies to hold up to 100% equity stakes in pipeline projects. While GAIL's domination in natural gas transmission and allocation is not ensured by statute, it will continue to be the leading player in the sector because of its existing natural gas infrastructure.

### **Final thoughts**

I think our citizens (and even people from rest of the world) are misusing petroleum products and this kind of abuse needs to be first controlled via price hikes and then by introducing alternate energy options and technologies to optimize the usage. There is a lot of scope for India to take out those old, fuel inefficient vehicles from our roads. I think the taxation needs to be restructured so that people and families who own more than one vehicle should be taxed more. There can be several other long term steps to improve the overall situation but please remember that at the end of it the petrol will anyhow get exhausted.

And a request to our great politicians who always oppose what the government is trying to implement. If you are really with the people of India, please come up with real practical suggestions to improve the situation. It wouldn't be too long before you will be stone-pelt by the younger generation for preventing them an opportunity to live in a developed country by 2020.

And my questions to my friends (not the poor) who are earning in thousands and lakhs. How dare you crib about a three rupees rise in petrol

while you still prefer to drive to office alone in a 5, 10 or 15 lakh car?. More over I haven't seen you cribbing while spending 1000 rupees for a dinner or while buying a shirt worth 1500 rupees.

### **7.5.7 Aviation Industries in India.**



The history of civil aviation in India started with its first commercial flight on February 18, 1911. It was a journey from Allahabad to Naini made by a French pilot Monseigneur Piguet covering a distance of about 10 km. Since then efforts were on to improve the health of India's Civil Aviation Industry. The first domestic air route between Karachi and Delhi was opened in December 1912 by the Indian State Air Services in collaboration with the Imperial Airways, UK as an extension of London-Karachi flight of the Imperial Airways.

The aviation industry in India gathered momentum after three years with the opening of a regular airmail service between Karachi and Madras by the first Indian airline, Tata Sons Ltd. However this service failed to receive any backing from the Indian Government.

At the time of independence nine Air Transport Companies were operational in the Indian Territory. Later the number reduced to eight when the Orient Airways shifted its base to Pakistan. The then operational airlines were Tata Airlines, Indian National Airways, Air service of India, Deccan Airways, Ambica Airways, Bharat Airways and Mistry Airways.

With an attempt to farther strengthen the base of the aviation sector in India, the Government of India together with Air India (earlier Tata Airline) set

up a joint sector company, Air India International, in early 1948. With an initial investment of Rs. 2 crore and a fleet of three Lockheed constellation aircrafts, Air India started its journey in the Indian aviation sector on June 8, 1948 in Mumbai (Bombay)-London air route.

For many years since its inception the Indian Aviation Industry was plagued by inappropriate regulatory and operational procedures resulting in either excessive or no competition. Nationalization of Indian Airlines (IA) in 1953 brought the domestic civil aviation sector under the purview of Indian Government. Government's intervention in this sector was meant for removing the operational limitations arising out of excess competition.

Air transportation in India now comes under the direct control of the Department of Civil Aviation, a part of the Ministry of Civil Aviation and Tourism of Government of India.

Aviation by its very nature constitutes the elitist part of our country's infrastructure. This sector has substantial contribution towards the development of country's trade and tourism, providing easier access to the areas full of natural beauty. It therefore acts as a stimulus for country's growth and economic prosperity.

The 1978 Airline Deregulation Act partially shifted control over air travel from the political to the market sphere. The Civil Aeronautics Board (CAB), which had previously controlled entry, exit, and the pricing of airline services, as well as intercarrier agreements, mergers, and consumer issues, was phased out under the CAB Sunset Act and expired officially on December 31, 1984. The economic liberalization of air travel was part of a series of "deregulation" moves based on the growing realization that a politically controlled economy served no continuing public interest. U.S. deregulation has been part of a greater global airline liberalization trend, especially in Asia, Latin America, and the EUROPEAN UNION.

Network industries, which are critical to a modern economy, include air travel, railroads, electrical power, and TELECOMMUNICATIONS. The air travel sector is an example of a network industry involving both flows and a grid.

The flows are the mobile system elements: the airplanes, the trains, the power, the messages, and so on. The grid is the infrastructure over which these flows move: the airports and air traffic control system, the tracks and stations, the wires and cables, the electromagnetic spectrum, and so on. Network EFFICIENCY depends critically on the close coordination of grid and flow operating and INVESTMENT decisions.

Under CAB REGULATION, investment and operating decisions were highly constrained. CAB rules limiting routes and entry and controlling prices meant that airlines were limited to competing only on food, cabin crew quality, and frequency. As a result, both prices and frequency were high, and load factors—the percentage of the seats that were filled—were low. Indeed, in the early 1970s load factors were only about 50 percent. The air transport market today is remarkably different. Because airlines compete on price, fares are much lower. Many more people fly, allowing high frequency today also, but with much higher load factors—74 percent in 2003, for example.

Airline deregulation was a monumental event. Its effects are still being felt today, as low-cost carriers (LCCs) challenge the “legacy” airlines that were in existence before deregulation (American, United, Continental, Northwest, US Air, and Delta). Indeed, the airline industry is experiencing a paradigm shift that reflects the ongoing effects of deregulation. Although deregulation affected the flows of air travel, the infrastructure grid remains subject to government control and economic distortions. Thus, airlines were only partially deregulated.

### **Benefits of Partial Deregulation**

Even the partial freeing of the air travel sector has had overwhelmingly positive results. Air travel has dramatically increased and prices have fallen. After deregulation, airlines reconfigured their routes and equipment, making possible improvements in capacity utilization. These efficiency effects democratized air travel, making it more accessible to the general public.

Airfares, when adjusted for INFLATION, have fallen 25 percent since 1991, and, according to Clifford Winston and Steven Morrison of the Brookings Institution, are 22 percent lower than they would have been had regulation continued (Morrison and Winston 2000). Since passenger deregulation in 1978, airline prices have fallen 44.9 percent in real terms according to the Air Transport Association. Robert Crandall and Jerry Ellig (1997) estimated that when figures are adjusted for changes in quality and amenities, passengers save \$19.4 billion dollars per year from airline deregulation. These SAVINGS have been passed on to 80 percent of passengers accounting for 85 percent of passenger miles. The real benefits of airline deregulation are being felt today as never before, with LCCs increasingly gaining market share.

The dollar savings are a direct result of allowing airlines the freedom to innovate in routes and pricing. After deregulation, the airlines quickly moved to a hub-and-spoke system, whereby an airline selected some airport (the hub) as the destination point for flights from a number of origination cities (the spokes). Because the size of the planes used varied according to the travel on that spoke, and since hubs allowed passenger travel to be consolidated in “transfer stations,” capacity utilization (“load factors”) increased, allowing fare reduction. The hub-and-spoke model survives among the legacy carriers, but the LCCs—now 30 percent of the market—typically fly point to point. The network hubs model offers consumers more convenience for routes, but point-to-point routes have proven less costly for airlines to implement. Over time, the legacy carriers and the LCCs will likely use some combination of point-to-point and network hubs to capture both economies of scope and pricing advantages.

The rigid fares of the regulatory era have given way to today’s competitive price market. After deregulation, the airlines created highly complex pricing models that include the service quality/price sensitivity of various air travelers and offer differential fare/service quality packages designed for each. The new LCCs, however, have far simpler price structures—the product of consumers’ (especially business travelers’)

demand for low prices, increased price transparency from online Web sites, and decreased reliance on travel agencies.

As prices have decreased, air travel has exploded. The total number of passengers that fly annually has more than doubled since 1978. Travelers now have more convenient travel options with greater flight frequency and more nonstop flights. Fewer passengers must change airlines to make a connection, resulting in better travel coordination and higher customer satisfaction.

### **Industry Problems after Deregulation**

Although the gains of economic liberalization have been substantial, fundamental problems plague the industry. Some of these problems are transitional, the massive adjustments required by the end of a half century of strict regulation. The regulated airline monopolies received returns on capital that were supposed to be “reasonable” (comparable to what a company might expect to receive in a competitive market), but these returns factored in high costs that often would not exist in a competitive market. For example, the airlines’ unionized workforce, established and strengthened under regulation and held in place by the Railway Labor Act, gained generous salaries and inefficient work rules compared with what would be expected in a competitive market. Problems remain in today’s market, especially with the legacy airlines.

### **Health of the Industry**

The airlines have not found it easy to maintain profitability. The industry as a whole was profitable through most of the economic boom of the 1990s. As the national economy slowed in 2000, so did profitability for the legacy airlines. Consumers became more price-sensitive and gravitated toward the lower-cost carriers. High labor costs and the network hub business model hurt legacy airlines’ competitiveness. Hub-and-spoke systems decreased unit costs but created high fixed costs that required larger terminals, investments in INFORMATION technology systems, and intricate revenue management systems. The LCCs have thus far successfully competed on price due to



lower hourly employee wages, higher PRODUCTIVITY, and no pension deficits. It remains to be seen whether the LCC cost and labor structures will change over time.

The Air Transport Association reports that the U.S. airline industry experienced net losses of \$23.2 billion from 2001 through 2003, though the LCCs largely remained profitable. While the September 11, 2001, terrorist attack and its aftermath are a major factor in the industry's hardships, they only accelerated an already developing trend within the industry. The industry was experiencing net operating losses for many reasons, including the mild recession, severe acute respiratory syndrome (SARS), and the increase in LCC services and the decline in business fares relied on by legacy carriers. Higher fuel prices, residual labor union problems, fears of terrorism, and the intrusive measures that government now uses to clear travelers through security checkpoints are further drags on the industry.

### **Remaining Domestic Economic Controls**

As a form of regulation, ANTITRUST laws inhibit post-deregulation restructuring efforts, making it harder to bring salaries and work rules into line with the realities of a competitive marketplace. The antitrust regulatory laws inhibit the restructuring of CORPORATIONS and block needed consolidation; the antitrust authorities view with suspicion efforts to retain higher prices. Historically, the CAB had antitrust jurisdiction over airline mergers. When Congress disbanded the CAB in 1985, it temporarily transferred merger review authority to the Department of Transportation (DOT). In 1989, the Justice Department assumed merger review jurisdiction from the DOT that, when combined with its antitrust authority under the Sherman Act, makes it the primary antitrust regulator of the airline industry.

The Justice Department has contested past merger proposals, including Northwest's attempt to gain a controlling interest in Continental and the merger of United Airlines and US Airways. Antitrust law also applies to international alliances, arrangements that attempt to ameliorate restrictive foreign ownership and COMPETITION laws. While labor contracts, airport asset

management, and other business practices are themselves high barriers to restructuring, these difficulties are magnified by antitrust regulatory hurdles. Cabotage restrictions, discussed below, also limit competition.

### **Reservation Systems**

During the regulatory era, rates were determined politically and changed infrequently. The CAB had to approve every fare, limiting the airlines' ability to react to demand changes and to experiment with discount fares. After deregulation, airlines were free to set prices and to change them frequently. That was possible only because the airlines had earlier created computer reservation systems (CRSs) capable of keeping track of the massive inventory of seats on flights over a several-month period.

The early CRSs allowed the travel agent to designate an origin-destination pair and call up all available flights. The computer screen could show only a limited number of flights at one time, of course; thus, some rule was essential to rank-order the flights shown. CRSs were available only to travel agents and, beginning in 1984, were highly regulated to ensure open access to airlines that had not developed their own CRS system. The DOT regulations restricted private agreements for guaranteeing access. However, the growth of INTERNET travel sites and direct access to airline Web sites created new forms of competition to the airline reservation systems. Therefore, the DOT allowed the CRS regulations to expire in 2004.

### **Problems with Political Control of the Grid**

A network can be efficient only if the flows and the grid interact smoothly. The massive expansion of air travel should have resulted in comparable expansions—either in the physical infrastructure or in more sophisticated grid management. Government management of the air travel grid has resulted in political compromises that cause friction with the smooth flow across the grid. Flight delays are increasing due to a lack of aviation infrastructure and the failure to allocate air capacity efficiently. The Air Transport Association estimates that delays cost airlines and passengers

more than five billion dollars per year due to the increased costs for aircraft operation and ground personnel and loss of passengers' time. The FAA predicts that the number of passengers will increase by 60 percent and that cargo volume will double by 2010.

## **Airports**

Airport construction and expansion face almost insurmountable political and regulatory hurdles. The number of federal requirements associated with airport finances has grown considerably in recent years and is tied to the awarding of grants from the federal Airport Improvement Program (AIP). Since 1978, only one major airport has been constructed (in Denver), and only a few runways have been added at congested airports. Airport construction faces significant nonpolitical barriers, such as vocal "not in my back yard" (NIMBY) opposition and environmental noise and emissions considerations. Federal law restricts the fees airports charge air carriers to amounts that are "fair and reasonable." These fee restrictions, although promoted as a way to provide nondiscriminatory access to all aircraft, limit an airport's ability to recover costs for air carriers' use of airfield and terminal facilities. Allowing airports more flexibility to price takeoffs and landings based on SUPPLY and DEMAND would also help ease congestion at overburdened airports.

## **Air Traffic Control**

Air traffic control involves the allocation of capacity and has a complex history of government management. Unfortunately, the Federal Aviation Administration (FAA), which manages air traffic control, made bad upgrading decisions. The advanced system funded by the FAA was more than a decade late and never performed as hoped. The result was that the airline expansion was not met by an expanded grid, and congestion occurred.

Better technology for air traffic control will help efficient navigation and routings. Global Positioning System (GPS) navigation technology holds great promise for more precise flight paths, allowing for increased airplane traffic. Ultimately, however, a privately managed system that allows for better

coordination of airline investment and operation decisions will be necessary to ease congestion. Air traffic control operation is a business function distinct from the regulation of air traffic safety. Using pricing mechanisms to allocate the scarce resource of air traffic capacity would reduce congestion and more efficiently allocate resources.

Implementing cost-based structures by privatizing air traffic control is a controversial and politically daunting issue in the United States, but twenty-nine nations—including Canada—have already separated their traffic systems from their regulating agency. Air traffic control PRIVATIZATION will likely be driven by the decreasing ability of the Airport and Airways Trust Fund to deliver the necessary financial support.

Currently, the FAA rations flights by delay on a first-come, first-served basis—a system that creates overcrowding during peak hours. A system based on pricing at rates determined by voluntary contractual arrangements of market participants, not government regulators, would reduce this overcrowding. One of the results would be the use of “congestion pricing,” such as rush hour surcharges or early bird discounts.

### **Airport Access**

FAA rules that limit the number of hourly takeoffs and landings—called “slot” controls—were adopted in 1968 as a temporary measure to deal with congestion and delays at major airports. These artificial capacity limitations—known as the high density rule—still exist at JFK, LaGuardia, and Reagan National. However, limiting supply through governmental fiat is a crude form of demand management. Allowing increased capacity and congestion pricing, and allowing major airports to use their slots to favor larger aircraft, would lead to better results.

## **Remaining International and Economic Rules**

### **International Competition**

“Open Skies” agreements are bilateral agreements between the United States and other countries to open the aviation market to foreign access and remove barriers to competition. They give airlines the right to operate air services from any point in the United States to any point in the other country, as well as to and from third countries. The United States has Open Skies agreements with more than sixty countries, including fifteen of the twenty-five European Union nations. Open Skies agreements have been successful at removing many of the barriers to competition and allowing airlines to have foreign partners, access to international routes to and from their home countries, and freedom from many traditional forms of economic regulation. A global industry would work better with a globally minded set of rules that would allow airlines from one country (or investors of any sort) to establish airlines in another country (the right of establishment) and to operate domestic services in the territory of another country (cabotage). However, these agreements still fail to approximate the freedoms that most industries have when competing in other global markets.

### **National Ownership**

National ownership laws are an archaic barrier to a more competitive air travel sector. These rules seem to reflect a concern for national security, even though many industries as strategic as the airline industry do not have such restrictions.

Federal law restricts the percentage of foreign ownership in air transportation. Only U.S.-registered aircraft can transport passengers and freight domestically. Airline citizenship registration is limited to U.S. citizens or permanent residents, partnerships in which all partners are U.S. citizens, or corporations registered in the United States in which the chief executive officer and two-thirds of the directors are U.S. citizens and where U.S. citizens hold or control 75 percent of the capital stock. Only U.S. citizens are able to

obtain a certificate of public convenience and necessity, a prerequisite for operation as a domestic carrier.

### **Additional Problems Resulting from the 9/11 Response**

After 9/11, safety and security regulation responsibilities were given to the new Transportation Security Administration (TSA) within the Department of Homeland Security. Created just months after 9/11, the TSA is an outgrowth of the belief that only the government can be entrusted to perform certain duties, especially those related to security. No one has clearly established that a government whose employees are difficult to fire, even for incompetence, will do better than a private employer who can more easily fire incompetent workers.

In September 2001, Congress passed the Air Transportation Safety and System Stabilization Act, which authorized payments of up to five billion dollars in assistance to reimburse airlines for the post attack four-day shutdown of air traffic and attributable losses through the end of 2001. It also created and authorized the Air Transportation Stabilization Board (ATSB) to provide up to ten billion dollars in loan guarantees for airlines in need of emergency capital. While the ATSB risked the kind of mission creep that is inevitable in an industry subsidy program, the deadline for applications to the ATSB has passed. Of the ten billion dollars authorized by Congress for these loan guarantees, the board actually committed less than two billion.

The main thrust of the plan was on making civil aviation sector financially self sustaining. From this point of view, efforts to generate larger internal resources are being made. The civil aviation sector has recently been opened up to private sector and private airlines have captured substantial share of this traffic on trunk routes. Under the Ninth Plan, it was proposed to provide adequate capacity in air transport operations. The objective was also to ensure healthy competition between the private and the public sector.

During the Tenth Plan, an outlay of Rs.12,928 crore was provided to the Ministry of Civil Aviation out of which rs.7,792 crore was spent. There was

a massive expansion in air transport services during this Plan due to opening up of domestic skies to private carriers. Important developments in the airline and airport sector included : (1) modernization and restructuring of Delhi and Mumbai airports launched through joint venture companies; (2) development of Greenfield airports at Bangalore and Hyderabad on a Build-Own-Operate-Transfer basis with PPP (public-private partnership); (2) approval of modernization of 35 non-metro airports and 13 other airports to world-class standards in phases; (4) liberalization of FDI (foreign direct investment) limit upto 100 per cent through automatic route for setting up Greenfield airports; (5) acquisition of modern and technologically advanced aircraft for Air India Ltd., Air India Charters Ltd., and Indian Airlines Limited; (6) liberalization of bilateral air services agreement in line with the contemporary developments in international civil aviation sector; (7) adoption of a limited Open Sky Policy in international travel to meet the traffic demand during peak season; and (8) adoption of trade facilitation measures in custom procedures to facilitate speedy clearance of air cargo.

The Eleventh Plan has laid down the following objectives for the civil aviation sector: (i) providing world class infrastructure facilities; (ii) providing safe, reliable and affordable air services so as to encourage growth in passenger and cargo traffic; and (iii) providing air connectivity to remote and inaccessible areas with special reference to north-eastern part of the country. The total projected outlay for the Ministry of Civil Aviation in the Eleventh Plan has been kept at Rs.43,560 crore at 2006-07 prices.

Air India and Indian Airlines operating in the international sector and domestic sector respectively since 1953 are both in the public sector. They enjoyed monopoly status for a considerable period of time. However, in recent years, a larger number of private sector companies have entered the civil aviation sector as the government has ended the monopoly of Air India and Indian Airlines by repealing the Air Corporation Act, 1953. Air India and Indian Airlines were merged on August 27, 2007 to form National Aviation Company of India Ltd. (NACIL). Presently, there are three companies in the public sector – NACIL, Air India Charters Ltd., and Alliance Air. In addition,

there are seven private scheduled operators. A new category of scheduled airlines i.e., Scheduled Air Transport (Regional) services has been introduced to enhance connectivity to smaller cities and within a region. Two cargo airlines are also operating scheduled cargo services in the country.

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## **Conclusion**

Air travel is a network industry, but only its flow element— the airlines—is economically liberalized. The industry is still structurally adjusting to a more competitive situation and remains subject to a large number of regulations. The capital, work rules, and compensation practices of the airline industry still reflect almost fifty years of political protection and control.

We are finally seeing the kinds of internal restructuring among airlines that was expected from deregulation. Yet, government still has much to do to ensure that the airline market will thrive in the future. The FAA is a command-and-control government agency ill-suited to providing air traffic control services to a dynamic industry. Land slots and airport space should be allocated using market prices instead of through administrative fiat. International competition will increase, and rules regarding national ownership need to change accordingly.

If the government deregulates the grid and transitions toward a market solution, the benefits of flow deregulation will increase, and costs for air travelers will fall even more.

### **7.5.8 Telecommunications Reform and the Emerging ‘New-Economy’: The Case of India<sup>23</sup>**

Telecommunications reform in recent years in almost all developed and developing nations created an opportunity to attract foreign direct investment. The investments have been taking place mainly in the emerging ‘new’ economy sector. The main drivers of this sector are the information technology (knowledge-based) and the liberalisation and reform in telecommunications. Among the developing nations, the Indian economy fared better in attracting foreign direct investment in this sector due to the economic reform measures continued since 1991. The economic and the regulatory reforms brought into the telecommunications sector of India have been addressed. Second, the emergence of the ‘new-economy’ and its

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<sup>23</sup> [www.trai.gov.in/npt1999.htm](http://www.trai.gov.in/npt1999.htm).

contribution to growth has been investigated. Finally, the challenges for the Indian economy in managing the newly emerged economic opportunities have been discussed.

## **Introduction**

The dynamism of global telecommunications markets is widely attributed to rapid technological development and an increasingly liberal policy environment. Over the past decade, a large number of Asian economies, including India, have also embarked on reform paths, and witnessed significant expansion of their telecommunication networks and tremendous improvements in quality. Furthermore, it is not always apparent where the improved performance is because of specific policy choices rather than in spite of them, and where more could have been achieved had policy been different. Choices have to be made regarding the privatisation of state-owned telecommunications operators, the introduction of competition, the opening of markets to foreign investment and the establishment of pro-competitive regulations.

While there is growing consensus that each of these elements is desirable, there are few countries that have immediately gone all the way on all fronts.

The Indian authorities have realised that development of an effective and efficient telecommunications sector is a key to the growing international competitiveness of the country. The government launched several reform measures in telecommunications in the last decade. Since 1991, the telecommunications sector has expanded exponentially as a result of these measures. In 1972, the country had only a million telephone lines, by 1996 it had more than 14 million, by 2000 more than 25 million and by June 2002 more than 41 million (Nasscom, 2002; Kathuria, 2000; World Bank, 1995). To examine the tele-communications reforms in India since 1991 and to investigate the emergence of the 'new-economy' out of the expanded and modern telecommunications network over the last twelve years. Finally, the challenges ahead have been identified in order to remain competitive.

Section two presents a systematic analysis of the economic reform measures in telecommunications industry. Section three provides an account on the industry structure during the pre- and post-reform era, section four covers the regulatory reform introduced since 1991, section five addresses the emerging 'new economy' sector and its challenges. Finally, a conclusion has been drawn.

## **Economic Reform**

The economic reform agenda in telecommunications has been addressed in two policy documents produced in 1994 and 1999 popularly known as: National Telecom Policy 1994 (NTP, 1994) and New Telecom Policy 1999 (NTP, 1999). These policies are briefly presented below:

### **1. National Telecom Policy 1994**

A major programme has been undertaken to expand and upgrade India's telecom network since 1991. The programme includes: complete freedom of telecom equipment manufacturing, privatisation of services, liberal foreign investment and new regulation in technology imports. Simultaneously, the government-managed Department of Telecommunications (DoT) has been restructured to remove its monopoly status as the service provider. Most value-added services, including cellular phones and radio pagers, which were virtually non-existent in the pre-reform era, have grown at an unprecedented rate (Hossain, 1998). The government programme was formalised on a telecom policy statement called "National Telecom Policy 1994" on 12 May 1994 (full record of this policy can be found in [www.trai.gov.in/ntp1994.htm](http://www.trai.gov.in/ntp1994.htm)).

#### **The major provisions the NTP94 have incorporated are:**

- to allow new entrants to provide basic telephone services to supplement DoT's service;
- to maintain DoT's status as sole provider of long distance services and confirms that DoT will remain a government Department;

- to set targets for providing all villages with access to a telephone by the end of 1997;
- to endorse the existing policy whereby the private sector will be the main provider of value-added services;
- to encourage pilot projects which envisage inflow of new technology and management techniques generally involves foreign investment; and to indicate that the mechanism will be set up to protect consumer interests and ensure fair competition.

What was the outcome of NTP94? Compared to its commitments and provisions endorsed by 1994 statement, the outcome was less satisfactory. Only a handful of the targets set by this policy agenda was achieved. –

“For example, as against providing one Public Call Office (PCO) per 500 urban Indian population and the telephone coverage of 576,490 villages in India, the DoT has achieved an urban penetration of one PCO per 522 and has been able to provide telephone services to only 310,000 villages. However, the DoT also has provided 8.73 million telephone lines against the eight-five year plan target of 7.5 million telephone lines.”

Overall, the NTP94 was not sufficient to make the India’s telecommunications sector fully open and liberalised. The incumbent monopoly (DoT) was indifferent in implementing the national telecom policy effectively due to its lack of commitment and also due to the instability at the Centre (frequent changes of governments) over 1994 and 1998. This paved the way for designing a new policy framework for telecommunications which was called the New Telecom Policy 1999 (NTP99) and was delivered by the new government led by BJP coalitions.

## **2. The New Telecom Policy 1999**

The New Telecom Policy 1999 (NTP99) was developed at the backdrop of three major events witnessed by the Indian economy after the reform process began in 1991. First, although NTP94 was a right step to bring

reform in the telecommunications industry, it failed to achieve a desired goal until 1997.

“Overall, the NTP99 is a comprehensive and progressive telecom policy framework. It addresses the outstanding issues of telecommunications development and the challenges of modern telecommunications technology. NTP 99 recognises the crucial role of private sector investment in the development process of the sector and to bridge the much-needed financial resources gap.”

Among other things the NTP99 has endorsed policies under 5 policy frameworks:

- Framework for Services Deployment
- Framework for Licensing of Telecom Services
- Framework for Restructuring of Telecom Organisations
- Framework for Further Liberalisation of Services
- Framework for Regulation.

Each of these policy frameworks will be discussed further in the subsequent relevant sections of this paper.

### **3. Post-Reform Industry Structure**

Under the Indian constitution, only the central government can legislate on telecommunications. The central government has been the monopoly provider of telecommunications services through the Department of Telecommunications (DoT), which is under the jurisdiction of the central government's Ministry of Communications.

#### **3.1 Industry structure before reform**

Before 1989, a Telecom Board with a director-general at the helm steered the Board on behalf of the central government. The DoT corporatised two of its operational wings in 1986. These are called Videsh Sanchar Nigam

Limited (VSNL), responsible for international operations and Mahanagar Telephone Nigam Limited (MTNL), which has operational responsibility for providing telephone services in metropolitan Delhi and Mumbai, which comprise nearly a quarter of the total telecom network. The rest of the country remained under the jurisdiction of the DoT. In May 1989, the Telecom Board was replaced by a Telecommunications Commission with a much broader mandate than the board. Telecommunications operations were divided into five areas and headed by five full time members of the Commission. These areas are: telecom policy, regulation, technical research and development, design and manufacture of equipment, and provision of telecommunications services. The Secretary of the DoT holds the position of Commission Chairman.

Table 1 presents the industry structure before NTP94 was introduced. Although the Indian economy embraced economic reform agenda in 1991, the reform in telecommunications began with the design of the NTP94 statement. By the end of March 1995, the country had 9.38 million telephone lines with installed capacity of a further 10 million lines. The demand for telephone sources over the last ten years has grown by almost 12.2 per cent with actual growth in installation of 11.8 per cent. The total workforce in the industry stood at 470,000 persons.

### **3.2 Industry structure after reform**

Immediately after the announcement of NTP94, the telecommunications industry in India came to terms with the on-going reform process in the sector. All players in the sector, foreign and local private investors and subscribers anticipated a major shake up of the industry after this policy statement came into being. As shown in the previous section, NTP94 was a half-hearted step on the part of the central government to bring major reform in telecommunications in India. Eventually, the implementation of this policy was not able to make major breakthrough in the growth of the sector until the NTP99 came out and was regarded as a comprehensive programme of telecommunications policy reform in India. This section presents the industry structure and shape after the introduction of the NTP94.



Table 2 presents the performance for basic services since 1996. Fixed or basic services have been provided by two major public carriers after liberalisation in early 1990s. The DoT (now Bharat Shanchar Nigam Limited, BSNL) has been covering all of India except two metros: Delhi and Mumbai. BSNL's share has increased from 79 per cent to 86 per cent between Mar-97 and June-01 while the share for MTNL has dropped from 21 per cent to below 13 per cent of the total connections. This suggests that the basic services have expanded all over India except in Delhi and Mumbai.

In the early years after liberalization, India restricted the number of licenses awarded in basic services. The market was divided into separate circles and the policy admitted one private operator in each to compete with the incumbent BSNL. New entrants were allowed to offer intra-circle long distance services, but the BSNL maintained its monopoly on inter-circle long distance telephony. Recently, in the year 2001, the policy was changed to allow unlimited entry into each circle for basic services and subsequent to the bidding process 22 license agreements have been signed. As opposed to the fixed license fee regime based on which licenses were awarded earlier, fresh licenses have been issued on the basis of a one time entry fee and a percentage of revenue share that is linked to the area of operation<sup>1</sup>. Table 3 presents the details of the new licenses issued.

In total, before liberalisation India's basic service comprised only 9.5 million, it has increased by almost 4.5 times to 42 million in 2003. By all means, the growth of basic telecommunications services in India has been phenomenal over the last five years. The prospect in the future is brighter with the policies in place under NTP99.

This policy's framework for service deployment suggests the following initiatives:

1 License fees is fixed as 12, 10 and 8 per cent of gross revenues for Circles A, B and C respectively.

- Availability of basic telephone services on demand by year 2002
- Target of teledensity of 7 per cent by year 2005 and 15 per cent by year 2010
- Completion of full rural telephone coverage by year 2002
- Target of rural teledensity of 4 per cent by year 2010
- Provision of Internet access in all Indian districts by year 2000
- Encouragement of sharing infrastructure facilities by all service providers
- Expeditious clearances for right-of-way to all service providers
- Direct interconnectivity of telecom networks as far as possible
- Identification of some areas as special thrust areas for service deployment
- Permission to use Ku-band satellite communications for long distance data communications
- Acceptance of all recommendations of the national Informatics Task Force in relation to ISPs.

The other growth area of the Indian telecommunications industry is the cellular mobile market.

Table 4 presents a brief profile of this market. The number of cellular subscribers in the country exceeded 10 million at the end of 2002 compared to mere 0.2 million in 1996. In the year 2001, the compound annual growth rate of subscribers was in excess of 90 per cent. Private participation in the cellular market was introduced in 1994. Initially fourteen licences were awarded, two in each of the four metros: Delhi, Mumbai, Chennai and Kolkata. Non-metro areas (Circles A, B and C) are serviced by other private service providers.

Introduction of private service providers in the mobile market has revolutionised the industry over the last five years. The NTP-99 attempts to create an environment to expand the subscriber base further in coming years. It provides for public sector entities BSNL and MTNL to be the third operator in each service area, while recently bidding for the fourth license resulted in licenses being awarded to 17 more operators.

Table 5 provides details of the existing players circle wise. The overall growth of basic services and mobile phone services are presented in

Table 6. In Delhi and Mumbai the growth in fixed line services was 21 per cent during this period while in the case of mobile services in four metros the growth has been 71 per cent between 2000 and 2001. However, the all India figures have been staggering for both the markets. The fixed line service has been nearly doubled and the mobile services grew by almost 10 times. This suggests that the telecom industry in India has been responding very positively to the reform measures introduced in early 1990s and to the policies incorporated in NTP 94 and NTP 99.

#### **4. Regulatory Reform**

India's economic reform in telecommunications goes hand in hand with regulatory reform from the early 1990s. Telecommunications regulatory reform in India can be divided into two categories: reform introduced under the NTP94 and reform introduced under the NTP99. This section presents an illustration on reform measures taking these two documents into consideration.

##### **4.1 Regulatory reform under NTP94**

The regulatory reform began with introduction of an independent regulatory agency called the "Telecom Regulatory Authority of India (TRAI)" in March 1997. NTP-94 had a provision to introduce such an independent entity to regulate telecommunications in India. The need for such an authority was felt due to on-going liberalisation and economic reform introduced to the

industry following the government's publication of NTP94. Among other things, NTP94 has brought the following changes in the industry:

- New entry for basic telephone services will be permitted as duopolies (that is, DoT and one other operator) in the twenty one 'Circles' into which the country has been divided;
- DoT will retain the long distance monopoly for five years after which the decision would be reviewed; and
- Foreign ownership of telecom operators will be welcome up to 49 per cent of equity (from World Bank, 1995: 104-5).

With all these changes in place an independent regulator for the industry was overdue. The Telecom Regulatory Authority of India Act 1997 established the Telecom Regulatory Authority of India (TRAI) in January 1997, with a view to provide an effective regulatory framework and adequate safeguards to ensure fair competition and protection of consumer interests. To achieve the objectives of the TRAI Act, TRAI was given power to give directions to service providers, make regulations, notify tariffs by Order, and adjudicate disputes arising between government (in its role as service provider) and any other service provider. Among all the powers and duties, its authority and jurisdiction to settle disputes among the service providers has been important. However, there was a ruling by Delhi High Court against the TRAI about its power and jurisdiction in July 1998. The High Court ruled, "it was not mandatory for the Indian government to seek recommendations of the TRAI prior to issuing licences for telecommunications services in the country". The judgement affirmed the powers of the DoT, i.e. the government, to issue licenses without recommendations from TRAI. It also clarified that TRAI did not have the power to over-ride the license conditions. The High Court concluded that "the powers of the TRAI cannot be construed as a precondition precedent to the exercise of any other powers by the DoT on behalf of the government under the Indian Telegraph Act No.13 of 1885". With this ruling in place the new and the independent telecom regulator in India had a controversial and bumpy start. In addition, another High Court judgment

in January 2000 observed that the TRAI Act 1997 did not empower the regulator to fix interconnection terms and conditions between service providers and that TRAI had merely a policing function in this regard. This meant that the Calling Party Pays (CPP) regime for cellular mobile that TRAI sought to introduce in November 1999 that inter-alia specified explicit revenue shares for calls from Basic to the cellular network could not be implemented. Soon after this judgement the TRAI Act was amended and a new Act, the TRAI (Amendment) Act 2000 was introduced. These episodes of conflict between the incumbent and the regulator undermined the credibility of the regulator during the initial years of telecom liberalisation in India. Prior to this, DoT was responsible for the industry regulation as a part of government operation. According to Selvarajah, “overall, the TRAI has the powers and functions of a typical telecom regulator”. It appears that in practice the TRAI faced major hurdles to function appropriately in the initial period due to some High Court rulings sought by the DoT about the jurisdiction and obligations of the TRAI. This has made TRAI less effective and has forced a process of continuous transformation in the early years.

The next section provides a brief overview of the players in regulation as it stands in India at present.

#### **4.1.1 Players in Regulation**

India’s telecommunications sector is regulated by the Ministry of Communications through three government bodies — the Telecom Commission, the Department of Telecommunications, and the Telecom Regulatory Authority of India. The Telecom Commission performs the executive and policy-making function, the DoT is the policy-implementing body while the TRAI performs the function of an independent regulator.

##### **a) Department of Telecommunications, Ministry of Communications**

The Department of Telecommunications, Ministry of Communications, is the Authority in India that looks after the licensing and overall policy making in India. Until recently, DoT was also the main service provider. The service provider role has been separated from DoT, and is now functioning as a

corporate body, Bharat Sanchar Nigam Limited (BSNL). Two other government corporations are also important service providers. Mahanagar Telephone Nigam Limited (MTNL) operates in Mumbai and Delhi as a service provider with license for, inter alia, basic service, cellular mobile and Internet access. Videsh Sanchar Nigam Limited (VSNL) has a monopoly in the international call segment and has a license for providing some other services including the Internet. The government is a major shareholder in both MTNL and VSNL, and has substantive control over the decisions of these service providers. In fact, they may also end up competing with each other for the same market. This has already started happening in certain cases, for instance, with MTNL and VSNL for the Internet market. A competitive situation would require greater autonomy for MTNL and VSNL.

(b) Telecom Regulatory Authority of India

On 24 January 2000, an Ordinance amended the TRAI Act 1997 and altered a number of aspects. For example, the adjudicatory role of the TRAI has been separated and has been provided to a Telecom Dispute Settlement and Appellate Tribunal (TDSAT)

This Tribunal has been provided the powers to adjudicate any dispute

- (i) between a licensor and a licensee;
- (ii) between two or more service providers;
- (iii) between a service provider and a group of consumers.

TDSAT has been given additional powers those it inherited from TRAI; for example, it can settle disputes between licensor and licensee. Further, the decisions of the Tribunal may be challenged only in the Supreme Court. The remaining functions of TRAI have been better defined and increased; for instance, with respect to powers relating specifically to interconnection conditions. TRAI now has the power to 'fix the terms and conditions of inter-connectivity between the service providers' (TRAI (Amendment) Act 2000), instead of 'regulating arrangements between service providers of sharing

revenue from interconnection' (TRAI ACT 1997). The new legalisation signaled an attempt to re-establish a credible regulator. The government would be required to seek a recommendation from TRAI when issuing new licenses. The adjudication of licensor-licensee disputes would be undertaken by an independent tribunal specialised in telecom. In terms of interconnection arrangements, TRAI was given the powers to override the provisions of license agreements signed with DoT. However, while there has been an increase in the powers of the Authority (other than dispute settlement), the Ordinance has led to a weakening of the guarantee that was provided in the Act with respect to the five year working period for the TRAI Chairman and Members. This statutory guarantee was done away with by the Ordinance, which provides for less stringent conditions for removal of any Authority Member or Chairman. To that extent, the independence of the Authority has been whittled down. More on TRAI is provided in the next section.

In its present form, the CCI Bill also envisages the dispute settlement function to be performed by the Communications Dispute Settlement Appellate Tribunal (CAT)

#### **4.2. Regulatory reform under NTP 99**

Since the regulatory outcome of the NTP94 has been disappointing, the government proposed new regulatory policies in its NTP99 policy statement.

The regulatory reform introduced by the NTP99 can be summarised as follows:

- Reaffirm the commitment for strong and independent telecom regulator
- Arbitration powers to the regulator in settling disputes between the government and other service providers
- Jurisdiction of licensing and policy making will, however, continue to fall under the government
- Prohibition of the provision of voice services over the Internet Protocol

- Recognition of the need for changes in the existing telecom legislations.

The opening up of the Internet sector set the background to NTP-99, is a major attempt to plug the loopholes in the 1994 policy. Its enunciation of policy objectives is itself a marked improvement. Provision of 'universal service' (including unconnected rural areas, re-targeted for year 2002) is sought to be balanced by the provision of sophisticated telecom services capable of meeting needs of the country's economy. The latter objective is further amplified to include 'Internet' access to all district head quarters (DHQs) by 2000 and providing high speed data and multimedia capabilities to all towns with a population of 200,000 and above by 2002. Apart from a target average penetration of 7 per cent by year 2005 (and 15 per cent by 2010), targets for rural 'tele-density' have been set to increase from the current level of 0.4 per cent to 4 per cent during the same period.

To meet these teledensity targets, an estimated capital expenditure of Rs. 4,000 billion for installing about 130 million lines will be required. Recognizing the role of private investment, NTP-99 envisages multiple operators in the market for various services.

The most important change has been a shift from the existing license fee system to one based on a one-time entry fee combined with revenue share payments.

NTP-99 allows DoT/MTNL to enter as third cellular mobile operators in any service area if they wish to provide these services. To ensure a level playing field, DoT and MTNL will have to pay license fee, but DoT's license fee will be refunded because it has to meet the Universal Service Obligations. It is worth noting that to the extent that the fee will be specifically refunded to bear the cost of Universal Service Obligation (USO), this aspect should be accounted for when calculating the USO levy and apportioning the revenues from that levy.



## **5. The Challenges Ahead**

The emergence of 'new' economy as a separate identity in the Indian economy is no doubt a huge boost for generating additional export revenues to achieve a healthy current account balance. The sector, however, is not immune from facing challenges in the future. In the present globalisation era, there is always a threat of competition from other developing countries such as China and South East Asian nations. In this section, an investigation on the challenges has been attempted. Before identifying the challenges and the weaknesses of the Indian economy against its competitors, let us first summarise the strength gained by India so far.

- Telecommunications technology and expanding teledensity found to be the major driver of the emerging 'new' economy sector. Indian union and state capital cities where the IT and ITE services industry is based have teledensity of 14 per 100 against the all India density of only 3 per 100. The subscribers for fixed line network increased by 8 folds since 1991, while the cellular phones increased by 30 folds since 1997.

## **6. Conclusion**

Telecommunications service in India is an example of a paradox of the 1990s. Despite the telecom policy and telecom regulation being controversial, communication has been the fastest growing sector of the Indian economy. There is still an opportunity to reform and simplify the regulatory framework further and maintain the growth rates during the next decade as seen in the past. What are the lessons from the Indian experience? First, the analysis of the India telecom sector presents a picture of "managed competition". While the traditional public monopoly is coming to an end, effective competition has been hard to achieve for a number of reasons. The incumbent with an extensive network has retained market power. The number of networks that have come up or are about to come up are limited because of the costs of building the network. The availability of spectrum is a constraint in the market especially for cellular mobile services. Given these circumstances, however,

the expansion of telecommunications services has been phenomenal over the last decade.

Second, new market-based approaches to the supply of telecommunications services have been introduced in India and technological changes have led to cost reduction and expanded scope of product choice. The number of initiatives on the drawing board makes impressive reading and present immense opportunity for the sector and thus for the economy. TRAI has already issued consultation papers on Internet Telephony and Interconnection and opening of international long distance (ILD) services to private competition. These initiatives suggest a greater reliance on market forces than before. As market-based approach to the provision of telecom services has been adopted, the question to be addressed is whether there should be more or less regulatory intervention.

Third, following the widespread adoption of market-based approaches to the supply of telecommunications services, there is also a growing consensus that regulators should not be involved in detailed “management” of the sector. Instead, the regulators’ role is seen to involve maintenance of a regulatory environment conducive to the efficient supply of telecommunications services to the public. Also, while there is likely be an increase in regulatory activity around the time of introduction of competition, the level of regulatory intervention can be expected to reduce once competitive markets are established. Regulation where none is justified can distort or undermine competition.

Finally, under the given market-based approach and the current regulatory framework in place, the telecommunications industry has contributed to establish a ‘new’ sector in the economy driven by the IT/Software and IT enabled services. Within a short period of time, the ‘new’ economy sector has substantially contributed to reversing the age old current account problem and has created hundreds and thousands of jobs in newly established domestic companies and in India based major MNCs. These achievements, however, are not immune from any threat in the future. The major challenges can be identified in terms of India’s image problem to

outside world, gradual withdrawal of tax incentives in place, WTO intervention on behalf of the other member nations and direct competition faced from East and South East Asian nations.

Table 1: Basic telecom information for pre-reform period

Number of telephone lines as at 31 March 1995	9.38 million
Installed capacity of telephone lines	10.00 million
Demand for telephones (FY 1995)	12.50 million
Growth in telephone lines (FY 1985 to FY 1994)	11.8 per cent
Growth in telephone demand (FY 1985 to FY 1994)	12.2 per cent
Total workforce (telecom services)	470,000

Source: Hossain (1998) cited from Hossain and Chatterjee (1996)

**Table 2:**

**Phone connections and share of main operators between  
1996-97 & 1998-99 Operator Connections ('000) Share (%)**

	Mar-97	Jun-01	Mar-97	Jun-01
BSNL (all India)	11,530	28,484	79.29	86.01
MTNL (Mumbai, Delhi)	3,012	4,322	20.71	13.05
Bharti, (M.P.)	- 122	- 0.37		
Hughes, (Maharashtra).	- 84	- 0.25		
Tata, (A.P.)	- 69	- 0.21		
Reliance, (Gujarat)	- 0.14	- 0.00		
STL, (Rajasthan)	- 13	- 0.04		
HFCL (Punjab)	- 24	- 0.07		
All India	14,542	33,118	100.00	100.00

Source: Kathuria (2000) and Tele.net Volume 2 Issue No. 8 August 2001

**Table 3**

**List of new Basic service Licenses issued**

**Operator Service Area for which the license have been issued**

Reliance	A.P., Delhi, Karnataka, Maharashtra, Tamil Nadu, Haryana, Kerala, M.P., Punjab, Rajasthan, U.P.(West), U.P.(East), West Bengal, A&N, Bihar, H.P., Orissa
Tata	Delhi, Gujarat, Karnataka, Tamil Nadu
Bharti	Haryana

Source: Tele.net Volume 2 Issue No. 8 August 2001

Table 4  
Mobile market share (%)

Region	Mar-97	Mar-98	Mar-99	Mar-00	Mar-01	Aug-01
All Metros (Delhi, Mumbai, Chennai and Kolkata)	325,967 (69)	551,757 (-6)	519,543 (53)	795,931 (71)	1,362,592 (28)	1,750,789
Rest of India	13,064 (2430)	330,559 (104)	675,903 (61)	1,088,380 (103)	2,214,503 (39)	3,071,398
<b>All India</b>	<b>339,031</b> <b>(160)</b>	<b>882,316</b> <b>(35)</b>	<b>1,195,446</b> <b>(58)</b>	<b>1,884,311</b> <b>(90)</b>	<b>3,577,095</b> <b>(35)</b>	<b>4,822,187</b>

Note: Figures in parentheses show percentage of growth

Source: Kathuria (2000) and Tele.net Volume 3 Issue No. 1 January 2002

Table 5  
List of Cellular Service Providers and their Area of Operation

<b>Category</b>	<b>City/Circle</b>	<b>Operator1</b>	<b>Operator2</b>	<b>Operator3</b>	<b>Operator4</b>
<b>Metros</b>	Delhi	Bharti	Essar	MTNL	Batata
	Mumbai	BPL	MNTL	MTNL	Bharti
	Chennai	RPG	Skycell	-	HMTL
	Calcutta	Spice	UMTL	-	Reliance
	<b>A' Circle</b>				
	Maharashtra	BPL	Birla AT&T	-	Bharti
	Gujarat	Fascel	Birla AT&T	-	Bharti
	A.P.	Tata	Bharti	-	HMTL
	Karnatka	Bharti	Modicom	-	HMTL
	T.N.	BPL	Aircel	-	Bharti
	<b>B' Circle</b>				
	Kerala	Escotel	BPL	-	Bharti
	Punjab	Modicom	-	-	Escotel
	Haryana	Escotel	ADL	-	Bharti
	U.P.(W)	Escotel	-	-	Bharti
	U.P.(E)	ADL	Koshika	-	Escotel
	Rajasthan	ADL	Hexacom	-	Escotel
	M.P.	RPG	Reliance	-	Bharti
	W.B.	Reliance	-	-	-
	<b>C' Circle</b>				
	H.P.	Bharti	Reliance	-	Escotel
	Bihar	Reliance	-	BSNL	-
	Orissa	Reliance	-	-	-
	Assam	Reliance	-	-	-
	N.E.	Reliance	-	-	-

Source: Tele.net Volume 3 Issue No. 1 January 2002

**Table 6**  
**Growth in Telecom markets in India (1997-2001)**

<b>Region</b>	<b>1997</b>	<b>1998</b>	<b>1999</b>	<b>2000</b>	<b>2001</b>
<b>All Metros</b>					
Fixed Line		3,955,462	4,581,634	5,131,756	5,828,608
Growth Rate			16	12	14
Mobile	325,967	551,757	519,543	795,931	1,362,592
Growth Rate	69	-	6	53	71
<b>All India</b>					
Fixed Lines	14,542,651	17,801,696	21,601,489	26,652,135	32,702,229
Growth Rate		22	21	23	23
Mobile	339,031	882,316	1,195,446	1,884,311	3,577,095
Growth Rate		160	35	58	90

Source: Present study estimate.

**Table 7**  
**'New Economy': Export Opportunities (US\$ million)**

<b>Year</b>	<b>Software/IT Exports</b>	<b>Domestic Software Market</b>
1996-97	1,100	730
1998-99	2,600	1,560
2000-01	6,217	2,160
2002-03*	9,500	2,700

\* Projections

Source: Nasscom (2002)

**Table 8**  
**Software Exports to Total Exports (%)**

Items	2001	2002	2003*
Software Exports	13.80	16.50	18.60
Other Exports	86.20	83.50	81.40

\* Projections

Source: Nasscom (2002)

**Table 9**  
**ITES Exports to IT Exports (%)**

Year	ITE Services	IT Services
1999-00	14.0	86.0
2000-01	14.5	85.5
2001-02	19.0	81.0
2002-03*	24.0	76.0

\* Projected

Source: Nasscom (2002)



**Table 10**  
**Key Segments of Global ITES/BPO**

Item	Contact/ Back Office	Transcri- ption Content	Other	Call Centre Operations	Translation Develop- ment Services
	(1)	(2)	(3)	(4)	(5)
Global Market *Market Size (\$ million, 2002)	8,600	2,000	425	2,200	250
Indian Market Size (\$ml, 2002)	380 (4.5)	600 (30)	32 (7.5)	440 (20)	43 (17)
Minimum Invest.	\$3,000 to \$1-2.5ml	\$1-2.5ml	\$0.5ml	\$10ml	\$10-15ml

Source: Nasscom's Handbook (2002)

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## **Chapter – 8**

### **Conclusion & Suggestions**

#### **What Does Deregulation Mean ?**

The reduction or elimination of government power in a particular industry usually enacted to create more competition within the industry.

#### **Economic development in India**

The economic development in India followed a socialist-inspired policies for most of its independent history, including state-ownership of many sectors; extensive regulation and red tape known as "Licence Raj"; and isolation from the world economy. India's per capita income increased at only around 1% annualized rate in the three decades after Independence.<sup>[1]</sup> Since the mid-1980s, India has slowly opened up its markets through economic liberalization. After more fundamental reforms since 1991 and their renewal in the 2000s, India has progressed towards a free market economy.

In the late 2000s, India's growth has reached 7.5%, which will double the average income in a decade. Analysts say that if India pushed more fundamental market reforms, it could sustain the rate and even reach the government's 2011 target of 10%. States have large responsibilities over their economies. The annualized 1999-2008 growth rates for Gujarat (9.6%), Haryana (9.1%), or Delhi (8.9%) were significantly higher than for Bihar (5.1%), Uttar Pradesh (4.4%), or Madhya Pradesh (6.5%). India is the eleventh-largest economy in the world and the fourth largest by purchasing power parity adjusted exchange rates (PPP). On per capita basis, it ranks 128th in the world or 118th by PPP.

The economic growth has been driven by the expansion of services that have been growing consistently faster than other sectors. It is argued that the pattern of Indian development has been a specific one and that the

country may be able to skip the intermediate industrialization-led phase in the transformation of its economic structure. Serious concerns have been raised about the jobless nature of the economic growth.

Although living standards are rising fast, 75.6% of the population still lives on less than US\$2 a day (PPP, around US\$0.5 in nominal terms), compared to 73.0% in Sub-Saharan Africa. In terms of occupation, two-thirds of the Indian workforce earn their livelihood directly or indirectly through agriculture in rural villages. As a proportion of GDP, towns and cities make over two thirds of the Indian economy.

The progress of economic reforms in India is followed closely. The World Bank suggests that the most important priorities are public sector reform, infrastructure, agricultural and rural development, removal of labor regulations, reforms in lagging states, and HIV/AIDS. For 2010, India ranked 133<sup>rd</sup> in Ease of Doing Business Index, which is setback as compared with China 89<sup>th</sup> and Brazil 129<sup>th</sup>. According to Index of Economic Freedom World Ranking an annual survey on economic freedom of the nations, India ranks 124<sup>th</sup> as compared with China and Russia which ranks 140<sup>th</sup> and 143<sup>rd</sup> respectively in 2010.

### **Industrial output**



An industrial zone near Mumbai, India.

India is fourteenth in the world in factory output. Manufacturing sector in addition to mining, quarrying, electricity and gas together account for 27.6% of the GDP and employ 17% of the total workforce. Economic reforms introduced after 1991 brought foreign competition, led to privatisation of

certain public sector industries, opened up sectors hitherto reserved for the public sector and led to an expansion in the production of fast-moving consumer goods. In recent years, Indian cities have continued to liberalize, but excessive and burdensome business regulations remain a problem in some cities, like Kochi and Kolkata.

Post-liberalisation, the Indian private sector, which was usually run by oligopolies of old family firms and required political connections to prosper was faced with foreign competition, including the threat of cheaper Chinese imports. It has since handled the change by squeezing costs, revamping management, focusing on designing new products and relying on low labour costs and technology.

### **Services**

India is fifteenth in services output. Service industry employs 23% of the work force and is growing quickly, with a growth rate of 7.5% in 1991–2000, up from 4.5% in 1951–80. It has the largest share in the GDP, accounting for 57% in 2010 up from 20% in 1950. Business services (information technology, information technology enabled services, business process outsourcing) are among the fastest growing sectors contributing to one third of the total output of services in 2000. The growth in the IT sector is attributed to increased specialisation and availability of a large pool of low cost, highly skilled, educated and fluent English-speaking workers on the supply side and on the demand side, has increased demand from foreign consumers interested in India's service exports or those looking to outsource their operations. India's IT industry, despite contributing significantly to its balance of payments, accounts for only about 1% of the total GDP or 1/50th of the total services.

The ITES-BPO sector has become a big employment generator especially amongst young college graduates. The number of professionals employed by IT and ITES sectors is estimated at around 1.3 million as on March 2006. Also, Indian IT-ITES is estimated to have helped create an additional 3 million job opportunities through indirect and induced employment.

## **Liberalisation in India**

The Indian government headed by P.V. Narsimha Rao adopted the policy of economic liberalisation in 1991 with the aim of bringing prosperity to the country. Since then foreign investment worth billions of US\$ has been made in the country but all this has only resulted into more poverty. The rural poverty has increased from 32 percent to 40 percent, and in States like Bihar, Maharashtra, and Karnataka and UP, the poor have become poorer. The economic liberalisation policy has only helped gone down during all these years of liberalisation.

Thousands of industrial units are lying closed, rendering millions of workers jobless. The new ventures are all going for very high tech projects, having a high degree of automation requiring minimal labour requirement. Every entrepreneur wishes to work with least labour component. As a result of all this the overall employment scenario has become very grim.

No wonder, then, that the forces of nationalism in India are against those who favour liberalisation. India has an annual GDP of \$300 billion, vast natural resources, and as many highly educated, skilled middle class citizens as the total US population. For almost half a century, India's GDP grew by an average of less than 4 percent a year. Taiwan's GDP grew by an annual 8 percent during the same period, and South Korea's by 9 percent. Foreign direct investment in China, the world's largest Communist country, is now running at \$37 billion a year, in India the figure is \$2 billion. In India, the share of unemployed within the labour force is gradually on the rise, from 4.3 percent in 1991 to 5.5 percent in 1995. In the last two years, unemployment definitely must have gone up as the labour content of production has been declining. With employment opportunities stagnating and simultaneous growth in population, unemployment would naturally rise steadily. The Planning Commission of India has estimated that the labour force between the ages of 15 and 59 years would rise from 294.6 million in 1992 to 393.02 million in 2007. Creating jobs for them would really be a difficult task.

Even in China, where the process of liberalisation is said to be quite successful, the problem of joblessness has emerged as a big social problem,

inspite of the fact that around 70 million unemployed are covered by the "unemployment insurance". In China there are 150 to 160 million jobless people in the cities and villages. The high rate of unemployment is a direct consequence of the new path of economic liberalisation, or the so called, economic development. In the process of improving productivity, updating equipment and upgrading technology for modernisation, and of course for profit maximisation, they resort to laying off workforce making industrialisation or the modernisation a curse for these workers.

The process of the so called 'economic liberalisation' can never succeed in India if judicious use of resources, including the foreign investment, is not made and, if the labourforce is neglected the way it is presently being done.

### **India's Liberalisation and Its Impact on India's Economic Sense**

India's liberalisation, no doubt, has changed the economic landscape of Indian lives though to various degrees and levels. It overhauled India's economy; government policies on economy, business, education, investment, foreign collaboration and privatisation; created billionaires owning multinational companies and acquired a competitive economic growth rate that poises the nation to be a world economic leader in the coming decade next to china.

But what has it done to the ordinary people of India?

Ideally, it would have transformed them into entrepreneurs, being able to make informed choices in doing business and managing various aspects of their lives. To make choices, they should be thinking rationally and acting freely; be creative, imaginative, good leaders, managers and decision makers, good individuals, role models to family, good politicians and good citizens.

And how many Indians have become anything of that?

In 1991, when a bankrupt India was initiated into economic liberalisation, hardly few Indians knew what it entailed and from the government's side, it did very little to create any public awareness on the topic. So in all probabilities, the public was forced to take it as it came; as the opening up of the new consumer shops across the nation, availability of

foreign branded goods in the place of ugly, inefficient, non-consumer caring local products and the opening up of unprecedented job markets both locally and internationally.

It is in the Indian blood to be enthused by chances. This time the chance came in the highly advanced IT industries an industry key to the materialisation and advancement of the liberalisation and globalisation packages. Indians' intuitive intelligence and flair for numbers made their overwhelming entry into the industry. When job opportunities in the industries soared up locally and internationally, so did the Indians qualifying out of universities and colleges for them. The industry added another dogma to the Indian communities around which they created a new religion the digital religion.

The industry also made many millionaires out of Indians.

Even earlier to liberalisation, Indian professionals were in great demand in the foreign nations. With the advent of liberalisation and the nations across the world embarking on massive developmental and construction projects their demand multiplied. Not only professionals, its blue colour force also gained demand overseas, especially in the Gulf regions.

The new riches brought in new challenges to the Indian communities, but the Indians never bothered about them. I shall discuss a few of those challenges here and in my future posts.

### **1. Indians adopted a new spendthrift economy.**

Indians in all my presumption had traditionally maintained a spiritual relationship with money. I am no talking about India's fake spiritual leaders' canon that being rich is a spiritual outcome of their birth. Those who earned money through hard work, had realised that its transaction should be carried out in a religious manner. That is money is not simply material, rather a disciplined and moral approach should regulate its creation and consumption.

But for the contrivances of globalisation and market, money is purely material regulated by strange rules, morality not one among them. They tossed into Indian hands plenty money; foreign money, bribe money, charity



and aid money, black money, loan money and all with such ease that Indians dropped their traditional sense of economy to adopt a spendthrift one.

A major share of India's growth profile comes from the consumer spending of its newly moneyed class. It comes to them as an ego boosting gala. One is tempted to strike a comparison between this gala and the old extravagance by India's racist categories – the royals, the feudal chieftains, the princely classes and their satellites- through pillaging India's national wealth. How devastating its impact was on the common man's economy no words can explain. Yet to their peril India's common man and woman have a piquant taste to follow their racial categories in attitude and lifestyle.

However, the good thing is that to the economic hold up, India's fifty years of democracy, an extended version of its dynasty and colonial ruling had held its common man, globalisation has provided some answers. Without instilling any dent on India's old feudal capital ownership, it created a new economic classification-the lower, middle and the upper among Indians against its old racial avarna-savrna categorization.

That is a credit to liberalisation. Global openings and the subsequent call for human skills gave the socially backward a new impetus to sell their skills in the lucrative markets, locally and internationally for good economic returns.

The new Indian dream is to scale down each of that economic category to reach top by whatever means. India's civil servants' answer to their dream is bribe. They no longer play tactics to lure customers into paying it but threaten them with the no bribe no service slap. Before, a few rupees, now it bypasses a portion of the customer's wealth. In Kerala, the most literate state in India, almost hundred percent of its civil servants do not full fill their official duties for which they take a salary from the government, without receiving a bribe.

True, liberalisation unleashed Indian potential and created opportunities. It produced Indian millionaires and billionaires. It displaced the economic landscape of the country to the point of no return. However damaging their impacts are, they are going to stay on for a long period. It is

for the Indians to redefine their applications and use them on their own terms and need. And Indians are capable to do that.

### **Economic Reforms in India since 1991: Has Gradualism Worked?**

India was a latecomer to economic reforms, embarking on the process in earnest only in 1991, in the wake of an exceptionally severe balance of payments crisis. The need for a policy shift had become evident much earlier, as many countries in east Asia achieved high growth and poverty reduction through policies which emphasized greater export orientation and encouragement of the private sector. India took some steps in this direction in the 1980s, but it was not until 1991 that the government signaled a systemic shift to a more open economy with greater reliance upon market forces, a larger role for the private sector including foreign investment, and a restructuring of the role of government.

India's economic performance in the post-reforms period has many positive features. The average growth rate in the ten year period from 1992-93 to 2001-02 was around 6.0 percent, as shown in Table 1, which puts India among the fastest growing developing countries in the 1990s. This growth record is only slightly better than the annual average of 5.7 percent in the 1980s, but it can be argued that the 1980s growth was unsustainable, fuelled by a buildup of external debt which culminated in the crisis of 1991. In sharp contrast, growth in the 1990s was accompanied by remarkable external stability despite the east Asian crisis. Poverty also declined significantly in the post-reform period, and at a faster rate than in the 1980s according to some studies (as Ravalli on and Datt discuss in this issue).

However, the ten-year average growth performance hides the fact that while the economy grew at an impressive 6.7 percent in the first five years after the reforms, it slowed down to 5.4 percent in the next five years. India remained among the fastest growing developing countries in the second sub-period because other developing countries also slowed down after the east Asian crisis, but the annual growth of 5.4 percent was much below the target

of 7.5 percent which the government had set for the period. Inevitably, this has led to some questioning about the effectiveness of the reforms.

Opinions on the causes of the growth deceleration vary. World economic growth was slower in the second half of the 1990s and that would have had some dampening effect, but India's dependence on the world economy is not large enough for this to account for the slowdown. Critics of liberalization have blamed the slowdown on the effect of trade policy reforms on domestic industry (for example, Nambiar et al, 1999; Chaudhuri, 2002). However, the opposite view is that the slowdown is due not to the effects of reforms, but rather to the failure to implement the reforms effectively. This in turn is often attributed to India's gradualist approach to reform, which has meant a frustratingly slow pace of implementation. However, even a gradualist pace should be able to achieve significant policy changes over ten years. This paper examines India's experience with gradualist reforms from this perspective.

We review policy changes in five major areas covered by the reform program: fiscal deficit reduction, industrial and trade policy, agricultural policy, infrastructure development and social sector development. Based on this review, we consider the cumulative outcome of ten years of gradualism to assess whether the reforms have created an environment which can support 8 percent GDP growth, which is now the government target.

### **Savings, Investment and Fiscal Discipline**

Fiscal profligacy was seen to have caused the balance of payments crisis in 1991 and a reduction in the fiscal deficit was therefore an urgent priority at the start of the reforms. The combined fiscal deficit of the central and state governments was successfully reduced from 9.4 percent of GDP in 1990-91 to 7 percent in both 1991-92 and 1992-93 and the balance of payments crisis was over by 1993. However, the reforms also had a medium term fiscal objective of improving public savings so that essential public investment could be financed with a smaller fiscal deficit to avoid "crowding

out” private investment. This part of the reform strategy was unfortunately never implemented.

As shown in Table 2, public savings deteriorated steadily from +1.7 percent of GDP in 1996-97 to –1.7 percent in 2000-01. This was reflected in a comparable deterioration in the fiscal deficit taking it to 9.6 percent of GDP in 2000-01. Not only is this among the highest in the developing world, it is particularly worrisome because India’s public debt to GDP ratio is also very high at around 80%. Since the total financial savings of households amount to only 11 percent of GDP, the fiscal deficit effectively preempts about 90 percent of household financial savings for the government. What is worse, the rising fiscal deficit in the second half of the 1990s was not financing higher levels of public investment, which was more or less constant in this period.

These trends cast serious doubts on India’s ability to achieve higher rates of growth in future. The growth rate of 6 percent per year in the post-reforms period was achieved with an average investment rate of around 23 percent of GDP. Accelerating to 8 percent growth will require a commensurate increase in investment. Growth rates of this magnitude in East Asia were associated with investment rates ranging from 36-38 percent. While it can be argued that there was overinvestment in East Asia, especially in recent years, it is unlikely that India can accelerate to 8 percent growth unless it can raise the rate of investment to around 29-30 percent of GDP. Part of the increase can be financed by increasing foreign direct investment, but even if foreign direct investment increases from the present level of 0.5 percent of GDP to 2.0 percent -- an optimistic but not impossible target -- domestic savings would still have to increase by at least 5 percentage points of GDP.

Can domestic savings be increased by this amount? As shown in Table 2, private savings have been buoyant in the post-reform period, but public savings have declined steadily. This trend needs to be reversed. Both the central government and the state governments would have to take a number of hard decisions to bring about improvements in their respective spheres.

The central government’s effort must be directed primarily towards improving revenues, because performance in this area has deteriorated

significantly in the post reform period. Total tax revenues of the center were 9.7 percent of GDP in 1990-91. They declined to only 8.8 percent in 2000-01, whereas they should have increased by at least two percentage points. Tax reforms involving lowering of tax rates, broadening the tax base and reducing loopholes were expected to raise the tax ratio and they did succeed in the case of personal and corporate income taxation but indirect taxes have fallen as a percentage of GDP. This was expected in the case of customs duties, which were deliberately reduced as part of trade reforms, but this decline should have been offset by improving collections from domestic indirect taxes on goods and by extending indirect taxation to services. This part of the revenue strategy has not worked as expected. The Advisory Group on Tax Policy for the Tenth Plan recently made a number of proposals for modernizing tax administration, including especially computerization, reducing the degree of exemption for small scale units and integration of services taxation with taxation of goods (Planning Commission, 2001a). These recommendations need to be implemented urgently.

There is also room to reduce central government subsidies, which are known to be highly distortionary and poorly targeted (e.g. subsidies on food and fertilizers), and to introduce rational user charges for services such as passenger traffic on the railways, the postal system and university education. Overstaffing was recently estimated at 30 percent and downsizing would help reduce expenditure.

State governments also need to take corrective steps. Sales tax systems need to be modernized in most states. Agricultural income tax is constitutionally assigned to the states, but no state has attempted to tax agricultural income. Land revenue is a traditional tax based on landholding, but it has been generally neglected and abolished in many states. Urban property taxation could yield much larger resources for municipal governments if suitably modernized, but this tax base has also been generally neglected. State governments suffer from very large losses in state electricity boards (about 1 percent of GDP) and substantial losses in urban water supply, state road transport corporations and in managing irrigation systems. Overstaffing is greater in the states than in the center.

The fiscal failures of both the central and the state governments have squeezed the capacity of both the center and the states to undertake essential public investment. High levels of government borrowing have also crowded out private investment. Unless this problem is addressed, the potential benefits from reforms in other areas will be eroded and it may be difficult even to maintain the average growth rate of 6 percent experienced in the first ten years after the reforms, let alone accelerate to 8 percent.

### **Reforms in Industrial and Trade Policy**

Reforms in industrial and trade policy were a central focus of much of India's reform effort in the early stages. Industrial policy prior to the reforms was characterized by multiple controls over private investment which limited the areas in which private investors were allowed to operate, and often also determined the scale of operations, the location of new investment, and even the technology to be used. The industrial structure that evolved under this regime was highly inefficient and needed to be supported by a highly protective trade policy, often providing tailor-made protection to each sector of industry. The costs imposed by these policies had been extensively studied (for example, Bhagwati and Desai, 1965; Bhagwati and Srinivasan, 1971; Ahluwalia, 1985) and by 1991 a broad consensus had emerged on the need for greater liberalization and openness. A great deal has been achieved at the end of ten years of gradualist reforms.

### **Industrial Policy**

Industrial policy has seen the greatest change, with most central government industrial controls being dismantled. The list of industries reserved solely for the public sector -- which used to cover 18 industries, including iron and steel, heavy plant and machinery, telecommunications and telecom equipment, minerals, oil, mining, air transport services and electricity generation and distribution -- has been drastically reduced to three: defense aircrafts and warships, atomic energy generation, and railway transport. Industrial licensing by the central government has been almost abolished except for a few hazardous and environmentally sensitive industries. The

requirement that investments by large industrial houses needed a separate clearance under the Monopolies and Restrictive Trade Practices Act to discourage the concentration of economic power was abolished and the act itself is to be replaced by a new competition law which will attempt to regulate anticompetitive behavior in other ways.

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

Industrial liberalization by the central government needs to be accompanied by supporting action by state governments. Private investors require much permission from state governments to start operations, like connections to electricity and water supply and environmental clearances. They must also interact with the state bureaucracy in the course of day-to-day operations because of laws governing pollution, sanitation, workers' welfare and safety, and such. Complaints of delays, corruption and harassment

arising from these interactions are common. Some states have taken initiatives to ease these interactions, but much more needs to be done.

A recently completed joint study by the World Bank and the Confederation of Indian Industry (Stern, 2001) found that the investment climate varies widely across states and these differences are reflected in a disproportional share of investment, especially foreign investment, being concentrated in what are seen as the more investor-friendly states (Maharashtra, Gujarat, Karnataka, Andhra Pradesh and Tamil Nadu) to the disadvantage of other states (like Uttar Pradesh, Bihar and West Bengal). Investors perceived a 30 percent cost advantage in some states over others, on account of the availability of infrastructure and the quality of governance. These differences across states have led to an increase in the variation in state growth rates, with some of the less favored states actually decelerating compared to the 1980s (Ahuwalia, 2002). Because liberalization has created a more competitive environment, the pay off from pursuing good policies has increased, thereby increasing the importance of state level action. Infrastructure deficiencies will take time and resources to remove but deficiencies in governance could be handled more quickly with sufficient political will.

### **Trade Policy**

Trade policy reform has also made progress, though the pace has been slower than in industrial liberalization. Before the reforms, trade policy was characterized by high tariffs and pervasive import restrictions. Imports of manufactured consumer goods were completely banned. For capital goods, raw materials and intermediates, certain lists of goods were freely importable, but for most items where domestic substitutes were being produced, imports were only possible with import licenses. The criteria for issue of licenses were nontransparent; delays were endemic and corruption unavoidable. The economic reforms sought to phase out import licensing and also to reduce import duties.

Import licensing was abolished relatively early for capital goods and intermediates which became freely importable in 1993, simultaneously with



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

Progress in reducing tariff protection, the second element in the trade strategy, has been even slower and not always steady. As shown in Table 3, the weighted average import duty rate declined from the very high level of 72.5 percent in 1991-92 to 24.6 percent in 1996-97. However, the average tariff rate then increased by more than 10 percentage points in the next four years. In February 2002, the government signaled a return to reducing tariff protection. The peak duty rate was reduced to 30 percent, a number of duty rates at the higher end of the existing structure were lowered, while many low end duties were raised to 5 percent. The net result is that the weighted average duty rate is 29 percent in 2002-03.

Although India's tariff levels are significantly lower than in 1991, they remain among the highest in the developing world because most other developing countries have also reduced tariffs in this period. The weighted average import duty in China and Southeast Asia is currently about half the Indian level. The government has announced that average tariffs will be reduced to around 15 percent by 2004, but even if this is implemented, tariffs in India will be much higher than in China which has committed to reduce

weighted average duties to about 9 percent by 2005 as a condition for admission to the World Trade Organization.

## **Infrastructure Development**

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

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

reached financial closure and some of those which were implemented ran into trouble subsequently.

Because of these difficulties, the expansion of generation capacity by the utilities in the 1990s has been only about half of what was targeted and the quality of power remained poor with large voltage fluctuations and frequent interruptions.

The flaws in the policy have now been recognized and a more comprehensive reform is being attempted by several state governments. Independent statutory regulators have been established to set tariffs in a manner that would be perceived to be fair to both consumers and producers. Several states are trying to privatize distribution in the hope that this will overcome the corruption which leads to the enormous distribution losses. However, these reforms are not easy to implement. Rationalization of power tariffs is likely to be resisted by consumers long used to subsidized power, even though the quality of the power provided in the pre-reform situation was very poor. The establishment of regulatory authorities that are competent and credible takes time. Private investors may not be able to enforce collection of amounts due or to disconnect supply for non-payment without adequate backing by the police. For all these reasons, private investors perceive high risks in the early stages and therefore demand terms that imply very high rates of return. Finally, labor unions are opposed to privatization of distribution.

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

The results in telecommunications have been much better and this is an important factor underlying India's success in information technology. There was a false start initially because private investors offered excessively high license fees in bidding for licenses which they could not sustain, which led to a protracted and controversial renegotiation of terms. Since then, the policy appears to be working satisfactorily. Several private sector service providers of both fixed line and cellular services, many in partnership with foreign investors, are now operating and competing with the pre-existing public sector supplier. Teledensity, which had doubled from 0.3 lines per 100 population in 1981 to 0.6 in 1991, increased sevenfold in the next ten years to reach 4.4 in 2002. Waiting periods for telephone connections have shrunk dramatically. Telephone rates were heavily distorted earlier with very high long distance charges cross-subsidizing local calls and covering inefficiencies in operation. They have now been rebalanced by the regulatory authority, leading to a reduction of 30 percent in long distance charges. Interestingly, the erstwhile public sector monopoly supplier has aggressively reduced prices in a bid to retain market share.

Civil aviation and ports are two other areas where reforms appear to be succeeding, though much remains to be done. Two private sector domestic airlines, which began operations after the reforms, now have more than half the market for domestic air travel. However, proposals to attract private investment to upgrade the major airports at Mumbai and Delhi have yet to make visible progress. In the case of ports, 17 private sector projects involving port handling capacity of 60 million tons, about 20 percent of the total capacity at present, are being implemented. Some of the new private sector port facilities have set high standards of productivity.

India's road network is extensive, but most of it is low quality and this is a major constraint for interior locations. The major arterial routes have low capacity (commonly just two lanes in most stretches) and also suffer from poor maintenance. However, some promising initiatives have been taken recently. In 1998, a tax was imposed on gasoline (later extended to diesel), the proceeds of which are earmarked for the development of the national highways, state roads and rural roads. This will help finance a major program

of upgrading the national highways connecting Delhi, Mumbai, Chennai and Calcutta to four lanes or more, to be completed by the end of 2003. It is also planned to levy modest tolls on these highways to ensure a stream of revenue which could be used for maintenance. A few toll roads and bridges in areas of high traffic density have been awarded to the private sector for development.

The railways are a potentially important means of freight transportation but this area is untouched by reforms as yet. The sector suffers from severe financial constraints, partly due to a politically determined fare structure in which freight rates have been set excessively high to subsidize passenger fares, and partly because government ownership has led to wasteful operating practices. Excess staff is currently estimated at around 25 percent. Resources are typically spread thinly to respond to political demands for new passenger trains at the cost of investments that would strengthen the capacity of the railways as a freight carrier. The Expert Group on Indian Railways (2002) recently submitted a comprehensive program of reform converting the railways from a departmentally run government enterprise to a corporation, with a regulatory authority fixing the fares in a rational manner. No decisions have been announced as yet on these recommendations.

### **Financial Sector Reform**

India's reform program included wide-ranging reforms in the banking system and the capital markets relatively early in the process with reforms in insurance introduced at a later stage.

Banking sector reforms included: (a) measures for liberalization, like dismantling the complex system of interest rate controls, eliminating prior approval of the Reserve Bank of India for large loans, and reducing the statutory requirements to invest in government securities; (b) measures designed to increase financial soundness, like introducing capital adequacy requirements and other prudential norms for banks and strengthening banking supervision; (c) measures for increasing competition like more liberal licensing of private banks and freer expansion by foreign banks. These steps have produced some positive outcomes. There has been a sharp reduction in the share of non-performing assets in the portfolio and more than 90 percent of

the banks now meet the new capital adequacy standards. However, these figures may overstate the improvement because domestic standards for classifying assets as non-performing are less stringent than international standards.

India's banking reforms differ from those in other developing countries in one important respect and that is the policy towards public sector banks which dominate the banking system. The government has announced its intention to reduce its equity share to 33-1/3 percent, but this is to be done while retaining government control. Improvements in the efficiency of the banking system will therefore depend on the ability to increase the efficiency of public sector banks.

Skeptics doubt whether government control can be made consistent with efficient commercial banking because bank managers are bound to respond to political directions if their career advancement depends upon the government. Even if the government does not interfere directly in credit decisions, government ownership means managers of public sector banks are held to standards of accountability akin to civil servants, which tend to emphasize compliance with rules and procedures and therefore discourage innovative decision making. Regulatory control is also difficult to exercise. The unstated presumption that public sector banks cannot be shut down means that public sector banks that perform poorly are regularly recapitalized rather than weeded out. This obviously weakens market discipline, since more efficient banks are not able to expand market share.

If privatization is not politically feasible, it is at least necessary to consider intermediate steps which could increase efficiency within a public sector framework (see for example Ahluwalia 2002). These include shifting effective control from the government to the boards of the banks including especially the power to appoint the Chairman and Executive Directors which is at present with the government; removing civil servants and representatives of the Reserve Bank of India from these board; implementing a prompt corrective action framework which would automatically trigger regulatory action limiting a bank's expansion capability if certain trigger points of financial

soundness are breached; and finally acceptance of closure of insolvent public sector banks (with appropriate protection for small depositors). Unless some initiatives along these lines are taken, it is highly unlikely that public sector banks can rise to the levels of efficiency needed to support rapid growth.

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

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

An important recent reform is the withdrawal of the special privileges enjoyed by the Unit Trust of India, a public sector mutual fund which was the dominant mutual fund investment vehicle when the reforms began. Although the Unit Trust did not enjoy a government guarantee, it was widely perceived as having one because its top management was appointed by the government. The Trust had to be bailed out once in 1998, when its net asset value fell below the declared redemption price of the units, and again in 2001

when the problem recurred. It has now been decided that in future investors in the Unit Trust of India will bear the full risk of any loss in capital value. This removes a major distortion in the capital market, in which one of the investment schemes was seen as having a preferred position.

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

### **Privatization**

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



study (see Davis et.al. 2000). There was clearly limited appetite for purchasing shares in public sector companies in which government remained in control of management.

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

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

An important recent innovation, which may increase public acceptance of privatization, is the decision to earmark the proceeds of privatization to finance additional expenditure on social sector development and for retirement of public debt. Privatization is clearly not a permanent source of revenue, but it can help fill critical gaps in the next five to ten years while longer term solutions to the fiscal problem are attempted. Many states have also started privatizing state level public sector enterprises. These are mostly loss making enterprises and are unlikely to yield significant receipts but privatization will eliminate the recurring burden of financing losses.

### **Social Sector Development in Health and Education**

India's social indicators at the start of the reforms in 1991 lagged behind the levels achieved in southeast Asia 20 years earlier, when those countries started to grow rapidly (Dreze and Sen, 1995). For example, India's adult literacy rate in 1991 was 52 percent, compared with 57 percent in Indonesia and 79 percent in Thailand in 1971. The gap in social development needed to be closed, not only to improve the welfare of the poor and increase their income earning capacity, but also to create the preconditions for rapid economic growth. While the logic of economic reforms required a withdrawal of the state from areas in which the private sector could do the job just as well, if not better, it also required an expansion of public sector support for social sector development.

Much of the debate in this area has focused on what has happened to expenditure on social sector development in the post-reform period. Dev and Moolji (2002) find that central government expenditure on towards social services and rural development increased from 7.6 percent of total expenditure in 1990-91 to 10.2 percent in 2000-01, as shown in Table 4. As a percentage of GDP, these expenditures show a dip in the first two years of the reforms, when fiscal stabilization compulsions were dominant, but there is a modest increase thereafter. However, expenditure trends in the states, which account for 80 percent of total expenditures in this area, show a definite decline as a percentage of GDP in the post-reforms period. Taking central

and state expenditures together, social sector expenditure has remained more or less constant as a percentage of GDP.

Closing the social sector gaps between India and other countries in southeast Asia will require additional expenditure, which in turn depends upon improvements in the fiscal position of both the central and state governments. However, it is also important to improve the efficiency of resource use in this area. Saxena (2001) has documented the many problems with existing delivery systems of most social sector services, especially in rural areas. Some of these problems are directly caused by lack of resources, as when the bulk of the budget is absorbed in paying salaries, leaving little available for medicines in clinics or essential teaching aids in schools. There are also governance problems such as nonattendance by teachers in rural schools and poor quality of teaching.

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

While the challenges in this area are enormous, it is worth noting that social sector indicators have continued to improve during the reforms. The literacy rate increased from 52 percent in 1991 to 65 percent in 2001, a faster increase in the 1990s than in the previous decade, and the increase has been particularly high in some of the low literacy states such as Bihar, Madhya Pradesh, Uttar Pradesh and Rajasthan.

The impact of ten years of gradualist economic reforms in India on the policy environment presents a mixed picture. The industrial and trade policy reforms have gone far, though they need to be supplemented by labor market reforms which are a critical missing link. The logic of liberalization also needs to be extended to agriculture, where numerous restrictions remain in place. Reforms aimed at encouraging private investment in infrastructure have worked in some areas but not in others. The complexity of the problems in this

area was underestimated, especially in the power sector. This has now been recognized and policies are being reshaped accordingly. Progress has been made in several areas of financial sector reforms, though some of the critical issues relating to government ownership of the banks remain to be addressed. However, the outcome in the fiscal area shows a worse situation at the end of ten years than at the start.

Critics often blame the delays in implementation and failure to act in certain areas to the choice of gradualism as a strategy. However, gradualism implies a clear definition of the goal and a deliberate choice of extending the time taken to reach it, in order to ease the pain of transition. This is not what happened in all areas. The goals were often indicated only as a broad direction, with the precise end point and the pace of transition left unstated to minimize opposition—and possibly also to allow room to retreat if necessary. This reduced politically divisive controversy, and enabled a consensus of sorts to evolve, but it also meant that the consensus at each point represented a compromise, with many interested groups joining only because they believed that reforms would not go “too far”. The result was a process of change that was not so much gradualist as fitful and opportunistic. Progress was made as and when politically feasible, but since the end point was not always clearly indicated, many participants were unclear about how much change would have to be accepted, and this may have led to less adjustment than was otherwise feasible.

The alternative would have been to have a more thorough debate with the objective of bringing about a clearer realization on the part of all concerned of the full extent of change needed, thereby permitting more purposeful implementation. However, it is difficult to say whether this approach would indeed have yielded better results, or whether it would have created gridlock in India’s highly pluralist democracy. Instead, India witnessed a halting process of change in which political parties which opposed particular reforms when in opposition actually pushed them forward when in office. The process can be aptly described as creating a strong consensus for weak reforms!

Have the reforms laid the basis for India to grow at 8 percent per year? The main reason for being optimistic is that the cumulative change brought about is substantial. The slow pace of implementation has meant that many of the reform initiatives have been put in place recently and their beneficial effects are yet to be felt. The policy environment today is therefore potentially much more supportive, especially if the critical missing links are put in place. However, the failure on the fiscal front could undo much of what has been achieved. Both the central and state governments are under severe fiscal stress which seriously undermines their capacity to invest in certain types of infrastructure and in social development where the public sector is the only credible source of investment. If these trends are not reversed, it may be difficult even to maintain 6 percent annual growth in the future, let alone accelerate to 8 percent. However, if credible corrective steps are taken on the fiscal front, then the cumulative policy changes that have already taken place in many areas, combined with continued progress on the unfinished agenda, should make it possible for India to accelerate to well beyond 6 percent growth over the next few years.

### **GDP growth rate**

Since the economic liberalisation of 1991, India's GDP has been growing at a higher rate.

<b>Year</b>	<b>Growth (real) (%)</b>
2000	5.5
2001	6.0
2002	4.3
2003	4.3
2004	8.3
2005	6.2
2006	8.4
2007	9.2
2008	9.0
2009	7.4

[Prime Minister's Economic Advisory Council](#) has projected the Indian economy to grow at 8.6% in 2010-11 and 9% in 2011-12 as of February 2011.

## Companies<sup>24</sup>

47 Indian companies were listed in the [Forbes Global 2000](#) ranking for 2009. The 10 leading companies were:

World Rank	Company	Logo	Industry	Revenue (billion \$)	Profits (billion \$)	Assets (billion \$)	Market Value (billion \$)
121	<a href="#">Reliance Industries</a>		Oil & Gas Operations	34.03	4.87	43.61	35.95
150	<a href="#">State Bank of India</a>		Banking	22.63	2.23	255.86	12.75
152	<a href="#">Oil and Natural Gas Corporation</a>		Oil & Gas Operations	24.04	4.95	35.35	28.91
207	<a href="#">Indian Oil Corporation</a>		Oil & Gas Operations	51.66	1.97	33.64	10.20
317	<a href="#">NTPC</a>		Utilities	9.63	1.86	24.58	29.70
329	<a href="#">ICICI Bank</a>		Banking	15.06	0.85	120.61	7.14
463	<a href="#">Tata Steel</a>		Materials	32.77	3.08	31.16	2.46
508	<a href="#">Bharti Airtel</a>		Telecommunications Services	6.73	1.59	12.28	23.63
582	<a href="#">Steel Authority of India Limited</a>		Materials	9.82	1.89	10.54	6.14
689	<a href="#">Reliance Communications</a>		Telecommunications Services	4.26	1.35	19.31	6.27

<sup>24</sup> Economic survey of India 2007 : Policy Brief.

## **What Are The Advantages And Disadvantages Of Privatisation In Indian Economy?**

The major advantages of privatization are as follows

- 1) It frees the resources for a more productive utilization.
- 2) Private concerns tend to be profit oriented and transparent in their functioning as private owners are always oriented towards making profits and get rid of sacred cows and hitches in conventional bureaucratic management.
- 3) Since the system becomes more transparent, all underlying corruptions are minimized and owners have a free reign and incentive for profit maximization so they tend to get rid of all free loaders and vices that are inherent in government functions.
- 4) It is less burdensome for the government.
- 5) Effectively minimizes corruption and optimizes output and functions.
- 6) Gets rid of employment inconsistencies like free loaders, or over employed departments reducing the strain on resources.

The major disadvantage of privatization is that private firms are less tolerant towards capitulations and appendages in government departments and hence tend to right size the human resource potential befitting the organization's needs and may cause resistance and disgruntled employees who are accustomed to the benefits as government functionaries.

Per capital income in 1991 were 3.7 which were 7.3 in 2000 and almost ten times increase by 17.3 % in 2010.

Employment generation is also possible due to privatisation and government also introduce 100 days employment programme. The standard of living of people also growing as compare to past years.

Automobile industry car productions in 1991 were 533,149 which is increase to 2,814,584 which is 29.39 % increase in the year of 2010. Total

vehicle production in the year 1991 were 81893 which is in the year 2011 3,536,783 i.e. 33.89% increase in comparison.

Slum clearance programmes, starvation fund to collector are also part of development in standard of living of the poor people as a part liberalisation.



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