Chapter 6

LIBERALIZATION AND STRUCTURAL ADJUSTMENT : THE INDIAN EXPERIENCE

The economic strategies adopted by the Government of India have been subjected to the rigorous empirical test of practical policy-making and implementation, and they have been largely successful.

6.1 Economic Reforms and Liberalization

The important planks of the strategy, inter alia, were: transition from a command economy to a 'market-friendly economy'; reduction in the role of public sector and investment therein, selective state intervention, and resolution of the problem of inter-sectoral mismatch between private savings and public demand for investment and consumption; dismantling the network of all-pervasive controls; stimulating growth through drastic reduction in taxes to remove constraints and release the forces of growth, consequent upon which revenues would rise rather than fall; reduction in interest rates to reduce costs and increase competitive capacity of domestic industry.

The Indian economy in mid-1991, when the new Government assumed office, was passing through a crisis of unprecedented magnitude. The macro-economic imbalances were multi-dimensional: despite a good monsoon in 1990 and recession in oil prices after the Middle East crisis, the inflationary spiral had gathered momentum and on point to point basis, the rate of inflation touched a peak of about 17 per cent in June 1991. The foreign exchange crisis had assumed serious proportions, with the reserves declining to about $ 1.12 billion, which barely covered two weeks of imports. The deficit on current account (B O P) was sizeable at $ 7.7 billion in fiscal 1990-91 (3.3 per cent of G D P). The fiscal deficit

for 1990-91 was 8.3 per cent of G D P and there was a sizeable deficit on revenue account. International confidence had virtually collapsed and channels of commercial lending had dried up. Remittances through legitimate channels were declining, while there was a reverse flow of non-resident Indian deposits, leading to further drain on foreign exchange. The sustainability of current account (B O P) had become doubtful owing to decline in reserves, stagnancy in exports and escalating debt burden. The decline in imports consequent upon the foreign exchange crisis was adversely affecting industrial growth, which had turned negative. The economy was on the brink of a precipice and the growth process was grinding to a halt.

The Government had achieved spectacular success in regard to the ongoing structural reform of the economy initiated in mid-1991. The economy had been placed on a higher growth trajectory and the fundamentals had recorded considerable improvement. The external sector, including exports and stability in the international value of the rupee – which at one time appeared to be the Achille's heel of the economy – had recorded excellent improvement. Confidence of international investing community had been restored and there was a marked improvement in the inflow of both direct foreign investment and portfolio investment. An overview of the progress made during the last three years presented a luminous picture.

Gross domestic product (G D P) increased during the last three years from 1.1 per cent in 1991-92 to around 4.3 per cent in 1992-93 and 1993-94; it was estimated to increase by 6.2 per cent in 1994-95 – higher than the growth rate achieved during the decade of the eighties. According to global experience, erosion in growth rate during the first two to three years of the structural reform process had almost come to be regarded as a normal feature of a difficult adjustment process; in this context, the progress registered by the Indian economy had been remarkable and won plaudits from the World Bank and other international bodies.

Industrial production had declined to about one - half per cent in 1991-92 as compared to between 7.5 and 9 per cent between 1985-86 and 1989-90. It improved to 5.6 per cent in 1993-94 and 8.4 per cent in 1994-95. The Finance Minister stated that the projects cleared in the private sector should result in the creation of additional 6 million jobs in 1993-94 in the country as against 3 million in 1991-92. Agricultural production had maintained a steady trend, and foodgrains production was estimated at 185 million tonnes in 1994-95 as compared to 182 million tonnes in the previous year. Procurement had been satisfactory and the stock of foodgrains stood at about 30 million tonnes – much higher than the minimum buffer stock norm of 22.3 million tonnes.

6.2 Outward Oriented Policy Adopted by Government of India

The balance of payments had recorded great improvement and exports which had declined by 1.5 per cent in 1991-92 increased by about 20 per cent in dollar terms in 1993-94 over the previous year. The current account (B O P) showed a small deficit of 0.1 per cent of G D P in 1993-94 as compared to a large deficit of 3.3 per cent of G D P in 1990-91. Imports increased by 6.1 per cent in dollar terms in 1993-94 and 21.8 per cent during 1994-95 reflecting revival of industrial production, which should expand the export production base. The brightest feature of the economic scenario in fiscal 1994-95 was in respect of foreign currency reserves (excluding gold and S D R holdings), which increased from $ 1.1 billion in June 1991 – a critical level for the economy – to $ 15 billion at end of 1993-94 and $ 20 billion at end of 1994-95.

The external debt amounted to Rs.1,27,798 crores at end of March 1994; this constituted 16.3 per cent of G D P as compared to 10 per cent in 1980-81. The debt-service ratio declined from 32.3 per cent in 1990-91 to 24.8 per cent in 1993-94. The economy had successfully emerged from the 'debt-trap' syndrome; and with rising foreign exchange reserves, the debt - G D P and debt service ratios

should continue to decline. Internal debt and interest burden however continued to escalate (vide Sec. 5.6).

The restoration of confidence of global investors in the Indian economy was reflected duriing 1993 - 94 in a surge in inflow of foreign investment at $ 4.1 billion $ 620 million of direct investment, $ 1.5 billion of global depository receipts (G D Rs), $ 1.7 billion of portfolio investment by F I I s and $ 350 million by offshore funds. The trend of rising foreign investment was being maintained during the subsequent fiscal year; and this was one of the direct manifestations of the success of economic reforms.

The Government in July 1991 devalued the rupee by 18 to 19 per cent to achieve macroeconomic stabilization and structural adjustment in the context of the post Gulf-war crisis. The objective as stated by the Reserve Bank was to enhance competitiveness of exports, reduce inessential imports, stabilize the capital account and stem flight of capital and restore viability of country's balance of payments position. Some of India's competitors had sizeably devalued their currencies during the eighties – China by 68 per cent and Indonesia by 65 per cent, while India had reduced the value of the rupee by only 53 per cent, even though inflation in China and Indonesia were lower than in India.

The mistake was not in adopting the import substitution policy in the 1950s but in not abandoning it in response to changing circumstances. The policy framework should have been changed to outward orientation when it became evident in the 1960s that export pessimism was not justified in view of rapid growth of world trade and the fact of South-East Asian economies having taken advantage of the great export opportunities arising from such expansion. Besides, the composition of developing countries' exports changed and manufactured goods constituted almost as large a portion of exports as agricultural products, minerals and foodstuffs.

The benefits of an outward oriented policy were considerable: it increased allocative efficiency; scale of production increased with corresponding benefits in the form of economies and externalities. With the adoption of innovative techniques and improved technology, there was an upsurge in efficiency and total factor productivity. Besides, with the stimulated inflow of foreign earnings, the foreign exchange constraint on growth was overcome, and the momentum of growth accelerated. As demand increased, the quantum of investment rose and there was fuller deployment of resources. Above all, it helped in restoring external sector viability and building up foreign exchange reserves.

Through stages, the Government rendered the rupee fully convertible on trade account. Import controls through licensing had mostly been abolished (except for some consumer goods), and raw materials, intermediates and capital goods *et al* could be freely imported on payment of customs duties, which had been brought down to a maximum of 50 per cent in March 1995. Basic customs duties on project imports and general capital goods had largely been reduced from 35 per cent to 25 per cent. The new system provided inbuilt incentives for exports, remittances and services exports. Export subsidies had been abolished; and restrictions on agricultural commodity exports largely removed.

The Government was likely to embark upon the process of making rupee fully convertible on capital account only after it secured an effective and adequate control on the macro-economic situation, including budgetary deficit. As far as non-residents were concerned, full capital account convertibility existed; controls were in force only for residents. The Government proposed to phase out most of the remaining licensing restrictions on imports and to provide exporters with easy access to imported raw materials and intermediates.The Government also proposed to reduce rates of duty and quantitative restrictions on consumer goods imports. Actually in the 1994-95 Budget, the Government had liberalized import of television and certain white goods. One of the considerations, inter alia, was

to augment revenue, besides increasing the efficiency and competitiveness of indigenous industry. Liberalization of trade, to the extent consistent with national interest, was an essential element in the process of globalization. As the World Bank[1] stated 'Global integration in trade, investment, factor flows, technology, and communication have been tying economies together'. It had facilitated transfer of technologies, which immensely contributed towards stimulation of productivity and more fructuous utilization of resources.

A successful transition to an outward oriented economy would enable India to take advantage of international trade and investment possibilities. Increasing absorption of the country's exports in world markets postulated that the country not only joins GATT but strengthens it, for as Bhagwati and Srinivasan[2] stated, a strengthened GATT means 'greater worldwide, multi-lateral discipline that could contain the outbreak of unilateralism by the stronger trading nations. Multilateralism is the best defence of the weak'. India had joined the GATT. Besides, it was imperative that India endeavored to join one of the major trade blocs that were emerging or would be constituted in the future: N A F T A, E C, Asean bloc with Japan as the centrepiece, and the rest comprising 'marginalised non-member nations'. Membership of one of these powerful blocs would also help in attracting direct foreign investment which gravitated to countries with trading markets.

The Government had achieved spectacular success during the last three years, and with the first phase of macro – economic stabilization programme – which was essentially an exercise in crisis management – being successfuly executed, the Government had undertaken the wide-ranging programme of macro - economic and structural reforms so as to set the economy on a sustainable path of 6 to 7 per cent growth.

India was passing through a second Industrial Revolution and the principal challenge was to close the gap between its economic dimensions today and its

great potential for tomorrow.

Having opted for the middle way in the broad spectrum of economic choices and policies, the role of the state would have to be limited and defined; and while ideological predilections would no longer determine the predominance of the public sector occupying commanding heights in the economy, it was also not intended to move to the other extreme of a completely non-interventionist state corresponding to Milton Friedman's liberalization utopia. It would be a market-friendly stance, intervention being limited to areas where it was necessary or where the private sector was unable or unwilling to operate. East Asian economies refute the case for thorough-going dirigisme as convincingly as they refute the case for laissez - faire. This could be as good an interpretation of the 'middle way' for India – enunciated by the then Prime Minister at the historic Davos conference – as any other delineation.

Emphasis was being placed upon a shift to a high technology economy. Growing productivity is the engine of development and productivity is stimulated by technological progress , which in turn is influenced by history, culture, education, institutions, and policies for openness in developing and developed countries. 'Technology is diffused through investment in physical and human capital and through trade'.[3]

The Government's Discussion Paper on Economic Reforms[4] (Ministry of Finance, June 1993) stated that two years was certainly enough to manage a crisis but it was not enough to complete the kind of structural reforms needed to put the economy on a sustainable path of 6 to 7 per cent growth, which was essential to break the shackles of poverty and stagnation.

While industrial licensing and controls on industrial growth had been greatly reduced at the Centre, the States by and large had not emulated the Central Government in this regard, consequent upon which new industries experienced difficulties in obtaining requisite sanctions from the State Governments who

were the implementing authority in regard to new projects.

The Plan expenditure on Rural Development, Education, Health, Employment and Anti - Poverty Programmes, suffered a setback in real terms during the years 1991-92 and 1992-93, the period during which emphasis in policies had to be laid on stabilization and fiscal consolidation. Allocation to social sectors was substantially stepped up in the Budgets for 1993-94, 1994-95 and 1995-96 reflecting the improvement in the fiscal situation.

The allocation for Rural Development and Poverty Alleviation Programmes was more than doubled from Rs.3100 crores in 1992-93 (B E) to over Rs. 7000 crores in 1994-95 (B E). Over the same period, the allocation for Education was increased by about 80 per cent and Health by 91 per cent.

The Government needed to increase revenues in order to contain the fiscal deficit, as also to improve the ratio of taxes to G D P. In this context, it was imperative to (1) widen the tax base by bringing within the tax net persons who did not pay taxes through extending further the presumptive scheme of taxation introduced in the 1992-93 Budget and increasing the quantum of levy; (2) bring agricultural incomes within the scope of taxation through direct and indirect taxes and making land revenue progressive; (3) increase user charges, particularly on power and other agricultural inputs, as recommended by the World Bank; and (4) increase the elasticity of revenues so that they increase more than in proportion to growth of national income; and further improve the administration of taxes to reduce evasion and avoidance. Deductions and allowances should be rationalized, while the basic tax rates were reduced, so as to give a fillip to work, savings and investment which promoted growth and incomes and eventually increased revenues. This was borne by experience.

6.3 Union Budgets: 1990-91 to 1995-96

The Union Budgets 1990-91 to 1995-96 have to be considered in the context of the serious multi-dimensional economic crisis in June, 1991 and the policy

initiatives amounting to a dual strategy of reform taken in July 1991. Fiscal adjustment was primarily directed at effectuating macro - economic stabilization, while measures were initiated to bring about structural reform of the framework of industrial, trade and other economic policies. The interventionist policies of the past were modified, and emphasis was laid, inter alia, upon (1)greater scope for the private sector for industrial development through dismantling the vast network of controls; (2) outward orientation of trade policies and moving towards greater globalization of the economy; (3) improving the quality of fiscal adjustment, reducing fiscal deficit and controlling inflation; (4) achieving transition towards a market economy; and (5) providing a fillip to exports in order to reduce current account (B O P) imbalances.

The following table gives an overview in figures of the grave multi-dimensional economic crisis facing the country in June 1991, when the new government took over. The 1991-92 Budget was presented on 24 July 1991.

Foreign Debt (end 1990)	$ 712 billion	24.1 per cent of G D P
Foreign Exchange Reserves (June 1991)	$ 1.12 billion	Equivalent to 15 days' import
Exports & Imports (1991-92)		
Exports	- 1.5	Percentage change over
Imports	- 19.4	previous year.
Deficit on Current Account	Over 3 per cent of G D P	
Fiscal Deficit (1990-91)	Rs. 44632 crores	8.3 per cent of G D P
Inflation (June 1991)	17 per cent	Change over previous year.

Source : Economic Survey 1994-95. Ministry of Finance G O I. Various Pages.
R B I Annual Report 1993-94. Various Pages. Tables 6.1.

(i) ***Union Budget 1990-91***

Since the Budgetary figures are given in Tables 7.4 to 7.7, details of Revenue and Disbursements are not indicated here. Analytical study of the Budgets and their implications are discussed.

The Union Budget 1990-91 was formulated in the context of rapid escalation of the Central Government's fiscal imbalances during the 1980s and the increasing indebtedness, particularly rise in domestic liabilities. Gross fiscal deficit which connotes the total resources gap in terms of the excess of aggregate disbursements over revenue receipts including grants, increased from Rs. 8887 crores in 1980-81 to Rs. 44632 crores in 1990-91. As percentage of GDP it rose from 6.5 per cent to 8.3 per cent in the respective years. Total liabilities of the Government rose from Rs. 61930 crores or 45.5 per cent of GDP in 1980-81 to Rs. 349347 crores or 65.2 per cent of GDP in 1990-91. These figures reflect the increasing share of non-developmental or consumption expenditure in total expenditure, and excessive dependence upon borrowed funds instead of resource mobilization and larger returns from public enterprises.

The Union Budget 1990-91 emphasized upon limiting the overall deficit to targeted levels, observance of fiscal discipline, better mobilization of taxes and revenues, constraints on increase in expenditure and curbs on proliferation of black money. The Budget also announced the abolition of the Gold Control Act and promised the enunciation of a long-term fiscal policy.

The Revenue Deficit in the 1990-91 Budget amounted to Rs. 18562 crores, and Budgetary Deficit Rs. 11347 crores. A substantial portion of revenue deficit was financed by surplus on capital account. The Gross Fiscal Deficit Rs. 44632 crores was financed by External Finance Rs.3181 crores, Market Borrowings Rs. 8001 crores, Other Liabilities Rs. 22103 crores and conventional Deficit Rs. 11347 crores (deficit financing).

The following figures show:

Budgetary Support for Central Plan Outlay.

	Budgetary Financing.	Public Sector Enterprises Financing.
1989-90	Rs. 18234 crores	Rs. 17479 crores
	51.1 per cent.	48.9 per cent.
1990-91	Rs. 17344 crores	Rs. 21985 crores
	44.1 per cent.	55.9 per cent.

Source : Budget Papers 1990-91 and 1991-92, GOI.

The Budget for 1990-91 abolished Investment Allowance and Investment Deposit Account and as a trade-off reduced the effective tax rate above Rs. 75000 income for widely held public companies from 54 per cent to 46 per cent (including surcharge). The minimum tax on profits (section 115 J) was withdrawn. Although the Government's perception was that these changes would stimulate new investment, the private sector strongly felt that abolition of investment allowance was a retrograde step, as it was a powerful tool for industrial growth. The only principal allowances that remained were in respect of setting up new industries (increase from 25 per cent to 30 per cent) and those relating to foreign exchange earnings.

As regards personal taxes, minor changes were effected, the exemption limit being raised from Rs. 18000 to Rs. 22000 and the lowest rate of tax of 20 per cent made applicable from the level of income of Rs. 30000 instead of Rs. 25000.

The objective of changes in indirect taxes was to raise revenues and check consumption of the elite classes, as also curb evasion. Changes in duties were made to develop quality - consciousness among exporters and stimulate growth and exports. In order to rationalize import duty and reduce multiplicity of rates,

the aggregate of basic and auxiliary duties was limited in most cases to 125 per cent.

(ii) ***Union Budget 1991-92***

The entire gamut of trade reforms, industrial policy changes, and fiscal measures pronounced by the Finance Minister in July 1991 constituted an economic revolution of sorts that could lead to transition from a command economy to a market economy, and change the tone and tenor of industrial and economic development in the country. The package of economic reforms was necessitated by the imperatives of the crisis arising out of the Gulf-War, a serious foreign exchange crunch, and compulsions of macroeconomic adjustments considered appropriate to defuse the crisis and facilitate IMF loans, short-term and long-term. But in actuality, enhanced liberalization of the framework of economic policies, entry of the private sector in state reserved sectors and reduction in the state's interventionist role and functions, and the need to create an environment largely in consonance with a global economic climate that would stimulate the exchange of goods, technology, and capital had become absolutely necessary.

The Finance Minister initiated bold and historic steps to dismantle at one stroke a vast complex network of controls, including part of MRTP legislation, institute a framework of policies designed to encourage the inflow of foreign investment capital with sophisticated technology, and adopt market-oriented strategies for fostering free markets and stimulating foreign trade.

The Reserve Bank, in order to achieve macroeconomic stabilization and structural adjustment, in the context of the post Gulf-War crisis, sharply devalued the rupee in two instalments in July 1991 by 18 to 19 per cent against major currencies. Devaluation had become necessary because exports and invisible earnings had slowed down and the foreign exchange reserves had declined to a low level of $ 1.2 billion in July 1991.

Monetary policy was tightened. Structural reforms in India's trade policy were initiated in order to liberate the system from controls and licences, to stimulate exports and increase enterprise and competitiveness. Imports were linked with exports. Decanalisation of 20 import and 16 export items was effected. Exporters were also allowed to open foreign currency accounts.

India's foreign indebtedness exceeded $ 90 billion in 1993-94. The various measures taken and I M F assistance increased the country's credit rating and also improved the scope for short-term commercial borrowings. The Government also initiated drastic changes in its industrial licensing and foreign investment policies as a part of a wider programme of macro-economic adjustment and fiscal reforms, so that the 'key sectors of our economy are enabled to attain an adequate technological and competitive edge in a fast changing global economy'. (New Industrial Policy 1991.

Union Budget 1991-92 provided for reducing the high fiscal deficit of 8.3 per cent of GDP during 1990-91 to 5.9 per cent in 1991-92. The Fiscal Deficit of Rs. 44632 crores and Revenue Deficit of Rs. 18562 crores were targeted to be reduced to Rs. 36323 crores and Rs. 16261 crores respectively. Similarly Budgetary Deficit was reduced from Rs. 11347 crores to Rs. 6855 crores in the respective years.

The effect of high fiscal deficits spilled over to the external sector and resulted in large current account deficits in the balance of payments and increased external indebtedness. Large fiscal deficits also preempted private savings and crowded out private investment. Interest rates were also pushed up, which contributed to discouraging new investment and reducing internal competitive ability of industry. Hence, the Government adopted measures for reducing expenditure, cutting subsidies and rationalizing defence expenditure in order to curb fiscal deficit.

Reduction in P S B R (Public Sector Borrowing Requirement) was a necessary concomitant of any exercise to cut fiscal deficit and this postulated rationalization of expenditure and plan outlays, and efficient implementation, return flow of funds to the budget from public enterprises through generation of surpluses, and efforts by all echelons of government to achieve economy and efficiency in expenditure.

The Budget for 1991-92 increased corporate tax rate by 5 per cent and reduced allowance for depreciation from 33 per cent to 25 per cent. This had been adopted on top of abolition of investment allowance in the 1990-91 Budget. Actually the effective tax rate for public companies, reduced from 54 per cent to 46 per cent as a trade-off with the withdrawal of Investment Allowance in 1990-91, was increased to 51.75 per cent in 1991-92 Budget. Higher duties on luxury goods were imposed, although the maximum import duty was reduced to 150 per cent.

Working capital costs had been sizeably enhanced by an almost unbridled increase in interest rates by banks. The costs of establishing new industrial projects and initiating programmes of modernization and upgradation of technology had considerably escalated as a result of the higher cost of imported machinery after devaluation; high interest rates ranging between 18 to 20 per cent charged by financial institutions on term-loans; 25 to 40 per cent premium on REP licenses; steep rise in prices of petroleum and oil products, and the consequential effect upon prices of industrial raw materials and intermediate goods; and the cost-push effect of increase in administered prices of coal, power, and steel, and higher price of cement. The expectation was that as a countervailing measure to devaluation, import duty on capital goods would be sizeably reduced, but the cut was only marginal from 85 to 80 per cent.

The liberalization and dismantling of controls, abolition of industrial licensing and foreign investment policy, have stimulated inflow of foreign investment capital

and sophisticated technology which should boost overall industrial growth. N R Is were permitted to establish ventures in infrastructure, housing, and real estate on a non-repatriable basis; and they were to be afforded facilities to establish new industries, although destabilization of the management structure of existing industries will not be allowed.

Concluding it may be stated that the Union Budget 1991-92 set in motion policy initiatives continued in subsequent budgets on structural adjustment 'designed to improve the efficiency, productivity and international competitiveness of Indian industry... and to strengthen the growth capability of the economy in the medium term and transform India into an internationally competitive economy open to trade and foreign investment'. (Isher Judge Ahluwalia)[5]. The private sector would have greater scope and an enlarged role, while the state would devote its energies to infrastructure, poverty alleviation and human resource development.

(iii) ***Union Budget 1992-93***

The macro-economic stabilization measures initiated in1991-92 incorporated positive steps to bring about fiscal adjustment by rationalizing tax and expenditure and reducing gross fiscal deficit. The measures met with success and the deficit was reduced from 8.4 per cent of G D P in 1990-91 to 6 per cent thereof in 1991-92. The Union Budget 1992-93 sought to effectuate fiscal consolidation and further reduce the gross fiscal deficit to 5 per cent of G D P (actuals 5.7 per cent). The reduction in gross fiscal deficit implied that there would be a diminution in capital expenditure as also a reduction in funds available to public enterprises to meet their financial requirements and in certain cases their losses. But it also implies provision of greater scope to private enterprise and foreign companies to establish and expand industries in the country.

The Budget also liberalized the trade regime, made the rupee partly convertible, abolished most non-tariff restrictions on imports, permitted investment

of foreign capital in power, oil, gas and telecommunications and legalized gold imports. Together with rationalization and reduction of customs duties, this signified basically the acceptance of an outward-oriented trade policy, which had become long overdue.

The economic situation however continued to be grim. Industrial production declined by 0.6 per cent and G D P by 1.1 per cent in 1991-92. Inflation was still about 13.6 per cent in March 1992, and the economy was faced with stagflation. Exports had declined by 1.5 per cent due to collapse of the Soviet Union and imports by 19.4 per cent. Industry was facing acute scarcity of raw materials and intermediates, with consequent effect upon production. The silver lining was that foreign exchange reserves had improved to $ 5.6 billion. *The Economist,* London stated that the 'pace of reforms has been breath–taking. The Rao Government has slashed red tape, liberalized trade, made exports attractive through devaluation, wooed foreign investment, loosened interest rates and encouraged private business to replace the public sector as the dynamo of the economy'[6]. The Government had indeed acted boldly, and as subsequent events have shown, the economy during the next three years recorded excellent progress.

The Budget 1992-93 sought to continue fiscal adjustment by reducing deficits. In order to achieve this reduction in deficit, the Government reduced non-interest components of non-Plan expenditure, effected cuts in major subsidies, non-Plan grants to States and non-Plan loans to public undertakings. It also imposed constraint on increase in defence expenditure and provided for smaller rise of 4.8 per cent as against 13.4 per cent in 1991-92 in Plan Expenditure.

The reduction in effective public sector outlays was in consonance with the trend the world over. The *World Development Report 1991,*[7] after distilling 40 years' experience of development, stated: 'Governments need to do less in those areas where markets work, or can be made to work, reasonably well. It was well-known that investment in public enterprises did not yield adequate surpluses

and revenues; the proliferation of activities by the public sector necessitated transfer of considerable funds from private savings, but the outlays had not yielded commensurate results'. Any calculation of cost-benefit analysis, in this context, suggests a dimensional change in the pattern of sectoral allocation of resources in the economy between the public and the private sectors. The public sector needs to concentrate its resources and energies on accelerating infrastructural growth and improving social services, while the private sector's role should be enlarged.

If public sector outlays are restricted, the burden of development would devolve on the private sector, which must provide the stimulus for growth. The Government has liberalized its policies. Even for infrastructural growth, which is basically an area for the public sector, in critical sectors like power, oil and telecommunications, it has not only allowed access to private industry, but also invited foreign participation and technology to stimulate growth. This is a challenge that the private sector must take up, if the momentum of growth in the economy is to be accelerated.

The Central Government's *Discussion Paper on Economic Reforms*[8] (June 1993) stated that reduction in fiscal deficit had to be achieved partly by reducing low priority expenditure, but it had essentially to be effectuated by augmenting revenues. Larger tax revenues were best achieved by a tax system easy to administer, moderate tax rates and broad tax base. Existing tax policies resulted in economically unsound investment and production choices. On the basis of reforms suggested by the Chelliah Committee, the Government had initiated several measures in the 1992-93 Budget itself.

Maximum marginal effective income tax rate had been reduced to 44.8 per cent, while wealth tax had been abolished on all productive financial assets like shares, bank deposits, units in Unit Trust and Mutual Funds. The threshold of exemption had been enhanced to Rs. 15 lakhs and tax levied at one per cent. The

personal tax relief had been partially neutralized by withdrawal of allowances under Section 80 CCA and 80 CCB; these measures depleted cash resources of assessess without commensurate benefit to revenue. Double taxation of firms had been mitigated to an extent. A system of presumptive taxation for small traders had been introduced in order to widen the tax base.

Under a new scheme, entire capital gains will be taxed at 20 per cent in case of individuals and 30 per cent – which is high – in case of companies. However, Section 54E which provided an optional tax shelter from capital gains, should not have been withdrawn. The improvization of indexation of cost of acquisition and improvement of capital assets, linked to a cost inflation index notified by the Government with 1981-82 as the base year, for purpose of calculation of capital gains, and fixation of cut-off date for valuation of assets acquired in earlier years as April 1981, instead of April 1974, should mitigate to a degree the effect of artificial escalation in values, on account of inflation.

The Budget says that only two-thirds of depreciation and other allowances brought forward will be allowed to be deducted in 1991 - 92 and the balance in next year. With escalation in costs of machinery the world over, it is imperative that in order to secure modernization and upgradation of technology, either depreciation should be allowed on replacement cost of assets, indexed to the price level, or investment allowance should be revived. Proposed allowance of at least a part of actual business expenditure is desirable, for artificial ceilings were often counter-productive.

Indirect taxes including auxiliary duties had been rationalized. The maximum rate of import duties had been reduced from 150 per cent to 110 percent (except on passenger baggage and alcoholic drinks). The duties on project imports and general machinery were pared from 80 per cent to 60 per cent, and in case of electronics industry from 60 per cent to 50 per cent. Regarding power projects, crude petroleum refining and coal mining, the import duty was reduced to

30 per cent. Numerous end-use exemptions and concessions were withdrawn.

The rationalization and reduction in import duties brought the duty structure in closer alignment with the level of import duties in other competitor countries, while the reduction in duties on capital goods would reduce capital outlays of industrial enterprises and render them better able to withstand foreign competition with reduced production costs.

The Budget sought to make up the loss of revenue from reduction in import duties by rationalizing excise duty structure, partially switching over from specific to ad valorem duties, and raising excise duty on several items including cement, cigarettes, tyres and tubes, major non-ferrous metals, steel products and iron forgings,paints, cables and watches. The rate of special excise duty was raised from 10 per cent to 15 per cent. Items of mass consumption like tea, coffee, sugar, vanaspati, kerosene and matchsticks, continued to be exempt.

The most significant features of the 1992-93 Budget were reduction in taxes on personal incomes and the exemption from wealth tax of investment in productive assets. This stimulated work, production, incomes and savings, and also contributed to improved voluntary tax compliance, leading to buoyancy in revenues in future years. It vindicated the thesis that lower taxes yield higher revenues, under certain circumstances, as also the Laffer Curve concept, which had been gaining greater acceptance both in developed and developing countries.

The Budget also marked a change to outward orientation of trade and move towards greater globalization of the economy, which in future years contributed to upsurge in exports and building up of foreign exchange reserves. It also confirmed the country's commitment to allround liberalization, and its marked progress in regard to macro-economic stabilization and structural adjustment in trade and industry.

(iv) *Union Budget 1993-94*

The Government's Annual Budget constituted a vital instrument for implementation of stabilization and macro-economic structural adjustment programmes. The 1993-94 Budget in India was a historic budget in the nature of a watershed, switching over from crisis management to consolidation and from inflation control to vibrant growth.

The cut in excise duties covered a broad spectrum ranging from automobiles, refrigerators and televisions to cosmetics, plastics and textiles, which should stimulate demand for these products through increase in consumer spending and increased investment in capital goods producing these items. The beneficial effect of excise duties would result in increase in production and incomes thereby yielding higher revenues. The Finance Minister stated[9] that out of revenue loss of Rs. 2249 crores in excise duties, production of excisable goods will go up, and the loss will therefore be partially offset by a gain of about Rs. 1000 crores on this account . This worked out to be a substantial part of the excise relief.

But this does not fully explain as to how taxes were cut and plan outlay increased without increasing the deficit. The key to this financial exercise lay in cutting budgetary support to public enterprises for financing their losses and capital expenditure. In future, they should raise funds from the capital market; and those which are unable to do so, should be restructured, and if found wholly unviable, wound up. Besides, the spillover effect of expenditure compression in the previous budgets, manifested itself. The austerity of two years had paved the way for sustained growth in the future. Defence expenditure was contained and subsidies were reduced. Efforts were made to limit administrative expenditure also. The provision for non-plan expenditure other than interest in 1993-94 was about Rs. 3180 crores lower than in 1992-93 (RE). It was envisaged that with reduction in fiscal deficit and government borrowings, growth in interest charges should decelerate in 1995-96.

A welcome feature of the Budget was that the Government had concentrated on sizeable increase in allocations to the infrastructure sector: Central plan outlay for energy sector increased by 33 per cent, communications by 26 per cent and transport by 32 per cent. A five year tax holiday for new power plants had been improvised. Outlays on social sector and rural development had also been increased: rural development by 62 per cent, education by 37.6 per cent and health by 60 per cent. The Budget marked a subtle change in trend in that (a) it was withdrawing from sectors in which the private sector was expected to perform better and (b) it sought to invest in infrastructure and provide essential services to the poor, in consonance with its 'market friendly' approach.

Import duties had been reduced on a wide range of commodities. Apprehension persisted that lower import duties may result in greater inflow of foreign goods and dumping. This may lead to closure of several marginal industries and disturb price equilibrium for indigenous producers. The fears were not illusory; coprolactum was actually being dumped to the detriment of industry. Retrieval was possible owing to increase in customs duty in the Budget. But timely government intervention may not be feasible in all cases. Reduction in import duties for import substitution industry products should have been phased over three to five years, as asked for by industry, to give it time for adjustment.

(v) ***Union Budget 1994-95***

The Budget for 1994-95 constituted another milestone in fiscal history in that it carried the reforms process several steps further through: (a) simplification and rationalization of the indirect tax structure; (b) cut in maximum customs duty from 85 per cent to 65 per cent; (c) increase in scope of Modvat and conversion of several specific duties into ad valorem duties, thereby increasing the buoyancy of the tax structure; (d) reduction in corporate taxation from 51.75 per cent (for public companies) and 57.5 per cent (for controlled companies) to a uniform rate of 46 per cent for all companies; (e) removal of surcharge on personal incomes, thereby reducing the maximum tax rate from 44.6 per cent to 40 per cent applicable over Rs. 1.20 lakhs; and (f) moving towards effecting full

convertibility of the rupee on current account. There was marked deceleration in the growth of external debt: increase of $ 8 billion in 1990-91; average increase of $ 3 billion in 1991-92 and 1992-93; and only $ 3 million in the first half of 1993-94. Out of its substantial foreign exchange reserves, government proposed to retire certain high cost borrowings and corporate sector would be permitted to follow suit.

The fiscal deficit in the year 1994-95 was high at about 6.7 per cent (7.4 per cent in 1993-94). Besides, if the fiscal deficit remains high, a refusal to print money will crowd out private investment and raise interest rates (through increased borrowings).

While critics of the Government maintained that fiscal deficit in the Budget would be inflationary , the Finance Minister had taken a calculated risk in that the tax loss to the Centre of Rs. 3064 crores on conventional basis was expected to be recouped through additional revenue emanating from accelerated industrial growth, and improved voluntary tax compliance. Revenue collections during the first three quarters of fiscal 1994-95 were buoyant.

An overview of the Budget shows that the Finance Minister presented a pragmatic growth-oriented budget that should stimulate capital formation, trigger industrial revival and extricate the economy, particularly the capital goods sector, from recession. He formulated a 'demand management' contra-cyclical budget, incorporating uncovered budget deficit, tax cuts and lower interest rates on long-term loans, designed to increase aggregate demand and reflate the economy. The alternative would have been to perpetuate recession and face the vicious cycle of higher taxes, lower industrial growth, reduction in revenues, further deficits and more taxes.

The budget needed to be viewed in the context of existing sizeable stocks of foodgrains, idle capacity in industry, foreign exchange reserves of $ 18 billion, exports rising at more than 20 per cent per annum in dollar terms and inflation of about 10 per cent as compared to 17 per cent in June 1991. The B O P deficit was down at 0.5 per cent of G D P. The government also proposed to reduce expenditure and curb fiscal deficit in the coming year. Based on empirical evidence,

the Finance Minister accepted the modern thesis that reduction in taxes after a level increases revenues (which would reduce the deficit) through higher production, investment and incomes, and reduced evasion.

The sizeable reduction in corporate taxation will increase corporate savings and provide capital for further expansion and industrial growth. Entrepreneurial initiative was imperative, to step up investment, particularly as high incentives and return on capital employed had been provided particularly for power and other infrastructural sectors. The country was passing through a second industrial revolution and the enhanced budgetary outlay for R&D in science and technology and incentives to electronics and telecommunications industry should accelerate the process of modernization and better equip the economy for entry into the 21st century.

Reforms in India had few parallels elsewhere and they could enable India to achieve growth at the rates attained by the successful East Asian economies. Thanks to remarkable improvement in foreign exchange reserves, only continued access to high quality long-term development assistance will remain critical for accelerated growth and poverty alleviation.

However, continued high fiscal deficits was a serious obstacle to attainment of India's medium-term development objectives. Not only the targeted fiscal deficit of 6 per cent G D P for 1994-95 had to be realized, but it was imperative to effect further diminution in 1995-96. The internal debt at about 53 per cent of G D P in March 1994 was also relatively high, and it contributed to high interest burden and revenue deficit. There was an upsurge in foreign direct and portfolio investment into India; it had increased from $ 22 million in 1990-91 to $ 433 million in 1992-93 and $ 4.1 billion in 1993-94. Large-scale disinvestment of public undertakings' shares upto 49 per cent as per the Rangarajan Committee report should contribute to reduction in fiscal deficit. In certain cases restructuring (and also closure) would be necessary.

Reduction in personal and corporate tax rates and rationalization and simplification of the tax structure had resulted in improved voluntary compliance and increased industrial activity; reduction in tax rates had added to buoyancy

in tax revenues. The Finance Minister concurred that such reduction would assist moral regeneration of the economy and moderate taxes would curb growth of black money and hawala market. The tax atmosphere had definitely improved and buoyancy in revenues should be more pronounced during 1994-95 and subsequent years.

(vi) ***Union Budget 1995-96***

The Union Budget 1995-96 was directed towards consolidation of gains. The Finance Minister in his Budget speech recapitulated the substantial progress made during the period of the Reforms since the Budget 1991-92, and stated that the reforms in the areas of taxation, trade and industrial policies and the financial sector needed to be completed as planned, so that the economy could be rendered more efficient and competitive. It was necessary to effectuate improvements and modifications in certain important sectors : agriculture, public sector, industrial relations, insurance, and the capital market. Delivery systems needed to be improved so that funds reached target groups without leakages and wastages.

The Budget emphasized upon fiscal discipline, growth with social justice and equity. It was imperative to control inflation, which had increased from around 7 per cent in mid-1993 to 11 per cent in 1994-95. Compared to 1994-95 (BE), the Fiscal Deficit in 1995-96 (BE) had been reduced from 6.7 per cent to 5.5 per cent (Vide Table 5.4). The Government had made an effort to reduce expenditure (other than interest) and restrain allocations to public enterprises.

The Finance Minister's task had been rendered easier due to the bouyancy in revenues, as shown by the following table :

Gross Tax Revenue

Rs. crore

1994-95 (BE)	1994-95 (RE)	1995-96 (BE)	1995-96 (RE)	1996-97 (BE)
87136	89831	103762	110354	132145

The gross tax revenue, according to revised estimates for 1994-95 and 1995-96 showed an increase of Rs. 2700 crores and Rs. 6600 crores at Rs. 89831 crores and Rs. 110354 crores over the budget estimates for the respective years. The Budget for 1996-97, recently presented (July 1997) provided for gross tax revenue at Rs. 132145 crores, which works out to a substantial increase of 51.7 per cent over the budget estimates for 1994-95.

The boyancy in tax revenues with reduction in tax rates is illustrated by the following table :

Personal taxes	**Buoyancy in tax revenues**	
	Years.	Income tax.
Maximum marginal tax rate reduced from 56 per cent on income over Rs. 1 lakh in assessment year 1990-91 to 40 per cent on income above Rs. 1.20 lakhs in 1995-96.	1986-87 to 1990-91	1.1
	1991-92 to 1995-96 (BE)	1.5
Corporate taxes		Corporate tax.
Effective corporate tax rate reduced from 57.5 per cent for certain domestic companies to 46 per cent for all domestic companies (with income above Rs. 75,000).	1986-87 to 1990-91	0.8
	1991-92 to 1995-96 (BE)	1.7

Source : Based on Economic Survey 1995-96, G O I, p 32.

This was a vindication of the strategy for tax reform; in other words, simplification and reduction in taxes had resulted in higher revenues – a strategy that had been stressed by the present scholar in 1991-92.

The emphasis in the Union Budget 1995-96 was on two other aspects, besides inflation control – for which monetary measures had also been initiated: (a) far-reaching social equity, poverty alleviation and rural development programmes, including housing facilities, education and health; and (b) incentives for infrastructural development, particularly power and telecommunications, for

which there had been an upsurge of investment proposals and which needed to be implemented expeditiously.

The increase in outlays on agriculture, poverty alleviation, social services and rural development is shown by the following table :

	1994-95 (BE) Rs. crore	1995-96 (BE)	Percentage Increase in 1995-96 (BE) over 1994-95 (BE).
Agriculture	2637	3022	14.6
Rural Development & Irrigation	6297	6828	8.4
Social Services of which.	7381	8839	19.8
Health	578	670	15.9
Family Welfare	1430	1581	10.6
Education	1541	1825	18.4

Recognizing the importance of infrastructure for industrial development, the Budget improvised a five year tax holiday for an enterprise which builds, maintains, and operates highways, bridges, airports, ports and rapid transport system. F I s were allowed 40 per cent deduction from their income derived by financing of investments in such enterprises, provided such deduction was credited to a special reserve.

The Budget, however, withdrew exemption from tax of 30 per cent of income derived by large-scale industrial enterprises under Section 80-1A in areas which were not backward on the basis of the specious argument that such an incentive was no longer necessary. This was likely to prove counter-productive, as investment allowance had also been withdrawn earlier. Some concession was provided to approved venture capital companies or funds, whose income by way of dividends and long-term capital gains would be exempt from tax.

The personal income tax exemption limit was increased from Rs. 35,000 to Rs. 40,000. In effect, working women would not be taxed upto Rs. 71,000 and others upto Rs. 68,000, thanks to basic exemption and other deductions. Status quo ante had been restored in respect of Section 80L limit of tax exemption to dividends, unit trust income, bank interest et al, which had been increased from Rs. 10,000 to Rs. 13,000.

With a view to widen the tax base, the tax net in respect of tax deduction at source (T D S) had been greatly extended to include (a) fees for professional and technical services, (b) interest on time deposits with banks (c) mutual fund interest and (d) payments to contractors and sub-contractors. While this had increased paper work for the industrial sector, time alone would show how far this improvisation succeeded in generating more revenue and widening the tax base. If refunds were not promptly paid by the I.T. Department in cases where T D S exceeded the tax liability, it could cause great difficulty to the general public.

The Budget continued the strategy of tax reform and checking inflation in regard to indirect taxes also; and sought to reduce the cost of inputs to industry, reationalize and simplify the tax structure and stimulate competition and efficiency with a view to reducing prices of consumer goods. The peak rate of custom duties was reduced to 50 per cent from 65 per cent in consonance with the policy of phased reduction in successive budgets. Uniform duty in regard to capital goods, components and machine tools was fixed at 25 per cent in respect of most of the items. Reduction in duties on import of raw materials and intermediates was beneficial, but the reduction in import duty on finished goods had an adverse impact upon domestic marginal industries owing to inflow of foreign goods at low prices.

Excise duties were also rationalized and lowered on certain items of mass consumption. However, excise duty on cement was raised. The system of filing

classification lists before withdrawing goods from factories was abolished. Eligibility limit for S S I exemption scheme was raised from Rs. 2 crores to Rs. 3 crores. The Modvat scheme was liberalized and simplified, as also extended to certain items.

The Finance Minister stressed that India's effort in seeking to effectuate a massive social and economic transformation within a democratic framework was unparalleled in the world. Successive budgets had been formulated to implement these policies and steer the economy in the right direction. The programme of liberalization and structural adjustment during the past four years had been largely successful, and this had been lauded by international agencies, although the speed of reforms was regarded as being rather slow and halting.

6.4 Control over Stagflation

The economy faced a second two-dimensional crisis in 1993: recession and inflation[10]. With fiscal deficit of 8.4 per cent of G D P in 1990-91, inflation at about 17 per cent in June 1991, and the precarious current account (B O P) position and minimal foreign exchange reserves, the macro-economic stabilization programme was directed, inter alia, at drastically reducing the budget deficit and tightening monetary policy with a view to reduction in inflation and achievement of external sector viabililty. That the rationale behind the stabilization and reforms programmes was sound and the Government succeeded in its objectives was true, but certain adverse spillover effects manifested themselves. Fiscal deficit was reduced to 5.7 per cent and inflation to 7 per cent in 1992-93. But this was effected not through a cut in non-developmental expenditure, but through a sizeable diminution in investment and developmental expenditure. Consequent upon severe compression, tight money and credit policy and a cut in plan outlays in real terms, the economy became engulfed in recession, – particularly cement, steel, automobiles and capital goods sectors –, and industrial production recorded a steep decline from around 8 per cent during the eighties

to a negligible growth rate during 1991-92 and 4.3 per cent in 1992-93.

The Government had expected that shortfall in public developmental expenditure would be substituted by private investment. Instead, demand for industrial products slackened and with recession manifesting itself, high interest rates and escalating capital costs, private investment also decelerated , thereby reducing the industrial growth rate. Money supply continued to increase, with M 3 rising by 18.2 per cent in 1993-94, and inflationary tendencies gathered momentum. The rate of inflation rose from 7 per cent to 9.2 per cent in September 1993 and 11.7 per cent in March, 1994.

With operational coordination of fiscal and monetary policy and finely tuned economic management, government initiated measures to combat the multiple macro-economic imbalances in the form of stagflation. Working in unison, the Finance Ministry and the Reserve Bank adopted a judicious policy-mix comprising fiscal and monetary measures directed towards extricating the economy from recession, and at the same time containing inflation and reducing it to a single digit figure. On the one hand, as stated earlier, the Finance Minister formulated an expansionist budget, incorporating uncovered budget deficit, tax cuts and lower interest rates on long-term loans, designed to increase aggregate demand and boost the economy. The Reserve Bank also reduced S L R and C R R to increase the capacity of banks to increase commercial lending, which had considerably declined. On the other hand, the central bank tried to keep monetary policy on a tight leash and reduce the growth in money supply. M 3 was lower during the first quarter of 1994-95, as also credit provided by it to the Government. The Reserve Bank also sought to restrict increase in M 3 to 15 per cent during the year.

The Government and the Reserve Bank recently signed an agreement to limit the issue of ad hoc treasury bills to Rs. 6000 crores for 1994-95. This was a historic step and the objective was to phase out completely after 1996-97 direct

monetization of fiscal deficit, and contain inflationary pressures arising out of monetary expansion. This would contribute to increased fiscal and monetary discipline and provide The Reserve Bank with greater moneouvrability in regard to effective monetary management. This 'accord of 1994' was comparable to the accord of 1951 signed by the Federal Reserve System and Treasury Department in the USA, and was consistent with the Government's commitment to reduce the fiscal deficit to 6 per cent of G D P. The Government had succeeded in extricating the economy out of recession and it was expected that industrial growth during 1994-95 should be about 8.5 per cent and higher during subsequent years. Inflation had also been reduced to around 8.5 per cent in October 1994 and was expected to decline further during the second half of fiscal 1994-95. Inflation actually came down to around 5 per cent in March 1996.

An important aspect of increase in foreign exchange reserves was the accretion of counterpart rupee funds to the money supply in the economy, and increase in reserve money. In order to neutralize the inflationary impact, the Reserve Bank was resorting to open market operations. During the first half of fiscal 1995-96, it sold some of its income earning securities to absorb the excess money supply. The objective of R B I monetary policy was threefold: to contain monetary expansion; rationalize and increasingly deregulate interest rate structure; and to strengthen the existing credit delivery system.

On a macro-economic basis, the ratio of savings to GDP had declined from 23.7 per cent in 1990-91 to 21.4 per cent in 1993-94. This needed to be analyzed in depth and addressed. Some other elements, *inter alia*, comprising the strategy may be highlighted: the new strategy of investment incorporated incentives such as low taxes on capital gains and other incomes and creation of a healthy investment climate conducive to the inflow of foreign direct investment and raising capital in foreign countries, which facilitated investment in capital goods both by foreign and domestic entrepreneurs.

Drastic structural reforms were initiated in industrial licencing and foreign investment policies in order that the principal sectors of the economy could attain an adequate technological and competitive edge in the process of globalization. The new Industrial Policy abolished industrial licencing in all industries except 18 strategic ones (later reduced to 6) irrespective of levels of investment; provided for existing industries to effect sizeable expansion without permission, relaxed conditions of entry for large-scale units in export oriented sectors, and abolition of mandatory convertibility clause in respect of term loans by financial institutions for new projects. The M R T P law was largely revoked, thereby removing severe constraints upon industrial expansion and diversification by large houses.

The foreign investment policy provided for considerable relaxation: (a) automatic approval to direct foreign investment upto 51 per cent of equity in high priority industrial companies, provided foreign exchange component of project cost was covered by foreign equity, and foreign technology agreements complying with specified norms, (b) non-discrimination between foreign and indigenous industries in payment of know-how fees and royalties and imports of industrial inputs; (c) Investment beyond 51 per cent equity could also be made subject to approval by Foreign Investment Promotion Board (F I P B) which had been instructed to process foreign investment applications expeditiously; (d) A further step towards globalization was taken with the streamlining of procedures for Indian companies to invest abroad; (e) Provisions of F E R A were relaxed to reduce constraints both in regard to foreign companies operating in India and Indian business investing abroad. These changes brought about a more competitive environment in Indian industry in which entrepreneurs were free to invest, expand and modernize. The inflow of foreign investment capital and proposals considerably increased; the bulk of investment was in critical areas such as power generation, petroleum refining, electronics *et al* with export possibilites.

6.5 Public Enterprises and Privatization Policy

The Agenda for Reforms stated that while certain enterprises had performed well, some others had not generated resources for reinvestment. The return on capital employed (other than oil sector) was meagre; while most state enterprises such as electricity boards, transport undertakings and irrigation works were incurring heavy losses. Budgetary resources were scarce, and allocation for education, health and poverty alleviation were inadequate. In such a context, the Budget could not indefinitely sustain maintenance of loss making enterprises and provide funds required for expansion of public undertakings.

The public enterprises needed to improve their operational efficiency and generate surpluses; and sick undertakings would be referred to B I F R for restructuring or eventual closure. The Government proposed to phase out budgetary support to loss-making undertakings in the form of non-plan loans after 1994-95. They should reorient their policies and operate them on commercial basis. They could also enter into joint ventures where feasible; and should raise money for expansion from the capital market; pricing policies would be modified to conform to commercial principles, where losses were attributable to subsidized pricing.

Public sector equity upto 49 per cent would be disinvested in the case of profitable enterprises, so as to raise resources for the budget, broad-base ownership and 'create a greater commercial orientation in the management'. These measures constituted indicators to management in the public sector and the relevant ministries that performance orientation of enterprises was imperative for ultimate survival. The Government, however, did not appear to favour privatization on a sizeable scale as a major plank of policy. The Government sought to provide increased scope for private enterprise to operate in reserved areas. Greater autonomy through M O U S and part privatization of shares in public undertakings to yield about Rs.2,500 crores in the year were envisaged. The Government's

privatization policy needed a sharper edge and greater content. Presently, it was directed to raise revenues for reducing fiscal deficit. Actually, several countries – U.K. having provided the lead – were resorting to privatization of public enterprises to increase operational efficiency in a competitive environment to generate surpluses for growth and buttress public revenues.

The state must invest in human resources by providing education and medical facilities. These investments stimulated economic growth and productivity through increased skills and ability to imbibe new technology; they were socially useful and also (in the case of female education) led to reduced fertility. Kerala had been cited even in international circles. Housing not only conferred social benefits, but also stimulated growth through increase in demand for steel, cement and other inputs. It had a multiplier effect and the growth effects radiated into other spheres in ever - widening circles. Expenditure on low cost housing as in Hong Kong and Singapore, constitutes a multifaceted instrument for H R D and economic growth.

Macro-economic stability and micro-economic efficiency were linked together, and as suggested by World Development Report 1991[11], governments could achieve both these goals by 'reappraising their spending priorities, implementing tax reform, reforming the financial sector, privatizing state owned enterprises, and using charges to recover the cost of some state-provided services'.

Export promotion needed to be given top priority. Policy framework for export promotion must identify thrust areas where the country had comparative advantage and marketing economies. Better co-operation between government and industry and rationalized incentives were necessary for stimulating exports, which was imperative for correcting the balance of payments on a sustainable basis. Despite substantial reserves, large scale capital outflows could create problems during a crisis period. Increase in agricultural production and productivity constituted a concomitant of industrial growth.

Reference may also be made to this author's concept of C N C Super-Multiplier,[12] whereby a decrease in corporate tax increased reserves and capital investment manifold due to multiplier and accelerator effects to areas linked to industry. The theory was empirically supported by experience in the East Asian economies. The success achieved by Hong Kong suggests that the major gains accrue from leaving retained earnings with corporations and promoting investment in equipment, rather than fine-tuning incentive structure to private investors through the tax system. (Also vide Sections 8.6 to 8.8 re detailed exposition of C N C Super Multiplier).

In improvising tax measures, the then Finance Minister had accepted the major concept that lowering of taxes led to increase in revenues. Dr. Singh[13] said that 'it is possible to reduce tax rates and yet mobilize additional revenue by improving tax administration and compliance'. Actually, revenues during 1994-95 were buoyant despite lower taxes.

Effects of Reforms have been shown in the Table 6.1.

6.6 Reforms in Other Sectors Needed

An analysis of the Indian experience would be incomplete without identifying the reforms that still needed to be implemented: Reforming company law and labour legislation, including formulation of an exit policy – a sensitive issue for certain foreign investors –; disinvestment of public undertakings' shares upto 49 per cent as per the Rangarajan Committee report; providing complete autonomy to public enterprises which function efficiently or even moderately so; dynamizing and modernizing the agricultural sector and stepping up outlays on anti-poverty schemes (even while reducing subsidies); completing reforms in financial sector, including insurance and banking; and implementing the proposed agenda of tax reforms – a field in which satisfactory progress had been registered.

The Government needed to formulate an exit policy which would allow restructuring and closure of loss making units both in the private and public

sectors. Foreign investors had expressed anxiety on the absence of such a policy; in case an enterprise lost its viability, it should have the basic right of closing shutters. This was also necessary to ensure that the reallocation of resources as a sequel to structural reform programmes was not impeded. A National Renewal Fund had been established by government, with the support of the World Bank, to provide a safety net for displaced workers in the public sector in the form of compensation and retraining. Sick public sector enterprises were also being referred to B I F R for formulation of rehabilitation programmes.

The Government proposed to step up the provision for infrastructural services, which constituted a bottleneck to growth of industry, agriculture and exports. The principal infrastructural sectors like power, oil, coal, transport and communications, were largely within the domain of public sector; government as a part of structural reforms, had provided for entry of private domestic and foreign investment capital into these sectors. The response from the latter in respect of development of power and oil had been significant. We have already indicated the important role of fiscal policy in stimulating development of both economic and social infrastructure.

An important aspect of the structural reforms programme and emphasis upon exports and increased competition, consequent upon reduction in tariffs and globalization of the economy, was the creation of an environment in which quality consciousness in the industrial sector had visibly grown. This should have a stimulating effect upon exports.

The States also need to be persuaded to push ahead with the reform process – which in certain cases had yet to take off. States managed and controlled development of power, road transport and irrigation – not to speak of agriculture as a whole – as also education, health and housing to a great extent; their participation in the reforms process was imperative if reforms were to be fully consummated.

These factors cumulatively constituted the elements comprising the strategies of growth which account for success. Strong fundamentals, control over fiscal deficit, relentless pursuit of exports and large inflow of direct foreign investment and modern technology – which had to be adapted – constituted the basics which facilitated high growth, and fiscal policy in this context had a vital role to play.

Table 6.1

Major Indicators of The Indian Economy Showing Effect of Reforms (1990-91 to 1994-95) as Percentage Change over Previous Year (except as stated otherwise)

	1990-91	1991-92	1992-93	1993-94	1994-95*
Growth in G D P at 1980-81 prices.	4.9	1.1	4.3	4.3	6.2
Industrial Production	8.2	0.6	2.3	5.6	8.4
Agricultural Production	3.0	- 2.0	4.1	2.2	2.2
Foodgrains Production (Million Tonnes)	176	168	180	182	185
Electricity Generated	7.8	8.6	4.9	7.4	8.5
Inflation (W P I)	12.1	13.6	7.0	10.8	10.4
	(17 per cent June 1991)			(4.3 per cent March 1996)	
(C P I)	13.6	13.9	6.1	9.9	9.7
Money Supply (M 3)	15.1	19.4	15.7	18.2	21.2
Exports (In dollar terms)	9.2	- 1.5	3.8	19.6	18.4
Imports (In dollar terms)	13.5	- 19.4	12.7	6.1	21.8
Deficit on Current Account as percentage of G D P	- 3.3	- 0.4	- 1.8	- 0.1	- 1.5
Foreign Exchange Reserves. $ Million	2236	5631	6434	15068	20809
	(1124 in June 1991)				
Increase in Employment In Million	n.a.	3	6	6	More than 6 Million

Table 6.1 (Contd.)

Major Indicators of The Indian Economy Showing Effect of Reforms (1990-91 to 1994-95) as Percentage Change over Previous Year (except as stated otherwise)

	1990-91	1991-92	1992-93	1993-94	1994-95*
Debt Service payment as percentage of current receipts	32.3	29.8	30.3	24.8	23.5
Gross Domestic Savings	23.7	23.1	20.0	21.4	24.4
(As Percentage of G D P)					
Public	1.0	2.1	1.5	0.5	1.7
Private	22.7	21.0	18.5	20.8	22.7
Gross Domestic Investment	25.7	22.9	23.3	21.6	25.2
(As Percentage of G D P)					
Public	9.7	9.2	8.9	8.6	8.8
Private	15.9	13.7	14.4	12.8	14.3
Foreign Investment Inflows (US dollars million)	22	158	433	4110	4900

Source : *Economic Survey 1994-95*, Ministry of Finance G O I. Various Pages. Ibid 1993, p 2.
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For Savings and Investment, figures in *Economic Survey 1995-96* have been taken for 1993-94 & 1994-95

* Estimates

Notes : 1) In 1995-96 G D P 6.2 per cent; Industrial Production 10 per cent.
2) Inflation in 1995-96; WPI 4.3; CPI 9.0 (Jan 1996)
3) F. E. Reserves in 1995-96; U.S.$ 17 billion.

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