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QUANTIFYING ECONOMIC REFORMS IN INDIA: WHERE HAVE WE BEEN & WHAT LIES AHEAD, 1960 – 2006

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ABSTRACT

We attempt to quantify economic reforms process in India during the period 1960 – 2006 in seven key areas viz., international finance, domestic finance, fiscal, trade and commerce, business regulations, public sector and social sector. Apart from aggregate measure of economic reforms, we also present the reforms index in these seven areas for the period 1960 – 2006. We begin with the methodology adopted to construct these indices and review the history of reforms process in India in general and in seven sectors from 1960 to 2006. We then present some important stylized facts on reforms. They show that reforms process has not always been uniform across the time in all the seven sectors. Reasonably liberal country was reversed back to regulations and restrictions during the mid-1960s – early 1980s. Though reforms process began in the 1980s they were not sufficient to undo the distorting policies adopted for over four decades. Amidst political chaos, economic crisis and social tensions, India began its true journey of reforming its economy. The period after 1990 witnessed a very significant opening of the economy to the world market. The change in reforms indices were the highest during the period 1991 – 2000. By the mid-2000, there was a widespread agreement and policy convergence in all seven sectors. However, there is much less convergence in public sector reforms because the privatization process has significantly slowed down and government control is many public sector undertakings are still reasonably high. Lastly, though there is significant variation in social sector reforms index, still there is a lot which needs to be done to include bottom sections of the society into the growth story of India.

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"Noted everything and its opposite are guaranteed to be true in India"

- Joan Robinson (Cambridge School, U.K.)

“A poor nation dares to dream of economic stardom, thanks to economic reforms”

- Author of the draft

1. Introduction

It is disappointing to see India having made inadequate progress since 62 years of its independence. Poverty levels though decreased, still hovers over 20% of total population. The problem with yesteryears was a low growth of GDP, the ‘*Hindu rate of growth*’ and much low percapita income growth. The growth rate of GDP of India between 1950 and 1980 was around 3% and annual average growth of percapita income was just 1.5% (RBI handbook of statistics, 2006). For a country like India which is world’s second largest populous nation, these growth rates found to be inadequate to make any significant impact. Some initiation was taken during the 1980s by the government of India to set things right. This improved the percapita income growth to 3.5% as poverty levels fell from over 45% in 1980 to 35% by the end of 1990. Thus, India realized that only a strong economic growth could increase the percapita income levels which in turn help reduce poverty. This further encouraged the government to make some serious corrections in its economic policies. Thus, the foundation for a strong economic growth was laid in the form of economic reforms in 1991 which is popularly known as Structural Adjustment Program (SAP). The focus of economic reforms was to strengthen the economic growth which should translate into improving socioeconomic conditions of the poor and thus reduction in poverty levels.

Since 1960, dramatic changes in development policy have occurred in India. From one of the most liberal regimes in the world, India became more of a closed economy from mid-1960s adopting the growth model of ‘state directed import substituting industrialization’. In mid-1980s and increasingly in 1990s, especially post economic crisis period, it has come to be accepted that this old model of industrialization through import substitution

was not sustainable and had to be replaced. After the economic crisis period 1989 – 1991 there was an increasing convergence among the political fraternity and policy makers in India as to how the economy should work and what should be the role of government in managing the economy. This view led to profound structural economic reforms in as many as all the areas starting from social sector to international financial sector. The most common features of all the reforms in all sectors has been (a) To minimize government intervention in business sector and allow market forces to determine the prices (b) Focusing the role of government in providing basic facilities like: education, health, sanitation and basic infrastructure (c) Considerably reduce the role of government in directing the allocation of resources and production of the economy (d) Open up the internal economy to foreign competition (e) Induce competition by allowing private sector to play a great role.

More than 25 years since the inception of first and second-generation reforms, the debate on the effects of economic reforms in India is yet to be settled. Liberals argue that economic reforms, measured as structural changes in economy and closer contact between the rich and poor will transform poor countries like India to reflect greater economic growth and reduction in poverty. Skeptics of economic reforms in India contend the opposite, where economic reforms processes might lead to exploitation of the weak by the strong, the exclusion of the poor, increased inequality, and economic insecurity resulting in social unrest and chaos in the society. Previous studies in the literature have examined this issue with single indicators, such as industrialization, trade openness, FDI, reforms dummy and combination of several such indicators. Yet, a comprehensive measure of economic reforms in India is absent.

The purpose of this paper is to present a set of qualitative indices that reflect the main elements of the first and second generation of reforms in India. The motivation for this work has been the "need" to have some qualitative measure to help determine the socioeconomic implications of economic reforms in India not just on aggregate basis, but reforms by sector. The economic reforms index is an aggregate measure of reforms carried out by the government of India in seven key areas namely, Social Sector,

Business Regulations, Public Sector, Domestic Finances, International Finances, Fiscal sector and Trade and Commerce. The indices presented here also have some weaknesses like any other subjective measures, in that they leave some of the most difficult but very important information which simply cannot be quantifying numerically. In some cases we had the problem of data constraints like number of poverty alleviation programs and Non-Tariff Barriers, to name a few, which from 1960 are absent! However, despite these shortcomings, we still believe that this measure of economic reforms is the most comprehensive work in comparison to other reforms indices in literature. For example, in Lora's reforms index for Latin countries, reserves to deposit ratio, ratio of Value Added Tax rate to total revenue receipts and so on represent the "outcome" of the reforms rather the "policy aspect", which we have tried to avoid.

2. Survey of Literature on Economic Reforms

In most of the studies in literature economic reforms is measured either by a simple dummy variable or with a set of few important economic variables like the industrialization and financial openness or sometimes combination of these variables. Later on, many other measures of reforms were developed using different methods. The well known Sachs & Warner (1995) binary index of openness is based on the weighted averages of some economic variables. However others, while accepting economic variables are important to measure reforms, argue that in practice it is hard to maintain a distinction between openness which is proxied by a set of economic variables and economic reforms measured as change in various policy related issues in a country. This becomes even more complicated in the case of many developing economies like India and other Latin countries because there is a paradigm shift from socialistic economic system towards a free market economy. Hence, in this case, simple openness variables and bi-dimensional indices made up of some key macroeconomic variables might not serve the purpose. This remains the major criticism of the previous works, which only look at single indicators such as industrialization, trade and investment, and there again mostly economic indicators.

In this line attempts were made to construct economic reforms index including sectoral reforms like trade, financial, fiscal and taxation. Three such attempts are noteworthy. First such attempt to quantify the reforms was done by Lora (1997) for 21 Latin American countries and this was later updated in 2001. Second, the economic reforms index developed by Morley et al. (2000) of United Nations Economic Commission for Latin America and the Caribbean's (UNECLAC) is said to be an improvised version over the Lora (1997 & 2001) index. While the first study covers 21 countries during the period 1985 – 1995, the second study also captures 21 countries but extended back till 1970. Because our measure of reforms is not as abbreviated as these two, we could not include more countries in the analysis. Further, our work builds on these two studies and strives for improvisation in terms of clear cut distinction between "policy outcomes" to "policy" itself. Third, European Bank of Reconstruction and Development (EBRD, 2008) measure of economic reforms in 32 countries under transition from centrally planned economic setup towards free market economic system. This covers former Soviet Union countries along with form communist countries from Central and East Europe during the period 1989 – 2008. Because this index is specifically constructed as weighted average of eight indices measuring the movement of a country from Soviet centrally planned economic system towards free market economic system, it cannot be applicable to other countries except transition countries.

Our reforms index however differs from the aforementioned studies in three aspects. First, we take our index back to 1960, which will allow researchers on Indian economy to examine the impact of the reforms by comparing the 1990s not only with 1980s, but also 1970s and 1960s which were the years of high regulatory and liberal regimes respectively. Second, we construct an index of the business regulations and social sector that no other earlier indices have done to capture more adequately the reforms of interest. Finally, unlike previous works, to the extent possible our indices try capture and quantify "government policy" *per se* and not "policy outcomes". In light of these observations, our index on reforms in India is a welcome contribution because this is a comprehensive measure of economic reforms in India which will help, we believe, decreasing many disagreements on the measurement issue.

3. Construction of Economic Reforms Index: Methodology

A comprehensive measure for Economic reforms in India is developed using Economic Reforms Index for the period 1960 – 2006. For this purpose, we use the Morris and McAlpin in 1982-83 method for constructing the Physical Quality of Life Index (PQLI hereafter)[1]. The need for composite indices aroused because the ratios have different numerators and denominators and hence their simple summation is not possible.

Construction of comprehensive measure of economic reforms is a four step process. In the first step, we segregate the sub-indices into seven different categories namely:

- **a.** International Financial Reforms (IFR)
- **b.** Domestic Financial Reforms (DFR)
- **c.** Trade Reforms (TR)
- **d.** Fiscal Reforms (FR)
- **e.** Public Sector Reforms (PSR)
- **f.** Business Regulations Reforms (BRR)
- **g.** Social Sector Reforms (SSR)

In the second step, we select various key indicators in each of these sub-sectors reflecting various facets of reforms carried out by government of India during the period 1960 – 2006. While selecting the indicators under each head, excess care is taken to identify the difference between "cause and affect" relationship to best represent the *policy aspect of reforms* carried out in each sector. For example, availability of number of doctors, physicians including basic infrastructure like hospitals and hospital beds attribute to the "cause" and the "affect" is better health performance indicators like high life expectancy, low infant mortality rates. Therefore availability of number of doctors and hospitals is the policy aspect of reforms, while the end result is the health indicators. Similarly, trade openness ratio (usually computed as exports + imports/GDP) is the end result of trade reforms which include: lowering various tariff barriers like peak customs duty, reduction

[1] PQLI was developed by Morris and Mc Alpin in 1982-83 for measuring the conditions of poor in India.

in custom duties on industrial and agricultural products, eliminating exports bias and so on. Likewise, private credit / GDP is the outcome of various reform measures like reduction of Statutory Liquid Ratio, reforms on entry restrictions on private and foreign banks and so on and so forth. Therefore, as far as possible we were cautious in not mixing the "cause" with "affect" variables while screening and selecting indicators under each index. Table 1 captures the indicators selected under each head .

Table 1: List of indicators selected under various sub heads

Area of Reforms	Selection of indicators
International Financial Reforms	Current Account Restrictions
	Capital Account Restrictions
	Existence of Competition Law
	Restrictions on Export proceeds
	Exchange Rate reforms
	Repletion of FERA with FEMA
	Restrictions on Joint Ventures
	Restrictions on Foreign access to Industries
	Restrictions on Foreign ownership
	Restrictions on Foreign entry requirements
	Restrictions on Performance Requirements
Domestic Financial Reforms	Government banks share in banking sector
	Foreign banks share in banking sector
	SLR & CRR regulations
	Lending rate regulations
	Minimum lending rate selective controls
	Ceiling on general lending rates
	Regulations on short/medium/long term deposit rates
	Central Bank’s autonomy
	Equity Financing requirements
	Overall financial system regulatory reforms
Trade Reforms	Customs collections rate
	Agricultural Import duty collections rate
	Industrial Import duty collections rate
	Peak customs duty
	Anti-Exports bias ratio
Fiscal Reforms	High marginal corporate tax rate
	High marginal income tax rate
	Corporate tax efficiency

	Income tax efficiency
	Tax administrative reforms
Public Sector Reforms	Privatization proceeds / GDP
	Public sector companies / Total companies
	Average Government stake holding in public sector undertakings / Total companies holdings
Business Regulations Reforms	Number of Industrial Licenses issued
	Number of Letter of Intents issued
	Amount of Plant & Machinery imports approved
	Number of Foreign Technical Collaborations
	Number of industries delicensed
	Number of firms registered under MRTP Act
	Number of Technical Design products imports approved
Social Sector Reforms	Pupil-Teacher Ratio
	Female Teacher / Male teacher (gender bias)
	Number of educational institutes
	Total Hospitals per 1 lakh population
	Total Hospital beds per 1 lakh population
	Total Doctors per 1 lakh population
	Evaluation of social sector projects by government

In the next step, the indicators under each head are converted into an index, namely individual indicator indices. For example, peak customs duty, agricultural and industrial tariff rates, customs collections rate and anti-export bias are all converted into an individual indicator index known as Trade Reforms Index (TRI). This is because the selected indicators are measured in different units either in real values or in ratios which include different numerators and denominators and hence their simple summation is not possible. Moreover, they have to be made unidirectional in order to be able to add them up meaningfully. For this purpose we used the methodology of PQLI. Accordingly, the worst and best values in each indicator during the period 1960 – 2006 are identified. The performance of each indicator in each year was put on a 0 to 100 scale where, 0 represents an absolutely defined worst performance and 100 represents an absolutely defined best performance and to aid the calculations, one unit point was added to the best values of the indicators (for example, see table 2). It must be noted that the worst and best values are based on the historical experience during the period 1960 – 2006, for example 0 represent the "worst observed" value and not the worst possible value. Similarly 100 represents either the best achieved or targeted value of the indicator.

Table – 2: Formulae for conversion of indicators into individual indices
(Example of Public sector reforms)

Indicators	Best Value	Worst Value	Formula
Privatization Proceeds / GDP	0.89 (0.89+1) = 1.89	00.00	$\frac{AV - 00.00}{1.89 - 00.00} * 100$
Public sector companies / Total companies	0.185 (0.185-1) = -0.815	1.543	$\frac{1.543 - AV}{1.543 - (-0.815)} * 100$
Government Stake holding in Public sector companies / Total companies holding	24.00 (24.00-1) = 23.00	74.77	$\frac{74.77 - AV}{74.77 - 23.00} * 100$

Source: authors own computations. "AV" denotes Actual Value

Thus,

$$\textbf{Indicator Index} = \frac{1}{m_i}\frac{1}{n_i}\sum_{j_i}^{m_i}\sum_{t_i}^{n_i}\left(\frac{\textbf{Actual value}_j - \textbf{Minimum value}_{jit}}{\textbf{Maximum value}_j - \textbf{Minimum value}_j} * \mathbf{100}\right)$$

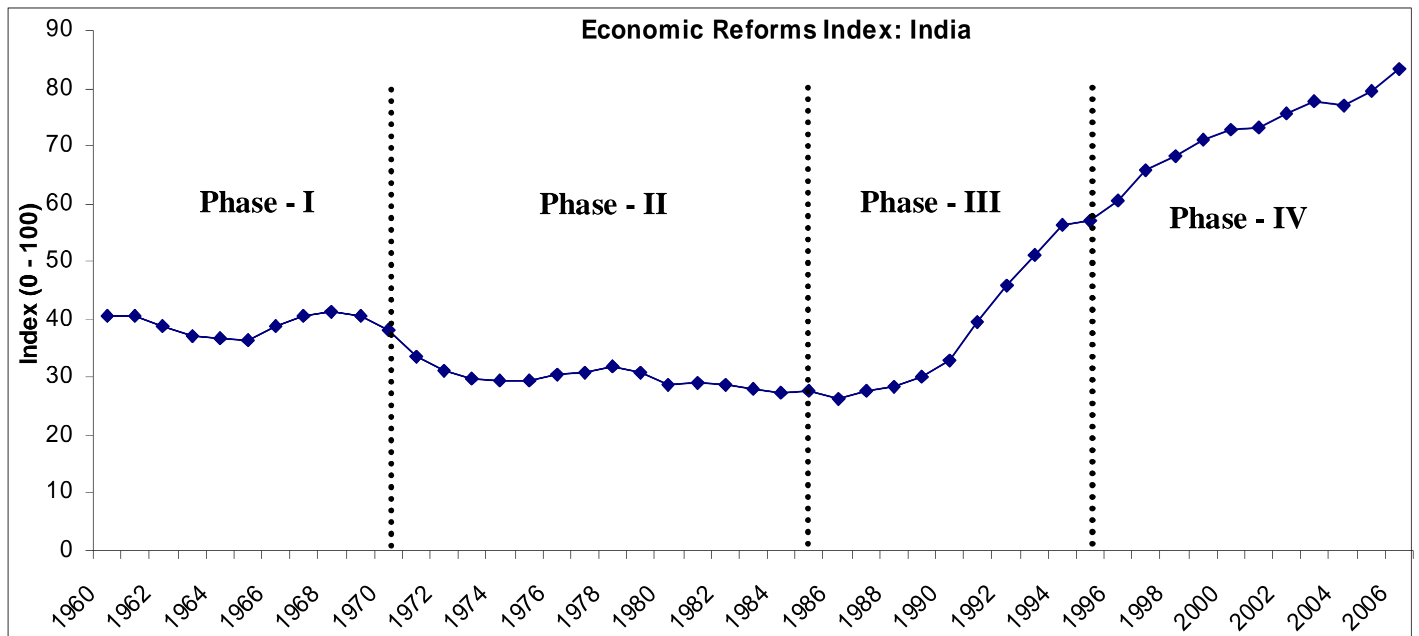
Where, *Indicator Index* is a value of j-$_{th}$ variable of t-$_{th}$ country (India) in time t, n stands for the number of the years and m for the number of variables. One main advantage of such transformation is that it allows the reform index to be measured over the same scale. This is an easy way to find out the performance of the reforms in each sector, as an increase in the value of an indicator index would necessarily mean improvement in the reforms process and vice versa.

In the final step, once the indicator indices are formed, they are combined together to compute composite reforms index. Within each component index the explicit weight attached to different indicator indices is equal. Thus, the comprehensive composite index is a simple average of all the individual indicator indices.

4. Trends and Patterns of Economics Reforms

We attempt to present the trends and patterns of economic reforms in India during the period 1960 – 2006. In doing so, we also examine the level and change in reforms by sectors and by period. The aggregate economic reforms index of India during the period 1960 – 2006 is displayed in graph 1. The reforms index as mentioned earlier is a simple average of the seven underlying sub-indices which would be dealt later in this section. This aggregate measure of economic reforms certainly gives a broad picture about how the reforms process was structured and when the process has occurred.

Graph 1



As seen the reforms process got the boost in the 1960s but slowed down considerably during entire 1979s and part of 1980s. In the late 1980s and early 1990s, the reforms got the momentum and the later part of 1990s and early 2000 was the phase of consolidation. Accordingly, we divide the total reforms phase in India from 1960 to 2006 into four phases viz., phase – 1 begins from 1960 to 1970. Phase – 2 stretch from 1971 to 1986 and phase – 3 which is considered to be the most critical phase in our analysis is from 1987 to 1996. The final phase is post 1997 onwards.

Phase – I: No more Liberalism, only Socialism (1960 – 1970)

Many might not be aware that India had one of the world's liberal economic regimes during the 1950s and the 1960s. As first five year plan was a major success, the government of India began to mobilize resources for the second five year plan (1957 – 1962). During this period there was heavy shortfall of resources. In order to make up for this deficit, government of India adopted the strategy of attracting FDI inflows into the country. As a result, the government's foreign investment policy was deemed to be the less restrictive policies among the major developing countries. As a part of these measures government of India relaxed the set of industries which were previously reserved only for public sector under undertakings for operations (Kumar, 1990). The government of India in 1960 also set up India Investment Center to attract FDI and facilitate transfer of technology. Further, in order to maintain proper system in place, Foreign Investment Promotion Board (FIPB henceforth) was formed in 1968. The role of FIPB was largely restricted towards giving permissions to the foreign Joint Ventures (JVs hereafter) which were below 40%. In those JVs where the foreign share was above 40% was refereed to the Cabinet committee of the Government of the day. In some of the industries according to government's classification, JVs were not considered necessary at all. In other sectors where the JVs were allowed were routed through FIPB. This apart, several tax holidays and other incentives were also announced for foreign investors. In fact the government rate of approval of applications for foreign companies exceeded than of local companies (public and private sectors). The foreign companies were also given free hand to expand its business and diversify their operations across the board. One of the major reasons for this was due to the deliberate attempt by government of India to frame regulatory norms for the existing FDI in the country. Rather the concentration of government of India's foreign investment policy during this period has always been on fresh investments following into the country. In large number of industries they own majority of the control and they controlled over one fifth of the total corporate India's assets during this period (Kidron, 1991).

On the other hand, local industries were encouraged to have foreign collaborations and to import the technical know-how needed to produce what was being imported into the country. During this period, the government of India gave high priority towards development of machine tools, textile machinery, and power equipment and so on. As a result, Indian industries were encouraged to import technical know-how and to enter into foreign collaborations to undertake manufacturing of capital equipment locally. Special efforts were made to protect Small Scale Industries in collaboration with the state governments. In order provide the financial infrastructure necessary for industry, the Government set up a number of development banks. The major objective of these development banks was to provide medium and long-term investments. Some of the development banks which were set up by government of India include: Industrial Finance Corporation of India (IFCI) 1948, Industrial Credit and Investment Corporation of India (ICICI) 1955, Unit Trust of India (UTI) 1963 and Industrial Development Bank of India (IDBI) 1964.

However, things began to change post 1962 and 1965 during which India was at war with China and Pakistan respectively. After which the inflation in India was at all time high. The fiscal deficit considerably increased from Rs. 507 crores in 1960 to over Rs. 925 crores in 1966 (RBI handbook of statistics, 2006). One of the major factors for this was high spending on defense sector. The high inflation had caused Indian prices to become much higher than world prices. On the other hand, India followed the system of 'fixed exchange rate regime' under which if a country experiencing high inflation vis-à-vis rest of the world, the goods become more expensive and foreign goods become cheaper. Therefore, inflation tends to increase imports and decrease exports. Added to these problems, India faced severe drought during the year 1965-66. As an important source of funding, India also heavily relied on foreign aid. Post 1965 Pakistan war, foreign aid was cut off by many western countries. All this forced India to devalue its currency in 1966.

During this crisis period, the active role of Reserve Bank of India (RBI henceforth), the central bank of India, also came into forefront. To curb the inflation, RBI resorted to direct control over the lending rates of banks, rather than indirect instruments such as the

Bank Rate for influencing the cost of bank credit. Ceiling rates of interest were made applicable to advances for certain purposes or to certain sectors to reduce the interest burden, thereby facilitating their development. Interest rates on deposits were also regulated. This regulated regime killed the competitive environment in the sector. Under the administrative set-up, the spreads of the banks were well worked out and the banks lost all initiative to optimize their resources, offer competitive rates and retain business. The net result was that borrowers had to pay higher interest rates. Because of the administered structure of interest rates, banks also could not price their products depending on the creditworthiness of the borrowers which also led to misallocation of resources (RBI report, 2008). Another control being imposed is the Credit Authorization Scheme (CAS) in 1965, in which the commercial banks are required to obtain prior permission of the Reserve Bank for sanctioning any fresh working capital limits above the prescribed norm which was revised from time to time.

However, some key reforms during this phase were also initiated with a focus on social sector development and industry. In order to further ensure the safety of deposits of small depositors in banks in India, the Deposit Insurance Corporation Act, 1961 was enacted. Accordingly, Deposit Insurance Corporation of India (DICI hereafter) was established in January 1962. After, USA, India is the only country where the deposits were insured during that point of time. The Corporation provided insurance cover against loss of all or part of deposits with an insured bank up to a certain level. To finance such investments, the Agricultural Refinance Corporation (ARC) was set up by the Act of July 1, 1963. Its objective was to refinance central land mortgage banks, State cooperative banks and scheduled commercial banks. Overall, this phase in Indian economy was marked with slow but steady shift from liberal economic regime to more of a controlled one.

Phase – II: Birth of License, Permits & Inspector Raj (1971 – 1986)

This phase in Indian economic history was considered to be the most 'restrictive' phase. In almost all the sectors there were excessive government controls and restrictions. It all began in 1964 when government of India appointed a Monopolies Inquiry Commission to examine whether the concentration of wealth and power in hands of few individual and family owned business groups. The Commission was requested to look at the prevalence of monopolistic and restrictive practices in important sectors of economic activity, the factors responsible for these and the legal solutions for them. After assessing the situation by industry and by product along with concentration ratio, the committee proposed a law to control monopolies and recommended the setting up of a permanent Monopolies and Restrictive Trade Practices Commission. Based on the recommendations of the committee, government of India passed Monopolies Restrictive Trade Practices Act (MRTP hereafter) and a Monopolies Commission was appointed in1969. Foreign companies also came under the MRTP Act during this period. MRTP Act restricted companies on the size of operation and the pricing of products and services.

In July 1969, an Industrial Licensing Policy Inquiry Committee (ILPIC) was appointed to examine the shortcomings in licensing policy. The committee strongly felt that the industrial licensing policy was not properly at its work resulting in underdevelopment of the industries in India. The committee also felt that the existing licensing policy it did not prevent investment in non-priority industries. Following the committee's suggestions, series of new measures were adopted by government of India to tighten the licensing policy in the form of introducing number of new restrictions on the large scale industries particularly on private sector. Thus, new industrial licensing policy was formulated by government of India in 1970.

The Industrial policy statement by government of India in 1973 focused on encouraging the small and medium scale industries at the expense of large scale industries. In the process the government of India identified a set of industries in which the large scale industries can enter but would be permitted to start operations only in rural and backward

areas with a view to developing those areas and enabling the growth of small industries around. For this, a new Secretariat for Industrial Approvals (SIA henceforth) was set up in late 1973. All the industrial licenses, capital goods, import licenses, terms of foreign collaboration were brought under the SIA from hereafter. The new companies of up to Rs.10 million by way of fixed assets were exempted from licensing requirements for substantial expansion of assets. This exemption however was not allowed to MRTP companies, foreign companies and existing licensed or registered undertakings having fixed assets of Rs.50 million and above.

Under licence, permits and inspect raj, the industries had to grapple not only in obtaining licences for each and every item but also had to face the harassment of the inspectors inspecting the industries. This also encouraged severe corruption among the government bureaucrats. For example, the Business Today magazine in 2002 published this table in which the details of number of inspectors inspecting each industry are given.

Table 3: Bloody Inspector Raj scenario in Indian Industries

Ministry	Number of Inspectors	Task of Inspectors
Ministry of Industries	5	Check Registrations, inventories, tax payment quality control and safety equipments
Ministry of Home	2	Check fire protection facilities and compliance with Explosive Act
Ministry of Planning & Statistics	1	Collect the data on production, manpower, man-hours utilized and lost
Ministry of Finance	12	Five of the 12 are from Income tax department in which three officials check same accounts three different times; the other seven officials are from excise department

Ministry of Separate Revenue	5	Enforcements, verification and recovery of sales tax, enrolment of professional taxes, weights and measures.
Ministry of Revenue Department (State government tax authorities)	1	Registration of the professionals in the company
Ministry of Labour	8	Checking compliance with different labour laws, checking the records on labour, wages and other welfare conditions
Ministry of Power & Energy	1	Checking electricity connections
Ministry of Family & Welfare	2	Checking hygiene and occupational health
Ministry of Urban Affairs & Employment	1	Checking sanitation
Ministry of Environment & Forest communications	2	Checking pollution control
Ministry of Telecommunications	1	Checking the telecom facilities
Ministry of Food & Drug Administration	1	Checking safety standards
Local Government Officials	2	Checking for Octroi and mass raids
Municipal Corporations	2	Checking the Municipal bye laws

Source: Business Today, 2002

In 1973, the government of India announced selected group of industries in which foreign companies and large Indian private business firms operations were strictly restricted. The final bolt however was the passage of Foreign Exchange Regulatory Act in late 1973. This not only restricts the scope of FDI regime in India, but also places several restrictions on foreign firms entry, operations, expansion of business and repatriation of income, dividends and profits to the home country. One of the draconian piece in the legislation includes either to 'Indianise' the existing foreign firms operating in India or drastically reduce their equity stake in the companies to below 40% and convert to Indian company regulated under Indian Companies Act of 1956. Only foreign firms operating in high end manufacturing sector were allowed to control equity stake of up to 51%.

Companies like Coca-cola in 1977 and IBM in 1978 preferred divesting their operations in India rather dilute their equity stake holding. In some of the startling revelations in annual reports of RBI reveals that as many as 54 foreign companies applied to wind up their operations by 1978 since the implementation of the FERA in 1973 and 9 companies applied to wind up their operations in 1981 (Annual reports of RBI, 1977 & 1981). This act also places severe restrictions on various items under current account and stringent regulations on proceeds from exports earnings.

On foreign trade front, most of the items that were imported to India were routed through State Trading Corporation, a government controlled organization. Only a few items that were inconsequential to the total outflow or inflow of foreign exchange were kept in the list of Open General License (OGL). The basic structure of the import licensing categories can be summarized into five groups namely, banned list of items; restricted list of items which can be imported only under special circumstances, permissible list in which commodities which are imported required to take permission, OGL which do not require any permission and finally canalized items which are restricted to be imported only by public sector undertakings. This apart, import tariff systems in India is one of the most complex systems in the world. The relatively high level of import tariffs makes them an important source of revenue for the government. Import tariffs are the second largest source of government revenue after excise duties. The basic tariff structure in India can be divided into three parts namely, basic customs duty, auxiliary duty and additional or countervailing duty. All the duties applied on an average range between 50% - 600%. Traditionally in India to contain the balance of payments situation government often resorted to increasing tariffs instead of adjusting exchange rate Though tariffs were marginally reduced post devaluation in 1966 largely due to pressures from western economies, they were raised again during 1968 – 1974 to control the declining foreign exchange reserves.

With respect to exchange rate reforms, in September 1975, the Indian rupee was pegged to a basket of currencies. The currency selection and weights assigned were left to the discretion of the RBI. The currencies included in the basket as well as their relative

weights were kept confidential in order to discourage speculation. Thus, sending a signal of moving towards free float exchange rate regime in the future. In an another significant move, banks in India were allowed by the RBI to undertake intra-day trading in the foreign exchange markets in 1978.

As a part of financial sector reforms, for the first time in India, social control over banking was introduced through the Banking Laws (Amendment) Act 1968, which came into force on February 1, 1969. The main purpose for the introduction 'social control' over the banks was to check for inappropriate control over these banks by some of the industrial houses. There were wide spread fears that few business groups might acquire control over some of the commercial banks through the banks associated with them. This would not only lead to unfair trade practices, but would also jeopardize the interests of the small and medium scale depositors of the banks. However, despite the system of social control on banks, a large segment of the population in India still remained outside the purview of the organized sector credit. Also, the number of bank branches in the rural areas was less in number. Rather the concentration of banks and branches were mainly restricted to urban areas. In the light of these circumstances, it was felt that if the banking funds were to supplement the economic growth and development process of the country, the nationalization of at least some of the major and big banks was the only solution. This paved way for Banking Companies (Acquisition and Transfer of Undertakings) Ordinance, in 1969. According to this Ordinance, banks with a deposit base of over Rs. 50 crores were to be nationalized by the government of India. Accordingly, 14 major banks with their deposit bases over this amount were identified and were nationalized. Thus, the control of government over the banking sector began in 1969.

Further strengthening the control over interest rates, for the first time in June 1973, the RBI imposed a minimum lending rate of 10% on all loans, except for the priority sector. The oil crisis on the other hand led to severe balance of payments problem. This brought export credit into the priority list to boost exports. In April 1974, interest rates on deposits were increased for various categories pushing up the cost of funds for the banking sector. In view of the inflationary situation, the minimum rate chargeable against

selective credit controls was also raised in July 1974 (RBI, Banking Report, 2007). Thus, the inflationary pressures triggered a very high interest rate regime in India in the 1970s. The burden of very high interest rates also started to affect the small borrowers like agriculture famers, labourers and ordinary employees. To counter this problem, the RBI in 1976 prescribed the maximum rate for bank loans in addition to the minimum lending rates. Thus, the Indian financial system was completely under the clutches of the government creating a very complex administered interest rate structure with virtually no role for market forces to play in pricing and allocation of credit Added to that, in November 1978, private sector banks were also advised to maintain one-third of their total advances to the priority sectors by the end of March 1980.

The other major reforms in financial sector during this period include creation of Credit Guarantee Corporation (CGCI) in 1971 for providing guarantees against the risk of default in payment. In order to ensure the development of the rural economy by providing credit for the purpose of development of agriculture, trade, commerce, industry and other facilities, particularly to the small and marginal farmers, agricultural laborers and small entrepreneurs, Regional Rural Banks (RRBs) were set up in 1975. Another important scheme, the Differential Rate of Interest (DRI) system was instituted in 1972 to cater to the needs of the weaker sections of the society and for their upliftment. The scheme targeted low income people in rural areas and gave them credit at concessional rate. The target group of this scheme was landless labourers, physically handicapped persons, orphanages, women's homes, scheduled castes and scheduled tribes who did not have any tangible security to offer and to the lending institutions. Under this scheme for each bank were one per cent of its total advances of the previous year. This was not only the phase of bank nationalization, but also insurance sector. In 1972, government of India also nationalized 55 Indian insurance companies and the undertakings of 52 insurers carrying on general insurance business companies to form General Insurance Corporation of India (GIC) under General Insurance Business (Nationalisation) Act, 1972.

The 1980s – Winds of change?

By the end of 1970s, the high tariffs and Quantitative Restrictions regime and the license, permit raj had developed into a very complex, costly, administrative system in India. The process of economic liberalization started to begin slowly but was largely fragmented. The decisions taken by the government were slow and steady, the impact was felt in mid and late 1980s. During this period there were strong debates between the reformers and others who supported government intervention. While reformists argued that free float exchange rate should be used to manage trade flows. It was also argued that restricting the imports of capital goods and essential raw materials was inhibiting productivity and creating unnecessary economy wide inefficiencies. Further, they recognized that countries may benefit from reforms only if the government had the will to initiate these reforms. Because, according to them, if the government policies are rigid, marked with higher restrictions, regulations and lower incentives, high bureaucratic procedures and rules and regulations for business operations, restrictive labour laws, enforcement of contracts and so on and so forth would not only hinder growth and development in the host country but would also affect productivity and human capital as allocation of resources to other sectors becomes restrictive.

In one of the major steps in what appears to be change in mind-set of the government of India was setting up of Economic Administrative Commission under L.K. Jha during Indira Gandhi's tenure in 1982. The committee recommended the introduction of action plans in ministries, fixing levels for disposal of cases, streamlining the procedure for inter-ministerial consultations in order to ensure better service delivery system to the poor. The concept of market playing a more important role is further enunciated under the government led by Rajiv Gandhi during 1984 – 1988. Beginning the decade on a healthy note, government of India delicensed one sector in 1982. Further in an unprecedented move, the government of India delicensed 24 sectors in 1984 and another 24 sector in 1985 followed by one more sector in 1986 (Government of India's Economic Surveys, and the Handbook of Industrial Policy and Statistics 1987). As a part of further reforms measures government of India created special provision for liberal re-approval of

production capacity based on 33% increase over highest annual production in immediate previous years. This procedure was further liberalised to 49% in high end manufacturing industries. In addition, restrictions on imports of high end capital goods and other key raw materials were liberalised in phases. Industries in the core group list were expanded, corporate taxes and other excise duties were marginally rationalised and tax reforms in terms of introducing modified value added tax was reached (Tripathi, 1988).

In order to attract FDI inflows especially into those sectors which would result in transfer of technology, two more export processing zones were added to the existing two. Added to this, permission for wholly owned foreign subsidiaries of export oriented units with 100% ownership was granted. These firms are typically known to exporting 75% of their total output (Ganguly, 1990). In 1986 for the first time in Indian economic history, permissions were granted to foreign equity to participate in high intensive technology industries. In a similar historic move, 51% equity holding for foreign firms was allowed in tourism sector (Goldstein, 1990). With respect to foreign technical collaborations, the FERA, 1973 placed significant restrictions in terms of stringent rules and tax incentives to those collaborations in which foreign equity holding is marginally lower. Such incentives were completed removed from 1984-85 onwards. These legislative changes were paralleled with change in attitude in governments towards receptivity of foreign investments. In order to by pass the bureaucratic procedures and regulatory bottlenecks government of India formulated a separate “one-committee approval system” in which approvals for foreign collaboration projects would be given in less than 60 days (India Investment Centre, 1987).

As a part of trade reforms, in the early 1980s, government of India transferred most of the items that were earlier imported through State Trading Corporation to OGL, wherein these imports and exports could be routed through private firms. Nearly 350 importable items were liberalized in two years (1984–1985) and many more were subsequently added to the list of OGL. In a major move most of the products were delicensed except a few products which are listed in negative list. The government also resorted to import duties cut in the mid-1980s.

Similarly, tax reforms were also among the major reforms which were initiated by the government of India during the post 1980s. The tax efficiencies have significantly improved during this point in time comparing to 1970s and 1960s. High marginal income and corporate tax rates were significantly slashed down post 1984. For instance, high marginal corporate tax rate of 65% in 1984 was cut down to 55%. Similarly, high marginal income tax rate of 62% in 1984 was cut down to 50% in 1985. Most importantly, tax administrative reforms got a big boost during this period.

Though some reforms measures were initiated in all the sectors, government control in financial sector on the other hand kept increasing even during the 1980s. Addressing the further needs to strengthen the proper credit allocation and penetrate into the rural areas, six more large banks with a deposit base of over Rs. 200 crores were nationalized by the government of India. With this move, the total public sector banks in India constituted 91% deposit-base of the total banking sector. Apart from tight regulatory norms, micro controls, selective controls and social controls, the banking system in India started to witness ‘statutory controls’ to curb the excessive credit creation by the commercial banks. To control this, RBI used two most vital monetary policy instruments namely Cash Reserve Ratio (CRR) and Statutory Liquid Ratio (SLR). Both CRR and SLR were at all time high during the period 1960 – 1992 making cost of business exuberantly high in India.

Phase – III: Political chaos, Economic mess & Rebirth of an economy (1987 – 1996)

"*By June 1991, the balance of payments crisis had become overwhelmingly a crisis of confidence – in government's ability to manage the balance of payments…A default on payments, for the first time in our history had become a serious possibility in June 1991.*"

- The Economic Survey (1991-92)

The period 1987 – 1989 is a prelude to the macroeconomic crisis which India was about to face in 1990 – 1991. Despite change in the mind set of the policy markers in the mid-1980s and significant reforms being initiated, Indian economy was seriously hit by economic crisis in 1990 – 1991. There is combination of internal and external factors which played a greater role in inviting this crisis. We illustrate briefly each of these factors. The first external factor to affect the Indian economy was the gulf war between Iraq and Kuwait. It is well known that almost 80% of the India's import bill is accounted of oil. Both Iraq and Kuwait are India's largest oil exporters. With the former, India had some long term contracts. This also in a way led to more permanent disruption of oil supplies from Iraq. Due to the war between the two countries the prices of the oil for the eight months starting from July 1990 to February 1991 sky rocketed effecting India's oil imports bill. For example the value of oil imports increased from US$ 2 millions in 1990 to US$ 6 millions in 1991. This apart, India's export earnings declined from these countries because of significant drop in India's exports to both Iraq and Kuwait. Moreover, remittances from Indian workers in both these countries have drastically come down. The second and most important external factor leading to India's crisis was a very slow growth in important trading partners. During this period, the export markets of India were growing at a very slow pace. For example U.S. economic growth, India' largest export market, declined from 3.9% in 1988 to -1% in 1991. The situation was almost similar in many other European countries. Consequently, India's exports growth slowed down considerably at this point in time. This was largely due to world wide economic recession in 1990 – 1991 which was building up from 1987 stock market crash in U.S.A. Finally, the collapse of former Soviet Union also had its toll on Indian economy. Soviet

Union was also one of the largest trading partners of India. India's exports to Russia significantly dropped during the period 1989 – 1991. This apart, trade with majority of the Eastern European countries and the then East Germany was financed by long-term trade credits. After the reunion of Germany, change in political regime in many of the Eastern and Central European countries like Poland means payment arrangements were terminated in 1990-91. As a result the share of these countries exports in India's total exports considerably gone down during this period.

Coming to internal factors, first and the most important thing is the series of high fiscal deficits in the late 1980s was a major cause of the economic crisis in India. The gross fiscal deficit increased significantly from an average of 7.2% in the 5 years 1980-1985 to 8.9% in the next period, 1985-90, and even further to 9.4% in 1990-91 (RBI, 2000). This eventually affected current account deficit, which kept rising steadily until they reached 3.5% of the GDP and 43.8% of total exports in 1990-91. The eventual outcome of these developments was the macroeconomic crisis in 1990-91.

Another major internal factor which has rather indirectly affected the crisis is the political uncertainty which peaked during the period 1989 – 1991. Allegations of huge corruption, nepotism, bureaucratic hassles (popularly known as 'babudom') for getting basic things done led to poor electoral performance of the Rajiv Gandhi led Indian National Congress (INC henceforth) party in 1989 general elections. Though the INC lost the general elections, in a fractured mandate, it emerged as single largest party. But Rajiv Gandhi refused to form a coalition government with the support of other parties. In the wake of this development, the Janata Dal party led by V.P. Singh, former finance minister during Rajiv Gandhi's INC government, 1984 – 1989, formed a coalition government in a rather strange support from both the lefts, Left Front (the front of Communist parties led by CPI-M, CPI, Forward Block and others) and the rights, Bharatiya Janata Party (BJP, profoundly known as Hindu National Party in international media) from outside the Parliament. Soon troubles began for the Janata government when V.P. Singh accepted the Mandal commission report on reservation for Other Backward Castes (OBCs henceforth) in August 1990. The announcement of OBC reservations in government led

to series of demonstrations and agitations for and against reservation, which continued for months. Business, schools, private life of general masses was greatly affected due to these violent protests. On the other hand, denying opening the locked doors of Lord Ram temple in Ayodhya, Uttar Pradesh, led the BJP withdrawing support to the Janata Party led government. A fraction of the Janata Party members broke away from V.P. Singh and formed the government with the help of INC's support from outside the Parliament. Chandrasekhar became Prime Minister of the country. However, reports of internal rifts between coalition partners and INC continued to surface and doubts about stability of the government turned into reality as government collapsed in 1990 after withdrawal of support by INC. As a result, a caretaker government was set up until the new elections that were scheduled for May 1991. The most important aspect noteworthy is that in this political entanglement for power, the political community replaced economy with capturing power as priority during an important period of three years during which the country was facing severe economic pressures from various internal and external factors.

The economic crisis forced the government of India to pledge the gold reserves with IMF to secure funds to avoid default its external debt obligations. All these events had a dramatic impact on business confidence in the country. Questions about the ability of the Government of India to manage the Indian economy and to deal with the economic shocks were often raised. Institutional ratings of Indian economy were significantly down during this point in time. While manufacturing sector registered negative growth rate, foreign investors were shying away from investing in India.

No More Years of Solitude – 1991, beginning of a new era

The assassination of Rajiv Gandhi while campaigning for the elections in Southern India on May 21, 1991 eventually led to sympathy wave giving almost a near to majority margin to INC in general elections in 1991. Under the leadership of P.V. Narasimha Rao and able Finance Ministry of Dr. Manmohan Singh, began India's new era. The July 1991 budget speech was considered a landmark in Indian economic history. In all sectors, there was a complete U-turn as far as the policy framework was concerned. Thus, began

India's journey of moving from market distorting policies to initially market correcting policies and eventually leading to market creating policies. Accordingly, we can broadly classify the reforms into five categories namely, (a) Industrial reforms (including public sector reforms); (b) International Financial reform (including exchange rate management reforms); (c) Domestic Financial reforms (including capital and money market reforms); (d) Fiscal reforms and (e) Social Sector reforms. We focus briefly on each of these categories one by one.

a. Industrial Reforms:

As a part of industrial policy reforms, government of India issued a new Industrial Policy in 1991. In a historic move, the government of India exempted 42 industries from the list of obtaining mandatory licensing. Similarly, another 42 industries were delicensed in 1992. Two more industries were added to this list in 1993. Exemption from licensing was issued not only for all new units, but also for those having an investment of Rs. 2.5 crores in fixed assets, and an entitlement to import up to 30% of the total value of plant and machinery. However, in 18 strategic industries industrial licensing system remained. Also, investment ceiling for small industries were removed. This apart, location restrictions were also removed. In one of the most important decisions, the pre-entry scrutiny of investment decisions of MRTP companies was abolished.

Major initiatives towards restructuring of public sector units (PSUs) were initiated beginning with referring the sick PSUs to Board for Industrial and Financial Reconstruction (BIFR). The government of India also setup Rangarajan committee to study the feasibility of disinvestment of some of the PSUs in 1993. Government of India also began disinvesting its stake in some of the PSUs. From 1992 to 1996, the total target set was Rs. 19,500 crores. Out of that, total Rs. 12,022 crores were realized, which is around 62%.

Following the New Industrial Policy of 1991, large number of foreign MNCs from different parts of the world rushed to enter into the huge Indian market. Companies like

General Motors, Ford Motors, and IBM that divested from India in the 1950s and 1970s reentered India during this period. A large number of Asian companies like Daewoo Motors, Hyundai Motors and LG Electronics from South Korea, Matsushita Television and Honda Motors from Japan invested in India during this period. FDI up to 51% equity was allowed in 34 formerly high priority industries and the concept of phased manufacturing requirement on foreign companies was removed. Foreign equity up to 51% was also allowed in trading companies primarily engaged in export activities. This apart, investment of foreign equity up to 40% was freely allowed. Also, FDI up to 100% has also been allowed under automatic route for most manufacturing activities in Special Economic Zones (SEZs). The performance requirements of whatsoever either for foreign firms to operate in India was scrapped. Similarly, relaxation of highly restrictive norms and regulations for entry of foreign firms in terms of approvals, licensing were significantly reformed. As a part of these measures, many stringent rules and regulations in FERA were liberalized.

b. International Financial Reforms:

Major reforms measures were introduced as a part of international financial sector reforms. To begin with we focus on exchange rate reforms. A two-step adjustment of exchange rate in July 1991 effectively brought to close the regime of a pegged exchange rate. Liberalized Exchange Rate Management System (LERMS hereafter) was put in place in March 1992 initially involving a dual exchange rate system. Under the LERMS, all foreign exchange receipts on current account transactions (exports, remittances, etc.) were required to be surrendered to the Authorized Dealers (ADs) in full. The rate of exchange for conversion of 60% of the proceeds of these transactions was the market rate quoted by the ADs, while the remaining 40% of the proceeds were converted at the Reserve Bank's official rate. The ADs, in turn, were required to surrender these 40% of their purchase of foreign currencies to the Reserve Bank. They were free to retain the balance 60% of foreign exchange for selling in the free market for permissible transactions. The LERMS was essentially a transitional mechanism and a downward adjustment in the official exchange rate took place in early December 1992 and ultimate

convergence of the dual rates was made effective from March 1, 1993, leading to the introduction of a market-determined exchange rate regime. In the process, government of India initiated steps to fully liberalize the current account convertibility in the union budget of 1991. Major step in this direction was relaxation of amendments in FERA act on surrender of export proceeds. The unification of the exchange rate of the Indian rupee in 1993 was an important step towards current account convertibility, which was finally achieved in August 1994, when India accepted obligations under Article VIII of the Articles of Agreement (AOA) of the IMF.

Several trade reforms initiatives were also carried out by government of India. The peak customs duty was brought down from 80% in 1991 to 35% in 1997. This apart, the government of India repeatedly pledged in all the union budgets that the peak customs duty would be brought down to Association of South East Asian Nations (ASEAN) levels by 2015. The import duty collections rate on agricultural products came down from 27% in 1991 to 15% by 1997. Likewise, import duty collections rate on industrial products was down from 51% in 1991 to 30% by 1997. The anti-export bias in the trade and payments regime was also reduced substantially by a phased reduction in the exceptionally high customs tariffs and a phased elimination of quantitative restrictions on imports. Policies were initiated to encourage foreign portfolio investments. In September 1992, foreign institutional investors were permitted to invest in India with some marginal restrictions.

c. Domestic Financial reforms:

In order to realize the full potential of reforms in the real economy, the need was felt for a vibrant and competitive financial sector, particularly, banking sector. For this purpose, the government of India appointed a high power committee to provide the recommendations on banking sector reforms. M. Narasimham, former RBI governor was appointed as Chairman of this high power committee. In November 1991, the committee submitted it’s banking sector reforms report and government implemented almost all the recommendations suggested.

In a major step forward, in May 1992, RBI issued greater freedom to banks in the matter of opening of branches. This does not require any special permission or extensive licensing requirements to open a new branch. A commitment was made by the government of India in the Uruguay Round of talks at WTO (World Trade Organization) to allow 12 licenses a year for new entrants and existing banks. However, India adopted a more liberal policy in permitting branches of foreign banks, thus over reaching the limits of the number which was promised at WTO meeting. In 1993, another important step in banking reforms was to allow private and foreign banks to open offices in India. In 1994, the government of India amended the Banking Companies (Acquisitions and Transition of Undertakings) Act 1970 allowing public sector banks to raise funds through capital markets to their capital up to 49% in order strengthen their capital base. In a major reforms initiative, all the commercial banks were also provided with freedom to fix their own deposit and lending rates. Thus, marking the era of free interest rate regime where the interest rates from then on were determined by the market forced and not by the regulatory authorities. All kinds of controls on both deposit and lending rates were deregulated by the RBI in mid-1990s. Over the years it has been observed that the administered interest rate regime proved to be inefficient and costly, without necessarily ensuring the flow of credit to the needy. Banks were allowed to charge interest rate on loans against fixed deposits equal to or less than their Prime Lending Rate (PLR). Deregulation of interest rates implied that banks were able to fix the interest rates on deposits and loans, depending on the overall liquidity conditions and their risk perceptions.

Government reduced Statutory Liquidity Ratio (SLR) to 25% and fixed it thereafter in 1997. Similarly, progressive reduction in CRR was also done. From 15% in 1990, the CRR came down to 5% in 2006. As on 2008, CRR is 3% in India. Steps were also taken to phase out of directed credit programs and redefined the priority sector. RBI stipulated minimum capital adequacy ratio of 4% to risk weighted assets to all the banks by March 1993, 8% by March 1996, and 8% by those banks having international operations by March 1994. The banking system was also made to adopt a uniform accounting practices

in regard to income recognition, asset classification and provisioning against bad and doubtful debts. RBI also set up of special tribunals to speed up the process of recovery of loans. Likewise, Asset Reconstruction Funds (ARFs) was also set up to take over from banks a portion of their bad and doubtful advances at a discount. In a further move to liberalize the banking environment, it was decided in December 1994 that banks need not obtain the Reserve Bank's prior permission for installation of Automated Teller Machines (ATMs) at licensed branches and extension counters. Banks, however, were required to report such installation, if any, to the RBI. Banks were also given the freedom to install ATMs at other places, in which case they should obtain a license from the concerned regional office of the Reserve Bank before operationalization of off-site ATMs (RBI Banking Report, 2007). As a part of strengthening the institutional system within banking sector, the Board for Financial Supervision (BFS) was set up by RBI to attend exclusively to supervisory functions and provide effective oversight in an integrated manner over the banking system, financial institutions and non-banking financial companies. The BFS initiated several measures to strengthen the supervisory systems. In order to have in place 'an early warning system' to take prompt corrective action, a computerized Off-Site Monitoring and Surveillance (OSMOS) system for banks was instituted in November 1995 (RBI Banking Report, 2007). Banks were given the total freedom to decide on the methodology of assessing working capital requirements. It was for corporates to convince banks about their working capital needs. Corporates could choose to go through a single bank, consortium arrangement or take a syndicate route. Thus, the concept of 'consortium lending' in banking system emerged. All restrictions relating to project loans by commercial banks were withdrawn. Traditionally, project finance was a domain of term-lending institutions. Thus, the concept of 'universal banking' in India started to emerge.

In its history of 126 years, the Bombay Stock Exchange (BSE) has seen several changes, but nothing like this any before. First and the major reforms measure to enthuse capital markets was to set up a firm and autonomous regulatory body governing stock market and money markets in India. As a result, Securities Exchange Board of India (SEBI) was created with powers in 1992. This also coincided with scrapping of its oldest regulating

act, the Capital Issues Control Act of 1947. Government of India relaxed the norms for Indian firms to raise capital form abroad. Soon many Indian companies started tapping external sources for securing funds. As a result many Indian companies issued American Deposit Receipts (ADRs) and Global Deposit Receipts (GDRs). Indian companies went ahead in getting listed in NASDAQ and other international stock exchanges. For the first time, modernized stock exchange, National Stock Exchange (NSE) and Over The Counter Exchange of India (OTCEI) were set up by government of India in November, 1992. By 1996, NSE goes on stream and launches 'screen based trading' for the first time in India. The BSE in 1995 launched its own online trading system called BSE Online Trade (BOLT). Likewise, the government of India also allowed the entry of private and foreign players into mutual fund industry which was otherwise restricted to only a handful of public sector players from 1987 to 1993. After several scams, in order to facilitate proper transactions, government of India in November 1996 set up National Securities Deposit Corporation (NSDC). Finally, as a part of corporate governance drive, steps to corporatize BSE in the lines of NSE were initiated by the government of India.

d. Fiscal reforms:

Tax reforms during 1990s have been mainly guided by the report of the Chelliah Committee on tax reform in 1993. The main objectives have been simplification of the tax system, rationalization of tax rates, fairness in tax system, improvement in tax administration and above all providing a growth promoting tax structure. The wide range of reform measures taken during the last decade included in the case of direct taxes comprise moderation of tax rates, widening of tax base, incentives for development of infrastructure and housing and strengthening of enforcement, and in the case of indirect taxes: reduction in multiplicity of rates, rationalization of the rate structure, drastic reduction in the scope for discretionary changes and uniform floor rates for sales tax by the States. Further, rationalization and improvements in tax administration, is of course a continuing process. The focus was also laid on changing the financing pattern of the fiscal deficits through borrowings at market rates and reduced dependence on the system of monetizing the deficits. Similarly, changes in expenditure pattern through reduced

transfer payments on services, subsidies, budget support to public sector entities, were also give due importance.

d. Social Sector reforms:

It is widely recognized by the government of India when economic reforms measures were initiated that the gap in social development needed to be closed. The gap must be closed by not only improving the welfare of the poor and increasing their income earning capacity, but also to create the preconditions for rapid economic growth. Thus, the major objective of the government in the early 1990s was to increase the social sector and rural development spending rapidly. The focus was not only laid on increasing the social sector spending, but also targeting subsides properly to ensure the subsidy amount reaches to the needy. Dev and Mooij (2002) find that central government expenditure on towards social services and rural development increased from 7.5% of total expenditure in 1990-91 to 10.5% in 2001. This apart the government of India also resorted to various social and rural sector development programs like food for work program, employment guarantee programs, Education schemes, labour welfare programs and many such programs. Some of the most important landmark programs during the first half of reforms years in India are the 73rd and 74th amendments to the Constitution of India in 1992. In this, each state was required to enact its own Panchayati Raj Act thereby setting a three-tier local government structure. Separate seats were reserved for women and lower caste people. This empowered the local bodies by allowing them to collect certain taxes, duties and toll taxes. Next on the list is Community Based Nutrition Project (CBNP) was started in Kerala in 1994 in which the women are encouraged and funded to start their own small businesses from a tea and coffee shops to restaurants or even fishing businesses. Likewise, in 1995 the Rogi Kalyan Samiti (RKS) in Madhya Pradesh in which management of hospitals was handed over to the society of people’s representatives of RKS. As a result, the hospitals are fully self equipped and self financed since the minimal fee charged goes straight into the hospital accounts. This scheme began with just one hospital in 1995 is spread to over 605 hospitals by 2002 and by 2007 to over 1000 hospitals. The education guarantee scheme in 1997 in the same state was also a huge

success in which a community that doesn't have school within one kilometer has to list 25 children, arrange for a space for a school and identify a teacher in that village and present the demand to the head of the village (called Sarpanch). In this scheme the state government guarantees a nicely built school within 90 days of the application being given to the head of the village. The state government also allows a minimal salary to the teacher along with supplying the study material to the children. In a major initiative by the then Chief Minister of Andhra Pradesh, N. Chandrababu Naidu, the program of Janmabhoomi (land of birth) used the local people instead of construction firms and contractors in developing their villages. Around 30% cost of the project was funded by the government and remaining 70% by the villagers. Technical and administrative powers to sanction works have been delegated to the community and procedures were simplified.

Phase – IV: Towards Economic Stardom (1997 & beyond)

The first generation reforms which began with a great fan fare saw a flurry of activity from the government of India in terms of putting a permanent full stop to licences, permits and inspector raj, automatic approvals of FDI up to 51% in majority of the industries, making rupee convertible on current account, opening up of financial sector to the outside world, initiating some bold trade reforms measures and some innovative social sector projects. But in 1996, it appeared that this buzz was short-lived as the beginning of economic reforms post 1997 saw the fizz literally dying. Despite numerous promises there were no major reforms were carried out in agricultural sector, public sector restructuring and labour laws. Two most important reasons for this is political uncertainty paving way for coalition politics and more so, the ruling government being the United Front which is a loosely held coalition government consisting of various small regional parties propagated by Left front parties and supported by INC from outside the Parliament. Both the ruling government and opposition were so fractionalised that it made life virtually difficult for the reformist finance minister, P. Chidambaram to introduce some of the tough economic reforms policies. As a result several reforms measures from disinvestment program to labour market reforms came to a complete grinding halt. Subsidies kept hurting government finances, power sector reforms remained in a mess, and bureaucratic processes still had its impact on the general business as well as consumer class. Thus, politics of coalition and populism blocked economic reforms during this period. This situation created thoughts in the minds of several Indians that reforms have reached its dead-end. But this was not so, as in 1998, the United Front government collapsed after INC withdrew its support from outside the Parliament. The general elections in 1998 again produced a hung verdict, in which the BJP emerged as single largest party, way ahead of other national parties. Taking support from many liked minded and anti-INC regional parties it formed government in centre under the banner National Democratic Alliance (NDA). The one good thing which the NDA-led government embraced was the continuation of economic reforms which was started by INC in 1991.

a. Industrial Reforms:

As a part of industrial policy reforms, seven more sectors were delicensed in 1998. One each sectors were further delicensed from 2003 to 2006. Significant reforms were initiated with respect to attracting FDI inflows into India especially post South East Asian crisis. The FDI limits were raised in the print media (up to 74%); Defense sector (up to 26%); private banking sector (up to 74%), oil exploration (up to 100%), petroleum product marketing (up to 100%), petroleum product pipelines (up to 100%), natural gas and LNG pipelines (up to 100%) and printing of scientific and technical magazines, periodicals and journals (up to 100%). More recently, the FDI ceiling in telecom sector in certain services was increased from 49% to 74%. Further, equity participation up to 24% of the total shareholding in small scale units by other industrial undertakings (including foreign firms) was also allowed. The objective therein has been to enable the small scale sector to access the capital market and encourage modernization, technological upgradation and ancillarisation. It is also noteworthy that as a part of further streamlining the relaxation of regulations, the government of India has merged the route of FIPB approvals with RBI's automatic route from 2001. Since then, the FDI inflows could be approved either through the automatic route or through the government route.

The real changes in the disinvestment process in India actually begun during the NDA rule. The government in March 1999 took a major decision of classifying the public enterprises into strategic and non-strategic areas. Except few industries like defense, railways, mining and minerals and atomic energy, the government decided to take the disinvestment plans on a case-by-case basis in the area of non strategic sector. In 1999, the government also created a separate ministry for disinvestment. During the period 1998 – 2004, government stake in as many as 28 companies have been sold in varying degrees. In some cases it was a strategic sale in which management control was genuinely transferred to a private partner. In some cases it was offloading major stake but the ownership control was retained by the government. In other cases it was a pure slump sale, while in minority of the cases it was pure disinvestment. Post 2005, with new

government in power which relied heavily on Left parties support did not allow the government to privatize any major public sector undertakings. However, in some public sector undertakings, the shares were offloaded.

Other major reforms under industrial reforms include: reservation of items of manufacture exclusively in the small scale sector has been an important tenet of industrial policy. Realizing the increased import competition with the removal of quantitative restrictions since April 2001, the Government has adopted a policy of dereservation and has pruned the list of items reserved for small scale industries sector gradually from 821 items as at end March 1999 to 506 items as on April 6, 2005. Further, in a most significant move, under the framework provided by the Competition Act 2002, the Competition Commission of India was set up in 2003 so as to prevent practices having adverse impact on competition in markets.

b. International Financial Reforms:

With respect to international financial sector reforms one of the significant reforms measure include replacing the FERA, 1973, that regulated all foreign exchange transactions with Foreign Exchange Management Act (FEMA), 1999. The objectives of FEMA have been to facilitate external trade and payments and to promote orderly development and maintenance of foreign exchange market. With replacement of FERA with FEMA, majority of the restrictions on export proceeds have been relaxed. Exchange rate was completely made free float. Attempts were also made to convert the rupee fully on capital account with the appointment of Tarapore committee. The foreign participating in JVs was increased from 51% to 74% in most of the industries in 1999. Subsequently this was increased to 100% except in few strategic sectors in 2001. Foreign firms were given full access to Indian market with access to all industries except six key industries.

With respect to trade reforms, quantitative restrictions on 722 products were first removed in the Export-Import policy of India in 1998. After that, 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. Due to removal of quantitative restrictions, there was a slight increase in the tariff rates on agricultural and industrial products. For example the imports collections duty on agricultural products increased from 15% in 1998 to 40% in 2001 before going below 30% by 2007. Same is the case with industrial products. Even the peak customs duty increased from 30% in 1998 to 35% 2001. Overall, the peak customs duty was reduced from thereon to 12.5% by 2006. As on 2009, the peak customs duty in India is 10%, thus inching closer towards the promise it made in mid-1990s to bring down the peak customs duty to ASEAN levels by 2015. Anti-export bias was completely eliminated from late-1990s. The total customs collections as percentage to imports in India have come down to below 10% by 2006.

c. Domestic Financial Reforms:

In financial sector reforms, to further strengthen the banking system, Committee on Banking Sector Reforms – (CBSR) under the Chairmanship of M. Narasimham was appointed by RBI. The committee submitted its second report in April 1998. Most of the recommendations were implemented by the government of India but slowly and gradually. Important among them include raising the capital adequacy ratio to 10% from the 8%; 9% in 2000 and 10% in 2002, 11% in 2003, 12% in 2004. In order to rationalize staff strengths, an appropriate Voluntary Retirement Scheme (VRS) were introduced by almost all the public sector banks with the full backing of government of India. Banks having high non performing assets were asked to transfer their doubtful and loss categories to ARCs which would issue Government bonds. In a major reform initiative, the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002 was enacted in March, 2002. To further strengthen the banking system, a Risk Based Supervision (RBS) approach that entails monitoring according to the risk profile of each institution was initiated on a pilot basis in April 2004. Finally much awaited reforms initiatives in banking sector include increase in the FDI limit in private sector banks under the automatic route to 49% in 2001 and further to 74% in March 2004, including investment by foreign institutional investors, subject to

guidelines issued by the RBI. Likewise, Amendments to the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 and 1980 were also carried out to allow nationalized banks to have access to the capital market, subject to the condition that the Government ownership would remain at least at 51% of equity of nationalized bank.

Another significant reform in financial sector was creating a separate regulator for insurance sector. An interim Insurance Regulatory Authority (IRA hereafter) was setup through a resolution in which K.C. Mittal & N.M. Govindharajan were members. IRA bill drafted and introduced in the parliament and referred to the standing committee. The final report of the standing committee was presented. Government of India gave greater autonomy to LIC, GIC, and their subsidiaries with regard to the restructuring of boards and flexibility in investment norms aimed at channeling funds to the infrastructure sector. Similarly, it also allowed 40% foreign equity in private insurance companies and 14% to overseas corporate bodies and financial institutions. The IRA bill when presented in the parliament was referred to standing committee on finance. The standing committee headed by Murali Deora decides that forging equity in private insurance should be limited to 26%. The IRA bill is renamed as the Insurance Regulatory and Development Authority (IRDA). After the clearance from the Cabinet, it was passed in Parliament paving way for President giving his assent. Thus, Insurance Regulatory and Development Authority (IRDA) was formed.

With respect to capital market reforms, new listing regulations were issued in 2000 followed by launch of internet trade by NSE and BSE. In a major reform measure, for the first time in India government of India allows derivatives trading in the form of index futures in both BSE and NSE. In order to promote securities lending and borrowing activities Borrowing and Lending Securities Scheme (BLESS) was formulated in 2001. After a major securities scam in 2001, the process of corporatization of BSE was initiated. From demutualization the BSE was corporatized formally in 2005. In an effort to reduce paper cost and move towards international practises, BSE and NSE introduce dematerialization of scrips from 2001. Finally, government allows trading of options of individual scrips and futures in individual stocks in 2002.

d. Fiscal Reforms:

As a part of tax reforms measures, the government of India focussed on streamlining of tax rates which removed uncertainty in the minds of business community. The tax rates were slashed significantly from 1991 to 2006. The high marginal income tax rates were brought down from 40% in 1995 to 30% in 2006. Likewise, the corporate tax rates were also cut from 43% in 1995 to 33% in 2006. The tax administration helped bringing down the tax defaults. On the other hand the reduction in tax rates were complimented by expanding the tax base by including as many services as possible each year in the union budget under service tax. The tax efficiency due to both these measures surged significantly. It was estimated by the government that from 2005 to 2008 are the best years in Indian tax history wherein the tax efficiencies were at all time high. In an another significant move, the government of India started to phase out slowly but steadily unnecessary exemptions from the tax system. To contain expenditure, the focus was particularly laid on phasing out those subsidies which were not important and were not properly utilised. The expenditure reforms also focused on curtailing unproductive expenditure. In order to ensure fiscal discipline the Fiscal Responsibility Enactment Bill proposed by government finally became Fiscal Responsibility Budget Management (FRBM) Act in 2003 which mandates the central government to eliminate revenue deficit by March, 2009 and to reduce fiscal deficit to an amount equivalent to 3% of GDP by March, 2008. The annual targets for fiscal correction were to be specified by rules to be framed under the Act. The rules also prescribe the formats for the medium term fiscal policy statement, the fiscal policy strategy statement and the macro-economic framework statement, which are required to be presented to Parliament along with the annual financial statement. By the late 1990s the state finances went out of control. In a joint effort on the part of the central government as well as state governments devised a medium term strategy for fiscal reform programs in the States. This strategy has taken the form of a package of advance financial assistance to be provided by the centre to the states for an appropriate time bound reform program by signing a Memorandum of Understanding (MOU). Thirteen states entered into an agreement with the centre. These

states are Punjab, Rajasthan, Himachal Pradesh, Manipur, Nagaland, Mizoram, Orissa, Sikkim, Uttar Pradesh, Madhya Pradesh, Assam, Andhra Pradesh and Jammu & Kashmir. The main objective of the program is to wipe out the revenue deficit in the state budget in the medium term. It also stressed on drastic cut in non-plan revenue expenditure, through appropriate taxation and expenditure measures and down-sizing of government, wherever possible. Focus was also laid on improving allocative efficiency and bringing subsidy reforms along with efficiency in delivery of public services. Lastly, one of the major reforms in taxation policies in India ever since independence is bringing consensus among state governments within just four years to introduce and implement Value Added Tax (VAT hereafter) in 2005. It is said that in countries like U.K. it took 10 or more years to introduce VAT. India is the only country which has introduced VAT in such a short span on time. Now India is a part of other 123 countries following VAT which was lead first time by UK in 1973.

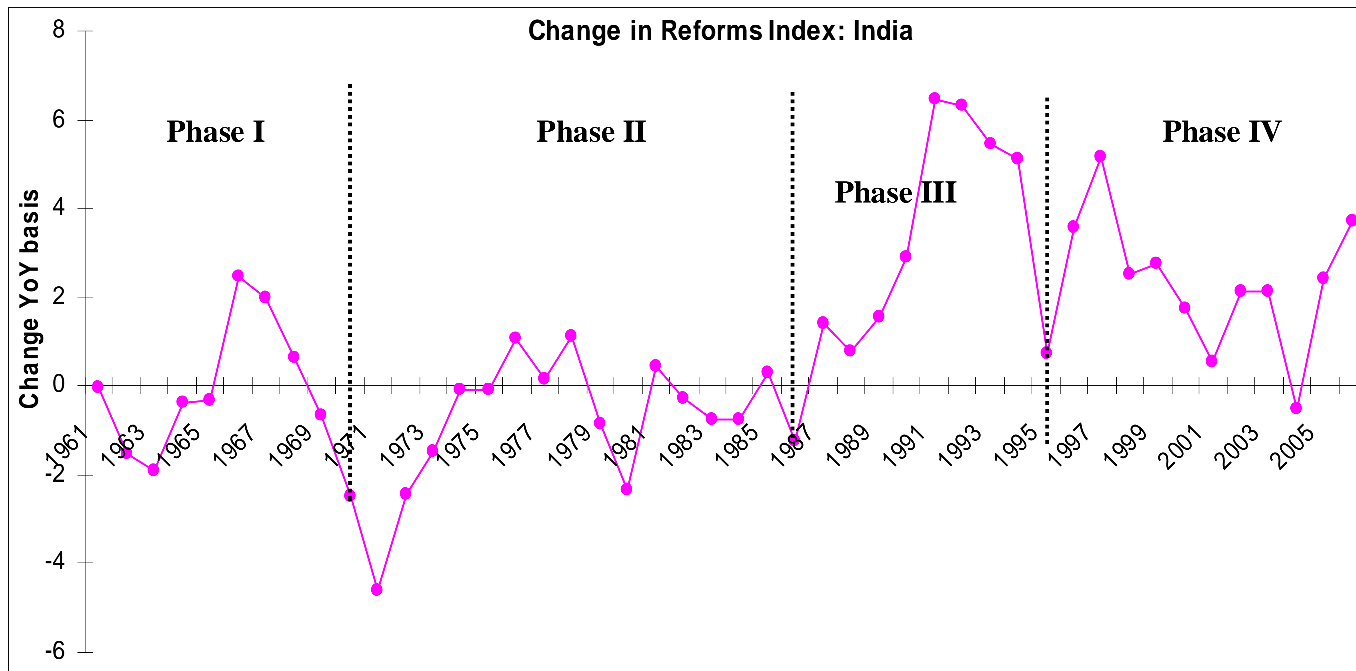
e. Social Sector Reforms:

Social sector reforms also had its share in overall reforms in post-1998 period. The government of India initiated various welfare schemes and programs for upliftment of the poor and the needy. Education schemes, mid-day meals programs to poor school children, rural employment guarantee programs, labour intensive projects providing short term employment for the rural workers, women empowerment schemes were all launched. Amidst these populist schemes, some stand out. By the early 2000, it appeared to the rural and urban masses that the 'great Indian wait' is almost over. In India it is very common that to get the basic things done, one has to wait for long at the district headquarters or at various government offices and submit the applications and obtain copies of the same to maintain the records and then keep waiting for the appropriate action to be taken by the government bureaucrats. In some way this style of working also increased inefficiencies in the public sector and also significantly encouraged corruption. To avoid these problems first time in Andhra Pradesh the project called TWIN Cities Network Services was initiated by N. Chandrababu Naidu government in Andhra Pradesh. Launched in 2000, the project help providing one-stop online shop for as many

as 18 to 20 government services. These include issuing driving licenses to paying property tax and other municipal taxes online. By the end of 2002, this project was a success and was later expanded to other districts. The major advantage for the people through this project is that it helped delink the masses with dealing with various government departments. Later on, many new items like paying telephone bills, electricity bills were also brought under this project. Similarly, his government in Andhra Pradesh has also started a new scheme for people called "E-seva" (Electronic Seva, meaning, electronic help). Under this scheme, people with minimum knowledge of operating computers were given jobs to help people pay their basic monthly bills starting from electricity, telephone, municipal, property and other taxes through these counters. Acceptance of applications for passports was also brought under this scheme. This was a huge success and was expanded to all parts of the states. In a similar attempt, Andhra Pradesh, Karnataka and Punjab launched Electronic Land Record System in which the registration of land records are done online and the entire process would be completed in just one hour. This was done through Computer-aided Administration of Registration Department (CARD). More than Rs. 50 crores projects now cover over 300 offices and more than Rs. 50 lakh transactions have been done till date. Winner of an international award, the program of Gyandoot (knowledge centre) was launched by the then Madhya Pradesh government in 2002. It connects the district headquarters to 21 multimedia kiosks or rural cyber cafes. This works between 20 - 30 villages in the state. The basic services include daily commodities marketing information including prices, copies of land records, bank loan information, information even on sale of various dairy commodities including cows, online land registrations and other government certificates. In other social service reforms, the introduction of Central Vigilance Commission in 1998 to control corruption and Right to Information Act in 2004 is often widely seen as major success.

The graph 2 captures the change in economic reforms index during the period 1960 – 2006. We divide this indicator into the aforementioned four phases.

Graph 2



The change in reforms index substantiates the text on economic reforms process in India during these four phases. The liberal economic regime in the 1950s and mid-1960s was converted into one of the most rigid economic regimes by introducing market distorting policies throughout the period of over 20 years starting from 1966 to 1986. The phase 1 and 2 in the above graph captures this path. The change in reforms was negative in as many as 18 financial years during the period 1961 – 1986 (26 years), which is around 69%!!! Post 1986, the change in economic reforms index became negative only in 2004 amidst of early call for general elections by the incumbent government. The change in reforms index was at all time high during the entire period beginning from 1988 to 2001. Overall, during the period 1961 – 2006, 45 years, the change in reforms index was negative for 19 odd years, which is about 44%. The negative change in reforms can also be interpreted as reversal in economic reforms in India.

The table 3 provides the list of events during the period 1961 – 2006 which eventually led to reversal or slowing down of economic reforms process considerably.

Table 4: List of events leading to slow down of reforms

Years	Events
1961	Excessive shortfall of funds to finance ongoing Second five-year plan
1962; 1963; 1964; 1965	External war with China in 1962 Post war effects of high deficit in 1963 and 1964 External war with East Pakistan in 1965 followed by severe drought
1969; 1970	Very low foreign exchange reserves forcing government to tighten restrictions and control hoardings by private and foreign players
1971	External war with East Pakistan
1972	Post war effects of high deficit and high inflation
1973; 1974	Years of first major oil crisis
1975	Abolishing democracy and implementing Emergency rule
1979; 1980	Heightened political instability
1981; 1982; 1983; 1984	Second oil crisis and debt crisis in other parts of the world
1986	Looming fiscal and balance of payments deficit
2004	Call for early general elections by incumbent government

6. Economic Reforms – Some Stylised Facts

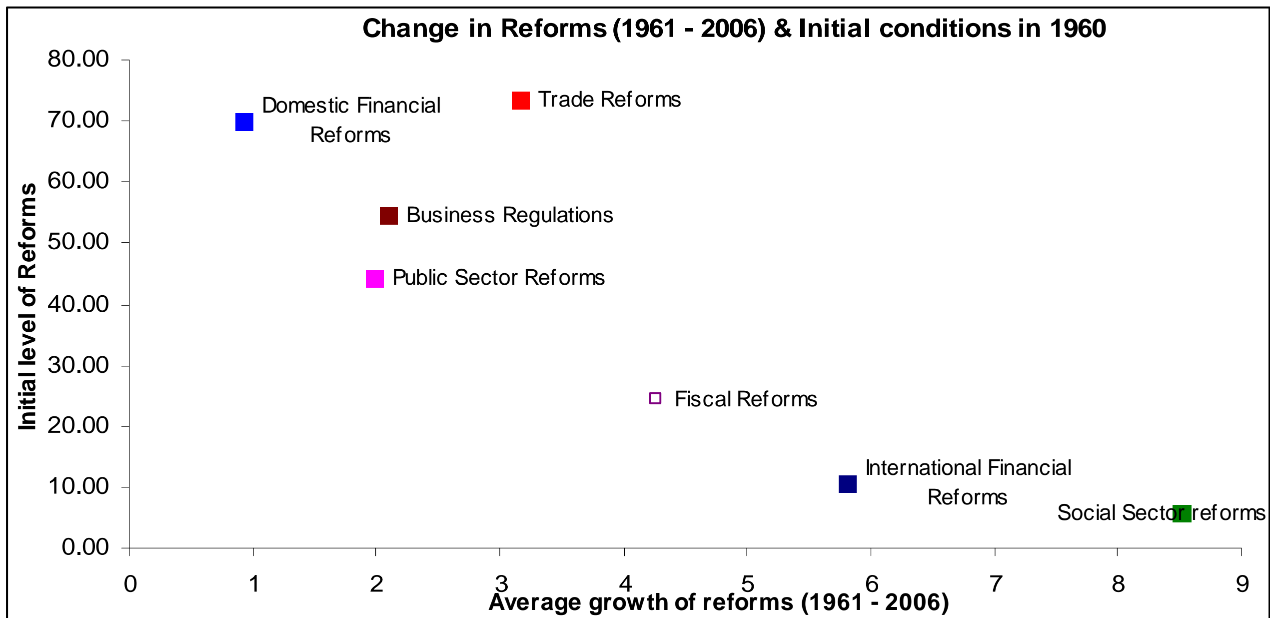
In this section we attempt to understand and present some of the important stylized facts with respect to reforms in India. We briefly examine the reforms conditions and the process of reforms by segment and period.

6.1. Initial Conditions of Reforms:

We begin with examining the initial conditions of reforms in India in all the seven reform areas. To compute the initial conditions we take the value of reforms index in 1960 for all

the seven subsectors. We then compute the average rate of growth of reforms in all these seven subsectors from 1961 to 2006. An increase in the score from the previous year signals the liberalization of policies on a whole in each sector.

Graph 3



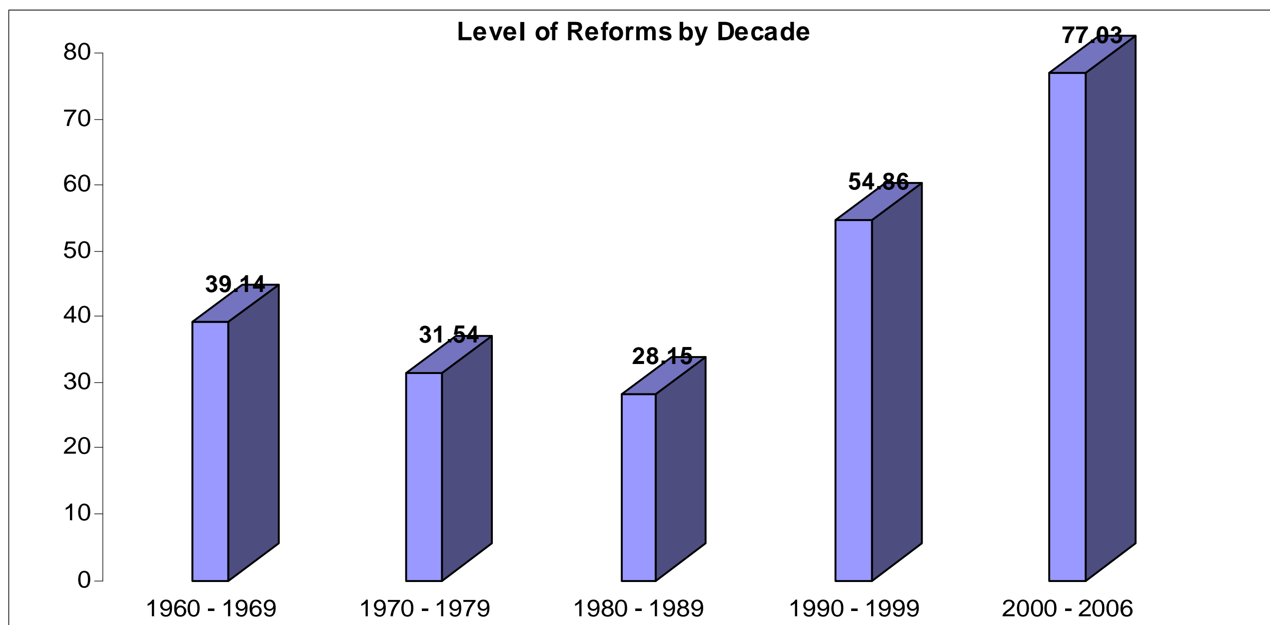
During our study period, the highest index score was recorded as 99 for Business regulations; while fiscal reforms with score close to 91 is recorded second highest followed very closely by trade reforms, international financial reforms and social sector reforms. Least reformed sector remains public sector with a score of 54.18. Graph 4 illustrates a negative relationship between initial economic reforms in 1960 and the rate of growth of reforms over 1961 to 2006 in all sectors. This inverse relationship to an extent suggests the case for convergence. It can also be inferred from the above figure that those sectors which have already obtained a higher degree of reforms in 1960 had less potential to liberalize further. However, this argument may not be valid in the case of case of India because there was significant reversal of reforms during the two decades of 1970s and early 1980s.

Another significant finding from the graph 4 is that there is significant convergence in social sector reforms followed by international financial reforms, fiscal reforms and marginally to an extent trade reforms. Sectors which remained less convergence are domestic financial reforms, public sector reforms and business regulations reforms. This also means there is significant room for further reforms in these sectors.

6.2. Level of Reforms by period:

We now capture the overall economic reforms index by period to show more explicitly the timing and the degree of economic reforms in India. The graph 4 captures the level of aggregate reforms in India by decades. The average values of reforms index during these five periods is presented.

Graph 4

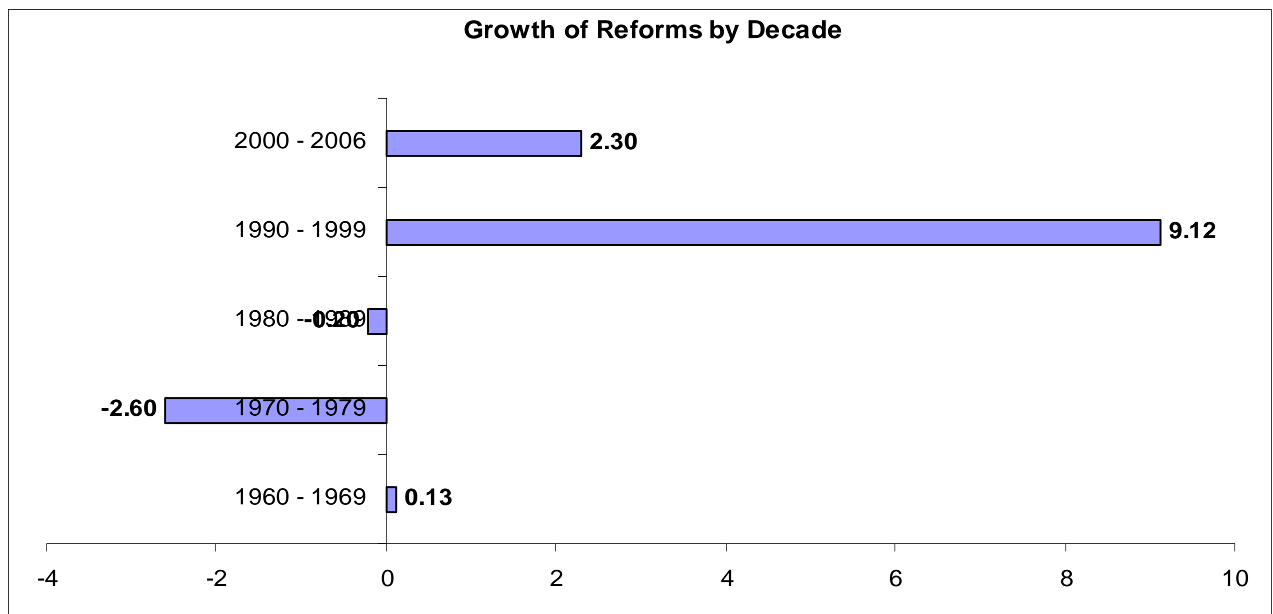


The graph 4 explains the story of reforms in India by period. The level of reforms was down from 39.14 in 1960 – 1969 to 31.54 during 1970 – 1979. Further there was a downfall in the index of reforms up to 3.39 points during 1980 – 1989. Significant rise in

reforms index can be seen during post 1990 period. Reforms increased from 28.15 to 54.86 during the 1990s to consolidate further.

Graph 5 captures the rate of growth of reforms during the same periods. The average growth rate of reforms during these five decades is presented in graph below. The average growth rate of reforms was very minute during 1960 – 1969. But during 1970 – 1979, the average growth rate of reforms registered -2.60% followed by -0.20% during the 1980s suggesting some undoing of the distorted policies adopted in the 1970s.

Graph 5

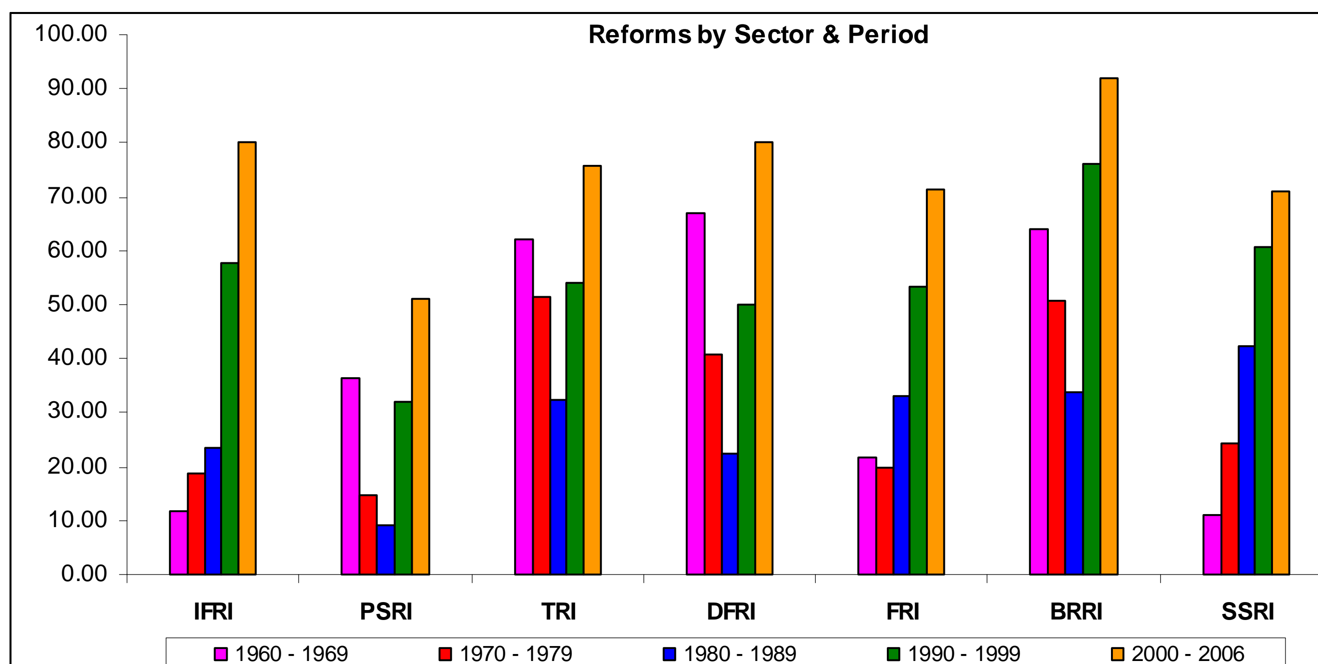


The growth rate of reforms were all time high during the 1990s. The average growth rate of reforms was 9.12% during this period. During the seven year period of 2000 – 2006 the growth rate of reforms is 2.30%. This must not be understood for decline in reforms. Two points are noteworthy in this respect. One, it can rather be interpreted as consolidation of reforms and hence convergence in the reforms process. Two, reforms in India are selective in nature due to various political, social and economic reasons and are not wholesale and do not come in package in comparison to other reforming countries like Latin America.

6.3. Reforms process by sector:

We now disaggregate the overall economic reforms index by sector to show more explicitly the timing and the degree of reforms in each subsector. When one speaks of reforms by sector, one generally means that they adopted reforms or changes in their respective reforms indices. But when thinking about whether a particular sector is or reformed, what is important to consider is the level of reforms rather than the rate of change of reforms in that sector. In graph 6 we show for each sector the level of its reforms index during 1960s, 1970; 1980s, 1990s and 2000 – 2006. The average values of reforms index for each sector during these periods is presented. There are some significant surprises in this graph.

Graph 6



Note: IFRI = International Financial Reforms Index; PSRI = Public Sector Reforms Index; TRI = Trade Reforms Index; DFRI = Domestic Financial Reforms Index; FRI = Financial Reforms Index; BRRI = Business Regulations Reforms Index; SSRI = Social Sector Reforms Index.

First, the level of reforms is not always uniform across the time in all the seven sectors. For example, the level of reforms in Social sector is higher in 1980s compared to 1970s and 1960s, but this not so with respect to reforms in other sectors. Second, the average level of reforms in public sector, trade and domestic financial sector are higher in 1960s compared to 1990s. This suggests significant distortion of policies during the 1970s and 1980s. Third, international financial sector, social sector, fiscal sector and business regulations are the most reformed sectors post 1990s. Conversely, domestic financial sector, trade and commerce and public sectors remain still relatively less reformed despite having significant reforms after the 1990s. Therefore, an alternative way of presenting the sector evidence is by showing when the reforms in these sectors reached certain threshold of reforms.

Which sectors were the major reformers in different periods?

During the 1960s domestic financial sector reforms, business regulation reforms were higher compared to the rest. This can be possible because the banking system during the 1960s was going through the process of stabilization and many measures were taken to curtail bank failures and fly by night operators with some reform measures. Similarly private and foreign players were freely allowed to operate in the sector. Business regulations were also very relaxed during the 1960s. As highlighted in section 5 in phase 1 of the reforms, there were literally no restrictions on either the foreign or private players operating in different industries in terms of neither entry restrictions nor operational rigidities. It was only in the 1970s and early year of the 1980s things were tightened as a result during these two periods, these two sectors were least reformed. In the 1980s, social sector, trade, business regulations sectors were the most reformed. During the 1990s and 2000 – 2006 periods almost all the sectors were reformed with once exception being public sector where the process of reforms was more gradual and slow. It is clear from the graph 6 that there are big differences in both the timing of reforms and the extent to which reforms have been accepted and adopted across the different sectors of the economy. The most widely adopted reforms have been

international financial reforms, social sector reforms, business regulations and fiscal reforms.

6.4. Reforms process by sector – Convergence:

The changes of reforms by sector from 1960 to 2006 are captured for each country in a three dimensional matrix in table 5. We define arbitrarily three aspects of reforms: below average reforms which have a score between 0 – 30; average reformers whose score falls under 31 – 70 and above average reformers where the score of reforms is above 71. Based on this we compare the reforms position of each sector in 2006 to 1960.

Table 5: Levels & changes of reforms by sector from 1960 to 2006

	2006			
	Rate of change 1960 / 2006	**Below Average (0 – 30)**	**Average (31 – 70)**	**Above Average (71 & >)**
1960	**Below Average (0 – 30)**	--------	--------	Social sector Fiscal sector International Finance sector
	Average (31 – 70)	--------	Public sector	Business regulations
	Above Average (71 & >)	--------	--------	Trade reforms sector Domestic finance sector

Source: computed & compiled by author

From the table 5 we cannot confidently say that the reforms process in all sectors has a degree of convergence. There is an amount of convergence in certain cases. But this cannot be attributed to all the sectors. Sectors which fall in the middle column of the table under “average” score are those sectors whose position has not improved drastically in comparison to sectors falling under fifth column of the table under “average – above average matrix”. The sectors whose reforms scores were average in 1960 improved their performance significantly and are in the category of above average in 2006. The findings about sectors like: trade reforms and domestic financial sector should not be mistaken for

significant convergence, where sectors which tend to relatively liberalize in 1960 would introduce fewer additional reforms in future because the scores of reforms index of trade and domestic financial sector reforms in the 1970s and 1980s are much lower than some other sectors. Hence, these results should be interpreted with caution. The significant catching up effects took place in the sectors like social sector, international financial sector and fiscal sector whose reforms levels have surged between 1960 and 2006.

7. Conclusions

This paper has presented quantitative indices of economic reforms in seven important areas for India during the period 1960 – 2006. The seven sectors identified are: public sector reforms; trade reforms; international financial reforms; domestic financial reforms; business regulations reforms; fiscal reforms and social sector reforms. These indices are an attempt to summaries the reforms process in India. The sub-indices help make possible comparisons of the degree of the reforms across the sectors over time. We make use of PQLI method to construct the economic reforms index. The aggregate economic reforms index for India shows that the reforms process picked up the pace during the late 1980s. The reasonable liberal economic regime in 1960s was slowly converted into a restrictive environment by applying market distorting policies from late 1960s onwards. Though there was change in mind set among policy makers in the 1980s the measures taken by the government was not sufficient to undo the distorting policies adopted over three decades earlier. In the wake of financial crisis, India recognized the need to correct the distorting policies and translate into market creating policies in 1990-1991. As a result, India began its journey of reforming the economy in 1991. The reforms indices also show that the reforms process has not always been uniform across the time and area of reforms. By the end of 2006, there was a widespread agreement and policy convergence in all seven sectors. However, there is much less convergence in public sector reforms because the privatization process has significantly slowed down and government control is many public sector undertakings are still reasonably high.

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Appendix

Annex 1: Economic Reforms indices – India

Year	International Financial Reforms	Public Sector Reforms	Trade Reforms	Domestic Financial Reforms	Fiscal Reforms	Business Regulations Reforms	Social Sector Reforms	Aggregate Economic Reforms Index
1960	10.45	44.40	73.68	70.00	24.43	54.64	5.79	40.49
1961	10.45	42.91	70.12	71.08	25.96	57.89	4.75	40.45
1962	10.45	41.15	64.53	69.26	23.91	59.88	3.17	38.91
1963	10.45	38.69	52.47	69.73	21.38	60.73	5.69	37.02
1964	10.45	36.57	51.10	66.48	21.06	62.55	8.20	36.63
1965	10.45	34.83	37.88	65.83	25.97	61.97	17.29	36.32
1966	11.82	32.95	62.67	64.26	19.74	69.01	10.92	38.77
1967	11.82	31.47	69.80	65.46	18.57	70.35	17.67	40.73
1968	11.82	30.16	70.46	65.10	20.41	71.75	19.89	41.37
1969	20.91	29.10	68.85	61.61	16.87	70.04	17.59	40.71
1970	20.91	28.02	61.54	59.03	14.04	62.05	21.84	38.20
1971	20.91	25.79	44.75	54.44	15.06	53.99	20.08	33.58
1972	20.91	23.65	33.62	53.00	12.11	55.84	18.70	31.12
1973	16.36	20.32	51.15	41.39	10.27	51.76	16.33	29.65
1974	16.36	13.78	56.97	37.79	19.68	40.25	22.04	29.55
1975	17.27	11.00	52.34	35.52	24.96	45.88	19.21	29.45
1976	17.27	7.77	53.80	31.48	28.98	50.82	23.44	30.51
1977	17.27	5.88	53.10	30.40	29.64	50.49	27.86	30.66
1978	19.55	4.56	52.42	33.92	24.23	50.22	37.63	31.79
1979	19.55	5.91	53.75	32.35	20.63	47.10	37.10	30.91
1980	21.82	4.91	57.16	21.90	21.01	36.06	36.96	28.55
1981	22.73	6.55	52.31	21.01	25.31	39.16	35.95	29.00
1982	22.73	7.88	45.63	21.44	25.17	38.53	39.67	28.72
1983	22.73	7.68	45.01	24.04	26.06	32.22	37.96	27.96
1984	22.73	8.40	33.87	21.22	31.97	33.36	38.84	27.20
1985	22.73	10.04	27.48	22.67	41.02	25.87	42.82	27.52
1986	22.73	10.69	16.50	21.38	39.85	29.44	43.36	26.28
1987	22.73	11.23	8.30	24.36	40.20	36.62	50.50	27.71
1988	27.27	12.34	15.06	21.84	42.41	32.86	47.74	28.50

1989	27.27	13.55	23.33	25.70	36.37	34.49	49.65	30.05
1990	27.27	14.75	26.09	26.05	44.95	37.04	54.65	32.97
1991	52.27	23.98	31.46	26.12	42.56	43.05	56.65	39.44
1992	52.27	23.82	46.65	27.59	42.90	67.33	59.91	45.78
1993	56.82	25.88	56.59	30.43	43.89	83.45	61.57	51.23
1994	59.09	34.73	56.90	41.44	53.41	84.51	64.19	56.32
1995	59.09	30.98	58.24	50.05	51.96	88.63	60.34	57.04
1996	62.73	36.08	58.17	60.24	59.26	86.69	61.23	60.63
1997	65.00	38.69	65.72	76.26	63.75	89.72	61.26	65.77
1998	67.27	45.53	70.26	78.17	64.58	90.25	62.04	68.30
1999	76.36	44.87	68.90	82.51	67.19	91.77	65.91	71.07
2000	80.91	61.63	65.50	80.33	68.41	90.60	62.29	72.81
2001	84.55	51.43	69.80	83.48	65.33	92.33	66.57	73.35
2002	84.55	51.11	76.74	84.89	70.10	92.67	68.45	75.50
2003	84.55	59.48	83.00	79.30	70.93	90.97	75.12	77.62
2004	84.55	52.09	85.34	78.94	72.19	89.17	77.54	77.12
2005	86.82	51.80	84.54	78.71	79.79	92.27	82.93	79.55
2006	86.82	54.18	87.26	78.49	90.21	99.61	86.41	83.28

Annex 2: Reform sub-indices