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INDIA'S NEW ECONOMIC POLICY: ITS IMMEDIATE IMPACT

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Introduction

The new economic policy was introduced in 1991. A short review of the changes it has effected in foreign collaborations, foreign trade and public sector divestment is given. This is contrasted with the QR (Quantitative Restrictions) policy formerly adopted by India for 40 years. This enables one to get a historical perspective.

FOREIGN COLLABORATIONS

Approvals

The Reserve Bank of India and SIA have approved 81 and 45 foreign collaborations respectively during January 1992. A breakdown of the number of approvals given by these two agencies during 1988-91 is given in Table 1. The RBI had started approving foreign collaborations only after the introduction of the New Economic Policy in July 1991.

Clearance System

Earlier, the Foreign Investment Board cleared all foreign tie ups. With the new government policy, there are now three autobahn lanes for approval. The first lane is cleared by the high power Foreign Investment Promotion Board (FIPB) which isheaded by the Principal Secretary to the Prime Minister and has the Secretaries to the MInistries of Finance, Commerce and

Table 1

COMPARATIVE STATEMENT OF FOREIGN COLLABORATION APPROVALS SINCE 1988 TO 1991

	1988	1989	1990 (Jan.-Dec.)	1990 (Aug.-Dec.)	1991 (Jan.-Dec.)	1991 (Aug.-Dec.)*
A. Total no. of Foreign Collaboration approvals by:						
i) SIA:	926	605	666	239	762	446
ii) RBI:	...	...	...	...	188	188
TOTAL	926	605	666	239	950	634
B. No. of FC approvals involving foreign equity:						
i) SIA	282	194	194	64	248	160
ii) RBI	...	...	...	...	41	41
TOTAL:	282	194	194	64	289	201
C. Total amount of foreign equity involved:						
i) SIA:	239.76	316.67	128.32	45	391.88	270.55
ii) RBI:	...	...	...	...	142.24	142.24
TOTAL:	239.76	316.67	128.32	45	534.11	412.79

* Period after new reforms came into effect

	1989			1990			1991		
	No. F.C.		Amount of	No. F.C.		Amount of	No. F.C.		Amount of
	Total	Fin.	F.E.	Total	Fin.	F.E.	Total	Fin.	F.E.
D. Share of major countries in:			Rs. in crores			Rs. in crores			Rs. in crores
1) U.K.	66	21	33.46	101	21	9.07	134	38	32.11
2) U.S.A.	127	35	62.16	133	42	34.48	177	53	185.85
3) Germany	112	38	120.33	128	40	19.51	157	35	41.80
4) Japan	62	11	8.78	46	9	5.00	72	15	52.71
5) France	23	3	8.46	38	12	8.88	40	11	19.34
6) Italy	37	14	6.90	40	15	6.83	61	22	17.82
7) All countries	605	194	316.67	666	194	128.32	950	289	534.11

Source: The Hindu, Feb. 16, 1992.

Industry as members. In the initial two months, only two proposals - Ford Maruti and Tata-IBM were approved. The original four-member committee was increased to include the Secretary of the Economic Affairs Ministry, the Secretary of the External Affairs Ministry besides the Secretary of the concerned ministry. Presently all the proposals involving more than 100 crores of rupees have to be cleared by the FIPB.

The second lane of approval is the Secretariat of Industrial Approval under the chairmanship of the Secretary, Industry Ministry. It handles all the routine cases. The third lane is the Reserve Bank of India which is authorised to consider those companies having 51 per cent foreign equity requiring automatic clearance. There has been an increase in the total number of approvals given during August-December 1991 as compared to 1990. The country-wise breakup for 1989-91 shows that most countries had reduced their number as well as amount of financial commitment during 1990 as compared to earlier years. However, with the introduction of the new policy, there has been an increase of nearly 50 per cent in the total number of foreign collaborations and more than three hundred per cent in the number of financial collaborations.

With the relaxation of foreign equity participation, Suzuki was allowed to increase its holding to 51 per cent in Maruti. During December, ABB also tried to increase its equity share. However, there was a problem of premium on the rights issue of ABB. The company tried to follow the earlier practice but the rules were changed in December allowing market prices for the additional equity participation.

Trade Missions

During September-October, some trade delegations came to India, but these were mainly exploratory. The seriousness of trade missions were increased during January-February 1992 with the visit of 100 Japanese industrialists and 25 German businessmen. The relative differences between these two delegations are given in Table 2. It shows the reaction of two countries for the new economic policies. The reaction depends on their areas of interest and the history of their operation in India. The Japanese delegation gave a request list of 21 requests. Among

Table 2

Nature of Fact Finding Missions of Japan and Germany

January - February 1992

Items	Japan	Germany
Delegation Strength	100	25
Composition	Chairmen/Managing Directors	Chairmen/Vice-Presidents
On Economic Reforms	"21" requests Wait for further relax policies in certain fields	Existing frame-work gives ample opportunities and endorsed Japanese request
Areas of Interests	Entertainment electronics, white goods, automobile financial and real estate activities	Machine tools, capital equipment low cost consumer durables, drugs and pharmaceuticals
History of Operation	Limited	Long history of collaborative operation
Position of India	Focal point Shifting from South-East Asia to South Asia	Focal point - as a sourcing point for components

other things, they wanted removal of the foreign currency remittance restriction; formulation of an exit policy; lifting of prohibition in commercial activities and real estate; and liberalisation in automobile and white goods industries. They also insisted on being allowed to establish a model industrial township. However, out of the 100 industrialists, only 71 were contemplating investment in India, 25 others showed interest in future investments and the, rest were undecided. In contrast, the German delegation was satisfied with the changes introduced in India.

FOREIGN TRADE

Performance

India's foreign trade during April-November in 1990-91 and 1991-92 are given in Table 3, both in terms of dollars as well as rupees. In terms of rupees, exports increased by nearly 28%,

Table 3

India's Foreign Trade
(April - November)

	1990-91	1991-92	% Change
	($ mil.)		
Imports	15,610	12,381	- 20.7
Exports	11,531	10,951	- 5.0
Trade deficit	4,079	1,430	- 35.0
	(in Rs. crores		
Imports	27,484	29,410	+ 7.0
Exports	20,303	26,012	+ 28.1
Trade deficit	7,181	3,398	- 47.3

nearly 28 per cent, while in dollars it declined by 5 per cent. Correspondingly, imports increased by 7 per cent in rupees and in dollars it decreased by 20 per cent. Though there was a reduction in the trade deficit on both accounts, afew changes took place during the 4th quarter of 1991-92. India decided to import one million tonnes of wheat, three lakh tonnes of edible oil and a limited quantity of cotton. This was done ith the intention of containing inflation in consumer goods. Besides, there has been a fallout to the disintegration of the Soviet Union. Most of the Rupee Trade Area has been affected not only in terms of exports, but also in termsof the imports of oil, kerosene, newsprint and fertiliser. The rupee payment area has been transferred to the general currency area. This may have an impact on the import figures.

Exim scrip

The present policy of Exim scrip and the low premium currently being quoted may be misleading because of the artificially restricted demand and supply of Exim scrip. The demand is restricted due to fiscal control of imports and the still high money margins. Besides, the supply of Exim scrip to 30 per cent is very restrictive. The reservation of 70 per cent is more than what is required for debt servicing. It indicates that the government is trying to follow the policy of making "haste slowly". Again there is an inbuilt notion of "REP" which is an outdated concept.

PUBLIC ENTERPRISES

Divestment

The government has started disinvesting in public enterprises. The first tranche was released during December 1991 and second tranche was released in February 1992. The nature of the second tranche is given in Table 4. There has been a change in the disinvestment pattern of the second transche as compared to the first tranche. Firstly, the number of competitors was increased to include public sector banks and institutions in addition to investment institutions and mutual funds. Secondly, the reserve price was increased to Rs.10.08 crores. Thirdly, the list of

Table 4

PSE Disinvestment

	Second Tranche
Month/Year	Feb. 1992
No. of Cos.	16
Bidders	Mutual Funds Public Sector Banks Financial Institutions
Reserve Price	Rs.10.08 Crores
Offer	- 16 PSEs - 120 packets - different combinations - each with 8 PSUs - increase in no. of shares (up to 49%) (H.P., B.P., MTNL, VSNL, Bongaigaon Refineries, MRL, BEL, BEML, BHEL, IPCL, ITI, Neyveli Lignite, HOC, HZL, SAIL, SCI)
Listing in Stock Exchange	Delhi: STC, MMTC & HZL Madras: Madras Refineries, B.P., HPF

public enterprises was reduced to 16 profitable units. Besides, these units have already started being listed in stock exchanges in Delhi and Madras. The government has decided to disinvest up tc 49 per cent of its stake in public enterprises. However, there is a problem of determining the offer price and delay in the transfer of share certificates.

Exit Policy

In January 1992 a paper was presented by the government to cover initially 58 sick enterprises and later 2.5 lakh private enterprises in the exit policy network. Initially, the sick PEs were offered to workers' cooperatives, but the unions refused to accept this offer. Secondly, the government proposed to refer sick units to the BIFR. However, a tripartite committee was appointed to deal with six sectors initially, namely, engineering, textile, road transport, power, chemicals and fertilisers. Thirdly, the government set up a Rs. 250 crore National Renewal Fund (NRF). This fund can be utilised in three ways. Firstly, if an unit requires money in the future, a part of the NRF is deposited with GIC under a special insurance scheme. Secondly, wherever the PEs require money for immediate restructuring, the NRF gives loans either for retrenching or retraining existing employees. Thirdly, whenever sick units are referred to the BIFR and it is decided to close them, the NRF acts as a social safety net providing grants along with sale of the assets.

EXCHANGE CONTROL REGIMES

Phases of QR Regime

Bhagwati and Srinivasan (1975) have differentiated five phases of exchange control regimes.

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Phase one-where there are extensive quantitative restrictions on international transactions. Normally, this is resorted to when there is a payment deficit. So most of the quantitative restrictions are used to control the balance of payments.

Phase two - the quantitative restriction becomes much more intensive. In addition, various price measures are used to control undesirable. This results in higher tariffs, surcharge and subsidies for exports and other price interventions. Still, the primary emphasis is on quantitative restrictions.

Phase three - generally starts with formally changing the exchange rate and removing some of the surcharges imposed during Phase 2. This reduces the reliance on quantitative restrictions. It is the beginning of the withdrawal of quantitative restrictions.

Phase four - If the couuntry is able to adjust to liberalisation there will be increased foreign exchange earning and relaxation of quantitative restrictions.

Phase five - is a fully liberalised exchange regime where there is full convertability of current account and quantitative restrictions are not used as a means for ex-ante balance of payments.

Indian Phase

Taking into account these five phases, if one looks at India's action: the last 40 years, one can classify them as follows:

Table 5

Phases of Q.R. Regime

Years	Phases	Problems	Mechanism	Result
1950-56	IV	No BoP problem	- liberal	
1956-62	I	BoP	- Licensing - Shift in investment - Extensive QR intensive	- Stagnant exports - Selective industria-zation
1962-66	II	BoP	- do - Export subsidy Import duties Halting liberaliza-tion	Emphasis on Heavy industries and infrastructure investments
1966-68	III	Devalua-tion	Eliminate distortion Export subsidies + decrease import duties Tidying up operation	- 2 Year poor harvest - price increase - export decrease - industrial recession - political pressure
1968-70	II	BoP	Revert to 1962-66	
1970-80	II	BoP (due to oil prices)	- do -	
1980-85	III	IMF loan	- Partial liberalisa-	- initial BoP improvement
1985-90	II		- Price increase	- liberalisa-tion
1991	III	IMF loan	- Trade deficit reduced	- MRTP limit raised - Export poor - Delay in policy implementa-tion

The position which India had in the early 1950s has not been achieved sinces. But there have been two attempts to move towards liberalisation - one was during 1966 when there was a devaluation and one was in 1981 when there was an IMF loan. During both these times, there was a move towards liberalisation, but due to exogenous factors and lack of structural adjustment, India reverted to stage two. During the first devaluation, there was a poor harvest, increasing price index, decline in export and political pressures. On the other hand, in 1981, the initial IMF loan was able to contain prices, increase exports and lead towards industrial liberalisation. However, due to political pressures, the experiment was shortlived. Due to partial liberalisation and structural liberalisation within the economy, a foreign exchange payment deficit was created as well as increased fiscal deficits in the country, which culminated in the necessity for a second IMF loan in 1991. Having learnt from past experience, the government has now initiated structural changes in the economy minimising earlier inadequacies in policy formulation and implementation.

The experience of the past eight months has been encouraging. This makes it imperative for the government to move surely towards more liberalisation. There will be difficulties for some more time before the Indian economy can integrate with the global system. There are some political pressures on the mistaken assumption of the 'Foreign Hand' (hangover of East India Company dominance). This means there has to be a lot more openness regarding the nature of economic policy. Besides, there are a lot of hindrances at the implementation level (mental map of bureaucrats) due to the existing plethora of rules and regulations. As the game plan changes, the rules of the game also require alterations.

EXPERIENCE

A. General

A.1 The New Economic Policy initiated in July 1991 has resulted during the first eight months in increased inflation which decreased slightly subsequently.

B. MNCs

B.1 The foreign collaboration approvals have increased during 1991-92 ascompared to the previous year.

B.2 The foreign collaborations have been classified into three groups for faster clearance.

B.2.1 The approvals of SIA increased but the financial commitment by MNCs was minimal i.e., on an average less than $1 million.

B.2.2 The approvals by RBI for increasing the existing shareholding of MNCs indicate a higher commitment by MNCs.

B.2.3 The initial response of MNCs has been to test the new economic policy.

B.3 The initial trade missions during September-October 1991 were preliminary. This was followed by two serious trade missions by Japanese and German businessmen during January-February 1992.

B.3.1 The Japanese delegation gave a 'Request list' of 21 points for further liberalisation before they considered India seriously for their investment.

B.3.2 The German delegation was more satisfied by India's policy initiatives.

C. <u>Foreign Trade</u>

C.1 There is a decline in trade deficit, both in terms of dollars and rupees.

C.1.1 Imports have increased in rupee terms, while in dollar terms it has increased much more.

C.1.2 Exports have increased by 28 per cent in rupee terms but has declined by 5 per cent in dollar terms.

C.2 The operation of Exim scrip as a transition towards convertability has been successful but import depending units are being affected due to the low percentage allowed for exim scrip.

D. <u>Public Enterprises</u>

D.1 The government has released two tranche during December 1991 and February 1992.

D.1.1 There has been a change in the position of bidders, reserve price and offer of units.

D.2 Exit policy discussion was initiated and a tripartite committee was formulated for six sectors.

D.3 A National Renewal Fund has been created.

E. Exchange Control Regime

E.1 On the basis of Bhagwati and Srinivasan's phases of QR regime, India appears to have reached stage 3.

E.2 With the earlier experience of devaluation in 1966 and IMF loan in 1981, India can either move backward to the QR regime phase or or phase 4 depending on the continuation of the liberalisation policy during 1992-93.

PROPOSED

A.1 The present policy of discriminatory price increase between essential and non-essential commodities should be continued.

B. MNCs

B.1 The present liberalisation needs to be continued. There is a likelihood of more FDIs to India.

B.2 The present policy of linking repatriation of profit and dividend to exports can be continued.

B.3 There are several state level irritants in the investment climate for both MNCs as well as local enterprises. This requires percolation of the liberalisation policy from the central to the state.

C. QR Regime

C.1 Due to QR regime of restricting import, the trade deficit might have declined. A step-wise liberalisation is necessary.

C.2 The exim scrip proportion of 30 per cent can be gradually increased so that only the minimum export earning is kept for payment of debt and debt servicing.

C.3 The objective should be convertible currency and liberal trade regime.

D. Public Enterprises

D.1 The two tranches released by the government is an indication of moving towards disinvestment in more profitable units. Thus it is advisable to concentrate on the following two alternatives:

D.1.1 The PEs in the competitive field can be privatised wholesale.

D.1.2 PEs operating in monopoly situations may be gradually done along with increasing scope for competition from private sector.

D.1.3 It is also necessary to formulate a competition policy of mergers, takeovers etc.

E. Exit Policy

E.1 The exit policy concentrates on public enterprises due to limitation of NRF. This can be overcome from the following two alternatives:

E.1.1 As the NRF fund is limited, it may be advisable to combine sectorwise. Initially take the sectors which have got lesser sickness. With the experience, the other sectors can be included.

E.1.2 The NRF can be increased by having compulsory insurance deposit for all the companies so that the corpus fund becomes much large enough to take a remedial action on sector-wise basis.

E.1.3 The proposed Tariff Commission can look at the competitiveness of sectors in global context.

F. Liberalisation

F.1 As India has been going one step forward and one step backward for the last 30 years and has a good industrial structure, it is an appropriate time to liberalise with minimum of dislocation. If this time is also lost, next time it will be much more difficult than at present. That means liberalisation has to continue.

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