THE WORLD BANK OPERATIONS EVALUATION DEPARTMENT

INDIA: Evaluating Bank Assistance for Private Sector Development

A Country Assistance Evaluation

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Abbreviations

ADB	Asian Development Bank
APERP	Andhra Pradesh Economic Restructuring Project
APPSR	Andhra Pradesh Power Sector Restructuring Project
BIFR	Board for Industrial and Financial Reconstruction
CEM	Country Economic Memorandum
ED	Export Development Project
ESIRLP	External Sector and Investment Regime Liberalization Project
ESW	Economic And Sector Work
FDI	Foreign Direct Investment
FERA	Foreign Exchange Regulation Act
GOI	Government of India
HPSRD	Haryana Power Sector Restructuring and Development Program
IDFC	Infrastructure Development Finance Company
IFC	International Finance Corporation
IL&FS	Private Infrastructure Leasing and Finance Services Project
IMF	International Monetary Fund
IT	Industrial Technology Project
NRF	National Renewal Fund
NRIs	Nonresident Indians
OED	Operation Evaluation Department of the World Bank
OPSR	Orissa Power Restructuring Project
OSEB	Orissa State Electricity Board
PSEs	Public Sector Enterprises
SAL/SAC	Structural Adjustment Loan/Credit
SEBs	State Electricity Boards
SSN	Social safety net

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Preface

This paper is one of the background papers prepared as an input to the India Country Assistance Evaluation (Task Manager: Mr. Gianni Zanini) by the Operations Evaluation Department (OED) of the World Bank. Findings are based on a review of project appraisal and completion reports, sector reports, and a number of other documents produced by the Borrower, the Bank, OED, and research papers. An OED mission visited India in April/May 1999. The mission interviewed current and retired government officials and Indian experts. Bank staff were interviewed at both headquarters and in the field office. Their valuable assistance is gratefully acknowledged.

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Executive Summary

1. The GOI's economic policy since 1952 was predicated on two basic premises—that the economy should operate as a closed economy, producing as many products as possible domestically and that the public sector should occupy the commanding heights in the economy. These policies had the most constricting impact on the private sector, financial sector and the external sector. There were severe restrictions on the external transactions, both current and capital. A major dent on India's closed economy was made by the economic reforms adopted in 1991, which related to the industrial policy deregulation, liberalization of foreign trade regime and investment, the financial sector and the fiscal policies. As a result, the Indian economy has been slowly opening out with a steadily rising ratio of exports/imports to GDP since 1991. India's links with the global financial markets become stronger with growing inflow of FDI, private portfolio investment and deposit inflows from nonresident Indians. The degree of financial integration of India with the international financial markets as reflected in interest rate differentials or the integration index has been increasing.

2. Despite the hostile economic environment, the private sector in India remained a major source of national income growth as well as employment. Efficiency-wise, however, the private sector remained high cost for lack of competition in view of the tight import and foreign exchange controls and the industrial policy. The microeconomic distortions to which these policies gave rise, created difficulties in pursuing a sound macroeconomic policy. Eventually India faced a severe balance of payments crisis in 1991, and to get out of the impasse, the GOI unleashed a radical reform program under which the industrial and trade regimes were substantially liberalized, thereby both opening the economy and providing an expanding space for the private sector. In particular, the protection from competition previously enjoyed by the PSEs was drastically attenuated by the liberalization of capacity licensing, trade policy and the imposition of hard budget constraints on PSEs. The long-term impact of these reforms on the private sector were favorable. There was a sharp turnaround in FDI and foreign portfolio inflows and the private sector recorded progress in many areas of their operation such as profit margin, pattern of sources of funding and net worth. With all the impressive results of reform, the private sector still suffered from many constraints, like high fiscal deficit, weak allocative policies of banks, and the continued dominance of the PSEs, labor market rigidities and lack of corporate governance.

3. The basic thrust of the World Bank's strategy in regard to opening of the Indian economy and the role of the private sector was that its lending should be linked to the progress on stabilization and the structural reforms which included private sector development, financial sector deregulation, industrial deregulation, and the orderly public sector retrenchment. This strategy and the dialogue based on it emanated from the several studies on industrial deregulation, trade reform, and the private sector and its participation in infrastructure. The central feature of these studies was that unless the microeconomic distortions, such as subsidies, wrong pricing of public utilities, labor market rigidities, high tariffs, and PSE's inefficient functioning were removed, the private sector development would not accelerate. Judging the Indian reforms ushered in 1991, it seemed that the ESW was very influential in crystallizing the GOI's thinking on the reform policies.

4. Amongst the Bank's lending instruments, three adjustment loans—SAL/SAC, SNN, and ESIRLP aiming at stabilization, structural transformation, fiscal consolidation, deregulation of the industry, and trade reform helped open the economy and reduced barriers to the growth of the private sector. Of thee two SAL/SAC and ESIRLP were well implemented and the outcome and the impact were satisfactory. There were other programs like IT, ED, and IL&FS, addressing the issues of the private sector, which were also reasonably successful in advancing the private

sector. In addition, the three power sector loans to three state governments—OPSR, HPSRD, APPSR, and the investment loan APERP to one of them, have paved the way for the entry of the private sector into the power sector, hitherto the virtual monopoly of the public sector.

5. Of the five completed lending operations of the Bank during 1991-99, SAL/SAC, ESIRLP, IT, and ED, are rated satisfactory in regard to outcome. Their relevance, efficacy, institutional development impact are also rated as substantial, while their sustainability as likely. The third adjustment operation SNN fares poorly in most of the rating categories. Of the other completed projects specifically directed at the private sector development, IT and ED also attract, more or less, the same rating as those for the SAL/SAC and ESIRLP and the present indications of their future performance. The other four OPSR, HPSRDP, APPSR, and APERP on the basis of the supervision reports, are rated as high in regard to relevance, substantial in respect of efficacy and institutional development impact, and likely in regard to sustainability. This somewhat optimistic rating is warranted on the ground that a consensus amongst all parties—consumer groups, and the labor—has been attained. It is too early to give rating in regard to outcome.

6. The overall effectiveness of the Bank's sectoral assistance strategy is judged to be satisfactory. There are, however, still many impediments to the private sector growth, such as labor market rigidities, lack of improvement in corporate governance, slow privatization of banks, the faltering reform of the PSEs, lack of development of ports, roads, and communication, all part of the infrastructure essential for the private sector development. It is in these areas that the Bank's needs to focus on in its future lending programs.

7. The Bank's ESW is awarded top rating in strategic relevance and timeliness, internal quality and likely impact. In particular, its studies on industrial deregulation, trade reform and the financial sector deregulation, coming as they did before the onset of the Indian reforms, had been influenced in shaping those reforms. The Bank may be even more effective in its ESW if it could involve the research institutions in India in preparation of its ESW. The Bank's comparative advantage lies in being a knowledge provider.

1. Introduction

1.1 The nature of India's investment and industrial policies and trade regime adopted since 1952 and the manner in which these were implemented over the years were largely the direct offshoot of the development model formulated by Mahalonobis. The basis of the model was that autonomous market forces were incapable of achieving the optimal results and that the state should intervene with a comprehensive regulatory apparatus, whose wings could spread to all sectors of the Indian economy. The implication of this was that the economy should pull itself up by its own bootstraps, producing as many products as possible domestically and assigning a marginal role to foreign trade, and that the private sector should have a minimal role in the economy.[1] These policies had the most constricting impact on the private sector, financial sector and most importantly, on the external trade. In words of Bhagwati and Srinivasan: "every item of indigenous production, no matter how much its cost of production exceeded the landed c.i.f. price, was automatically shielded from competition through imports, indeed the onus being put on the buyer to show conclusively that he could not procure the item from indigenous producers."[2] A closed trade regime eliminated competition, which could have ensured domestic industry's efficient functioning; bureaucratic industrial policy raised cost of doing business in India, the prominence given to the public sector led to preemption of resources particularly from the financial system and capital markets away from the private sector. In short, the whole policy framework, both in its macroeconomic dimension and microeconomic connotation worked to the detriment of the dynamic growth of the private sector and thereby the Indian economy as a whole. There were some faint-hearted efforts made during the 1980s to liberalize the economy from the straightjacket of government regulation and to provide an expanding space for the private sector but the system remained substantially intact. In some ways, it actually became "more complicated, because almost every reform was hedged about with pages of rules to prevent abuse. The folds of India's regulatory system overlapped each other so luxuriously that extreme violence will be needed to expose even an inch of the economy to daylight."[3]

2. Degree of Openness of the Indian Economy

2.1 Until 1990, India had comprehensive restrictions on its external transactions—trade and investment, which insulated it from the influence of developments in the world economy. As a consequence, Indian producers had very little incentive to enhance productive efficiency through use of foreign inputs of technology. In the 1985, the trade regime was gradually relaxed by moderating restrictions on intermediate and capital goods imports. However, partial and half-hearted reforms did not benefit domestic industry both in the private and public sectors, and its efforts in export development.

2.2 *Pari Passu* with a restricted trade regime, India controlled stringently its capital account. Foreign direct investment (FDI) was mostly limited to the transfer of technology; portfolio flows

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[1] J. Bhagwati, "The Design of Indian Development," and T. N. Srinivasan, "India's Export Performance: A Comparative Analysis," included in *India's Economic Reforms and Development, Essays for Manmohan Singh*, 1998, edited by I. Ahluwalia and I.M .D. Little, Oxford University Press, Delhi; V. Joshi and I.M.D. Little, 1994, *India: Macroeconomics and Political Economy, 1964-1991*, Washington, D.C., World Bank, and New Delhi Oxford University Press; D. Khatkhate, 1992, "India on an Economic Reform Trajectory" in *India Briefing*, 1992, edited by L. A. Gordon and P. Oldenburg.
[2] J. Bhagwati and T.N. Srinivasan, *Foreign Trade Regime and Economic Development in India* (New York, NBER and Columbia University Press, 1975).
[3] *Economist*, May 4, 1991, "A Survey of India," page 13.

were generally not permitted, external commercial borrowing was controlled, and capital outflows were largely prohibited. Access to international markets was mainly limited to public sector enterprises and current account deficits were financed through official concessional and non-concessional loans. Though, there was some let-up in the restrictive capital account policies during the 1980s, the basic tenor continued unabated. (Details of pre-1991 external policies are summarized in Annex II, Tables 1 and 2.)[4]

2.3 A major dent on the India's closed economy was made by the well-orchestrated economic reforms adopted in 1991. The structural reforms related to the industrial policy regulatory framework, foreign trade and investment, the financial sector and the fiscal policy. In the following two years, the reforms were intensified and strengthened in the trade and foreign exchange areas so much so that the Indian economy was shorn of barriers which insulated it from the global mainstream. Particularly striking was the virtual opening of the current account of the balance of payments and the strategic parts of the capital account both of which together with the market-oriented exchange rate management strengthened the process of financial integration (see for details Annex II, Tables 1 to 3).[5]

2.4 With the reforms in progress, the Indian economy has been slowly opening out. The ratio of external trade, both imports and exports to GDP has inched up since 1991. India's links with the global financial markets are forged by growing inflow of FDIs, private portfolio investment and deposit inflows from nonresident Indians (NRIs). Between 1991-92 to 1997-98, FDI (net) increased from mere $154 million to $3 billion, and net portfolio investment, from nil to $2.8 billion (it reached a peak of $3.5 billion in 1997-98). Economic links as represented by trade flows between India and other Asian countries strengthened, with the share of all Asian countries in India's exports increasing from 24 percent in 1990-91 to 29 percent in 1997-98. And yet, the degree of openness of the Indian economy is less than that of other developing countries. The ratio of all capital inflows—equity, portfolio and FDI together, as a ratio of GDP is higher in China, Indonesia, Malaysia, the Philippines, and Thailand during the period 1991 to 1996. The broader and more comprehensive measures based on interest rate differentials or the integration index confirm these trends.[6]

[4] For details, see V. Joshi and I.M.D. Little (1994), *India: Macroeconomics and Political Economy, 1964-91*, op. cit.; G. Pursell (1992), "Trade Policies in India" in D. Salvotore (ed.), *National Trade Policies*, New York, Greenwood Press; IMF (1997), *India: Selected Issues*, Chapter IV, "Trade Reforms and Economic Response."

[5] The analytics of trade reform has been comprehensively discussed in V. Joshi and I.M.D. Little (1996), *India's Economic Reform, 1991-2001* (Delhi, Oxford University Press).

[6] M. Bramh Bhatt, et. al. (1996), *India in the Global Economy*, the World Bank, Washington, D.C., D. Khatkhate and J. Nayak (1996), "India: Private Capital Flows and Financial Integration" (mimeograph), World Bank, Washington, D.C.

3. Private Sector Performance and Policy Environment

3.1 Despite the apathetic economic policies, the private sector in India remained until 1991 a major source of national income growth as well as employment, which all spoke for its intrinsic strength. Of the aggregate total investment of 24 percent of GDP during the period 1989 to 1993, almost 60 percent was accounted for by the private sector, both organised and informal. Of the total domestic savings of 22 percent of GDP, the private sector generated almost the whole of it, with the public sector recording a gradual decline from what it had achieved earlier. However, a ratio of private investment to total investment in India averaged lower by almost five percentage points than in many comparable developing countries.[7] The comparable East Asian ratios were even higher than the average in developing countries. Net value added by the private sector, was about 73 percent of the total national income during 1989 and 1993, though it declined from 85 percent during 1970s. The capital/output ratio of the private sector was 3.7 percent during 1989-90, almost about one third less than that of the public sector. The total employment generated by private sector consisting of both organized and informal segments amounted to 213 million compared to 19 million in the public sector but in organized sector, the public sector's share of employment was more than twice than that of the private sector.

3.2 The earnings before taxes/net worth ratio of firms in Indian organised private sector was the highest during 1989-93, as compared to those in Korea, Thailand, Malaysia. However, the position was reversed in regard to the ratio of long-term debt to net assets of the private sector firms. In India, this ratio was only 46 percent, whereas the Korean and Thailand ratios were 117 percent and 163 percent respectively.[8]

3.3 Efficiency-wise, the Indian private sector remained high-cost for lack of competition from both outside the country in view of the tight import and foreign exchange controls and inside because of the way industrial policy was operated. Since the capacity licensing system gave established producers priority in the allocation of new licenses, many of them tended to bid for licenses on a preemptive basis, and thus kept out potential new entrants. This also led to market concentration in many subsectors of the private sector which was high in relation to what was prevalent in many other developing countries in Asia and elsewhere.[9]

3.4 The extant policy framework until 1991 and the institutions that it spawned restricted the private sector activity in several ways. First of all, the public sector investment in industry and infrastructure crowded out the private sector. The wherewithal of finance was not forthcoming to finance this sector's investment nor did the high-cost public investment in infrastructure permit the private sector to produce optimally. Second, there was a forest of sprawling authorizations and other regulations. Notable among these were the licensing of both imports and exports, the granting of import and export monopolies to parastatals, licensing of productive capacity in the industrial sector, the introduction of regulatory restrictions on foreign investment and technology, control of large and dominant firms, preferential treatment of small scale industry, application of industrial location policies, the adoption of reservations and other preferential policies in favour of public enterprises, imposition of administered prices, stringent controls on the portfolio of the financial system and the adoption of strict policies applicable respectively to labour, take-overs, mergers, and the liquidation of enterprises. Though the use of these instruments was not

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[7] World Bank, 1994, "India: Private Sector Assessment," Country Operations, Industry and Finance Division, India Department, South Asia Region.

[8] World Bank 1994, *Private Sector Assessment*, op. cit.

[9] Ibid. I. Ahluwalia, 1985, *Industrial Growth in India* (New Delhi: Oxford University Press); I. Ahluwalia, 1991, *Productivity and Growth in Indian Manufacturing* (Oxford University Press, New Delhi).

uncommon in several developing and even developed countries, their reach in India had been far and wide. Through such policies, the Government of India (GOI) in effect exercised broad discretionary powers over virtually every aspect of economic activity in India.[10]

3.5 India thus suffered grievously both from the wrong kind of macroeconomic management, particularly fiscal and foreign exchange policies, and microeconomic distortions for over four decades, since India gained independence. The experience demonstrated convincingly that unless microeconomic distortions as represented by industrial policy, trade, regime and price controls which stymied the growth of the Indian economy were eliminated, it would be difficult to pursue a sound macroeconomic policy. There was no simple dichotomy between microeconomic and macroeconomic management. India's microeconomic management was riddled with myriad controls. If controls were bad for efficiency and growth, then India's macroeconomic management would adversely affect growth as well, even if reasonably good for stability. The 1991, balance of payments crisis exacerbated the effects of this dichotomy to a point that the Indian authorities were compelled eventually to adopt a series of macroeconomic measures, coordinated concurrently with the structural adjustment policies.[11] Macroeconomic stabilization pursued through a combination of fiscal and monetary policies included also measures for structural change aimed specifically at improving the environment for private sector investment. Indeed the reforms undertaken in the first round in 1991, eliminated or substantially reduced the severity of much of the previously applicable industrial and trade regulatory regime.

3.6 The number of sectors reserved exclusively for public sector investment were reduced to six and the requirement for prior GOI approval of domestic investment was eliminated, except for a negative list of eighteen sensitive industries. Investment licensing requirements today apply to sub-sectors accounting for only about 15 percent of domestic value added. Furthermore, there was a sweeping liberalization of the Foreign Exchange Regulation Act (FERA) to encourage direct as well as portfolio investment, large-scale reduction of import quotas, a steady fall in the peak tariff rate from over 200 percent in 1991 to 45 percent in 1999 (with import weighted average rates declining from 87 percent to 30 percent in the same period),[12] removal of asset-based classification of monopolies, freeing of most administrative restrictions on capital markets; substantial banking sector reforms, and significantly faster government approval of foreign investment in many areas.

3.7 Since public investment in the leading sectors dwarfed the private sector growth, a number of steps were taken to place them on a level playing field vis a vis the private sector, apart from initiating a process of privatization of some of public sector enterprises (PSEs). The protection from competition previously enjoyed by the PSEs was attenuated to some extent by the liberalization of reservation policy, capacity licensing and trade policy. The GOI as well as the state governments have imposed hard budget constraints on the PSEs; support for the sick PSEs was virtually terminated, and perhaps most importantly the GOI started to divest, albeit partially and haltingly, the equity holding in PSEs. Between 1991-92 and 1996-97 partial sale of PSE equity, ranging from 10 percent to 40 percent of total equity covering 39 PSEs (however, average sale is only 10 percent mainly to the private investors, but also to some PSEs), yielded about $3.2

[10] D. Khatkhate, 1992, *The Regulatory Impediments to the Private Industrial Sector Development in Asia: A Comparative Study*, World Bank Discussion Papers, No. 177, World Bank, Washington, D.C.

[11] V. Joshi and I.M.D. Little, 1994, *India: Macroeconomic and Political Economy, 1964-1991*, op. cit; V. Joshi and I.M.D. Little, 1996, *India's Economic Reforms 1991-2001*, op. cit.; D. Khatkhate, 1997, "India's Economic Growth: A Conundrum," *World Development*, Vol. 25, No. 9, United Kingdom; A. Desai, 1993, *My Economic Affair*, Wiley Eastern, New Delhi.

[12] M.S. Ahluwalia (1999), "India's Economic Reform: An Appraisal" (unpublished).

billion to the GOI.[13] And finally, the GOI took a much delayed decision in referring all loss-making PSEs to the Board for Industrial and Financial Restructuring (BIFR) for either restructuring, privatization, or closure. While these policy measures were overdue, they made little dent on unshackling the public sector. The public sector firms continued to be bailed out, those firms referred to the BHFR continued to bleed to death without proper management and investment. In contrast, the private sector firms being substantially freed from the government control, are making life difficult for the PSEs through offering intense competition.

3.8 The structural adjustment policies did not benefit private investment in their aftermath but helped after a lag. Thus, private investment as a ratio of GDP remained around 13 percent between 1991 and 1994 but spurted up to around 16 percent thereafter.[14] At a more disaggregated level, the effects of structural reforms on the private sector were even more impressive, in all areas such as profit margin, pattern of sources of funding and net worth (Annex II, Table 4). There was a sharp turnaround in direct foreign investment (FDI) and portfolio inflows as observed earlier.

3.9 With all the impressive breadth and depth of the reforms, achieved since 1991, and the promise that they would continue, some major problems relating to the private sector-led growth of the Indian economy remain to be tackled. These challenges were formidable as they involved politically sensitive reforms bearing on further opening of the economy to foreign trade, particularly in regard to consumer goods. This was dramatized by the government's regressive action to impose an across-the-board tariff of 8 percent (later reduced to 4 percent). There is still an array of reforms to be undertaken such as labor law reform, PSE privatization, and infrastructure development, particularly power, on which a workable consensus is just emerging. Policies relating to tax, trade, financial sector and infrastructure are intermingled with fiscal policy and other macroeconomic policies and they would affect the pace and thrust of future reforms essential for sustainability of the progress of the private sector.

4. The World Bank's Sector Assistance Strategy

4.1 The Bank's relationship with India, which spanned over four decades has been chequered going through phases. Until 1990, the Bank was involved in financing projects largely in the public sector and the private sector's crucial role and the opening of the economy were emphasized when general economic policy strategy was elaborated in the ESW and in the Bank's continuous dialogue with the Indian authorities. The Bank's sector assistance strategy acquired a sharper focus on the private sector and trade reform since 1991. The basic thrust of this strategy was that the Bank's lending should be linked to the progress on stabilization and the structural reform. The latter involved opening of the economy, industrial deregulation, financial sector reform, private sector development and orderly public sector retrenchment. This theme was reiterated in the annual country assistance papers since then, with further elaboration of the detailed roadmap for the domain of the private sector.[15]

4.2 The Bank pushed the private sector envelope further to deeper and accelerated private sector participation in infrastructure, financial sector and even in areas such as health, education, and environmental protection, which were traditionally the preserves of the public sector. In order to ensure that these strategic objectives were achieved, the Bank made its lending to India primarily policy-based. This meant that if structural reform or stabilization were inadequate, the Bank's lending would be reduced.

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[13] IMF, 1996, *India: Selected Issues*, Table V.3, Washington, D.C.
[14] IFC (1999), *Trends in Private Investment in Developing Countries, Statistics for 1970-97*.
[15] World Bank (India Department), *Country Strategy Papers, 1991, 1992, 1993, 1998*.

5. The World Bank's ESW and Dialogue with the Country

5.1 The Bank's advice regarding the opening of the Indian economy and the role of the private sector was based on its sustained economic and sector work (ESW). In these studies, the Bank articulated a comprehensive reform agenda, embracing all the structural aspects of the Indian economy. Between 1987 and 1991, the Bank prepared papers covering wide-ranging subjects apart from its usual Country Economic Memorandums (CEMs). In March 1987, a paper "Export Development: A Proposed Strategy," was issued. It was followed by two other trade-related papers, "Strategy of Trade Reform (November 1990) (prepared at the request of the GOI), and "Trade Logistics (October, 1989), "Industrial Regulatory Reform (May 1991). Of these studies, two, "The Industrial Reform" and "Strategy of Trade Reform" could be considered to be catalyst. The former suggested an integrated approach to industrial deregulation by emphasizing important linkages between various sectors of the Indian economy. The Bank stressed that domestic deregulation of industries should not be viewed in isolation from the trade regime, tax policy, public enterprise sector, and the financial sector. This study also posited a clear relationship between the macroeconomic imperative and the microeconomic distortions and enlarged on the sequencing issues. The latter focused on different tradeoffs such as the extent to which the protection was reduced, the extent of necessary macroeconomic measures and the degree of industrial restructuring. The report presented a reform scenario which balanced the need for improved incentives for efficiency, the extent of required restructuring and the stringency of fiscal and exchange rate adjustment. This scenario indicated a trade policy adjustment in phases—the first beginning with elimination of quantitative restrictions on imports, exchange rate adjustment and gradual reduction in tariff rates. As the fiscal position improved with changes in taxation and tax reform, the pace of trade reform should be stepped up. Judging the Indian reforms ushered in 1991, it emerges clearly that these two studies were very influential in crystallizing the GOI's thinking on the economic reforms. These reports were timely coming as they did before 1991 reforms and complimented the excellent advice available to the GOI from the academicians like Messrs. Bhagwati and Srinivasan and others.

5.2 After the reforms, the Bank brought out three more studies—"India: Private Sector Assessment" (January 1994), "Issues in Trade Reform (August 1994), and "India Country Framework Report for Private Infrastructure (1999)." The first of these reports, after analyzing thoroughly the private sector functioning, sketched out a strategy for private sector development which included further liberalization of foreign investment policies, deregulation of the financial sector and changes in the legal framework. The second report expatiated on further areas of trade reform. The third report undertaken at the initiative of the GOI on infrastructure, an outcome of the seminar the Bank organized in cooperation with the GOI, in which the Bank staff, Indian and other foreign experts and practitioners participated, covered cross-cutting issues, such as the public-private sector's interfaces for contracting private infrastructure projects and the role of the Indian debt market in providing long-term funds for private infrastructure in telecommunications, power, ports, roads, etc. The conclusion of this report had a considerable bearing on the private sector issues in India and helped chart out an operational strategy in accelerating private sector participation in infrastructure activity. This report sparked off an increasing focus by the Bank on regulatory and policy issues for private infrastructure. A series of workshops and interactions as part of the infrastructure report were held. In telecoms, the Bank was a consistent advocate of competition which has now been adopted by the GOI as a part of its new telecom policy.

5.3 A question can legitimately be raised why the Bank's ESW for all its analytical soundness and immediacy of the policies emanating from them encountered obstacles in its dissemination among the Indian officials. Few of the studies, except CEMs and few others, did not reach a grey cover stage (which implies the GOI concurrence with their substance). Apathy and suspicion about accepting the Bank's views in public may be attributed to two factors—one historical and the other institutional, apart from the fact that the Bank is a marginal lender, though an important one. The former is rooted in the economic philosophy espoused in India over almost forty years, which ran counter to the private sector-oriented and nondirigistic approach of the Bank. Accepting the recommendatory part of the Bank's analysis was therefore an anathema to the Indian officials, being taken as intellectual servitude to the Bank and abdicating what the Indian intellectuals and the political class considered as the precious heritage.[16] Further, difficulties also arose because of the general perception that the ESW often smacked of being preachy and condescending in tone if not in substance. Though Indian mind-set was changed to a great extent under the compulsion of events during the 1990s, admission of change even remotely influenced by the Bank's ESW tends to arouse hostility, thereby making it difficult to secure public approbation for the reform policies. The second factor is a high degree of sensitivity of the policy-makers to the exigencies of the parliamentary procedures. Any basic reform has to go through the parliamentary committees which often interject if the legislation is of a controversial nature, and the officials need to persuade the committees that the policies embodied in the legislations are home-grown and endogenously formulated and not dictated from outside.

5.4 The limited leverage the Bank could exercise in influencing policy has to be also viewed in the context where the Bank has a small role to play in terms of its importance in overall investment in India. The Bank's influence is even less in the area of development of private sector where the local capacity is very strong and the Bank is one among several agencies offering advice on policy matters.

6. The World Bank's Lending Operations Relating to Private Sector Development

6.1 When India embarked on comprehensive reforms which marked a watershed in the Bank's longstanding relationship with India, the Bank initiated a series of lending operations bearing on the private sector development and the opening of the economy. The Bank first approved in December 1991, a Structural Adjustment Loan/Credit (SAL/SAC) a first ever quick disbursing loan for India and followed it up with two other adjustment loans—social safety net sector adjustment program (SSN) in December 1992, and external sector and investment regime liberalization project (ESIRLP) in June 1993. These adjustment programs touched upon solving economy-wide problems, so that the private sector development and the openness of the economy would proceed unhampered with new incentive framework in place. The impact of these was reinforced by several other lending operations of which the following are chosen for evaluation in this paper. They are: Private Infrastructure Leasing and Finance Services Project (IL&FS) approved in March 1996, Industrial Technology Project (IT) approved in March 1989, Export Development Project (ED) approved in September 1989, Orissa Power Restructuring Project (OPSR) approved in April 1996, Haryana Power Sector Restructuring and Development Program (HPSRD) approved in December 1997, Andhra Pradesh Power Sector Restructuring Project (APPSR) approved in February 1999, and the Andhra Pradesh Economic Restructuring Project (APERP) approved in 1998.

[16] See, D. Khatkhate (1994), "Intellectual origins of Indian Economic Reform," *World Development,* Vol. 22, No. 7, Oxford, U.K. See also, Swaminathan, Aiyar (1999), "The World Bank (1999), "India's Political Economy," the background paper for the India CAR where he argues that "the central government in power belonging to all parties did not want to be seen as being influenced by the World Bank, so there was no open policy dialogue, and even CEMs were kept secret, until recently."

6.2 The strategy underlying three adjustment operations—SAL/SAC, SNN, and ESIRLP aimed at phasing out the state control on the economy, private sector development, openness of the economy, elimination of barriers to cost-effective service provision, divestiture of the public sector enterprises; poverty alleviation, and creation of incentive structure. Being the first policy-based loan to India, the SAL/SAC program was broadly based in order to ensure the greatest gains possible from policy interlinkages involved. It built a policy matrix, decisive enough to signal a clear break from the piece-meal approach of the past. The program was realistic as a full array of measures, projected in it were fully owned by the borrower and were either implemented or were in the process of being implemented at the time of loans disbursements. This was borne out by the fact that of the twenty five specific agreed actions relating to formulation of satisfactory policy for adjustment by industrial firms, initiation of measures for restructuring or closure of unviable PSEs, twenty-two had been fully and three substantially complied with.

6.3 The other two adjustment operations of the Bank, SNN, and ESIRLP were a part of the Bank's policy of support to the Indian structural adjustment program, but they addressed the specific areas which assumed importance in the wake of sweeping structural changes. The concept of SNN program was based on the need to mitigate adverse impact of possible industrial restructuring. At the initial stage, the design of SNN included a setting up of National Renewal Fund (NRF) to facilitate industrial restructuring and the reintegration of retrenched labour into the economy. However, the scope of the design was widened later when it was realized that the adjustment policies would impinge on the expenditure on social sectors. Accordingly, an appropriate conditionality matrix was devised. The third adjustment lending operation, ESIRLP carried the same strategy of the first two policy-based loans of further strengthening the structural adjustment process. The design of ESIRLP was linked specifically to a substantial liberalization of the foreign exchange management, convertibility on the current account, and further tariff reductions. The impact of these on the private sector development was reinforced by several other lending operations, referred to earlier. Of these, only two IT and ED were completed while the remaining are still ongoing. (Details of the design of these projects are given in Annex I.)

7. Implementation of the World Bank's Operations

7.1 Implementation of the Bank's programs, on the whole, was smooth, though it varied from one operation to another. The highest degree of success was achieved in respect of two policy-based programs—SAL/SAC, and ESIRLP, largely due to the fact that most of the conditions were met by the GOI before the loans went to the Board. Though there was non-compliance with some minor covenants, the program remained on track. The implementation of the ESIRLP, which was of one tranche kind of operation was ensured by the success of the SAL/SAC.

7.2 The SNN's implementation was undermined by its poor design. The National Renewal Fund (NRF) was the key component of the project. However, the way it was designed did not reflect the full ownership by the GOI. The NRF was to provide a social security to the laid-off labor in terms of compensation for loss of jobs and provision of retraining facilities. These were thwarted by the rigidities in the corporate structure. The closure of firms was rendered difficult by the procedures followed by the Board for Industrial and Financial Reconstruction (BIFR) and lack of necessary cooperation from labor. Apart from this, the GOI, for political reasons could not dismantle the National Textile Corporation, an umbrella organization covering several textile mills with a 40,000 strong labor force. The NRF in the end was used for voluntary retirement scheme for a small number of workers who were on the cusp of retirement in any case.

7.3 While the IT and ED projects were implemented as expected, the IL & FS project, supposed to be path-breaking and innovative one insofar as the development of the private sector was concerned faced numerous impediments in its implementation. Disbursement had been extremely slow and the closing date of the project had to be deferred beyond the original 2001. The failure was ascribed to the deficient performance indicators which were inadequate to measure project performance and did not recognize the realities of the operating environment. Only when the borrower objected to the faulty indicators as the cause of the unsatisfactory rating by the supervision missions, did the Bank revise the indicators in January 1999. The Bank was also slow to recognize the conflict of interests arising from a multiplicity of roles the IL & FS was required to play in the context of the nascent private sector participation in infrastructure development.

7.4 There were two steps envisaged in implementation of the OPSR. The first was to insulate tariff-setting from political pressures through the creation of an independent regulator with powers over licensing of service providers and tariff-setting. The second step was to create distribution entities, run on commercial lines, which would take measures to reduce the current high level of non-technical losses. Orissa had been highly successful in achieving this, because of the Bank's negotiating conditions requiring GOI's advance clearance, Orissa Assembly's passing of the Electricity bill, creation of an independent regulator as tariff-setter and license-enforcer with required authority and autonomy. The OSEB's commercial functions were vested in new corporation. The state government already diverted part of its shareholding in the Orissa power Generation Company (OPGC), and the distribution business was divided into four separate zones. There were some problems, however, because of the lack of cooperative attitude of labour, despite the effort made by the state government and the Bank to explain the benefits to all concerned in order to reach a consensus. The program implementation was rated by the Bank's supervision mission as satisfactory.

7.5 Haryana power project, HPSRD, financed by the Bank, has been on track. It created a regulatory body with similar authority and functions as in the case of OPSR and would sell part of its distribution in course of 1999, on the joint venture basis. Andhra Pradesh Government which received a loan for the power sector (APPSR) only in the beginning of 1999 has already passed the necessary legislative amendments to initiate the setting up of an independent regulator and corporatize its power sector. The Bank could be considered to be instrumental in greatly influencing the power sector reforms at the state level by energizing the leverage it obtained through these operations, though the Bank's success was in no small measure due to the borrower's full ownership of the project. As regards the APERP, it started well with most fiscal targets met and the Budget for 1999-2000 was consistent with the agreed targets. The program implementation as a whole during the initial phases appeared to move in a right direction to warrant a satisfactory rating by the first supervision mission. But it was felt that the physical progress in some areas was achieved at the cost of institutional capacity building and policy reform.

7.6 There was mutual understanding as to the goals of the strategy and sequencing amongst the various donors both multilateral organizations like the IMF, Asian Development Bank (AsDB), and the individual countries. The AsDB's financial sector loan was coordinated with the Bank's lending operation at the pre-appraisal stage. At least in the Bank's two lending operations, ESIRLP and IT, Japan was involved—in the first as a co-financier and in the latter as a provider of technical components. Both the Bank and the government of Japan worked in unison to avoid any conflict. There were, however, some problems in ensuring coordination between the Bank and the IFC. The relationship between the two seemed to be unequal. There had been a strong feeling in the IFC that its views in the private sector assistance strategy in India counted much less than they should have been as the private sector was their main client. On the other hand, there had been some uneasiness expressed by the borrowers like the Infrastructure Development Finance Company (IDFC) about the IFC's initial aloofness regarding participation.

7.7 The Bank generally strove to seek a consensus on policies and reforms, so that its lending operations would yield maximum benefits, while incurring minimum risk, though this goal did not always succeed. However, in regard to the power projects in Orissa and Andhra Pradesh, it took particular care to take a participatory approach. Both the power sector programs were prepared in consultation with the management, staff and labour union of the concerned SEBs. Consultations with the public at large were carried out, which brought together the state governments, the SEBs and their consumer groups.

8. Outcome and Impact

8.1 Of the three completed adjustment operations, the SAL/SAC and ESIRLP succeeded as anticipated. During the three year period 1991/92-1993/94, of these two operations, the actual value of the macroeconomic variables generally rose beyond the targets. Per capita GDP, exports, total investment and saving, current account balance, foreign investment and foreign exchange reserves reached a level which indicated that the economy was well on the way to stabilization and growth and the momentum of reform was maintained, though there were slippages in regard to the rate of inflation, and fiscal balance. The OED evaluation report recorded that "the government showed with its action and not just its plans that it had seized the day," and awarded satisfactory rating to the SAL/SAC and highly satisfactory to the ESIRLP in respect of outcome. The SNN, the third adjustment lending, however, yielded poor result and had a limited impact. This was attributed to the diffusion of objectives and conditions, which resulted in reducing its value added. It appears in hind-sight that both the Bank and the borrower were considerably less prepared for an adjustment style operation in the social sector where measurement problems were severe and the knowledge about their functioning was inadequate. Furthermore, in the SNN operation, the fiscal adjustment goal was treated in isolation from the macroeconomic stabilization objective of the overall adjustment program and therefore, the selected policy targets were inappropriate. The OED report rated the outcome of the SNN as moderately satisfactory.

8.2 Amongst the two completed non-adjustment credits in support of the private sector, ED's outcome was up to the expectation. Exporters managed to reduce costs and increase productivity, improve their financial position and enhance their international competitiveness. The implied objective of a more competitive market was also achieved. Many of the industrial, fiscal and export policy initiatives adopted since 1992 represented a marked departure from the earlier practices. The ED's outcome, therefore, should attract a satisfactory rating as against unsatisfactory given by the OED. The IT achieved broadly its initial objectives. Six venture capital companies managed nine funds and invested in over 300 companies and the returns were around 20 percent on average. Most of the institutions set up adopted innovative hands-on risk-taking approach that venture capital required, and sponsored some exciting and valuable technology-based projects. The OED's rating of IT's outcome as highly satisfactory reflects the extent of its success. (For details of individual project ratings, see Annex II, Table 5.)

9. Sustainability

9.1 The set of indicators to evaluate the sustainability of the Bank's program during a period 1994-99 are: fiscal position which includes government saving and debt service as percentage of GDP; investment/GDP ratio, public enterprises reform which includes, PSE profits/loss, rates of return to capital, labor market which includes productivity and public sector employment and human capital development. On the basis of these selected indicators, it seems that the Bank's operations could be said to have been reasonably successful in contributing to the sustainability of India's reforms. As noted earlier, India's consolidated fiscal deficit had been scaled down through not to the same extent expected. However, sustainability on the evidence of this indicator is uncertain. In the last two years particularly since 1996 consolidated fiscal deficit got stuck at around 8–9 percent of GDP and it was ratcheted upward because of the reluctance or inability of the Central and State governments to restrain current expenditure. The problems raised by large fiscal deficit seemed, however, to have prompted them to reform the PSE sector to get resources through divestment. On the other hand, both saving and investment as the ratio of GDP spurted up smartly after initial setback early in the reform phase. In particular, the private savings, always the mainstay of India's saving performance, increased by 2-3 percentage points, and the GOI also succeeded in recording positive saving, though by a very small margin. The changes in the labor market were modest but they reflected a thin end of the wedge in the labor market policy. For the first time, many of the private sector firms as well as the PSEs have begun in the last 2-3 years to lay off workers by offering attractive voluntary retirement schemes.

9.2 More significant was a transformation in the attitudes and perceptions of the political parties about the desirability of economic reforms. When the adjustment policy was initiated in 1991, it was the policy of one dominant political party. Since then two coalitions of the left of centre ideology have come and gone and the present one of the right of centre persuasion followed suit. But the reforms were, far from being reversed, continued, implying that there was a consensus in favor of reform emerging across the wide spectrum of political opinions, though difference might exist as to the pace and modality of reforms and the space they should occupy in the national economy. (For ratings of individual projects, see Annex II, Table 5.)

10. Institutional Development Impact

10.1 The institutional development as projected in the Bank's operations could be considered as substantial because the Indian reforms supported by the Bank changed the paradigm of planning and the interventionist ethos to pave the way for a private sector-led growth of the Indian economy. The policy matrix India adopted identified many important institutional development measures which included, changes in industrial licensing, rewriting of legislation (e.g., amending the Sick Industrial Companies Act), abolition of the roles of those occupied with various levels of government activities (e.g., abolition of capital issue control department, limited permissible list for imports, establishing new regulatory functions and bodies (e.g., bodies to regulate the stock exchange and activities of mutual funds, regulationary commissions to oversee telecommunication tariffs and power tariff at state level etc.). In certain projects like IT, the Bank helped to introduce a new way of thinking. The IT project was one of the pioneers in the formative stages of the venture capital industry in India. It also contributed to innovative reactions in the Government Science laboratories in which India invest a huge amount. However, India's requirements have been so immense and wide ranging that its present institutional capabilities are extremely limited to cope with them. The bureaucracy used to old ways of controlling economic activities, would have to be retooled and retrained to perform new functions that have devolved on it in the context of reforming economy. (For ratings of individual projects, see Annex II, Table 5.)

11. Assessment of the World Bank's Aggregate Sectoral Assistance Strategy

11.1 The impact of the lending operations of the Bank during 1990-99 and of the nonlending services reflected in the Bank's ESW on the private sector development, was substantial and multi-dimensional. The lending operations well founded on the solid and relevant analytical work triggered unshackling of the Indian economy from the decades-long stultifying policy regime hostile to incentives, efficiency, and rapid growth, and set it on a steady and sure trajectory of structural transformation. With elimination of trade restrictions, the economy was opened to the fresh breeze of competitiveness and modernization blowing from outside. The country's rising inflow of FDIs and other types of foreign capital was assured. The fact that the economy could rebound from crisis to stable growth with expanding space for the private sector testified to the relevance and the efficacy of the Bank's lending and nonlending services rendered to India. In particular, the Bank's ESW in the areas of industrial deregulation and trade reform imparted a comparative perspective to the reform process and helped to operationalize the abstract ideas of structural adjustment in the particular Indian context thereby creating a more receptive audience for acceptance of the Bank's suggestions. On the whole, outcome of the Bank's assistance strategy in regard to the private sector development was satisfactory based on substantial relevance, modest institutional development impact and likely sustainability (see Annex II, Table 8). ESW is given a top rating.

12. Enhancing Effectiveness of the World Bank's Assistance

12.1 The progress in structural adjustment, private sector development and opening of the economy that India recorded during the 1990s has been no doubt impressive, judging it by its past performance. However, what is achieved has been a relatively easy part of the structural transformation of the economy. The following could be the unfinished tasks for the Indian policy makers and the Bank can play a more effective facilitating role to hasten the completion of these tasks through policy-laden lending operations and modulating its ESW.

- Not much attention is paid to the corporate legal reform. India's bankruptcy and liquidation laws and procedures are outdated, inadequate, and time-consuming, thereby contributing to corporate misgovernance. This calls for more emphasis in the Bank's future strategy on the legal and corporate governance issues than on economic policy issues as such. Despite easing of industrial and trade regulatory regimes, the bureaucrats have not yet changed their old attitudes to the extent desired. Any new enterprise entering the field still has to obtain a variety of clearances, for environment, access to port facilities, etc. These difficulties are further compounded by the state governments whose diktats often run counter to those of the central government. This implies that the civil service and legal reform is critical to the creation of more congenial environment for the development of the private sector.

- Financial sector reform is critical to the private sector development. Despite the recent reforms, it is not yet at a stage to assist the private sector development. A large amount of nonperforming assets do not permit banks to reduce real interest rates to any significant extent. Banks, being still government-owned are bereft of any proper incentives to cater to the efficient and dynamic private sector. Hence, privatization of banks is imperative. The Bank can attempt to induce change in the financial sector both by offering desired technical assistance and whenever necessary providing loans to facilitate labor retrenchment which poses severe obstacles in privatization of banks.
- Though industrial deregulation has been effected, the private sector still harbors several obstacles. There are miles to go in the development of communication, transport and power, the essential ingredients in making private sector vigorous and strong. It is also necessary to take a more determined action for privatization of PSEs to create a level-playing field for the private sector. The present privatization process is somewhat synthetic as the equity of some PSEs is sold to other PSEs with high cash resources, so that incentives that go with privatization are absent. The Bank has done substantial policy work in its ESW but what is necessary is that it should create conditions which can make that advice operational by say bringing on board the IFC with appropriate programs.

- India's fiscal deficit is stubbornly high and unless the pricing policy, particularly in regard to power tariffs, irrigation, water charges, and fertilizer is changed, it will continue to be an albatross round the Indian economy. This places in sharp focus the need for the

Bank to pursue more vigorously its current strategy of sub-national lending for structural adjustment and fiscal reform at the level of the states and to constantly remind the GOI, through both ESW and its lending programs the imperative of sealing down fertilizer and other subsistence.

- There are several ways by which the receptivity of ESW and the advice embedded in it can be improved. Firstly, the Bank can farm out much of its analytical work to the research bodies in India and base its final recommendatory part on those studies. It should be recognized that much of the thinking on economic reform is not new in India. The Bank has a comparative advantage is in respect of operationalization of the reform ideas in a particular country context, and presenting an international perspective on experience. There is also a merit in a widely expressed view that the Bank should circulate an initial draft of some of its ESW to the Indian counterparts, official and non-official, as the basis for starting a dialogue on the issues involved. After eliciting comments and criticisms, the final version could then be sent to the Indian authorities. In this way the ownership by the country of the ESW, even if partial, can be ensured.

- Another vehicle for effective ESW could be a seminar forum where papers on various aspects of a particular sector or policy written by the Bank's staff, Indian scholars and other acknowledged experts in the field are discussed. A publication of the seminar proceedings will assure a rapid and effective dissemination of the intellectual underpinnings of the Bank's work and create an awareness amongst wider public, politicians, and the intelligencia. This was borne out by the success of the seminar on the banking sector reform in 1997, organized by the Bank in cooperation with the Indian research institute and on the infrastructure reform and the private sector participation.

Annex I - Details of the Design of the Selected Programs

1. The design of the IT and ED operations was similar because the Bank extended loans through selected financial intermediaries (FI) to firms in the private sector. The first was to enable the FIs to finance part of their equity investment in the venture capital funds (VCF) established by them or their subsidiaries. The ED assisted assorted FIs to finance part of the marketing and technical services associated with the preparation and implementation of client firms' export development programs and to help the FIs to strengthen their capacities to appraise export projects and to advise firms on export strategy issues.

2. The IL&FS was designed to develop prototype contractual arrangements for private investment in infrastructure (Urban by passes and bridges and such others), thereby facilitating entry of the private sector on a much larger scale in fields hitherto dominated by the public sector. It had three components—investment, sub project preparation, and a training and technical assistance. The first of these represented a line of credit to IL&FS, the proceeds of which would be used to provide long term finance to entities set up for construction and operation of commercial infrastructure project. The sub-project preparation component was meant to cover specialized consultancy services to advise public authorities granting the sub-project concession and a training and the TA component was to cover cost of the IL&FSs staff development.

3. The OPSR, HPSRD, and APPSR stood apart from other private sector oriented projects of the Bank, as being innovative and attempted to break the main barriers to the growth of the private sector—viz. shortage of power and its high cost. These three projects were designed to promote reinforcing and rehabilitation of the transmission and distribution systems and developing private power distribution. Built into the design were demand management system, institutional development, and training. The Bank loans were predicated on prior or concurrent enacting comprehensive reform legislation by the concerned states, to facilitate privatization of power generation transmission and distribution and the establishment of the regulatory commission to formulate tariff policy and other operational aspects of power use.

4. The Bank's APERP in the amount of $543.2 million approved in February 1999 was designed to provide resources to the Andhra Pradesh Government to meet priority needs in human development—primary education, health, and in the maintenance of economic assets affecting the rural poor, such as irrigation, roads, etc. The loan was linked to a program of fiscal reform aimed at bringing about a permanent shift in public expenditure toward these priorities; while maintaining tight control over total expenditure and debt. The link between the proposed investments and the fiscal reform program was intended to be established by means of fiscal benchmarks to be monitored throughout the project period. In a way this was a policy-based lending to a state government.

Annex II - Table 1. Trade Policy Measures, 1991-99

Status Before July 1991	*Initial Reforms (July 1991-April 1992)*	*Status in May 1999*
Import restrictions		
Quantitative restrictions on 90 percent of value added in manufacturing, 94 percent in agriculture. Import licensing based on 26 separate lists.	Most quantitative restrictions on import of capital and intermediate goods eliminated and a single negative list established. Quantitative restriction on 47 percent of value added in manufacturing maintained. Limited import of consumer goods possible through open general license, special import license scheme, and consumer goods imported as baggage.	Quantitative restrictions maintained on some 1,776 tariff lines (roughly one half of value added in manufacturing (mostly consumer goods) and more than 80 percent in agriculture), committed to WTO to abolish licensing of imports by 2003. Signed agreement with WTO to give MFN in financial services to all countries.
Import of 55 goods canalized (including steel products, petroleum products, minerals, cotton, and fertilizer.	Most items unrestricted, except for 8 goods categories, including petroleum products, fertilizer, seeds, and cereals.	No change.
Other nontariff barriers: Actual user policy, phased manufacturing program, and government purchase preferences.	Abolished.	No change.
Tariffs		
Maximum rate: 400 percent. Import-weighted average: 87 percent; Dispersion (stand, deviation): 41 percent.	Maximum rate: 110 percent Import-weighted average: 64 percent Dispersion: 34 percent	Maximum rate (including surcharges and special import duties: 40 percent Import-weighted average: 20 percent Dispersion: 17 percent
Rate of effective protection in manufacturing: 114 percent (1989/90) 1/	Rate of effective protection in manufacturing: 78 percent (1993/94) 1/	Rate of effective protection in manufacturing: 43 percent (1995/96) 1/
Export controls		
439 items of various product categories subject to controls.	296 items remain subject to controls.	152 items remain subject to controls, comprising mainly agricultural items. Canalized items comprise mainly petroleum products, iron ore, and other minerals.
Export taxes		
Export taxes levied on some mineral and agricultural items.	Scope of export taxes greatly reduced.	26 items subject to duties and cess duties.
Export subsidies		
Direct subsidies targeting specific sectors.	Export subsidies streamlined. Direct subsidies eliminated and sector-specific subsidies replaced by more general duty exemption schemes such as advance licensing, duty drawback and EPCG schemes, and tax exemptions.	Most duty exemption schemes replaced by new passbook scheme. Restrictions on EPCG imports relaxed and duties reduced. Exporters exempt from income tax and MAT.

1/ Sharma and Mehta (1996).

Annex II - Table 2. Pre-1991 Regime of Capital Control

Foreign direct investment (FDI): FDI was seen primarily as a vehicle for the transfer of technology. A selective policy of case-by-case approvals was designed to channel foreign investment into areas which required sophisticated technology; where critical production gaps existed; or where there were prospects for substantial export potential. Foreign collaboration was also regulated, for example, requiring that Indian firms obtain permission to engage foreign technicians. The normal ceiling for FDI was 40 percent of the paid-up equity capital, although a higher percentage of foreign equity could be approved for priority industries, and up to 100 percent for wholly export-oriented industries. This regime proved highly rigid, with the result that investment over 1980-91 averaged only $150 million per year.

Portfolio equity investment: Portfolio investment was in general not permitted. However, with the goal of promoting investment in India from oil-exporting developing countries, such countries were permitted to acquire up to 40 percent of equity in companies covered under the industrial policy and export-oriented companies, even if the technology requirements for FDI were not met.

External commercial borrowing (ECB): ECB required prior approval by the Government of India. Applications were considered on a case-by-case basis, taking account of the purpose of borrowing; the export potential of projects; and the capacity to generate foreign exchange to meet debt service and other payments.

Nonresident (NRI) deposits: Various deposit schemes were made available that allowed nonresidents and overseas corporate bodies to repatriate earnings from abroad. As a means of bolstering reserves, these schemes were further enhanced by: (i) offering interest rates above international levels; (ii) providing exchange rate guarantees from the central bank; and (iii) offering certain tax advantages.

Short-term credit: Such credit was in general permitted for trade-related financing only, and required Reserve Bank of India approval. However, use of short-term credit expanded during the late 1980s as the external current account widened.

Outward investment was strictly limited with a goal of conserving domestic savings for domestic investment.

Annex II – Table 3. Capital Account Reform Measures, 1991-98				
Year	*Current Account Measures*	*Capital Account Measures*	*Exchange Rate Measures*	*Other Measures*
1990-91	Measures taken to control imports and expedite the repatriation of export proceeds	Access to short-term credit to the Indian borrowers, particularly Bankers' Acceptance Facility restricted		
	New Trade policy announced in July 1991	Negotiated with the IMF for the withdrawal of loans under the Compensatory and Contingency Financing Facility (CCFF) and First credit tranche of its Stand-by Arrangement.		
		Foreign Currency Banks and Other Deposits Scheme (FC(B&O)D) introduced.		
1991-92	Persons of Indian origin permitted to import gold	Foreign Currency Ordinary Non-repatriable Scheme (FCON) introduced.	Downward adjustment of Indian rupees in terms of U.S. dollar by 18 percent.	Pledging of monetary gold in the international market.
		Liberalization of foreign direct investment of industries in Annexure III of the Statement of Industrial Policy, 1991.	Liberalized Exchange Rate Management System (LERMS) through which one leg of the exchange rate, applicable to 40 percent of all current receipts, essential imports and debt-service payments, was determined by the Reserve Bank and the other leg, which applied to all other transactions, was determined by the market.	
1992-93	Persons of Indian origin permitted to import silver up to 100 kgs.	Indian company launches the first GDR issue of India.	Exchange rate was unified through which the external value of the rupee to be market related.	Comprehensive amendments to the FERA.
		Non-Resident Non-Repatriable Account		

Annex II – Table 3. Capital Account Reform Measures, 1991-98				
Year	*Current Account Measures*	*Capital Account Measures*	*Exchange Rate Measures*	*Other Measures*
		Scheme (NRNR) introduced.		
1993-94		FCNR (B) scheme introduced.		
		FC(B&O) D scheme withdrawn.		
1994-95	India accepted obligations under Article 2, 3, and 4 of Article VIII of the Articles of Agreement of the IMF.	FCNR(A) scheme withdrawn in a phased manner		
	Interest accrued on NRNRD along with other current account liberalization measures made eligible for repatriation.			
1995-96		Liberalized Guidelines for Indian investment abroad in Wholly Owned Subsidiaries and Joint Ventures with fast track approvals from the Reserve Bank.	The Report of the Expert Group on Foreign Exchange Markets in India (Chairman: Shri O.P. Sodhani) submitted.	Post shipment credit in foreign currency (PSCFC) scheme withdrawn.
		ADs allowed to decide their foreign exchange overnight open position limits subject to approval from RBI and their maintaining of Tier I capital funds of 5 percent of the foreign exchange open position limits.		
1996-97		100 percent dedicated debt funds allowed to invest in private debt instruments of Indian companies.	Aggregate Gap Limit (AGL) left to be fixed by individual banks depending upon their foreign exchange operation, risk-taking capacity, balance sheet size and other relevant parameters subject to approval from the RBI.	
		Greater access to	ADs permitted to	

Annex II – Table 3. Capital Account Reform Measures, 1991-98

Year	*Current Account Measures*	*Capital Account Measures*	*Exchange Rate Measures*	*Other Measures*
		investment proposals under the Automatic Approval Route to foreign investors.	offer cost effective and risk reduction option strategies.	
		Applications for raising foreign currency loan under US$3 million scheme and short-term loan to be considered by the RBI.	ADs permitted to use interest rate swaps, currency swaps, forward rate agreement instruments to hedge their asset liability portfolio.	
		RBI appointed a committee on Capital Account Convertibility which submitted its Report on May 30, 1997.	Ads having the requisite infrastructure, risk control mechanism and satisfying capital adequacy norms, were permitted to initiate cross currency positions in the overseas market.	
		FII allowed to invest in GOI dated securities.		
1997-98	Major revisions in the EXIM Policy 1997-2002		ADs were allowed to book forward cover for exporters and importers without the requirement of documentary evidence of a firm order for letter of credit, but on the basis of a declaration of exposure supported by past performance and business projection.	CRR of 10 percent imposed on incremental liability over April 11, 1997 under FCNR(B) deposit.
	RBI announced detailed eligibility criteria to apply for authorization as a nominated agency for import of Gold/Silver/ Platinum.		ADs permitted to provide forward exchange cover to FIIs in respect to their investments in debt instruments in India.	Banks including primary cooperatives which are ADs in foreign exchange permitted to fix interest rates on NRE term deposits of 6 months and above.
			ADs permitted to extend forward cover to holders of	RBI appointed a Committee on Hedging through

Annex II – Table 3. Capital Account Reform Measures, 1991-98

Year	*Current Account Measures*	*Capital Account Measures*	*Exchange Rate Measures*	*Other Measures*
			FCNR/NRE to enable them to hedge the balance therein	international Commodity exchanges which formally submitted its recommendations on November 21, 1997.
			ADs were permitted to invest/borrow amounts up to a maximum extent of 15 percent of their unimpaired Tier I for US$10 million, whichever is higher, capital as against the previous ceiling of US$ 10 million.	Interest rates charged on rupee loans out of/against FCNR(B) deposits made consistent with lending rates for rupee loans in general.
				The incremental CRR of 10 percent on NRE and NRNR deposit scheme imposed on the increase in the level outstanding as on April 1, 1997, was removed, with effect from December 6, 1997.
1998-99		FIIs allowed to invest in GOI Treasury bills.	ADs permitted to provide forward cover to FIIs in respect of their fresh investment in India in equity and appreciation in the market value of their existing investment in India.	

Source: Reserve Bank of India *Bulletin* issues, 1991-1999.

Annex II - Table 4. Performance of the Top 110 Private Sector Manufacturing Companies

As of March 31	*1990*	*1991*	*1992*	*1993*	*1994*	*1995*
Sales (Rs billion)	412.8	495.3	597.9	689.7	848.2	1,010.7
Net worth (Rs billion)	113.0	140.3	174.8	246.3	365.6	533.2
Current ratio	1.71	1.64	1.57	1.69	1.84	1.94
Profitability ratios						
BDT/networth (percent) 1/	37.6	39.2	37.6	27.9	25.7	25.2
AT/Networth (percent) 2/	17.6	19	17.4	13.4	15.5	16.5
Lending (Rs billion)	72.5	99.5	164.7	186.2	235.1	308
Of which: (percent)						
Internal	26.6	42.4	30.4	28	26.6	27.3
External	73.4	57.6	69.6	72	73.4	72.7
B1 Share markets	8.6	7.1	4.2	26.3	33	37.4
B2 Borrowings: banks	8.6	8.3	7.9	8.4	-1.4	14.9
B3 Borrowings: FIs	8.1	8.7	18.7	10.6	0.5	-0.3
B4 Borrowings: debentures+FDs 3/	26.1	5.7	11.4	13.5	16.1	2.9
B5 Borrowings: commercial+others	5.1	6.1	5.6	3.3	5.3	2.3
B6 Current liabilities	17.0	21.6	21.7	9.8	19.8	15.5
Average ratios						
Total borrowings/net worth	1.25	1.20	1.36	1.20	0.97	0.78
Long-term borrowings/net worth	1.01	0.94	1.08	0.95	0.81	0.63

Sources: Data from centre for Monitoring Indian Economy as reproduced in O. Goswami (1998) "Twenty Questions for Every One: The Tragedy of Industrial, Financial, and Corporate Reform," included in Economic Reform: The Next Step, Vol. I (ed.) by Rajeev Gandhi Institute for Contemporary Studies, New Delhi.

1/ Profits after tax.
2/ Profits before depreciation and taxes.
3/ Fixed deposits.

• **Annex II – Table 5. Country Assistance Strategy Evaluation Matrix**				
Strategic Objectives	*Strategic Actions*	*Progress Indicators*	*Bank Groups Assistance*	*Other Assistance*
A. Structural Adjustment, Industrial and Trade Deregulation, Provision of Safety Net				
Deregulation of domestic industry and promotion of foreign direct investment.	Major industries freed from licensing. Removal of restriction in 1993 on firms holding 40 percent foreign equity to dispose of assets or borrowing in Indian market.	Export expansion of 12 percent during early part of 1990s. GDP growth of average 6 percent. Rise in domestic saving and investment.	**Lending** Structural Adjustment Loan/Credit (SAL/SAC) in 1991—fully disbursed. Also an Economic Restructuring Loan (APERP) was given to Andhra Pradesh in 1999. **Nonlending** Solid ESW in areas of industrial deregulation starting from 1987 onward.	IMF provided structural adjustment facility. AsDB's assistance coordinated with the Bank's and IMF's assistance.
Liberalization of trade and foreign exchange regime.	Exchange rate was first allowed to be market-determined and then unified (in 1993). Amendment of the Foreign Exchange Act in 1992. Tariff reduction from maximum of 400 percent to 45 percent. Gradual removal of quantitative restrictions on all imports.	Exchange rate: a managed float. Current account convertibility and a gradual liberalization of capital account achieved. Import weighted average tariff reduced from 87 percent in 1991 to 30 percent in 1999 and the maximum to 45 percent.	**Lending** SAL/SAC and external sector and investment regime liberalization project loan (ESIRLP); the loan fully disbursed. **Nonlending** Extensive ESW on trade reform and policies began even before 1991.	IMF's SAF and AsDB's loan

• **Annex II – Table 5. Country Assistance Strategy Evaluation Matrix**				
Strategic Objectives	*Strategic Actions*	*Progress Indicators*	*Bank Groups Assistance*	*Other Assistance*
Fiscal consolidation and public sector enterprise reform	Comprehensive tax reform in 1994-95. Fertilizer and other subsidies scaled down though not to the extent expected, stricter control on overall government expenditure. Public sector reform began with hard budget constraints imposed on them and sale of equity to the public.	Fiscal deficit of the central government is reduced in the early phases to 6.3 percent. It has since risen. The state government's fiscal deficit still higher than targeted.	The same as above.	The same as above.
Financial sector deregulation	Interest rates on loans and deposits deregulated. Capital adequacy ratios raised to 8 percent. Accounting norms were made stringent. Directed credit reduced somewhat. Prudential controls strengthened.	Nonperforming assets steadily reduced. Most of the public sector banks achieved 8 percent capital adequacy ratios. There was some sale of equity by public sector banks to public.	**Lending** In addition to SAL/SAC, the Bank gave financial sector development project loan in 1995. About 33 percent of it is disbursed. **Nonlending** The Bank's solid ESW on financial sector and banking reforms.	AsDB provided financial sector loans and the IMF provided extensive technical assistance in money market.
Improvement of social sectors and expansion of program to protect workers from negative consequences of stabilization and adjustment.	GOI made a supplementary budget allocation of $183.3 million for social sector. A standing sector coordination committee was set up for improving social services. Targeted at disadvantaged groups and areas for increased expenditure. National Renewal Fund (NRF) was set up and a business plan was drawn.	Major thrust in raising basic education. Increased expenditure on social sectors. Though NRF did not function as anticipated, it helped to some extent to compensate workers retrenched by the public sector undergoing restructuring.	**Lending** Bank provided quick disbursing social safety net sector adjustment loan of $500 million (SSN) in 1992. It was fully disbursed. **Nonlending** Extensive ESW on social sectors, poverty alleviation, which laid the foundation for the program.	In addition to the Bank financial and technical assistance was provided by the governments of Japan, Switzerland, the European Community, and the USAID.

• **Annex II – Table 5. Country Assistance Strategy Evaluation Matrix**				
Strategic Objectives	*Strategic Actions*	*Progress Indicators*	*Bank Groups Assistance*	*Other Assistance*
B. Private Sector Development and Participation in Infrastructure				
Create a facilitating environment for the private sector development. Help the private sector to be effective exporter. Enable private sector to acquire and develop technology. Helping small innovative firms obtain financing through venture capital activity. Encourage private sector participation in the infrastructure activities.	Structural reforms like industrial deregulation and trade reform. About 400 firms used technical development fund which encouraged venture capital. Assisted financial institutions to strengthen the capacities of their clients to formulate export strategy. Helped firms in the development of technology. Three states: Haryana, Orissa, and Andhra Pradesh enacted necessary legislation for power reform. Regulatory commission were also set up. Public participation facilitated and consensus among all parties obtained. Preliminary steps taken to unbundle the services-generating transmission and distribution.	Venture capital activity gathered popularity and speed. In 1999, the Government of India announced in 1999, a Rs 100 crore venture capital fund. Exporters were familiarized with foreign markets. Three states: Haryana, Orissa, and Andhra Pradesh created a framework for private sector participation in power.	**Lending** Bank gave three power sector loans to Haryana, Orissa, and Andhra Pradesh. These are Orissa Power Sector Restructuring Project (OPSR), Haryana Power Sector Restructuring and Development Program (HPSRD), and Andhra Pradesh Power Restructuring Project (APPSR). **Nonlending** A discussion paper on Regulatory Reform was prepared and a handbook on competitive procedures for power sector project. India Country Framework Report for Private Infrastructure was prepared in 1999.	ODA provided technical assistance for OPSR. The role of the IFC was marginal.

Annex II - Table 6. Ratings Country Assistance Strategy Evaluation Matrix*

Categories Rating	*SAL/SAC*	*SNN*	*ESRTL*	*IT*	*ED*	*IL&FS*	*OPSRP*	*HPSRDP*	*APPSR*	*ESW*
1. Outcome	Satisfactory	Moderately satisfactory	Satisfactory	Highly satisfactory	Satisfactory	Satisfactory	--	--	--	--
Relevance	Substantial	Negligible	Substantial	Substantial	Substantial	High	High	High	High	High
Efficacy	Substantial	Negligible	Substantial	Substantial	Substantial	Modest	Substantial	Substantial	Substantial	Substantial
2. Overall impact or institutional development	Substantial	Negligible	Substantial	Substantial	Substantial	Modest	Substantial	Substantial	Substantial	High
3. Sustainability	Likely	Uncertain	Likely	Likely	Likely	Likely	Likely	Likely	Likely	Likely

*These ratings are given by the author of this paper.

Annex II - Table 7. Ratings for Economic and Sector Work (ESW)*	
Categories for ratings	*Ratings*
1. Strategic relevance and timeliness	1
2. Internal quality	1
3. Presentation and readability	1
4. Likely impact	1

*Ratings are by the author of the paper.

Annex II – Table 8. Ratings for Aggregate Assistance Strategy for the Sector*	
Categories	*Ratings*
1. Outcome Relevance Efficacy	Satisfactory High Substantial
2. Overall impact and institutional development Impact	Substantial
3. Sustainability	Likely

*Ratings are by the author of this paper.

Annex III: Summary of Discussion at CAE Workshop on Private Sector Development

March 31, 2000

Participants, while endorsing the main thrust of this paper observed:

- Industrial strategy in pre liberalization era introduced many distortions in the Indian economy.
- Reforms were crisis-driven.
- Government's approach to start reform with power sector reform with generators was faulty.
- The mind–set of the bureaucracy has not yet changed sufficiently and still was an impediment to reforms and the workings of markets.
- Remedies suggested: the Government should curtail borrowings and expenditure in order not to crowd out private sector. The Bank can play a catalytic role in promoting private sector R&D activities.

Suggestions for the future:

- The World Bank should involve itself more in financing airports, sea ports.
- The Bank /IFC should provide inputs in policy formulation relating to the private sector.
- The Bank and the IFC should extend credit lines to the private sector.
- The Bank should co-opt Indian scholars and the research institutions in its ESW.
- The Bank should help the private sector in: quality management, meeting international standards relating to environment, increasing exports, building Brand Equity, guarding intellectual property rights, small -scale industry, skill building and entrepreneurial talent.
- The Bank should find ways to influence the government by being proactive without being dominating.