LIBERALISATION, PRIVATISATION AND GLOBALISATION : AN APPRAISAL

INTRODUCTION

Since Independence, India followed mixed economy system. India had a very controlled and regulated economy before 1991, where most of the sectors were regulated by the government sector. Due to its policies; India lagged behind many countries which gained independence at the same time as we did.

CRISIS OF 1991 / NEED FOR ECONOMIC REFORMS

Some of the reasons that led to the crisis of 1991 and forced the government to adopt new economic policies were:

(a) High Fiscal Deficit – Fiscal deficit refers to borrowings by the government to meet its excess expenditures.

Fiscal deficit was estimated to be **5.4% of GDP in 1981-82, and it increased up to 8.4% of GDP in 1990-91.** The Indian economy was caught in a debt trap.

(b) Balance of Payment Crisis – By the end of 1990, our Balance of payment account revealed that:

* **Current Account Deficit was rising** (increased from 2000 crores in 1980-81 to around 18000 crores in 1990-91). Even after imposing heavy tariffs and fixing quotas, there was a sharp rise in imports. Exports were low due to inferior quality of goods and their high prices in international markets.
* **Borrowings from rest of the world was increasing**.

(c) Fall in foreign exchange reserves – In 1990-91, foreign exchange reserves were not sufficient enough to make payments for more than 14 days. Foreign currency was not available to pay interest and principal amount to international lenders. Thus, no country was willing to lend money to India.

(d) Inflation – Inflation was triggered by rapid increase in money supply (due to borrowings by the government to meet its fiscal deficit) and due to increase in prices of essential goods.

(e) Poor performance of PSU's – Most of the public sector enterprises were running in losses and were proving to be a huge burden on government treasury. Government had to shut down many of these enterprises which led to increase in unemployment level.

Thus, new economic policy was required to put the economy on the fast track of growth which was caught in the "low equilibrium trap".

In 1991, India approached International Bank for Reconstruction and Development (IBRD) (also known as World Bank) and IMF and received 7 billion dollars as loan to manage the crisis.

For availing the loan, IMF and World Bank expected India to:

(a) **liberalise and open up the economy** by removing trade barriers on private sector.
(b) **Reduce the role of government** in many areas.
(c) Remove restrictions imposed on trade

India agreed to the conditions of World Bank and IMF and announced the New Economic Policy (NEP) in the year 1991.

ECONOMIC REFORMS SINCE 1991 – NEW ECONOMIC POLICY (NEP)

In 1991, the government of India initiated a **series of economic reforms to pull the economy out of crisis of 90's.** These reforms came to be known as New Economic Policy (NEP).

NEP consisted of wide range of economic reforms which includes reforms in industrial sector, financial sector, international trade etc.

The set of policies can be classified into two categories:

Stabilisation measures – These were **short term measures** which were meant to **correct the Balance of payment situation** and to **bring inflation under control.**

Structural Reform Policies – These are **long term measures** which aimed at **improving the efficiency of the economy** and **improving its competitiveness in international markets.**

Government of India initiated a variety of policies which falls under three heads:
(a) Liberalisation (b) Privatisation (c) Globalisation

LIBERALISATION

Liberalisation means **removing all unnecessary controls and restrictions like permits, quotas, license etc. imposed by the government on private sector.**

Prior to 1991, various rules and laws imposed by the government became a major hindrance in the path of growth and development. These controls gave rise to corruption, unnecessary delays and inefficiency.

Thus, it became necessary to liberalise the economy. Greater reliance was to be placed on market forces of demand and supply rather than checks and controls.

Economic reforms under liberalisation

Liberalisation was introduced in many areas in 1991. Some of these were:

(A) Industrial Sector Reforms –

Prior to 1991, Industrial sector was regulated in many ways:
(a) **License was required** to open up a new firm or to expand production.
(b) **Private sector was not allowed** in many industries.
(c) **Price was controlled** by the government.

Reform policies introduced after 1991 removed many of these restrictions:

(a) **Industrial licensing was abolished for all products except for few industries** and these were – alcohol, cigarettes, drugs, defence equipment etc.

- No license were needed to set up new units or to expand or diversify the existing line of manufacture.

(b) **No. of industries reserved for public sector has been reduced from 17 to 3.** Industries reserved for public sector are: defence equipment, atomic energy generation and railways.

(c) **Limit on production have been removed** and now producers are free to determine the prices.

(d) Many production areas which were earlier **reserved for the Small-scale industries have been de-reserved.**

(e) Industrialists are now **free to import technology from abroad** in order to upgrade their technology. No prior permission from government is required.

(B) <u>FINANCIAL SECTOR REFORMS</u>

Financial sector includes financial institutions such as commercial banks, stock exchange market and foreign exchange market.

Prior to 1991, financial sector was controlled by RBI though high interest rates, high CRR, high SLR etc.

One of the major aims of financial sector reforms was to **reduce the role of RBI from being a regulator to being a facilitator**. As a regulator, RBI would itself fix interest rate structure for commercial banks. But as a facilitator, RBI facilitate the free play of market forces and leave it to commercial banks to decide their interest rates. **Now, competition rather than control rules the decision-making process.**

Reforms led to **establishment of private sector banks** (Indians as well as foreign banks). **Foreign Investment was also raised in the banks.**

Banks which fulfil certain conditions were **allowed to set up new branches without approval from RBI.**

Foreign Institutional Investor's (FII's) were allowed to invest in Indian financial markets.

(C) <u>TAX REFORMS / FISCAL REFORMS</u>

Tax reforms are mainly related with **government's taxation and its public expenditure policy** which are collectively known as fiscal policy.

Prior to 1991, both direct taxes and indirect taxes were very high. This encouraged tax evasion.

After 1991, government has **reduced both direct tax rates and indirect tax rates**.
In order to encourage the public to pay taxes, **tax procedure have been simplified**. This has raised tax compliance and thus tax revenue of the government.

(D) FOREIGN SECTOR REFORMS / EXTERNAL SECTOR REFORMS

In 1991, in order to solve the BOP crisis, **the rupee was devalued against foreign currencies**. This made our goods cheaper in foreign markets and thus increased exports and resulted in increase in foreign exchange.

We moved from a policy of government-controlled exchange rate to market determined exchange rate i.e. **we moved from fixed exchange rate to flexible exchange rate.**

(E) TRADE AND INVESTMENT POLICY REFORMS

Prior to 1991, India was following a protectionist policy i.e. imports were restricted through various ways such as import quotas, high tariff rates etc. Main aim was to protect domestic industries from foreign competition. This reduced efficiency and competitiveness in international markets.

Reforms in this sector was meant to increase our international competitiveness and also encourage foreign investments and advanced technology in the country.

Some of the steps which were taken:

(a) Quantitative **restrictions on imports and exports were removed**.
(b) **Tariff rates were reduced**.
(c) Licensing system for imports (import licensing) **were abolished except for hazardous industries.**
(d) Export duties were removed in order to enhance our competitiveness in international markets.

PRIVATISATION

Privatisation means **transfer of ownership or management of a government owned enterprise to private sector.**

It implies gradual withdrawal of government ownership/management from the public sector enterprises. It may happen in two ways:
(a) Sale of government enterprises to the private entrepreneurs.
(b) Withdrawal of government ownership and management from the mixed enterprises.

Need for privatisation

(a) Many public sector enterprises were **running into very huge losses** and were proving to be a huge financial burden for the government. The government decided to privatise many public sector enterprises.

(b) **Leakage, inefficiency and corruption** had become so rampant in PSU's that their privatisation was considered as only remedy.

Some of the **measures adopted by government to privatise PSU's were:**

(a) Disinvestment – Disinvestment refers to process whereby **government sells a part of its equity holdings in public sector units to public or to private investors**.

Objectives of government

(a) To **raise revenue** to manage its deficits.
(b) With private sector on board, it will help to **increase the efficiency** of PSU's.
(c) Will help **modernise** the public sector.

(b) Policy for Navratnas : Government decided to give greater **managerial and operational autonomy to some important profit-making PSU**'s i.e. they were allowed to make various decisions without taking government's nod.

Some of the companies that were given navratna status were:
BHEL, CIL, GAIL, MTNL Etc. Over the years performance of these companies have improved.

Government has given operational, managerial and financial autonomy to many other profit-making enterprises and are termed as "mini-ratnas".

GAINS FROM PRIVATISATION

(a) Privatisation **leads to increase in efficiency** and thus an increase in level of productivity as private producers uses the resources in the best possible manner because of their objective of profit maximization or cost minimization.

(b) Privatisation **enhances competition in the market** – both domestic as well as international. This leads to upgradation and modernisation which are essential for growth and development.

NEGATIVES OF PRIVATISATION

(a) Privatisation is **driven by profit motive rather than social motive**. Thus goods and services are produced for those who can afford to buy them, weaker and poorer sections of the society suffer the most.

(b) Privatisation **leads to increase in level of inequality in the society as wealth is concentrated in few hands.**

GLOBALISATION

Globalisation means **integrating the economy of a country with the world economy.**

Globalisation refers to **growing economic interdependence** among countries in the world. Now each country depends on one another with regard to technology, goods services, capital etc.

It is turning the world into one borderless world.

Points in favour of Globalisation

(a) Increase in inflow of foreign capital – Globalisation will attract foreign capital which will lead to technological upgradation.

(b) Improvement in quality – Domestic companies have to improve their quality if they want to withstand foreign competition. Thus, consumers will be benefited.

(c) Rise in employment – With setting up of foreign companies within the domestic territory; there will be rise in production and thus a rise in level of employment.

(d) Greater access to global markets

Points against Globalisation

(a) Burden on domestic producers – Many domestic producers will not be able to compete with stiff foreign competition and cheap imports.

(b) Result in rise in level of inequality – Benefits have mainly been enjoyed by the developed nations and multinational companies. This has increased the gap between the rich and the poor.

(c) Benefits of globalisation accrue more to developed countries as they are able to expand their markets in other countries.

Policy strategies promoting Globalisation of the Indian Economy

(a) **Increase in Equity Limit of foreign Investment** – Equity limit of foreign investment has been raised from initial 40% to 51-100%.

(b) **Reduction in Tariffs** – In order to encourage competitiveness, tariff barriers have been withdrawn from most of the goods traded.

(c) **Withdrawal of quantitative restrictions** – Since 2001, the quantitative restrictions on all imports have been totally withdrawn.

INDIAN ECONOMY DURING REFORMS: AN ASSESSMENT

OR

What was the performance of the Indian economy after the reform period?

(a) **Rise in GDP growth** – After the introduction of economic reforms in 1991, country has shown a rise in GDP growth rate.

(b) **Rise in inflow of foreign capital** – After liberalising and privatising the economy there has been a increase in inflow of foreign capital (both in form of FDI's and FII's)

(c) **Rise in foreign exchange reserves** – Foreign exchange reserves rose substantially from 6 billion dollar in 1990-91 to 125 billion dollar in 2004-05.

(d) **Control on Inflation** – During the reform process, Inflation have been kept under control. On an average during the two decades after the reforms it has been in the range of 5-7%.

(e) During the reform period, government has been able to **control its fiscal deficit.**

CRITICISM OF LPG POLICY OR FAILURES OF ECONOMIC REFORMS

(A) **Reforms and Employment** – Though GDP growth rate has increased, reforms have not been able to generate enough employment opportunities.

Industrial sector and service sector is unable to generate enough jobs for people from agriculture sector as they lack required skills and knowledge.

(B) **Growth and Agriculture** – During the reform period there has been **decline in agricultural growth rate.**

Economic reforms have not been able to benefit the agriculture sector because of following reasons –

(a) **Investment done by government in agriculture sector has been reduced.** Government has reduced its investment on irrigation projects, power, roads and research.

(b) Due to **reduction in subsidies**; there has been an increase in cost of production, which has badly affected the small and marginal farmers.

(c) **Export oriented growth** has favoured increased production of cash crops rather than food grains. This has increased prices of food grains.

(d) Various policy changes took place during this period –

*__Reduction in import duties__ on agricultural products.
*__Quantitative restrictions on imports of agricultural products have been removed__. Thus, now Indian farmers have to face stiff competition from abroad.

(C) REFORMS IN INDUSTRIAL SECTOR

During the reform period there has been a decline in growth rate of Industrial sector.

Reasons:

(a) **Globalisation has led to decrease in demand for domestic industrial products** due to cheaper imports.

(b) **Infrastructure facilities** such as power supply, transportation etc. have **remained inadequate** due to lack of investment.

(c) Due to globalisation, there is free movement of goods and services from developed countries. It has badly affected domestic industries and employment in developing countries.

(d) Developing countries like India **do not have access to markets of developed countries due to high non-tariff barriers.**

NCERT QUESTIONS

1. Why did RBI have to change its role from controller to facilitator of financial sector in India?

Ans. **Prior to liberalisation, RBI used to regulate and control the financial sector** that includes financial institutions like commercial banks, stock exchange operations and foreign exchange market.

With the economic liberalisation and financial sector reforms, RBI needed to shift its role from a controller to facilitator of the financial sector. This implies that the financial organizations were **free to make their own decisions** on many matters without consulting the RBI.

This **opened up the gates of financial sectors for the private players**. The main objective behind the financial reforms was to encourage private sector participation, increase competition and allowing market forces to operate in the financial sector.

2. How is RBI controlling the commercial banks?

Ans. RBI controls the commercial banks **via various instruments like SLR, CRR, Bank Rate, Repo Rate** and fixing the interest rates and deciding the nature of lending to various sectors. It is mandatory for all commercial banks to follow or maintain these rates. All these measures control the operations of commercial banks and also control money supply in the Indian economy.

3. Distinguish between the following:
(a) Strategic and Minority Sale
(b) Bilateral and Multi-Lateral Trade
(c) Tariff and Non-Tariff Barriers

Ans. (a) <u>**Strategic Sale**</u>: Strategic sale refers to the **sale of 51% or more stake** of **a PSU** to the private sector.
The **ownership of PSU is handed over** to the private sector.

<u>**Minority Sale**</u>: It refers to the **sale of less than 49% stake of a PSU** to the private sector.
The **ownership of PSU still remains** with the government as it holds 51% of stake.

(b) <u>Bilateral Trade</u>: It is a trade agreement between **two countries.**

<u>Multilateral Trade</u>: It is a trade agreement among **more than two countries**.

<u>Tariff barriers</u> – It refers to the tax imposed on the imports by the country to protect its domestic industries. It includes custom duties, export duties etc.

<u>Non-Tariff Barriers</u> – It refers to the restrictions other than taxes imposed on imports by the country. It includes quotas and licenses.

4. Why are tariffs imposed?

Ans. Tariffs are imposed **to make imports from foreign countries relatively expensive than domestic goods**, thereby discouraging imports indirectly. These are imposed to provide a safe and protective environment to the infant domestic firms from their technologically advanced foreign counterparts. **Tariff facilitates domestic firms to survive and grow.**

5. What is the meaning of quantitative restrictions?

Ans. Quantitative restrictions refers to the **restrictions in the form of limits or quotas on the number of commodities that can either be imported or exported**. Quantitative restrictions on imports are imposed to discourage imports of foreign goods and to reduce Balance of Payment (BOP) deficits.

6. Those public sector undertakings which are making profits should be privatised. Do you agree with this view? Why?

Ans. An efficient and profit earning PSU is a revenue generator for the government. But if, a PSU is an inefficient and loss-making unit then the same PSU becomes a burden on the government's revenue and may lead to budget deficit. **The loss-making PSU's should be privatised whereas it would not be fair to privatise a profit-making PSU.**

Privatising of PSU may lead to **concentration of monopoly power** in private hands. Further some of the PSU's like water, railways, electricity etc. enhances the welfare of nation and is meant to serve general public at nominal cost. Privatisation of such PSUs will **lead to loss of welfare of poor people**.
Hence, only **less important PSUs should be privatised** while core and important PSUs is to be owned by public sector.

Instead of privatisation of profit-making PSUs, government can allow more degree of autonomy and accountability in their operations, which will only increase their productivity and efficiency but also their competitiveness in the market.

7. Do you think the navratna policy of the government helps in improving the performance of public sector undertakings in India? How?

Ans. To **improve efficiency, enhance professionalism and to enable PSU's to compete effectively in the market**, government awarded the status of Navratnas to 9 PSUs. Some of them are:

(a) Indian Oil Corporation Ltd. (IOC)
(b) Bharat Petroleum Corporation Ltd. (BPCL)
(c) ONGC
(d) SAIL

These corporations were **granted a greater degree of financial, managerial and operational autonomy**. This boosted their efficiency and effectiveness. They also became highly competitive and some of them are becoming giant global players.

Consequent to their better performance, government retained them under public sector and enabled them to grow themselves not only in the domestic market but also in the international market.

Thus, the navratna policy has certainly improved the performance of these PSUs.

8. What are the major factors that led to high growth of the service sector?

Ans. The major factors that led to high growth of service sector in India are:

(a) **Structural transformation** – Indian economy experienced structural transformation that implies shift of economic dependence from primary sector to tertiary sector. Due to this transformation, there was increased demand for support services which boosted the service sector.

(b) **Liberalisation and economic reforms**: The growth of Indian service sector is also attributable to the liberalisation and various economic reforms that were initiated in 1991. Due to these reforms, various restrictions on the movement of international finance were minimised. This led to huge inflow of foreign capital, foreign direct investment and outsourcing to India. This encouraged the service sector growth.

(c) **Advanced technology and growth of IT sector**: The advancements and innovations in the IT sector enabled use of internet, telecommunication, mobile phones and electronic transactions across different countries. All these contributed to the growth of the service sector in India.

(d) **Cheap labour and reasonable degree of skill in India**: Due to availability of cheap labour and reasonable degree of skilled man power in India, developed countries found outsourcing to India feasible and profitable.

9. Agriculture sector appears to be adversely affected by the reform process. Why?

Ans. The economic reforms of 1991 did not benefit the agriculture sector. The following are the reasons that explain the adverse effects of the economic reforms on India's agriculture sector:

(a) **Reduction of public investment**: There has been a decrease in public investment in the agricultural sector. There has been huge cutback from Indian government to provide sufficient irrigation facilities, electricity, information system and roads. Also, investment in agriculture research and development was not as extensive as it was during the green revolution phase.

(b) **Removal of subsidies**: Removal of subsidies on fertilisers increased the cost of production. This made farming more expensive and thus it adversely affected the marginal and poor farmers.

(c) **Liberalisation and reduction in import duties on agricultural products**: Due to WTO commitments, Indian government reduced import duties on agricultural products that forced the poor and marginal farmers to compete with their foreign counterparts in the international markets. Stiff competition in the international market along with traditional techniques of farming badly affected the poor farmers.

(d) **Shift towards cash crops**: The export-oriented production strategies led to the shift of agriculture production from food grains to the production of cash crops like cotton, jute etc. This led to reduced availability of food grains and thus lowered nutritional values which further reduced their productivity.

(e) **Inflationary pressures on food grains**: The shift towards cash crops production along with the removal of subsidies led to inflationary pressures on the prices of food grains.

10. Why has the industrial sector performed poorly in the reform period?

Ans. Similar to the agricultural sector, industrial sector's performance was also poor. The poor performance of industrial sector may be due to the following reasons:

(a) **Cheap imports**: The demand for goods produced by domestic industries reduced due to cheaper imports. The imports from the developed countries were cheaper due to removal of import tariffs.

(b) **Lack of investments**- Due to lack of investments in infrastructure facilities such as better quality transportation system, power supply etc., the domestic firms could not compete with their developed foreign counterparts in terms of cost of production and quality of goods.

(c) **High Non-Tariff barriers by the developed countries**: It was very difficult to access the developed countries market due to high non-tariff barriers maintained by developed countries.

(d) **<u>Vulnerable and infant domestic industries</u>**: During the pre-liberalisation period, the domestic industries were provided a protective environment to grow and expand. But at the time of liberalisation, the domestic industries were still not developed up to the extent it was thought and thus they could not compete with the multi-national companies.

11. Discuss economic reforms in India in the light of social justice and welfare.

Ans. The economic reforms have enabled India to access and compete in the international markets. This facilitated the movement of goods and services across the international boundaries.

Moreover, the boom in the outsourcing and the service sector led to India's economic growth and GDP to increase by many folds.

But on the other side, agriculture that employed a significant proportion of population, failed to be benefited by these economic reforms.

Also, the reforms favoured the high-income group population at the cost of their poor counterparts. This resulted in wide and still increasing economic and social inequalities among different sectors of population.

The economic reforms led to development of those areas that were well connected with the metropolitan cities leaving the remote and rural areas underdeveloped. This led to wide regional disparities.

The boom in service sector, especially in the form of quality education, superior health care facilities, IT, tourism etc. were out of reach of the poor section of the population.

Thus, it can be concluded that the economic reforms failed to provide social justice and enhance welfare of the general public of India.