Liberalisation, Privatisation and Globalisation

Reasons for Economic Reforms

1. Poor Performance of Public Sector: In the 40 years period (1951-90), public sector was assigned an important role to work for the economic development of India. However, except for few public enterprises, the overall performance was very disappointing. Considering the huge losses incurred by a good number of public sector enterprises, the Government recognised the need for making necessary reforms.

2. Deficit in Balance of Payments (BOP): Deficit in BOP arises when foreign payments for imports exceed foreign receipts from exports. Even after imposing heavy tariffs and fixing quotas, there was a sharp rise in imports. On the other hand, there was slow growth of exports due to low quality and high prices of Indian goods in the international market.

3. Inflationary Pressures: There was a consistent rise in the general price level in the economy due to increase in money supply and shortage of essential goods.

4. Fall in Foreign Exchange Reserves: Foreign Exchange Reserve (also termed as Forex Reserves or FX Reserves) are external assets (like convertible foreign currencies, Gold, Special Drawing Rights, etc.) held by the Central Bank for direct financing of external payments imbalances.

In 1991, foreign exchange reserves fell to the lowest level and it led to the foreign exchange crisis in the country. Foreign exchange reserves declined to a level that was not adequate:

- To finance imports for not more than two weeks; and
- To pay the interest that needs to be paid to international lenders. Moreover, no country or international funder was willing to lend to India.

5. Huge Burden of Debts: The expenditure of the government was much higher than revenue. As a result, government had to borrow money from banks, public and from international financial institutions.

6. Inefficient Management: The origin of the financial crisis can be traced from the inefficient management of the Indian economy.

- The government had to generate surplus revenue to meet challenges like unemployment, poverty and population explosion. However, there was no additional revenue due to continuous spending on development programmes by the government.
- Government expenditure began to exceed its revenue by such large margins that it became unsustainable.
- At times, the foreign exchange borrowed from other countries and international financial institutions was spent on meeting consumption needs. Moreover, neither any attempt was made to reduce such profligate or reckless spending nor sufficient attention was given to boost exports to pay for growing imports.

Crisis of 1991 Forced India for Financial help from IMF and World Bank

To manage the economic crisis of 1991, Indian Government approached for loan from:

- International Bank for Reconstruction and Development (IBRD), popularly known as World Bank (to facilitate lending for reconstruction and development); and
- International Monetary Fund (IMF) (to avail short-term loans to solve Balance of Payments problem).

India availed $7 billion loan from these agencies as loan. Dr. Manmohan Singh was the Indian Finance Minister in 1991 and he was greatly acknowledged for his capabilities to steer away the economic crisis looming large on the Indian Economy.

For availing the loan, these international agencies expected India to liberalise and open up the economy by:

- Removing restrictions on the private sector;
- Reducing the role of the government in many areas; and
- Removing trade restrictions.

India agreed to the conditions of World Bank and IMF and announced the New Economic Policy.

The Economic Policy

The New Economic Policy (NEP) was announced in July 1991. The main aim of the policy was to create a more competitive environment in the economy and remove the barriers to entry and growth of firms.

The New Economic Policy can be broadly classified into two kinds of measures:

1. Stabilisation Measures: They refer to short-term measures which aim at:

(i) Correcting weaknesses of the balance of payments by maintaining sufficient foreign exchange reserves; and

(ii) Controlling inflation by keeping the rising prices under control.

2. Structural Reform Measures: They refer to long-term measures which aim at:
(i) Improving the efficiency of the economy; and
(ii) Increasing international competitiveness by removing the rigidities in various segments of the Indian economy.

Main Policies of New Economic Policy

The government initiated a variety of policies which fall under three heads:
1. Liberalisation
2. Privatisation
3. Globalisation

Liberalisation

Liberalisation means removal of entry and growth restrictions on the private sector.

- Liberalisation involves deregulation and reduction of government controls and greater autonomy (freedom) of private investment, to make economy more competitive.
- Under this process, business is given free hand and is allowed to run on commercial lines.
- The purpose of liberalisation was:

  - To unlock the economic potential of the country by encouraging private sector and multinational corporations to invest and expand; and
  - To introduce much more competition into the economy and creating incentives for increasing efficiency of operations.

The economic reforms taken by the Government under liberalisation include the following:
(i) Industrial Sector Reforms
(ii) Financial Sector Reforms
(iii) Tax Reforms
(iv) Foreign Exchange Reforms
(v) Trade and Investment Policy Reforms

Industrial Sector Reforms

In order to make necessary reforms in the industrial sector, the Government introduced its new industrial policy on July 24, 1991. The various measures under industrial policy reforms include:
1. Reduction in Industrial Licensing: The new policy abolished industrial licensing for all the projects, except for 18 industries. This number was further reduced to 5 industries. They are:

(i) Distillation and brewing of alcoholic drinks;
(ii) Cigars and cigarettes of tobacco and manufactured tobacco substitutes;
(iii) Electronic Aerospace and defence equipments;
(iv) Industrial explosives;
(v) Specified Hazardous chemicals.

- No licences were needed (i) To set up new units; or (ii) Expand or diversify the existing line of manufacture.
- However, compulsory licensing is required for the above mentioned 5 industries on account of environmental, safety and strategic considerations.

2. Decrease in role of Public Sector: One of the striking features was the substantive reduction in the role of the public sector in the future industrial development of the country. Under the New Economic Policy, number of industries reserved for public sector was reduced from 17 to 8, which was further reduced to just three (in 2010-11) namely Atomic Energy, Railways and Defence Equipments.
3. De-reservation under small-scale industries: Many goods produced by small scale industries were de-reserved. In many industries, the market was allowed to determine the prices through forces of the market (and not by directive policy of the government).
4. Monopolies and Restrictive Trade Practices (MRTP) Act: With the introduction of liberalisation and expansion schemes, the requirement for large companies, to seek prior approval for expansion, establishment of new undertakings, merger, amalgamations, etc. were eliminated.

Industrial Sector Reforms

1. Change in the Role of RBI: The role of RBI was reduced from regulator to facilitator of financial sector. As a result, financial sector was allowed to take decisions on many matters, without consulting the RBI.

2. Origin of Private Banks: The reform policies led to the establishment of private sector banks, Indian as well as foreign. For example, Indian banks like ICICI and foreign banks like HSBC increased the competition and benefitted the consumers through lower interest rates and better services.

3. Increase in limit of Foreign investment: The limit of foreign investment in banks was raised to around 74%. Foreign Institutional Investors (FII) such as merchant bankers, mutual funds and pension funds were now allowed to invest in Indian financial markets.

4. Ease in Expansion Process: Banks were given freedom to set up new branches (after fulfillment of certain conditions) without the approval of the RBI.

Tax Reforms

Tax reforms refer to reforms in government's taxation and public expenditure policies, which are collectively known as its 'Fiscal Policy'. Taxes are of two types:

• Direct Taxes consist of taxes on incomes of individuals as well as profits of business enterprises. For example, Income tax (taxes on individual incomes) and Corporate tax (taxes on profits of companies).

• Indirect Taxes refer to those taxes which affect the income and property of persons through their consumption expenditure. Indirect taxes are generally imposed on goods and services. For example, Goods and Services Tax (GST).

The major Tax Reforms made are:

1. Rationalisation of Direct Taxes: Since 1991, there has been a continuous reduction in income and corporate tax as high tax rates were an important reason for tax evasion. It is now widely accepted that moderate rates of income tax encourage savings and voluntary disclosure of income. However, tax reductions negatively affected the developmental and welfare expenditure of government.

2. Reforms in Indirect Taxes: Considerable reform have been made in indirect taxes to facilitate establishment of common national market for goods and commodities.

3. Simplification of Process: In order to encourage better compliance on the part of taxpayers, many procedures have been simplified.

Foreign Exchange Reforms

The important reforms made in the foreign exchange market are:

1. Devaluation of Rupee: Devaluation refers to deliberate reduction in the value of domestic currency vis-a-vis any foreign currency by the government of a country. To overcome Balance of Payments crisis in 1991, the rupee was devalued against foreign currencies. This led to an increase in the inflow of foreign exchange.

2. Market Determination of Exchange Rate: The Government allowed rupee value to be free from its control. As a result, market forces of demand and supply determine the exchange value of the Indian rupee in terms of foreign currency.

Trade and Investment Policy Reforms

The reforms in the trade and investment policy were initiated:

- To increase the international competitiveness of industrial production.
- To promote foreign investments and technology into the economy.
- To promote efficiency of local industries and adoption of modern technologies.

The important trade and investment policy reforms include:

1. Removal of Quantitative restrictions on Imports and Exports: Under the New Economic Policy, quantitative restrictions on imports and exports were greatly reduced. For example. quantitative restrictions on imports of manufactured consumer goods and agricultural products were fully removed from April 2001.

2. Removal of Export Duties: Export duties were removed to increase the competitive position of Indian goods in the international markets.

3. Reduction in Import Duties: Import duties were considerably reduced, which improved the competitiveness of domestic industries as it enabled them to import raw materials at better prices.

4. Relaxation in Import Licensing System: The Import licensing was abolished, except in case of hazardous and environmentally sensitive industries.

Privatisation
Privatisation refers to shedding of the ownership or management of a government owned enterprise.
Privatisation implies greater role of the private sector in the economic activities of the country. Over the years, Indian Government has diluted its stake in several public enterprises, including IPCL, IBP, Maruti Udyog, etc.

Privatisation can be done in two ways:
1. Transfer of ownership: Transfer of ownership and management of public sector companies from the government to the Private Sector
2. Disinvestment: Privatisation of the public sector undertakings (PSU) by selling off part of the equity of PSUs to the public. This process is known as disinvestment.

Purpose
The purpose of privatisation was mainly to improve financial discipline and facilitate modernisation. It was also believed that private capital and managerial capabilities will help in improving performance of the PSUs.
Globalisation
Globalisation means integrating the national economy with the world economy through removal of barriers on international trade and capital movements.
It involves creation of networks and activities transcending economic, social and geographical boundaries. In short, globalisation aims to create a borderless world.

Changes made by the Globalisation of the Indian Economy
1. The New Economic Policy prepared a specified list of high technology and high investment priority industries, in which automatic permission will be available for foreign direct investment up to 51 per cent of foreign equity.
2. In respect of foreign technology agreements, automatic permission is provided in high priority industry upto a sum of rupees 1 crore. No permission is now required for hiring foreign technicians or for testing indigenously developed technology abroad.
3. In order to make international adjustment of Indian currency, rupee was devalued in July 1991 by nearly 20 per cent. It stimulated exports, discouraged imports and raised the influx of foreign capital.
4. To integrate Indian economy with world, the Union Budget 1992-93 made Indian rupee partially convertible and then the rupee was made fully convertible in 1993-94 budget.
5. A new five year export-import policy (1992-97) was announced by the Government to establish the framework of globalisation of India's foreign trade. The policy removed all restrictions and controls on the external trade and allowed market forces to play a greater role in respect of exports and imports.
6. In order to bring the Indian economy within the ambit of global competition, the government has modified the customs duty to a considerable extent. Accordingly, the peak rate of customs duty has been reduced from 250 per cent to 10 per cent.

Positive and Negative Traits of Globalisation
In Favour of Globalisation
- Greater access to global markets;
- Advanced technology;
- Better future prospects for large industries of developing countries to become important players in the international arena.
- Better prospects for skilled people across the globe to increase their earnings by utilising their skills.

Against Globalisation
- Benefits of globalisation accrue more to developed countries as they are able to expand their markets in other countries.
- Globalisation compromises the welfare and identity of people belonging to poor countries.
- Market-driven globalisation increases the economic disparities among nations and people.
- As a result of Globalisation, MNCs have gained strong position in the developing countries, due to which domestic companies are forced to face stiff competition.

Outsourcing

Outsourcing refers to hiring business services from external sources, mostly from other countries, which were previously provided internally or from within the country.

India has become a favourable destination of outsourcing for most of the MNC's because of:

- Availability of Skilled Manpower: India has vast skilled manpower which enhances the faith of MNCs for investment in India.
- Favourable Government Policies: MNCs get various types of lucrative offers from the Indian Government such as tax holidays, tax concessions, etc.
- Low Wage Rates and availability of cheap labour in India for skilled work.
- Considerable growth of Indian IT industry, which has proved its competitive strength in the world.

Developed Countries oppose outsourcing to India because:

- Outsourcing leads to outflow of funds from the developed countries to India, which reduces the income disparities between the two countries.
- Outsourcing reduces the employment generation and creates job insecurity in the developed countries.

World Trade Organisation (WTO)

Origin of World Trade Organisation (WTO)

Prior to WTO, General Agreement on Trade and Tariff (GATT) was established as global trade organisation, in 1948 with 23 countries. GATT was set up to administer all multilateral trade agreements by providing equal opportunities to all countries in the international market. WTO was founded in 1995 as the successor organisation to the GATT.

- The WTO agreements cover trade in goods as well as services, to facilitate international trade.
- At present, there are 164 member countries of WTO and all the members are required to abide by laws and policies framed under WTO rules.
- As an important member of WTO, India has been in the forefront of framing fair global rules, regulations and advocating the interests of the developing world.
- India has kept its commitments made to the WTO. India has taken reasonable steps to liberalise trade by removing quantitative restrictions on imports and reducing tariff rates.

Some Major Functions of WTO:

(i) To facilitate international trade (both bilateral and multilateral trade) through removal of tariff as well as non-tariff barriers;
(ii) To establish a rule-based trading regime, in which nations cannot place arbitrary restrictions on trade;
(iii) To enlarge production and trade of services;
(iv) To ensure optimum utilisation of world resources; and
(v) To protect the environment.

Should India be a member of WTO?

Some scholars are of the view that there is no use for a developing country like India to be a member of the WTO. According to them:
(i) Major volume of international trade occurs among the developed nations; and
(ii) Developing countries are being cheated as they are forced to open up their markets for developed countries and are not allowed access to markets of developed countries.

An Appraisal of LPG Policies (Economic Reforms)

Arguments in Favour of Economic Reforms

1. Increase in rate of Economic Growth: The growth in GDP was 5.6% during 1980-91 as compared to growth rate of 6.7% in 2017-18. GDP grew by 7.2% in the financial year 2022-23.

- During the reform period, the growth of agriculture has declined and industrial sector reported fluctuation, whereas, growth of service sector has gone up. This indicates that the growth is mainly driven by the growth in the service sector.
- During 2012-15, there has been a setback in the growth rates of different sectors. Agriculture recorded a high growth rate during 2013-14, but witnessed negative growth rate in the subsequent year. Service sector witnessed the highest ever growth rate of 9.8% in 2014-15. The industrial sector witnessed a steep decline during 2012-13, but began to show a positive growth thereafter.

2. Inflow of Foreign Investment: The opening up of the economy has led to the rapid increase in foreign direct investment (FDI). The foreign investment (FDI and foreign institutional investment) increased from about US $ 100 million in 1990-91 to US $ 30 billion in 2017-18.
3. Rise in Foreign Exchange Reserves: There has been an increase in the foreign exchange reserves from about US $ 6 billion in 1990-91 to about US $ 413 billion in 2018-19, which increased to US $ 590.70 billion (as on 22nd September, 2023 as per RBI). India is one of the largest foreign exchange reserve holders in the world.
4. Rise in Exports: Since 1991, India experienced considerable increase in exports of auto parts, pharmaceutical goods, engineering goods, IT software and textiles.
5. Control on Inflation: Increase in production, tax reforms and other reforms helped in controlling the inflation. The annual rate of inflation reduced from the peak level of 17% in 1991 to around 5.48% in 2015-16. For 2023-24, RBI estimates indicate that inflation will be around 5.1 per cent.
6. Increase in role of Private sector: Abolition of licensing system and removal of restrictions on entry of the private sector, in areas earlier reserved for the public sector, have enlarged the area of operation of the private sector.

Criticism of Economic Reforms

1. Growing Unemployment: Though the GDP growth rate has increased in the reform period, but such growth failed to generate sufficient employment opportunities in the country.

2. Neglect of Agriculture: The new economic policy has neglected the agricultural sector as compared to industry, trade and services sector.
(i) Reduction of public investment: Public investment in agriculture sector, especially in infrastructure, which includes irrigation, power, roads, market linkages and research and extension (which played a crucial role in the Green Revolution), has been reduced.
(ii) Removal of subsidy: Removal of fertilizer subsidy increased the cost of production, which adversely affected the small and marginal farmers.
(iii) Liberalisation and reduction in import duties: This sector has been experiencing a number of policy changes such as: (a) Reduction in import duties on agricultural products; (b) Removal of minimum support price; and (c) Lifting of quantitative restrictions on agricultural products. All these policies adversely affected the Indian farmers as they now have to face increased international competition.
(iv) Shift towards cash crops: Due to Export-oriented policy strategies in agriculture, the production shifted from food grains to cash crops for the export market. It led to rise in the prices of food grains.

3. Low level of Industrial Growth: Industrial growth recorded a slowdown due to the following reasons:
(i) Cheaper Imported Goods: Due to globalisation, there was a greater flow of goods and capital from developed countries and as a result, domestic industries were exposed to imported goods. Cheaper imports replaced the demand for domestic goods and domestic manufacturers started facing competition from imports.
(ii) Lack of infrastructure facilities: The infrastructure facilities, including power supply, have remained inadequate due to lack of investment.
(iii) Non-Tariff Barriers by Developed countries: All quota restrictions on exports of textiles and clothing have been removed from India. But some developed countries, like USA have not removed their quota restrictions on import of textiles from India.

4. Ineffective Disinvestment Policy: The government has always fixed a target for disinvestment of Public Sector Enterprises (PSEs). For instance, in 1991-92, it was targeted to mobilise 2,500 crore through disinvestment. The government was able to mobilise 3,040 crore more than the target. In 2017-18, the target was 1,00,000 crore, whereas, the achievement was about 1,00,057 crore.
However, according to some scholars, the disinvestment policy of government was not successful because:
• The assets of PSEs were undervalued and sold to the private sector.
• Moreover, such proceeds from disinvestment were used to compensate shortage of government revenues rather than using it for the development of PSEs and building social infrastructure in the country
5. Ineffective Tax Policy: The tax reduction in the reform period was done to generate larger revenue and to curb tax evasion. But, it did not result in increase in tax revenue for the government.

- Tariff reduction decreased the scope for raising revenue through customs duties.
- Tax incentives provided to foreign investors to attract foreign investment further reduced the scope for raising tax revenues.

6. Spread of Consumerism: The new policy has been encouraging a dangerous trend of consumerism by encouraging the production of luxuries and items of superior consumption.
7. Unbalanced Growth: Growth has been concentrated only in some select areas in the services sector, such as telecommunication, information technology, finance, entertainment, travel and hospitality services, real estate and trade, rather than vital sectors, such as agriculture and industry, which provide livelihood to millions of people in the country.

Demonetisation

- Demonetisation is the act of removing a currency unit of its status as Legal Tender.
- These notes accounted for almost 86% of the country's cash supply. As per the scheme, people had to deposit the invalid currency in the banks and restrictions were also placed on cash withdrawals.
- On May 19, 2023, RBI announced to withdraw 2,000 currency notes from circulation and general public were encouraged to deposit or exchange the 2000 bank notes.

Features of Demonetisation

1. Demonetisation is viewed as a Tax Administration Measure'. Cash holdings arising from declared income was readily deposited in banks and exchanged for new notes. However, people holding black money had to declare their unaccounted wealth and pay taxes at a penalty rate.
2. Demonetisation is also interpreted as a shift on the part of government indicating that Tax Evasion will no longer be tolerated or accepted.

3. Demonetisation also led to channelizing savings into the formal financial system. Though, much of the cash deposited in the banking system is bound to be withdrawn. But, some of the new deposits schemes offered by the banks will continue to provide base loans, at lower interest rates.
4. Demonetisation also aims to create a less-cash or cash-lite economy, Le., channeling more savings through the formal financial system and improving tax compliance.

- However, digital transactions require internet connectivity as they need cell phones for customers and Point-of-Sale (PoS) machines for merchants.
- On the contrary, these disadvantages are counterbalanced by an understanding that it helps people into the formal economy, thereby increasing financial saving and reducing tax evasion.

Impact of Demonetisation

1.	Money/ Interest rates	i. Decline in cash transactions. ii. Bank deposits increased. iii. Increase in financial savings.
2.	Private wealth	Declined since some high demonetised notes were not returned and real estate prices fell.
3.	Public sector wealth	No effect.
4.	Digitization	Digital transactions amongst new users and use of RuPay Cards and Aadhar Enabled Payment System (AEPS) increased. Demonetisation has increased the popularity of e-wallets.
5.	Real estate	Prices declined.
6.	Tax collection	Rise in income tax collection because of increased disclosure.

Goods and Services Tax

- GST or "Goods and Services Tax" is a comprehensive Indirect Tax which has replaced many Indirect Taxes in India. The Goods and Services Tax Act was passed in the Parliament on 29th March, 2017. The Act came into effect on 1st July, 2017.
- It is a comprehensive, multi-stage, destination-based tax that is levied on every value addition. GST has been identified as one of the most important tax reforms post-independence.
- The Government of India implemented GST following the credo of 'One Nation and One Tax and wanting a unified market in order to ensure the smooth flow of goods and services across the country.

- Among other benefits, GST is expected to improve the ease of doing business in tax compliance, reduce the tax burden by eliminating tax-on-tax, improve tax administration, mitigate tax evasion, broaden the organised segment of the economy and boost tax revenues.
- GST has replaced 17 indirect taxes (like Value Added Tax, Service Tax, Excise Duty, Sales Tax, etc.) and 23 cesses of the Centre and the States, thereby eliminating the need for filing multiple returns and assessments. It has rationalised the tax treatment of goods and services along the supply chain from producers to consumers.
- GST is charged at each stage of value addition and the supplier setoff the levy on inputs in the previous stages of value chain through the tax credit mechanism.
- The last dealer in the supply chain passes on the added GST to the consumer, making GST a destination-based consumption tax.
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Types of Taxes under GST

The types of taxes levied under GST are:

(i) Central Goods and Services Tax (CGST): It is the GST levied on the 'Intra-State' supply of goods or services by the Centre.

(ii) State Goods and Services Tax (SGST): It is the GST levied on the 'Intra-State' supply of goods or services by the State (including Union Territories with legislature).

(iii) Integrated Goods and Services Tax (IGST): It is the GST levied on the 'Inter-State' supply of goods or services and is collected by the Centre. IGST is equivalent to the sum total of CGST and SGST.

Some Facts about GST

1. Single Tax Structure: GST aims to subsume a multiple taxes into one single tax across the country and make goods uniformly priced across India. Though, in this process, some goods become costly and some become cheaper.

2. Effect on Prices: With the implementation of GST, luxury goods have become costlier, while items of mass consumption have become cheaper.

3. Consumption Based Tax: GST is a 'Consumption Based Tax', ie. the tax is received by the state in which the goods or services are consumed and not by the state in which such goods are manufactured.

4. Invoice Matching: The Indian GST will have a mechanism of matching of invoices. Input Tax Credit of purchased services and goods will be available only when the inward supply details filed in by buyer matches the outward supplies details filed in by supplier.

5. Anti-Profiteering Measure: It is one of the key features of the recently implemented GST law. These measures prevent entities from making excessive profits. As per the Anti- Profiteering rules, the benefit of reduced GST tax rates and increased input tax credit should be passed on to the consumer in the form of reduced price.

6. Registration under GST: A business whose aggregate turnover in a financial year exceeds 20 lakhs has to compulsorily register under Goods and Services Tax. This limit is set at 10 lakhs for North Eastern and hilly states flagged as special category states.

Input Tax Credit under GST

Input Tax Credit means reducing the taxes paid on inputs from taxes to be paid on output. When any supply of services or goods are supplied to a taxable person, the GST charged is known as Input Tax.

GST Council

Goods and Services Tax Council is a constitutional body for making recommendations to the Union and State Government on issues related to Goods and Services Tax.

1. Constitution: As per Article 279A of the amended Constitution, the GST Council which will be a joint forum of the Centre and the States, shall consist of the following members:

Chairperson: Finance Minister.

Vice Chairperson: Chosen amongst the Ministers of State Government.

Members: Minister of Finance and all Ministers of Finance/Taxation of each State.

2. Quorum: 50% of the total number of Members of the Goods and Services Tax Council shall constitute the quorum at its meetings.

3. Majority required for taking Decisions: Every decision of the GST Council shall be taken at a meeting, by a majority of not less than 75% of the weighted votes of the members present and voting, in accordance with the following principles, namely:

- Vote of the Central Government shall have a weightage of one-third of the total votes cast, and
- Votes of all the State Governments taken together shall have a weightage of two-thirds of the total votes cast, in that meeting.