GLOBAL ACADEMY

Class-XII Economics Notes
Ch-3 Liberalisation, Privatisation and Globalisation: An Appraisal

Introduction
Since independence, India followed the mixed economic system, by combining the advantages of the market economic system (capitalist economy) with those of the planned economic system (socialist economy).
But, in reality, the public sector dominated the control and regulation of our economy and private sector was ignored. There was a huge investment in the public sector and very low investment in the private sector. The dominance of public sector for about 4 decades led to establishment of various rules and laws, which hampered the process of growth and development.

Reasons for Economic Reforms
The economic condition of India in the year 1991 was very miserable. It was due to the cumulative effect of number of reasons. Let us discuss the various reasons, which aroused the need for making major economic reforms in the country:

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 recognized 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:-** 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 more than two weeks; and
   - To pay the interest the needs to be paid to international lenders.
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 was not able to generate sufficient revenue from internal sources such as taxation, running of public sector enterprises, etc.
   - 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.

The New Economic Policy

The New Economic Policy (NEP) was announced in July 1991. It consisted of wide range of economic reforms. 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:
   (a) Correcting weaknesses of the balance of payments by maintaining sufficient foreign exchange reserves and
   (b) Controlling inflation by keeping the rising prices under control.
2. **Structural Reform Measures:-** They refer to long-term measures which aim at:
   (a) Improving the efficiency of the economy; and
   (b) 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:

(i) Liberalisation (ii) Privatisation (iii) Globalisation

Liberalisation, Privatisation and Globalisation or 'LPG' are the supporting pillars, on which the structure of new economic policy of our government has been erected and implemented since 1991.

Liberalisation

Prior to 1991, there were large number of government restrictions in India in the areas of licensing, import and export trade, dealings in foreign exchange, etc. In July 1991, a package of economic reforms was announced, which marked the beginning of process of 'Liberalisation' in India. **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 liberalization was:
  - To unlock the economic potential of the country by encouraging private sector and multinational corporations of 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 liberalization include the following
  (i) Industrial Sector Reforms
  (ii) Financial Sector Reforms
  (iii) Tax Reforms
  (iv) Foreign Exchange Reforms
  (v) Trade and Investment Policy Reforms

  Let us now discuss each reform in detail.

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 a short list of industries (like liquor, defence equipments, industrial explosives, etc.).
   - No licences were needed (i) To set up new units, or (ii) Expand or diversify the existing line of manufacture.
   - However, licence is required for certain industries, related to security 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. The number of industries, exclusively reserved for the public sector, reduced from 17 to following 3 industries: (i) Defence equipments; (ii) Atomic energy generation; and (iii) Railway Transport.
3. **De-reservation under small-scale industries:-**Many goods produced by small scale industries have now been de-reserved.
   - The investment ceiling on plant and machinery for small undertaking enhanced to rupees one crore.
   - 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) Art:-** With the introduction of liberalization and expansion schemes, the requirement for large companies, to seek prior approval for expansion, establishment of new undertakings, merger, amalgamations, etc. were eliminated.

Financial Sector Reforms

Financial sector includes financial institutions like commercial banks, investment banks, stock exchange operations and foreign exchange market. The financial sector in India is controlled by the Central Bank-Reserve Bank of India (RBI).

The reforms introduced under financial sector are:

1. **Change in 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 51%. Foreign Institutional Investors (FII) such as merchant bankers, mutual funds and pension funds were now allowed to invest in Indian financial markets.

Though banks have been given permission to generate resources from India and abroad, certain aspects have been retained with the RBI to safeguard the interests of the account-holders and the nation.

4. **Ease in Expansion Process:-** Bank 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:

- **Reduction in Taxes:-** Since 1991, there has been a continuous reduction 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.
- **Reforms in Indirect Taxes:-** Considerable reform have been made in indirect taxes to facilitate establishment of common national market for goods and commodities.
- **Simplification of Process:-** In order to encourage better compliance on the part of taxpayers, many procedures have been simplified.

The Goods and Service Tax Act was passed in the Parliament on 29th March, 2017 to simplify and introduce a unified indirect tax system in India. The Act came into effect on 1st July, 2017. This is expected to generate additional revenue for the government, reduce tax evasion and create 'one nation, one tax and one market'.

Foreign Exchange Reforms

The important reforms made in the foreign exchange market are:

1. **Devaluation of Rupee:-** Devaluation refers to reduction in the value of domestic currency by the government. To overcome Balance of Payments crisis, 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

Before 1991, a lot of restrictions (high tariffs and quotas) were imposed on imports to protect the domestic industries. However, this protection reduced the efficiency and competitiveness of domestic industries and led to their slow growth. So, 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 focal 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 reduced to improve the position of domestic goods in the foreign market.
4. **Relaxation in Import Licensing System:-** The Import licensing was abolished, except in case of hazardous and environmentally sensitive industries. This encouraged domestic industries to import raw materials at better prices, which raised their efficiency and made them more competitive.
   Another important feature of new economic policy was the promotion of the policy of "Privatisation".

Privatisation

Privatisation means transfer of ownership, management and control of public sector enterprises to the entrepreneurs in the private sector.

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** and management of public sector companies from the government to the Private Sector,
2. 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.

The purpose of privatisation was mainly to improve financial discipline and facilitate modernization. It was also believed that private capital and managerial capabilities will help in improving performance of the PSU's

Navaratnas and Mini Ratnas

The government also made attempts to improve the efficiency of public sector undertakings by giving them autonomy in taking managerial decisions.

- For instance, some PSUs have been granted special status as navaratnas and mini ratnas.
- In order to infuse professionalism and enable PSU's to compete more effectively in the liberalized global environment, government chose nine PSUs (BHEL, BPCL, SAIL, etc.) and declared them as 'Navaratnas' in 1996.
- They were given greater managerial and operational autonomy in taking various decisions, to run the company efficiently and to increase their profits.
- The granting of navaratna status resulted in better performance of these companies.

- Apart from this, other profit-making enterprises were granted greater operational, financial and managerial autonomy and they were referred as 'Mini Ratnas'. As on 13th September, 2017, there are 8 Maharatnas, 16 Navratnas and 74 Miniratnas.
- A few examples of public enterprises with their status are as follows: (i) Maharatnas – (a) Indian Oil Corporation Limited, and (b) Steel Authority of India Limited, (ii) Navratnas – (a) Hindustan Aeronautics Limited. (b)Mahanager Telephone Nigam Limited: and (iii) Miniratna- (a) Bharat Sanchar Nigam Limited; (b) Airport Authority of India and (c) Indian Railway Catering and Tourism Corporation Limited.

Globalisation

Globalisation means integrating the national economy with the world economy through removal of barriers on international trade and capital movements.

- Globalisation is generally understood to mean integration of the economy of the country with the world economy.
- However, it is a complex phenomenon. It is an outcome of the set of various policies that aim to transform the world towards greater interdependence and integration.
- 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 Public 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 1991by 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 Budget1992-93 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 governments 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 in 2007-2008 budget.

Positive and Negative Traits of Globalisation

The process of globalisation through liberalization and privatisation policies, has produced positive as well as negative results, both for India and other countries.

In Favour of Globalisation

Globalisation resulted in:

- Greater access to global markets,
- Advanced technology;
- Better future prospects for large industries of developing countries to become important players in the international arena.

Against Globalisation

Globalisation has been criticized by some scholars because according to them.

- Benefits of globalisation accrue more to developed countries as they are able to expand their markets in other countries.
- Globalisation compromises the welfare and identify of people belonging to poor countries.
- Market-driven globalisation increases the economic disparities among nations and people.

Outsourcing

Outsourcing refers to contracting out some of its activities to a third party which were earlier performed by the organization. **For example,** many companies have started outsourcing security service to outside agencies on a contractual basis.

- Outsourcing is one of the important outcomes of the globalisation process.
- It has intensified in recent times because of the growth of fast modes of communication, particularly the growth of Information Technology (IT).
- With the help of modern telecommunication links, the text, voice and visual data in respect of these services is digitized and transmitted in real time over continents and national boundaries.
- India has become a favourable destination of outsourcing for most of theMNC's because of low wage rates and availability of skilled manpower. **For example**, Indian Business Process Outsourcing (BPO) companies are already gaining prominence and earning precious foreign exchange.
- Some of the services outsourced to India include:
  (i) Voice-based business processes (known as BPO or Call Centres);
  (ii) Record Keeping
  (iii) Accountancy
  (iv) Banking services
  (v) Music Recording
  (vi) Film editing
  Book transcription
  (vii) Clinical advice, etc.

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 organization, 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. WTOwas founded in 1995 as the successor organization 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 multi-lateral 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 utilization 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)

Economic reforms created mixed reactions at different levels. Let us discuss some of the positive and negative aspects of economic reforms.

Arguments in Favour of Economic Reforms

The following are some of the important arguments advanced in favour of economic reforms:

1. **Increase in rate of Economic Growth:-** The growth in GDP was 5.6% during 1980-91. During 2018-19, growth in GDP is estimated at 7.2% as compared to growth rate of 6.7% in 2017-18.
    - 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 10.3% 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 $ 73.5 billion in 2014-15.With launch of 'Make in India' initiative in September 2014, Foreign Direct investment (FDI) Policy was further liberalized. Due to this reason, FDI inflow in India increased by 48%.
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 $ 321billion in 2014-15. India is one of the largest foreign exchange reserve holders in the world.
4. **Rise in Exports:**- During the reform period, India experienced considerable increase in exports of auto parts, 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
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

Critics have raised a series of criticism against the New Economic Reforms, especially in the areas of employment, agriculture, industry, infrastructure development and fiscal management.

1. **Growing Unemployment:-** Thought 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 in the reform period.
   - (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 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 manufactures started facing competition from imports. **For example,** cheaper Chinese goods pose a big threat to Indian manufacturers.
   (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 2014-15, the target was Rs. 56,000 crore, whereas, the achievement was about Rs. 34,500 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 tread 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.