CHAPTER 3

LIBERALISATION, PRIVATISATION AND GLOBALISATION: AN APPRAISAL

- In order to overcome crises of 1990's, the Government of India initiated multi-dimensional economic reforms, which are collectively known as **New Economic Policy (NEP)**.

- **The New Economic Policy** replaces liberalisation in place of licensing (*L*), privatisation in place of Quotas (*Q*) and globalisation in place of Permits (*P*) for exports and imports.

- **Need for Economic Reforms**
  - ***Huge Fiscal Deficit:*** Gross fiscal deficit (excess of government expenditure over government revenues) rose from 5.7% to 6.6% of GDP during 1980-81 to 1990-91.
  - ***Weak BOP Situation***: India was not able to earn enough foreign exchange through exports to finance its imports. The comparatively high demand for imports than exports resulted in BOP deficit.
  - ***High Level of Inflation***: The rate of inflation rose from 6.7% p.a. to 10.3% p.a. during 1980s to 1990-91 depicting the failure of government policies to control inflation.
  - ***Falling Value of Rupee***: The need to mend the value of currency (value fell due to continuous devaluation) and to encourage the credit worthiness of India, reforms became necessary.
  - ***Sick PSUs***: The failure of PSUs to perform its roles efficiently and effectively made economic reforms inevitable.

- The three elements of New Economic Policy (NEP) are **Liberalisation, Privatisation and Globalisation.**

- **Liberalisation** refers to the freedom of the economy from direct or physical controls (such as, industrial licensing, price control, import license) imposed by the government. It implies greater dependence on the market for making various economic decisions.

- **Economic Reforms under Liberalisation**
  - **Industrial Sector Reforms**
    - Liberalisation implies **de-regulation** of industrial sector of the economy.
    - Abolishment of license requirements, except licenses for alcohol, industrial explosives etc.
    - Encouragement and impetus to the private sector via liberal tax laws, tax holidays, abolishment of quotas, etc.
    - Large scale industries were allowed to produce goods and services that were initially reserved only for small scale industries.
  - **Financial Reforms- Reforms in Commercial Banks, Stock Exchange, Investment Banks**
    - It refers to the process of liberalising the working of financial markets by eliminating various controls.
    - The role of RBI shifted from a regulator to a facilitator. The need for financial reforms was felt to encourage competition in the banking sector.
    - Foreign Institutional Investors (FII) such as merchant bankers, mutual funds, pension funds were encouraged to invest in India.

- **Fiscal Policy Reforms**
  - The reforms that relate to revenue and expenditure of the government are referred to **fiscal policy reforms**. The principal component of fiscal reforms is **tax reforms.**
  - Tax reforms involved- lowering tax rates and broadening tax base.
  - Corporation tax rates were lowered.
  - Reforms in indirect taxes for establishing an integrated national market.
  - The tax system has been simplified, which was earlier very complicated.

- **External Sector Reforms**

  It includes **foreign exchange reforms and foreign trade policy reforms.**
  - **Abolishment of import licensing** and **QRs** on the imports of **capital goods** and **intermediate goods.**
  - Switch over to **flexible exchange rate regime** (exchange rate determined by the demand and supply of the foreign exchange) **from fixed exchange rate regime** (exchange rate fixed by the government).

❖ **Devaluation**
- **It implies deliberate official lowering** of the value of the country's currency with respect to foreign currency. That is, the value of domestic currency falls in terms of foreign currency.
- This encourages exports and discourages imports. Devaluation prevails under the fixed exchange regime. For example,

  [illegible]

❖ **Privatisation** is the process of involvement of private sector in the ownership or operation of a state owned enterprise.

❖ **Disinvestment** refers to a situation when the government sells off a part of its share capital of PSUs (Public Sector Undertakings) to the private investors.

❖ ***Navaratnas* Policy**

In 1966, in order to improve efficiency, to infuse professionalism and to enable PSUs to compete effectively in the market, government awarded the status of **'*Navaratnas*'** to the following nine PSUs. These are
- Indian Oil Corporation Ltd (IOCL)
- Bharat Petroleum Corporation Ltd (BPCL)
- Hindustan Petroleum Corporation Ltd (HPCL)
- Oil and Natural Gas Corporation Ltd (ONGC)
- Steel Authority of India Ltd (SAIL)
- India Petro-chemicals Corporations Ltd (IPCL)
- Bharat Heavy Electricals Ltd (BHEL)
- National Thermal Power Corporation (NTPC)
- Videsh Sanchar Nigam Ltd (VSNL)

❖ **Globalisation** may be defined as a process associated with increasing openness, growing economic independence and promoting economic integration in the world economy. It is an extension of liberalisation and privatisation.

- **Outsourcing** refers to a system of hiring business services from the outside world to penetrate in the local market.

- **India is emerging as an important destination of outsourcing**
    - **Easy Availability of Cheap Labour-** Wage rates in India are comparatively lower than those in developed countries.
    - Indians have fairly **reasonable degree** of skills and techniques.
    - India has a fair **international** worthiness and credibility.
    - India has a virgin market for finished goods and services.
    - The democratic political environment in India provides a **stable and secure environment.**
    - Easy and abundant availability of **raw materials.**

- **World Trade Organisation (WTO)** is an organisation that has been set up to promote free trade in the international market.

- **Benefits to be a Member of WTO- India's Experiences**
    - Opened up new avenues for Indian exports.
    - Greater volume of Indian exports due to the end of quota restrictions imposed by the developed countries.
    - India experienced a rise in export of agricultural products due to the agreed reduction in agricultural subsidies in developed countries.
    - India got equal opportunity as other developing countries did. Simultaneously, India experienced a stronger bargaining power collectively along with other developing countries.

- **Reasons for Poor Performance of Agricultural Sector in Post Reform Period**
    - **Reduction of public investment** such as irrigation facilities, electricity, information system, agricultural R & D, market linkages and roads.
    - **Removal of subsidies** pushed up the cost of production of agriculture which adversely affected poor and marginal farmers.
    - **Liberalisation** forced the poor and marginal farmers to compete with their foreign counterparts in the international markets.
    - **Shift towards cash crops** led to the reduced availability of food grains, which consequently led to lower nutritional values thereby reducing farmers' productivity.
    - **Inflationary pressures on food grains** due to the shift towards cash crops production along with the removal of subsidies.

- **Reasons for Poor Performance of Industrial Sector in Post Reform Period**
    - Availability of **cheaper imports** (due to the removal of import tariffs) led to the fall in the demand of domestic goods.
    - **Inadequate infrastructures** and facilities (including power supply) impaired the domestic firms to compete with foreign counterparts in terms of cost of production and quality of goods.
    - **High non-tariffs barriers** by the developed countries further obstructed the growth prospects of Indian industries.
    - At the time of liberalisation, the Indian industries were **vulnerable and infant** depending on the traditional and cost inefficient technologies, lacking quality and hence failed to compete with foreign industries.

- **Strategic Sale** refers to the sale of 51% or more stakes of a PSU to the private sector, (the highest bidder for sale). It implies the transfer of ownership to the private hands.

- **Minority Sale** refers to the sale of less than 49% stake of a PSU to the private sector. The ownership remains in the hands of the public sector.

- **Bilateral trade** is a trade agreement between two countries, providing equal opportunities to both of them.

- **Multilateral trade** is a trade agreement among more than two countries providing equal opportunities to all the member countries.

- **Tariff Barriers** refer to the tax imposed such as custom duties, export-import duties on the imports by the country to protect its domestic industries. Tariffs discourage imports by making them relatively expensive.

- **Non-tariff Barriers** refer to the restrictions other than taxes such as quota and licenses, on the imports by the country.

- **Quantitative Restrictions (QRs)** refer to the restrictions in the form of limits or quotas on the amount of commodities that can either be imported or exported. QRs usually on imports (refer to non-tariff measures) that are imposed to discourage imports of foreign goods and to reduce Balance of Payment (BOP) deficits.

- **Direct taxes** are those taxes in which the burden falls on that person only on whom tax is imposed such as income tax, wealth tax.

- **Indirect taxes** denote those taxes in which the burden can be shifted onto others such as sales tax, service tax etc.

- **Positive impact of LPG policies**
    - **Increase in the GDP Growth Rate**- Growth rate increased from 5.8 % in 1985-90 (seventh five year plan) to 9.0 in 2007-12 (eleventh five year plan).
    - **A Safety Check on Fiscal Deficit-** Fiscal deficit reduced from 8.5% in 1985-90 to 5.1% in 2010-11.
    - **Stimulating Industrial Production**- Industrial production increased from nearly 8% in 1990-91 to 16.1% in Feb. 2010.
    - **Substantial Rise in the Foreign Exchange Reserves**- Introduction of LPG has given strength to the economy and raised the morale of global investors in the Indian markets.
    - **Shift from Monopoly (due to License Raj) to Competitive Market (involving more engagement of private sector)**
    - **Rise in exports** from Rs 44041.8 crores in 1991-92 to Rs 1157474.6 crores in 2010-11.
    - **Foreign Direct Investments (FII) increased** significantly from US $ 100 million in 1990-91 to US$ 150 billion in 2003-04.