Unit II- Liberalisation, Privatisation & Globalisation: An Appraisal

Economic Reforms and their Need

Objectives

After going through this lesson, you shall be able to understand why India followed the economic reforms in the year 1991.

Introduction

What does the word 'reform' mean? The dictionary meaning of the word 'reform' is to make changes in something so as to improve it. In this sense, economic reforms can be defined as changes in the economic policies so as to improve the economic condition. In other words, economic reforms refer to a set of tools and policies initiated in an economy in order to facilitate the process of growth and development.

Need for Economic Reforms in India

In the initial years of planning, India followed the lines of a socialist economy. Public sector was accorded a dominant role in the growth and development process. This was done in order to achieve the twin objective of development of the heavy and capital industries essential for the growth process along with the welfare of the masses. As against this, the private sector played only a subsidiary role.

The private sector was subject to various restrictions such as licensing, and the permission to produce only a few goods and services. On the international front, we followed an inward looking trade policy, that is, the policy of import substitution. Imports of the goods that could be produced domestically were discouraged.

The domestic industries were under a safety net, where they were protected from the foreign competition through barriers such as tariffs and quotas. The rationale behind such a move was to protect the infant industries from foreign competition as well as to save the scarce foreign exchange that was lost in the imports of unnecessary items.

Such a policy yielded fruitful results in the short run, but in the long run it had serious negative consequences. The public sector was plagued with inefficiencies and incurred huge losses. Moreover, excessive control on the private sector hampered their growth and the industrial sector lacked modernisation.

As a result, Indian economy regressed into a state of stagnation. By the year 1991, India found itself in a serious economic crisis. The public expenditure continued to rise and far exceeded the revenue receipts. As a result, the government had to increasingly resort to borrowings from the foreign countries. Moreover, due to the rising imports the foreign exchange reserves of India continued to fall. The foreign exchange reserves fell to such low level that they were not enough to pay even for the imports of ten days. As a result, the international market lost faith in the Indian economy. No new loans and grants were available to India from foreign countries.

To move out of the situation, India approached the International Bank for Reconstruction and Development (IBRD) and International Monetary Fund (IMF) for financial support. These institutions provided help in the form of loan but on the condition that the Indian economy would liberalise. That is, the international institutions insisted India to remove restrictions on the private sector and open up the economy to world economy by removing trade restrictions. Thus, the initiation of reforms became inevitable.

Factors that Necessitated Economic Reforms in India

The following are the factors that necessitated the need for the economic reforms in India.

1. ***Huge fiscal deficit***: Throughout 1980s, fiscal deficit (fiscal deficit reflects the total borrowings and other liability requirements of the government) was getting worse due to huge non-development expenditures. As a result, gross fiscal deficit rose from 5.7% of

GDP to 6.6% of GDP during 1980-81 to 1990-91. Subsequently, a major portion of this deficit was financed by borrowings both from external and domestic source.

The increased borrowings resulted in increased public debt and mounting interest payment obligations. The domestic borrowings by government increased from 35% to 49.8% of GDP during 1980-81 to 1990-91. Moreover, the interest payments obligations accounted for 39.1% of the total fiscal deficit. Consequently, India lost its financial worthiness in the international market and, fell in a debt trap. Thus, economic reforms were needed urgently.

2. *Weak BOP situation*: Balance of Payment (*BOP*) represents the record of inflow of foreign exchange into the country and the outflow of foreign exchange from the country Due to lack of competitiveness of Indian products, India was not able to earn enough foreign exchange through exports. As against this, the imports continued to rise. As a result, the foreign exchange earnings fell short of the payment obligations.

The current account deficit (representing the excess of export payments over import earnings) rose from 1.35% to 3.69% of GDP during 1980-81 to 1990-91. In order to finance this huge current account deficit, Indian Government borrowed a huge amount from the international market. Consequently, the external debt increased from 12% to 23% of GDP during the same period. On the contrary, Indian exports were not potent enough to earn sufficient foreign exchange to repay these external debt obligations. This BOP crisis compelled the need for the economic reforms.

3. *High level of inflation*: The high fiscal deficits forced the Central government to monetise (i.e. finance) the deficit. The government resort to borrowings from RBI in the form of deficit financing (that is, printing of new currency notes). This deficit financing increased the level of money supply, which resulted in a rise in the inflation rate. The rate of inflation rose from 6.7% per annum to 10.3% per annum during 1980s to 1990-91. However, a rise in the inflation rate made the domestic goods more expensive that hampered our exports.

4. *Sick PSUs*: Public Sector Undertakings (PSUs) were assigned the prime role of industrialisation and removal of income inequality and poverty. But the subsequent years witnessed the failure of PSUs to perform these roles efficiently and effectively. Instead of being a revenue generator for the Central government, these became liability. The sick PSUs added an extra financial burden on the government's budget.

5. *Fall in the foreign exchange reserves*: Foreign exchange reserves of India fell to a very low level. The foreign exchange reserves fell to such a low level that they were not enough to pay for the imports of even two weeks. The situation became such worse that India had to mortgage its gold reserves with the World Bank to repay the mounting debts. In such a situation, India had to follow the path of liberalisation as suggested by the World Bank and IMF.

In light of the above factors, India initiated the multi-dimensional economic reforms in the year 1991, which are collectively known as ***New Economic Policy (NEP). The New Economic Policy*** replaces liberalisation (*L*) in place of licensing, privatisation (*P*) in place of quotas and globalisation (*G*) in place of permits for exports and imports. In the subsequent lessons, we will discuss about this policy in greater detail.

Features of Liberalisation Policy in India

Objectives

After going through this lesson, you shall be able to understand the following concepts.

• Meaning of Liberalisation

• Features of Liberalisation with Respect to the Various Sectors of the Economy

Introduction

As we know that prior to 1991, a host of controlling systems such as licensing system, foreign exchange control, control on expansion, etc. was imposed on the private sector. However, owing to this, inefficiencies crept into the system and economic growth was badly hampered. GDP growth rate hit an all time low. With the aim of reviving the economy, New Economic Policy was introduced in the year 1991. Liberalisation forms the foremost element of this policy.

Liberalisation refers to the freedom of the economy from direct or physical controls (such as, industrial licensing, price control, import license, etc) imposed by the government. It implies greater dependence on the market for making various economic decisions. In other words, it refers to a gradual move from a planned socialist economy towards market economy.

It is assumed that the greater role of the market increases competitiveness and makes the system more efficient. This fosters the growth process. The success stories of the countries such as Singapore, Korea and Thailand confirms the role of liberalisation in growth and development process.

Let us analyse the liberalisation measures followed by India in detail.

1. *Industrial Sector Reforms*

Prior to the reforms of 1991, private sector played only a secondary role in the process of industrial development. The state directly controlled the private sector. The private sector was allowed entry in only a few industries. Moreover, the limits of production by private entrepreneurs were pre-decided by the government.

In addition, the establishment of new industries or the expansion of existing industries required permission from the government in the form of licensing. The state fully controlled the operations of the private sector, either directly or indirectly. Under the liberalisation policy, various reforms were followed in the industrial sector. The following are the major highlights of the industrial sector reforms.

a. ***Abolition of licensing***: Prior to the reforms of 1991, for setting up a new firm or to expand an existing firm, the entrepreneurs had to obtain permission from the government in the form of licenses. Under the new industrial policy 1991, this system was abolished. In other words, with the industrial reforms the private players were free to start a new venture without the need to obtain a license.

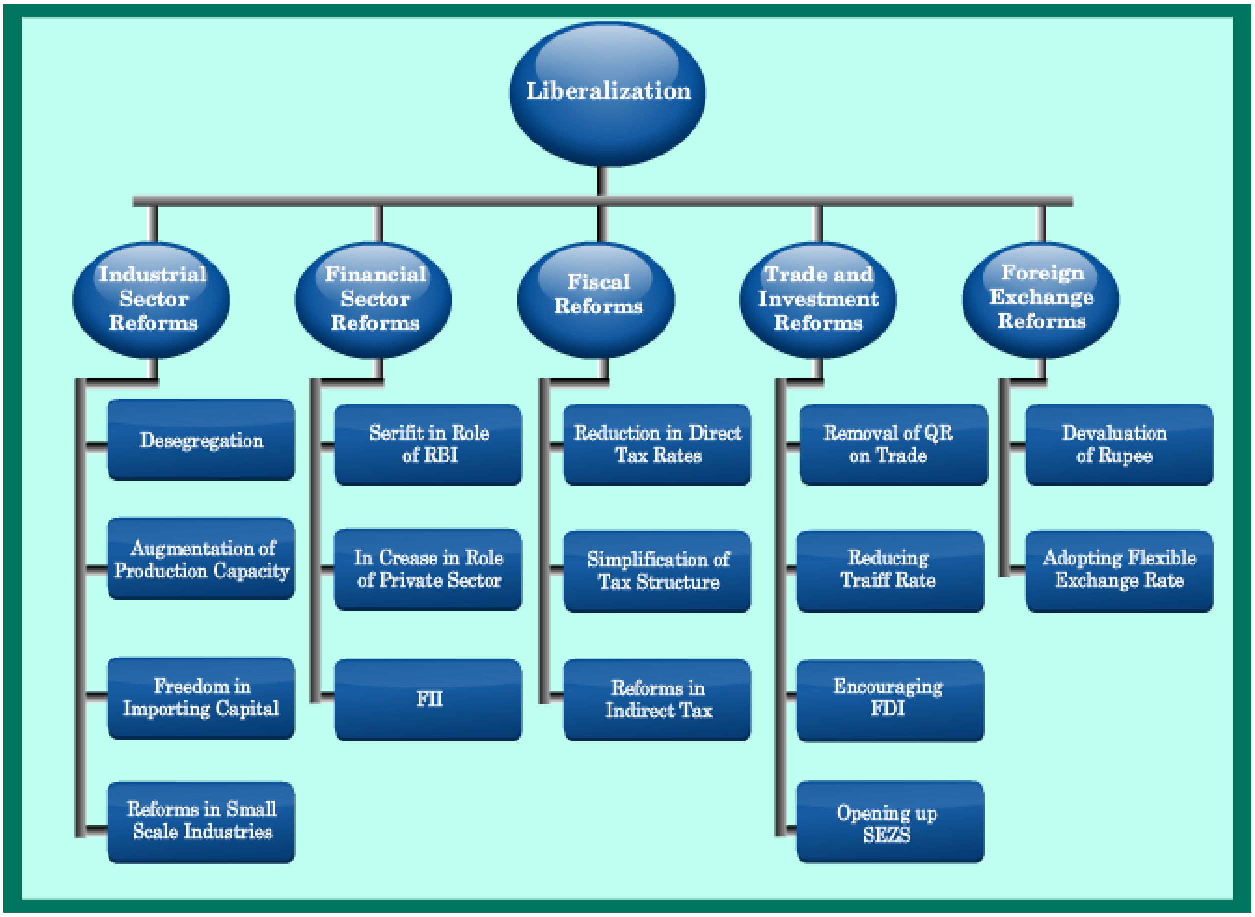
However, the system of licensing was retained in six industries namely, liquor, cigarette, defence equipment, dangerous chemicals, industrial explosives, and drugs and pharmaceuticals. Besides, impetus was provided to the private sector in the form of liberal tax laws, tax holidays, abolishment of quotas, etc.

b. ***Dereservation***: With liberalisation policy, the number of industries exclusively reserved for the public sector was considerably reduced. The private sector was allowed to operate in majority of the industries with only 8 industries under the exclusive purview of the government. Later, this number was further reduced to 3 namely, railways, atomic mineral and atomic energy.

c. ***Augmentation of production capacity***: Prior to the liberalisation policy, industries had to obtain permission from the government in order to expand the scale of production. With the introduction of liberalisation policy, the MRTP companies (companies having assets worth more than Rs 100 crore) were free to expand the scale of their business according to the market conditions.

d. ***Freedom in importing capital goods***: Under the policy of liberalisation, industrialists were also permitted to import capital goods from foreign countries. As against earlier, where there was a restriction on importing the capital goods from other countries, now, there was no such restriction. This implied modernisation and improvement in the techniques of production.

e. ***Reforms in the small-scale industries***: In India, small scale industries are defined on the basis of maximum investment that is allowed in the unit. With the commencement of reforms, the maximum limit has been increased from Rs 5 lakh to Rs 1 crore. This encouraged development and modernisation of the industries. Further, the number of products reserved exclusively for the small-scale industries was considerably reduced. That is, an increasing number of manufacturers could now produce the products that were earlier exclusively reserved for the small-scale industries.



2. ***Reforms in the Financial Sector***

The financial sector, including the commercial banks, investment banks and stock exchange operations is controlled by the RBI. RBI controls the commercial banks of the country via various instruments such as Statutory Liquidity Ratio (SLR), Cash Reserve Ratio (CRR), Bank Rate, Prime Lending Rate (PLR), Repo Rate, Reverse Repo Rate, deciding the nature of lending to various sectors, etc.

These are those ratios and rates that are fixed by the RBI. It is mandatory for all the commercial banks to follow or maintain these rates as per the direction of the RBI. All these measures control the commercial banks' operations and also control money supply in Indian economy. The following are reforms undertaken in the financial sector.

a. ***Shift in role of RBI***: With liberalisation, the role of RBI has changed from a controller to a mere facilitator of the operations of the financial sector.This implies that the financial sector was free to make its own decisions on various matters without consulting the RBI. This opened up the gates of financial sector for the private sector.

b. ***Increasing role of the private sector***: The private sector was allowed greater role in the financial sector. A number of private sector banks (both Indian and foreign) were established. Moreover, the limit for foreign investment was increased to 50%. Banks now enjoyed the freedom to set up new branches without prior permission of the RBI.

c. ***Foreign institutional investment***: Foreign Institutional Investors (FII) such as merchant bankers, mutual funds, pension funds were encouraged to invest in India. It should be noted that despite the reforms, certain functions such as printing of new currency notes, custody of foreign exchange, etc. were still retained with the RBI with the aim of safeguarding the welfare of the nation.

3. *Fiscal Reforms*

Fiscal reforms refer to the reforms in the taxation and expenditure policy of the government. Some of the reforms taken in this direction are discussed below.

a. ***Reduction in direct tax rates***: Attempts have been made to reduce the tax rates for direct taxes (such as income tax and corporation tax). It was realised that high tax rates encourages evasion of taxes by people. As against this, moderate tax rates encourage saving and investment. In light of this view, as part of the fiscal reforms, the tax rates were lowered.

b. ***Simplification of tax structure***: Prior to the reforms in the year 1991, the structure of tax was very complicated. This scenario consequently resulted in high evasion of tax by the tax payers. Thus, efforts were made to simplify the tax procedures.

c. ***Reforms in indirect taxes***: Reforms were initiated in the indirect taxes with the aim of establishing an integrated national market. In the year 2005, an important breakthrough in the taxation policy of the government was the introduction of VAT. Under VAT, tax is charged on the value added at each stage of production, instead of paying sales tax on the total value at each stage. This greatly simplified the indirect tax system in the country.

4. *Trade and Investment Reforms*

Many reforms were implemented in the trade as well as investment sector. The following are some of the important reforms in this sector.

a. ***Removal of quantitative restriction on trade***: 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. They are imposed to discourage imports of foreign goods and to reduce Balance of Payment (BOP) deficits. With reforms such restrictions were removed.

b. ***Reducing tariff rates***: Tariffs are duties imposed on the imports. Tariffs 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. As a liberalisation measure, tariffs were reduced considerably.

c. ***Encouragement to Foreign Direct Investment (FDI)***: Emphasis was laid by the planners to encourage competition in the market and to attract the Foreign Direct Investment (FDI) from other countries. Thus, with liberalisation in trade and investment market, the barriers on trade and investment were removed.

d. ***Opening up of Special Economic Zones (SEZ)***: SEZ are the specific areas which are established to encourage free manufacturing and export activities. In the year 2000-01, during the annual EXIM policy of the government, the setting up of SEZs were announced by the government in order to accelerate the trade process in the country.

5. *Foreign Exchange Reforms*

The foreign exchange reform was the first external sector reform that was initiated in the year 1991. The first step in this direction was the devaluation of Indian rupee against the foreign currencies. The devaluation of Indian rupees refers to a fall in the value of rupee against a foreign currency say, a dollar. In other words, after devaluation, a dollar can buy more Indian goods. This had a positive effect in the form of increasing the Indian exports, thereby, increasing the inflow of foreign exchange into the Indian economy. This solved the problem of acute foreign exchange crises in the country.

After the devaluation of rupee in 1991, the determination of exchange rate was left to the forces of market (that is, demand and supply). That is, the foreign exchange system was shifted from a fixed exchange rate system to a floating exchange rate regime. Under the flexible exchange rate, the exchange rate is determined by the demand and supply of the foreign exchange. However, this increased the volatility of the exchange rate by subjecting it to the international market and Indian economic conditions.

Thus, it can be said that under the NEP, India introduced a host of liberalisation policy measures. All such measures imparted greater freedom and autonomy in the system. The next important step in the reform policy is the privatisation policy. The next lesson deals with the privatisation policy in detail.

Features of Privatisation Policy in India

Objectives

In this lesson, you will go through the following topics.

• Meaning of Privatisation

• Difference between Privatisation and Disinvestment

• Case for Privatisation

• Policy Measures for Privatisation

• Case against Privatisation

Introduction

In the previous lesson, we learnt about the meaning of liberalisation as well as its effect on the different sectors of the economy. Here, in this lesson we will discuss about the next important step in the economic reform policy, that is, privatisation.

Privatisation

Privatisation refers to the process of increasing the involvement of private sector in the ownership or operation of a state owned enterprise. In other words, privatisation refers to the gradual transfer of ownership or management of state owned enterprises from the public sector to the private sector enterprises. It implies assigning a greater role to the private sector undertakings in the growth and development process. Privatisation can take place in the following manner.

a. Sale of Public Sector Undertakings (PSU's) or Government Sector Undertakings to the Private Sector.

b. Withdrawal of ownership by the government from the enterprises jointly owned and managed by the government and the private sectors.

c. Allowing the entry of private sector into the industries that are exclusively reserved for the public sector.

d. Limiting the expansion of the existing PSUs.

e. Sale of a part of equity or share of the PSU's to the private investors

Difference between Privatisation and Disinvestment

Privatisation refers to a greater role or involvement of the private sector in the functioning of the economy. As against this, disinvestment refers to selling off only part of equity or share by the Public Sector Undertakings (PSU's) to the private investors. In other words, disinvestment refers to a transfer of a part of the ownership of the public sector enterprises to the private sector.

It can be said that disinvestment is one of the ways of privatisation. In other words, disinvestment leads to privatisation. It should be noted that while disinvestment necessarily leads to privatisation, on the other hand, privatisation does not necessarily imply disinvestment.

Need for Privatisation in India

In the process of industrialisation in India, public sector was accorded high priority. In fact, it was the development of heavy and capital industries by the public sector that initiated the process of industrialisation. However, the functioning of the public sector enterprises suffered from grave inefficiencies arising out of corruption and red-tapism. As a result, a majority of the state owned enterprises suffered huge losses.

Accordingly, in the New Economic Reforms of 1991, privatisation was initiated as an important measure. It was decided to gradually phase out the public sector and pave the way for privatisation. Except a few strategic industries such as railways, defense, etc., all other services were decided to be opened up for the private sector.

Case for Privatisation

Privatisation is said to provide an impetus to the overall growth and development process of an economy. Under the reform policy, India too followed the path of privatisation. The following are some of the arguments that were given in favour of privatisation in context of India.

1. ***Curb high budget deficits***: With a continuous rise in the government expenditure that fell short of the receipts of the government, budget deficit was rising to a high level. Privatisation was seen as a way for reducing the soaring budget deficit.

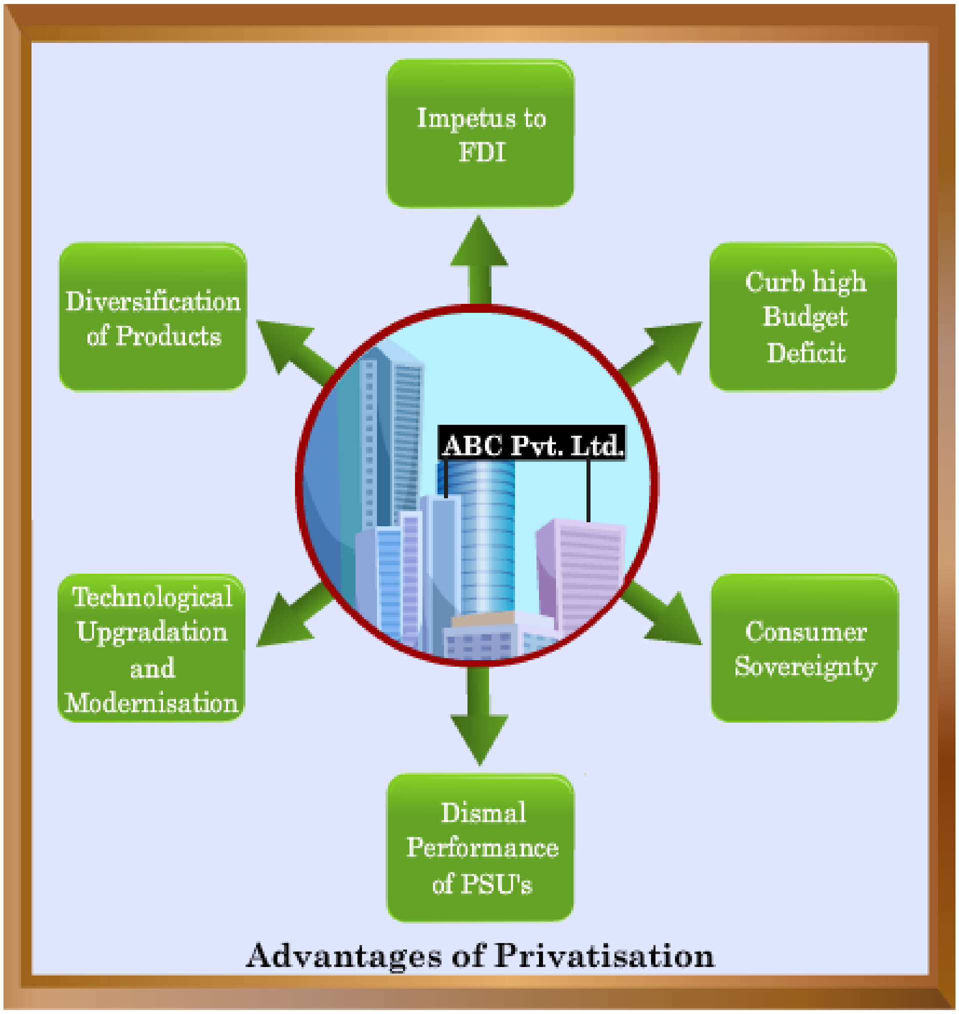
2. ***Dismal performance of PSU's***: The operation of the public sector enterprises suffered from serious inefficiencies. They faced mounting losses over the years. In such a situation, it was decided to follow disinvestment for the PSU's. It was assumed that the private entrepreneurs, working under the profit motive would be more efficient in their operations.

3. ***Consumer sovereignty***: Privatisation promotes efficiency and competiveness of an organisation. The sole motive for the private sector enterprises is to earn profit through consumer satisfaction. Thus, privatisation promotes consumer sovereignty.

4. ***Technological upgradation and modernisation***: The private enterprises work in a competitive environment. To survive in the competition, they constantly work towards the technological upgradations and modernisation so as to improve the efficiency. Such modernisation and upgradations fosters economic growth.

5. ***Diversification of products***: Due to their efficient and competitive working, private enterprises are able to generate huge profits. These profits are in turn, used for expansion and diversification. Thus, it leads to improved growth.

6. *Impetus to FDI*: It was assumed that privatisation would make Indian market more conducive for investment. In other words, it would attract FDI in the economy and thereby, push up the growth process. Thus, emphasis was put on promoting FDIs.



Policy Measures for Privatisation

In an attempt towards privatisation, India adopted various policy measures. The following are some of the policy measures adopted for privatisation in India.

1. *Reducing the role of public sector*: As we know that earlier public sector held a monopoly in various industries, therefore, only a few industries were opened up for the private sector. Moreover, the private sector was functioning under a strict licensing and control system. Under privatisation, the number of industries that were exclusively reserved for the public sector was reduced considerably from 17 to 8. At present, only 3 industries are exclusively reserved for the public sector, namely, railways, atomic mineral and atomic energy. Thus, the private sector has crept in the operation of almost all the industries.

2. ***Disinvestment***: For disinvestment, the government adopted the following two methods.

a. *Selling-off a part of the equity of the PSU's*: Under privatisation, a large portion of the equity of the PSU's was sold to the private sector.

b. *Strategic sale of PSU's*: Strategic sale of a number of companies such as Modern Foods India, Bharat Alluminium Company (BALCO), Maruti Udyog Ltd., etc. was undertaken.

3. ***Memorandum of Understanding (MOU)***: With a view of improving the performance of the public sector undertakings, the government entered a MOU with them. Under this, the PSU's were given clear targets and to achieve these targets the PSU's were given an autonomy in the decision making process. Based on their performance, the PSU's were rated as excellent, very good, good and fair.

4. ***Navratna Policy***: 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 high-performing PSUs.

a. Indian Oil Corporation Ltd. (*IOCL*)

b. Bharat Petroleum Corporation Ltd. (*BPCL*)

c. Hindustan Petroleum Corporation Ltd. (*HPCL*)

d. Oil and Natural Gas Corporation Ltd. (*ONGC*)

e. Steel Authority of India Ltd. (*SAIL*)

f. India Petro-chemicals Corporations Ltd. (*IPCL*)

g. Bharat Heavy Electricals Ltd. (*BHEL*)

h. National Thermal Power Corporation (*NTPC*)

i. Videsh Sanchar Nigam Ltd (*VSNL*)

Later, GAIL (Gas Authority of India Limited) and MTNL (Mahanagar Telephone Nigam limited) were also awarded the status of Navratnas.

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

Case Against Privatisation

Although, privatisation is said to greatly boost the process of growth and development of an economy, excess privatisation can also have certain negative consequences. The following are some of the probable disadvantages of privatisation.

1. ***Loss of socialist pattern***: With privatisation, the economy moves away from the socialist pattern. Under a socialist pattern, the government plays a dominant role with the aim of enhancing social welfare along with growth. However, the private players work with the main motive of earning high profits and during this process, often, the social justice and welfare is lost.

2. ***Rise in inequality***: Private sector operates only in those areas that are profitably viable. In other words, they have a tendency to produce goods and services for only that section of the society that has the purchasing capacity. In the process, the weaker section gets neglected and the inequalities rise.

3. ***Neglect of strategic areas***: The development of the areas that require huge investment or have long gestation periods (such as infrastructure) are not taken up by the private sector. However, such areas are strategic (that is, essential) from the point view of growth and development of the country. These areas remain neglected under complete privatisation.

Thus, it can be said, that under the reform policy, Indian economy embarked on the path of privatisation and various policy measures were introduced in this regard. However, caution must be taken so as to avoid its probable negative impacts.

Features of Globalisation Policy in India

Objectives

After going through this lesson, you shall be able to understand the following concepts.

• Meaning, History and Strategies of Globalisation

• Concept of Globalisation and Outsourcing

• WTO and its Benefits

Introduction

Today, it is generally said that it is an era of globalisation. But, what is meant by the term 'globalisation'? Globalisation can be defined as a process associated with increasing openness, growing economic independence and promoting economic integration in the world economy. In other words, it is an integration of various economies of the world with each other.

Globalisation Strategies in India

Globalisation was the third step under the New Economic Reforms of 1991. It is an extension of the liberalisation and privatisation policies. To open up the Indian economy to the world economy, various steps were taken. The following are some of the important strategies followed by India in the direction of globalisation.

1. *Encouragement to foreign capital investment*: With the aim of encouraging foreign capital investment, the following steps were taken.

a. The equity limit of foreign capital was initially raised from 40% to 51% which was further raised to 100%.

b. Foreign Direct Investment up to 100% was also allowed in high priority industries.

c. Foreign capital investment upto 100% was allowed in the export houses.

d. Special Economic Zones (SEZs) were set up for the promotion of exports. The industries in the SEZ's were provided with infrastructure facilities such as electricity, roads, transport, storage, etc.

e. Foreign Exchange Management Act (FEMA) was introduced with the view of attracting higher foreign investment.

2. *Partial convertibility of rupee:* Under the reforms, partial convertibility of rupee was also allowed. Partial convertibility implies that for the purpose of international transactions, foreign currency could be bought or sold at a market determined price. This convertibility can be used only for transactions involving import and export of goods and services, remittances to the family and for interest or dividend payments on investment. However, as the name partial convertibility suggests, this convertibility was not applicable for capital transactions.

3. *Removal of barriers*: With globalisation, the various barriers on trade such as tariffs on imports and exports, custom duties and import quotas, etc. were reduced considerably. This was done in consideration with the WTO recommendations while benefiting India at an international level.

4. *Facilitation of international trade:* With the formation of WTO, the trade in goods as well as in services was encouraged. All the restrictions that were earlier imposed on trade were removed, except for some specific goods. Open competition was encouraged in the trade market.

Globalisation and Outsourcing

Outsourcing refers to a system of hiring business services from the foreign countries to penetrate into the local market. In other words, the domestic country offers various business services to the foreign companies. The services which are usually outsourced are legal services, IT, security, teaching etc. Nowadays, India is emerging as a favourite destination for outsourcing industries. The following advantages qualify India to be an important spot for outsourcing by various MNCs.

a. ***Easy availability of cheap labour***: Wage rates commanded by the labour in India are much lower as compared to that commanded by the labour having equal level of qualification in the developed countries. Thus, MNCs find it economically feasible to outsource their business in India.

b. ***Reasonable degree of skills***: Indians have fairly reasonable degree of skills and techniques. Hence, they need low training period and thus, low cost of training.

c. ***International worthiness***: India has a fair international worthiness and also credibility. This enhances the faith of the foreign investors in India.

d. ***Virgin market***: India has a virgin market for produced goods and services. This not only helps the MNCs to explore the wide domestic market of India but also conquer the international market as the cost of production in India is relatively cheaper.

e. ***Stable political environment***: The democratic political environment in India provides a stable and secured environment to the MNCs to expand and grow.

f. ***Favourable government policies***: The most important point that makes India as the most favourite spot for outsourcing is the favourable government and tax policies. In order to attract increasing FDI, Indian government offers various concessions to MNCs in the form of tax holidays, low rate of tax, easy tax policies, etc. All these policies enable the MNCs to retain a major portion of their earnings in the form of savings that they can invest to grow and expand their business.

g. ***Lack of competitors***: The most important advantage for the MNCs in India is that they don't face stiff competition from the Indian domestic industries. This almost enables them to enjoy a monopoly status in the Indian markets.

h. ***Reasonable degree of infrastructural investment***: Indian government has invested heavily in the past two decades in the infrastructural sector. Various steps have been taken for connecting remote and rural areas to the metropolitan and other major cities. This has not only reduced the cost of production of the MNCs but also helped them operate efficiently and effectively.

i. ***Cheap and abundant availability of raw materials***: India is well enriched in natural resources. This ensures cheap availability of raw material and undisturbed and perennial supply of raw materials to the MNC's.

Benefits of Outsourcing for India

Today India is seen as a hub of the outsourcing activities. The outsourcing industry has provided India with many benefits. The following are some of the major benefits provided by the outsourcing industry to India.

a. ***Employment***: For a developing country such as India, employment generation is an important objective and outsourcing proves to be a boon for creating more employment opportunities. It leads to generation of newer and higher paying jobs.

b. ***Exchange of technical know-how***: Outsourcing enables the exchange of ideas and technical know-how of sophisticated and advanced technology from the developed countries to India.

c. ***International worthiness***: Outsourcing to India also enhances India's international worthiness and credibility. This increases the inflow of investment to India.

d. ***Encourages other sectors:*** Outsourcing not only benefits the service sector but also affects other related sectors such as industrial and agricultural sector through various backward and forward linkages.

e. ***Contributes to human capital formation***: Outsourcing helps in the development and formation of human capital by training and imparting them with advanced skills and thereby, increasing their future scope and suitability for high ranked jobs.

f. ***Better standard of living and eradication of poverty***: By creating more and higher paying jobs, outsourcing improves the standard and quality of living of the people in the developing countries. It also helps in reducing poverty.

g. ***Greater infrastructural investment***: Outsourcing to India requires better quality infrastructure. This leads to modernisation of the economy and larger investment by the government to develop quality infrastructure and develop quality human capital.

However, outsourcing has gained opposition from the developed countries. Developed countries argue that outsourcing leads to the outflow of investments and funds from the developed countries to the less developed countries. Also, they believe that MNCs contribute more to the development of the host country than the home country. Further, outsourcing reduces the employment generation in the developed countries as the same jobs can be done in the less developed countries at relatively cheaper wages. Similarly, it is argued that outsourcing leads to job insecurity in the developed countries.

Formation of WTO

World Trade Organisation (WTO) was formed in the year 1995 to promote the access of free trade across all the member nations. This organisation was formed by replacing the already existing General Agreement on Trade and Tariffs (GATT). The basic objective of WTO was to promote good trade relations among different countries of the world.

WTO also helps in establishing interlinkages among the different countries of the world. Moreover, this organisation also helps in establishing a framework for negotiating and formalising the trade agreements among the different countries of the world. The free trade among different nations of the world is facilitated through reduction in tariff and non-tariff barriers.

Further, in order to accelerate social and economic development of the developing nations of the world, it was necessary to integrate their economies with the economies of the developed nations of the world. Thus, the setting up of WTO was a major step in the developmental path of the world economy.

Benefits of WTO

Some of the benefits for an economy as a member of WTO (World Trade Organisation) are as follows.

a. ***Provides equal opportunities to all***: WTO provides equal opportunities to all its member countries to trade in the international market. With all countries having equal access to grow, being a member of WTO was a major benefit for any economy of the world.

b. ***Avenues for greater export***: It provides its member countries with wider scope to produce at large scale and to cater to the needs of people across the international boundaries. This provides ample scope to utilise world resources optimally and greater market access. Accordingly, the share of a country’s trade in the international trade increases.

c. ***Removal of barriers***: WTO advocates for the removal of tariff and non-tariff barriers, thereby, promoting healthier and fairer competition among different producers of different countries. The removal of barriers assures greater penetration of exports to developed countries, thereby, directly boosting a country’s exports. Moreover, the countries of similar economic conditions (say Asian countries), on attaining membership of WTO, can raise a united voice to safeguard their common interests.

d. ***Safeguards common interests***: The countries having similar economic conditions, being members of WTO can raise their voice to safeguard their common interests.

WTO and Indian Economy

As a member of WTO, India has also benefited in the trade front. India is expected to benefit From WTO on the following grounds.

a. As a member of WTO, India is expected to gain in terms of rise in the income. India is expected to add 3.5 to 7 billion US dollars annually as a result of the rise in the volume of trade.

b. The exports of traditional items of India, particularly textile and clothing are expected to experience a boost.

c. With the reduction in the quantitative restrictions, the agricultural exports of India are likely to increase.

d. WTO has resulted in greater discipline in the world trade. This creates a secure and predictable environment for international trading.

Economic Reforms in India– Critical Appraisal

Objectives

In this lesson, we will critically examine the impact of economic reforms on the Indian economy.

Introduction

In the last few lessons, we discussed the three policy measures of New Economic Policy, namely, Liberalisation, Privatisation and Globalisation (LPG). We also discussed the different strategies that were adopted and implemented under these three policies. Now, in this lesson, we will discuss the impact of these policies and reforms on the different sectors of the economy. We will also critically evaluate the reforms in terms of its positive impact and negative impact.

Economic Reforms and Its Impact on Different Sectors of the Economy

The economic reforms, initiated in the year 1991, influenced all the major sectors of the Indian economy. There were some sectors which were positively influenced by these reforms while, on the other hand there were some other sectors which were adversely affected. The following is the critical appraisal of the impact of these reforms on some of the sectors.

Agricultural Sector

The economic reforms of 1991 did not benefit the agricultural sector significantly. The primary focus of the LPG reforms was on the industrial sector, while the agricultural sector was neglected. Due to this, the performance of the agriculture sector suffered a huge setback. The following are the reasons that explain the poor performance of the agriculture sector in the post-reform period.

1. ***Reduction of public investment***: There was a drastic decrease in the volume of public investment in the agricultural sector. An acute cutback from the Indian Government in providing sufficient irrigation facilities, electricity, information system, market linkages and roads made the situation of agricultural sector even worse. Moreover, investment in agricultural research and development was not as extensive as it was during the Green Revolution phase.

2. ***Removal of subsidies***: Removal of subsidies, particularly fertiliser subsidies pushed up the cost of production in agriculture. Consequently, this made farming more expensive. This in turn adversely affected the poor and marginal farmers. Also, due to this there standard of living declined drastically.

3. ***Liberalisation and reduction in import duties on agricultural products***: Due to adherence to the WTO commitments, Indian Government reduced import duties and other quantitative restrictions on agricultural products. This opened the gates for foreign competition. The poor and marginal farmers were forced to compete with their foreign counterparts. This stiff competition in the international market along with traditional techniques of farming badly affected the poor farmers.

4. *Shift towards cash crops and lack of food grains*: The export oriented production strategies led to the shift of agricultural production from food grains to the production of cash crops such as cotton, jute, etc. This led to the reduced availability of food grains and consequently lower nutritional values in the country.

5. *Inflationary pressures on food grains*: The shift towards the production of cash crops along with the removal of subsidies exerted inflationary pressures on the prices of food grains. The setback in the agriculture sector adversely affected the other sectors as well. As agriculture forms the principle source of raw material and inputs for the industrial sector, a reduction in the production and productivity in the agriculture sector hampers the growth of the industrial sector. Besides this, agriculture is still the primary source of occupation for the majority of the population in India. Thus, a slow growth and income level in the agriculture sector implied spread of poverty.

Industrial Sector

Similar to the agricultural sector, the industrial sector’s performance during the reform process was also very dismal. Such dismal performance of industrial sector can be attributed to the following reasons.

1. *Cheaper imports*: Complying with the commitments of WTO, India had to remove tariffs and other import duties on the industrial products. As a result, the domestic industrial products faced stiff competition from the cheap imported goods. The foreign products were not only cheap but also were superior in quality as compared to the domestic industrial products. As a result, the domestic industrial production suffered a setback.

2. *Lack of investment*: Due to lack of investment in infrastructural activities such as power supply, the domestic firms could not compete with their foreign counterparts in terms of cost and quality of goods. The inadequate infrastructural investment pushed up the cost of production of the domestic producers and consequently, led to the non-feasibility of their growth prospects in the industrial sector.

3. *High non-tariffs barriers by the developed countries*: Although, the trade and other barriers were removed from the Indian market, many other developed nations did not remove such barriers from their own market. Thus, it was very difficult for the developing nations to have access over the market of developed countries. For instance, US did not remove quota restrictions on imports of textiles from India and China. This implied that the domestic producers could not benefit by increasing the exports.

4. *Vulnerable and infant domestic industries*: During the pre-reform period, the domestic industries were provided a protective environment to grow and expand. As a result, the domestic industries were still not developed to the extent it was expected and thus, were unable to compete with the multinational companies (MNC's). Further, the dependence of domestic industries on traditional technologies which were neither cost-effective nor quality-effective was another important factor for their dismal growth.

Service Sector

It was the service sector that benefited the most from the reforms. This sector showed tremendous performance growth under the reforms. The following are the major factors that led to high growth of service sectors in India.

1. ***High demand for services as final product***: India was a virgin market in case of service sector. So, when service sector started booming due to business outsourcing from the developed countries to India, there was a very high demand for these services, especially for banking, computer service, advertisement and communication. This high demand in turn led to a high growth rate of service sector.

2. ***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 investments and outsourcing to India. This in turn encouraged the service sector growth.

3. ***Structural transformation***: Indian economy is experiencing structural transformation that implies shift of economic dependence from primary to tertiary sector. Due to this transformation, there was an increased demand of services by other sectors which further boosted the service sector.

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

5. ***Increased volume of trade***: Low tariff and non-tariff barriers on imports by India are also responsible for high growth rate of the service sector. The foreign trade reforms enabled the domestic products to interact and compete in the international market.

6. ***Cheap labour and reasonable degree of skill in India***: Due to the availability of cheap labour and reasonable degree of skilled man power in India, developed countries found outsourcing to India feasible and profitable. The business outsourcing in itself provides substantial encouragements (such as in the form of development of human capital) to the growth of service sector.

Economic Reforms and Social Justice

The economic reforms have enabled India to have access to and compete in the international market. This has facilitated the movement of goods and services across the international boundaries. Further, the increased inflows of foreign capital and investment to India have eliminated the shortage of foreign exchange to finance the imports of sophisticated and advanced technologies to India.

Moreover, the boom in the outsourcing and the service sector led India's economic growth and GDP to increase by many folds. But on the other hand, it is said that the reform has led to an increase in the inequalities. The following points reflect the adverse impact of the economic reforms on the social justice.

1. *Neglect of agriculture sector*: The reform process were introduced largely in favour of the industrial sector and the service sector, while on the other hand, the agriculture sector that employed a significant proportion of population was neglected. Thus, the reforms failed to benefit the agricultural sector in India.

2. *Favour high income groups*: The reforms favoured the high income group population at the cost of their poor counterparts. The high income group has experienced increase in income, thereby, appreciating the quality of their consumption basket. As against this, the low and middle income groups still fight hard to earn their livelihood. That is, the standard of living of the higher income groups has further improved, while that of the poor section has worsened. This resulted in wide economic and social inequalities among different sections of the population.

3. *Neglect of the rural areas*: Further, the economic reforms developed the areas that were well connected with the metropolitan cities, leaving the remote and rural area undeveloped. This is because the urban areas focussed their operations only in those areas that were well versed with the infrastructural facilities. Consequently, there emerged wide regional disparities.

The boom in the service sector, especially, in the form of quality education, superior health care facilities, IT, etc. were out of the reach of the poor section of the population, resulting in the neglect of the poor and rural areas. Infact, the population engaged in the agricultural and allied sectors has still not been able to share the fruits of advanced technology and modern techniques.

4. *Focus on only select areas*: The reform process generated growth by focussing only on some selected areas of service sector such as IT, telecommunication, travel and tourism, real estate, etc. On the other hand, the vital sectors of the economy remain neglected. This again resulted in an increase in the regional disparities while benefiting only the selected areas.

Critical Appraisal of Economic Reforms

Let us analyse the positive and negative impacts of the economic reforms in India.

Positive Impact

India was forced to introduce economic reforms in the year 1991. The economic reforms became inevitable due to rising inflation, acute BOP crisis, mounting fiscal deficits and slow economic growth rates. The economic reforms were assumed to be the only way out to save the Indian economy. The following are the arguments in favour of the economic reforms:

1. *Increase in the growth rate of GDP*: The high economic growth rates were experienced due to the economic reforms. In the pre-liberalised Period, despite various growth measures of the government, the economic growth rate of India was lower than 4% p.a. However, with the implementation of reforms, the economy has grown with a substantial pace. At present, the economy of India is growing with a rate of around 8% p.a.

2. *Safety-check on fiscal deficit*: Prior to 1991, the fiscal deficit of India was as high as 8.5% of GDP. The reason for such a high fiscal deficit was mainly higher level of non-developmental expenditure of the government. Therefore, introducing the economic reforms became inevitable. With reform process in India, the fiscal deficits have been controlled at the levels of approximately 5%.

3. *Stimulating industrial production*: In order to foster the industrial production and growth, it was expected that opening up of the Indian economy will attract foreign industries that will infuse competition in the domestic market. Under reform process, Indian industries are now experiencing increased growth rates due to increased level of competition in the market.

4. *Rise in the foreign exchange reserves*: In the year 1991, India faced an acute BOP crisis. In order to build-up the foreign exchange reserves, it was assumed that trade reforms such as removal of quotas, tariff and non-tariff barriers will lead to a sharp rise in the exports and foreign exchange reserves. However, with reform process in India, there increased the availability of foreign reserves in the domestic market.

5. *Protection of consumer's interest*: With increased flow and availability of goods and services under the reform process, the variety of goods and services for the consumers were also increased. The consumers now had the access over a wide range of goods and services.

6. *Helped in making India a preferred destination*: With economic reforms and increased level of economic activity, the status of India as a preferred destination for investment has increased. The image of India as an emerging economic power is gaining momentum in the eyes of the other countries of the world.

Negative Impact

Despite the various positive aspects of the LPG policies, there are various negative impacts of the policies on the Indian economy. The following points highlight these negative impacts of NEP on the Indian economy.

1. *Ignored agricultural sector*: Agricultural sector supports the livelihood of the majority of people in India. The LPG policies favoured industrial sector while neglecting (or at the cost of) the agricultural sector. With the initiation of LPG policies, the agricultural sector was forced to face stiff competition from the foreign counterparts. Indian farmers depending on the vagaries of climate, found it very difficult to stand against the foreign counterparts who employed advanced and modern techniques in agriculture. Therefore, the growth of agricultural sector was largely impeded by globalisation.

2. *Uneven growth process*: The LPG policies lead to the concentration of MNC's (Multinational companies) in only the urban areas of India, while the rural areas were neglected. Therefore, the 'rural-urban' divide widened. As a result, the workforce form the rural areas increasingly started migrating towards the urban areas for better employment opportunities. However, the industrial sector failed to absorb this excess labour. Thus, LPG policies favoured the urban centres more than the rural areas and led to uneven growth in the country.

3. *Consumerism*: The arrival of MNC's in the country has popularised the concept of consumerism. Consumers, in the wake of western civilisation are spending in no limits to showcase their materialism. This, on the one hand, provides advantages to the traders and producers but, on the other hand, makes the households more vulnerable.

4. *Colonialism*: India has been the victim of political colonialism in the past. Now, it has become a sufferer of economic colonialism due to the invasion of MNC's in India. These companies have given a stiff competition to domestic producers, thereby, affecting the growth of the economy as a whole. The supply of advanced and modern products from the foreign countries have made Indians both economic as well as demand dependent on these products at the cost of the domestic products. This may lead to economic colonisation.

5. *Weakening of cultural values*: The process of economic reforms has made people of the economy to be more concentrated towards money. It has erupted the cultural and family values of the society in an attempt of being more materialistic.

6. *Negative impact of the fiscal policies*: In the reform period, with a view to raise the tax revenue and to bring a larger section of the population under the ambit of taxation, the government lowered the tax rates to moderate levels. However, the government was not successful in its attempts. Moreover, owing to reductions in the tariffs and other duties, the revenue could not be increased through these channels. In addition to this, in order to attract greater foreign investment, various concessions and incentives such as tax concessions were provided to the foreign investors, which further limited the scope of revenue for the government.

7. *Unemployment*: Growth in GDP as a result of the reform process has not been able to generate enough employment opportunities. The growth in GDP has been brought about by employing modern and improved technology that substituted labour for machines. MNCs that played an important role in India’s economic growth provided employment only to the educated and specialised workforce. These MNCs relied on the modern and efficient technology rather than labour for the production of goods and services. As a result, the employment remained low.

Thus, it can be said the reform process has been a mixed bag of the positive as well as negative impacts in the economy.