Indira Gandhi
National Open University
School of Social Sciences

EEC-12
Indian Economic Development since Independence

Block

8

ECONOMIC REFORMS IN INDIA

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March, 2002

ISBN-81-266-0452-2

Further information on the Indira Gandhi National Open University courses may be obtained from the university's office at Maidan Garhi, New Delhi-110 068.

Printed and published on behalf of the Indira Gandhi National Open University, New Delhi, by Professor Kapil Kumar, Director, School of Social Sciences.

Laser typeset by : HD Computer Craft, EA1/75, Main Market Inderpuri, New Delhi-110012. Ph: 5811437

Printed at

BLOCK 8 ECONOMIC REFORMS IN INDIA

Introduction

Block 8 discusses the measures of economic reform introduced in India since 1991. In the background of the preceding policy regime that relied heavily on 'command and control' strategy of economic development, the present policy focuses on a path that is largely decided by the market forces. An attempt, therefore, is made to introducing the basic concepts of economic reform through Unit 25. The succeeding Unit 26 deals with privatisation moves in India and examines the privatisation of some of the economic activities hither to performed by the public sector. The basic thrust of ensuring the economic development in a competitive environment by India is discussed in Unit 27 under the title, Globalisation of Indian Economy. The concluding Unit 28 of the block deliberate upon the features of economic reform in India in the presence of social justice as an important objective.

UNIT 25 THEORETICAL ISSUES

Structure

25.0 OBJECTIVES

This unit will enable you to answer the following:

- The meaning of various terms like 'liberalisation' 'privatisation', and 'globalisation';
- The need and importance of liberalisation in the context of Indian economy;
- Forms of privatisation;
- Globalisation connotations;
- Courses or factors leading to globalization; and
- Rationale behind economic reforms.

25.1 INTRODUCTION

India followed the strategy of planning for her industrialization during the first four decades since the First Five Year Plan in 1951. The plans were implemented under the framework of a mixed economy with a substantial role for the public sector and a state regulated private sector. The former was given the charge of heavy and key industries (due to high gestation period, low rate of return and huge investment requirements), and the latter mainly the consumer goods industries. Four basic objectives, of each successive Five Year Plan were *'rapid economic growth'*, '*modernization'*,'*self-reliance' and 'social justice*'. Self-reliance was sought to be created by protecting the home market from foreign competition by high rates of tariff and other forms of restrictions.

The principal instruments of actual policy used to serve the objective of self-reliance were an elaborate industrial licensing system under the *Industries Development and Regulation Act (IDRA*) of 1951 and a protective foreign trade regime. It controlled not only entry into an industry and capacity expansion but also technology, output mix and import content. Moreover, concentration of economic power was controlled by the *Monopolistic and Restrictive Trade Practices (MRTP) Act of 1969*. Finally, the *Foreign Exchange Regulation Act* (FERA) of 1973 was used to regulate foreign investment in India. These acts together created a highly protected industrial regime where there was neither any significant role of even internal competition nor any strict planning for industrial development.

The Government of India embarked on major economic reforms programme in 1991 with objective of moving Indian economy from a planned framework towards a market oriented one. In pursuing this the government took many policy decisions designed to encourage *fiscal discipline, privatisation of public sector enterprises (PSEs), promote liberalisation and deregulation of domestic financial markets, and foreign investment*. These economic reforms broadly speaking fall into the three generic terms called *liberalisation, privatisation and globalisation.*

25.2 CONCEPTS OF LIBERALISATION

Liberalisation is a process of change in the economic policy. During the past decade, liberalisation has been the hallmark of economic policy throughout the world. Virtually all governments have taken significant steps to widen the role of private enterprise in economic activity, be these the former centrally planned economies of East Europe or Latin American countries or even advanced mixed economies of Europe. In some countries — for example the former centrally-planned economies — this constituted (i) a veritable *change of regime*. For others — for example a number of Latin American countries — it constituted (ii) a major *shift in the philosophy and approach towards fostering development*. In still others—for example some European economies — it constituted (iii) an *adjustment of the role of government in a mixed economy*.

25.2.1 Measures of Liberalisation

A wide variety of specific types of measures have given effect to liberalisation policies. As observed above, there are : (i) a veritable change of regime, as in former centrally controlled economies of East Europe, (ii) a major shift in the philosophy and approach towards fostering development, as in Latin American Economies, or (iii) an adjustment in the role of the government, as in the advanced economies of Europe.

The change of regime has required the disengagement of the State from production of goods and services across virtually the whole economy, and the establishment of the institutional and legal frameworks appropriate to the functioning of a market economy. In economies that rely mainly on private enterprise to organise production, the role of the state has been reduced and revamped. In both controlled transition and market economies these moves have resulted in privatisation of State enterprises. In market economies there has also been extensive reduction in government regulations on private sector activity, and some revamping of regulations to meet emerging needs, as in the areas of finance and environment protection.

25.2.2 Gains from Liberalisation

In all countries, *external transactions have been a key component of liberalisation* strategies. This is because liberalisation of international trade, investment and capital movements can improve allocative efficiency and can bring about greater dynamism in an economy, thus providing faster economic growth. Among the expected benefits of increased openness to trade are as follows:

i) improvements in innovativeness and productivity of domestic firms due to external competition.

ii) consumers gain from the wider choice of goods and services and reduced prices resulting from increased international competition and specialisation. Economies open to competition from abroad are also presumed to be efficiency improving.

iii) producers acquire strength to adjust to adverse external shocks, and less prone to wasteful rent seeking.

iv) the increased mobility of factors of production — especially capital and, with it, technology — can help a country overcome the dangers of being trapped by static comparative advantage and achieve the continued shifts in its resource endowments required for sustained economic growth and productivity gains.

v) liberalisation of capital movements means that the link between domestic savings and domestic investment can be relaxed, that is, domestic investment need not be constrained by weak domestic saving behaviour and, conversely, high domestic savings should flow abroad to where they are demanded.

25.2.3 Progress of Liberalisation

Liberalisation has, however, proceeded at different speeds and in different ways as far as trade, investment and finance are concerned. While there are still a number of sectors where liberalisation has been partial-including agriculture and textiles and clothing, which are of particular importance to developing countries — liberalisation of international trade has progressed to an impressive extent.

Investment liberalisation has proceeded in a much more uneven manner. As a rule, changes involved the tempering or removal of obstacles to foreign investors, the establishment of standards for their treatment, and incentives to attract the increased foreign direct investment (FDI), with some steps also taken to ensure the proper functioning of markets. Furthermore, these liberalisation measures were generally accompanied by other measures aimed at improving the investment climate for Transactional Corporations (TNCs), especially by granting better protection to foreign investors.

The liberalisation of trade and FDI regimes has been accompanied by **a liberalisation of financial transactions.** Financial liberalisation is generally less advanced in developing countries, but the pace of change has been much more rapid. Inward investment by non-resident investors is virtually free in a number of developing countries. As for outward transactions, an increasing number of developing countries have adopted capital account convertibility in recent years. *Liberalisation of transactions in* foreign *currency among residents has gone much further*. Indeed there has been a tendency to encourage residents to hold foreign exchange deposits with banks at home. Liberalisation of trade and investment has been influenced by the expansion and intensification of regional integration efforts.

Check Your Progress 1

1) What do you mean by economic reforms?

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2) Define the term liberalisation.

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3) Distinguish between domestic liberalisation and external liberalisation.

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25.3 CONCEPT OF GLOBALISATION

Globalisation can be defined in several different ways depending on the level we choose to focus on. We can speak of the globalisation of the entire world, a single country, a specific company or even a particular line of business or function within a company.

At the worldwide level, globalisation refers to the growing economic interdependence among countries as reflected in increasing cross-border flows of goods, services, capital and know-how. Clear evidence of this is offered by the following trends:

- Between 1989 and 1999 cross border trade in goods and services grew at an average annual rate of 6.1 per cent almost twice as fast as the average annual growth rate of 3.1 per cent in the world's GDP during the same period.
- From 1980 to 1999 foreign direct investment grew from 4.8 per cent to 9.4 per cent of the world GDP.
- In 1970, cross border transactions in bonds and equities as a ratio of GDP stood at under 5 per cent in the US, Germany and Japan.By 1999 the respective figures for these countries had soared to 149 per cent, 202 per cent and 87 per cent.

At the level of a specific country, globalisation refers to the extent of the interlinkages between a country's economy and the rest of the world.

Despite an increasingly global world, not all countries are equally integrated into the global economy. Some key indicators to measure the global integration of any country's economy are exports and imports as a ratio of GDP, inward and outward flows of foreign direct investment and portfolio investment and inward and outward flow of royalty payments associated with technology transfer.

At the level of a specific industry, globalisation refers to the degree to which a company's competitive position within that industry in one country is interdependent with that in another country. The more global an industry, the greater is the advantage that a company can derive from leveraging technology, manufacturing progress, brand names and/or capital across countries. Globalisation industries tend to be dominated in every market by the same set of global companies, which co-ordinate their strategic actions across countries. The athletic footwear industry, for example, is dominated by Nike, Reebook and Adidas. There has been increasing globalisation of the pharmaceutical industry. The data indicate that in this industry cross-border investment has grown faster than cross-border trade.

At the level of a specific company, globalisation refers to the extent to which a company has expanded its revenue and asset base across countries and engages in cross border flows of capital, goods and know-how across subsidiaries. Toyota is a good example of a highly globalised company. At the end of 1998, one third of Toyota global output came from wholly or partially owned affiliates in 25 foreign countries spread over the Americas, Europe and Asia. Furthermore, Toyota exported 38 per cent of its domestic production from Japan to foreign markets and engaged in significant intra-firm flows among its affiliates. For example, within its south-east Asian regional network, Toyota exported diesel engines from Thailand, transmissions from the Philippines, steering gears from Malaysia and engines from Indonesia. Key indicators of the globalisation of a company are international dispersion of sales revenues and asset base, inter-firm trade in intermediate and finalised goods, and inter-firm flows of technology.

25.3.1 What Drives Globalisation?

Globalisation occurs because specific managers in specific companies make decisions that result in increased cross-border flows of capital, goods and/or know-how. Managers are making such decisions at an increasing rate because globalisation is becoming both more feasible and more desirable. Four trends lie at the core of these developments.

1) *An ever-increasing number of countries are embracing the free market ideology*

The shift from a 'planning' mentality to a 'market' mentality by economy policy-makers in industrialised and industrialising nations is well-known and has been well documented.

2) *The economic centre of gravity is shifting from the developed to the developing countries*

Economic liberalisation promotes competition, efficiency, innovation, new capital investment and faster economic growth. Not surprisingly, the embrace of market mechanisms has allowed the developing economies of the world to start catching up with the advanced economies. The world's economic centre of gravity is shifting. Virtually any company today that seeks to grow has little choice but to go where the growth is. For the vast majority of the world's top 500 industrial corporation, such growth is rarely in the home market.

3) *Technological advances are constantly improving communication*

Cost of air transportation, telecommunication and computers have declined sharply since 1980. The decline in transportation costs has shrunk the cost of shipping goods. In the case of computers and telecommunications, both the sharp cost decline and the recent widespread adoption of technologies such as video-conferencing and e-mail have made co-ordination of far-flung operations not only more feasible but also more reliable and efficient.

4) *The opening of borders to trade*, investment and technology transfers not only creates new market opportunities for companies but also enables competitors from abroad to enter their home markets. As competition intensifies, it fuels the race among competitors to serve globalising customers, to capture economies of scale, to exploit the cost-reducing or quality enhancing potential of optimal locations and to tap technological advancements wherever they may occur. The result is that globalisation has now become a self-acceleration process.

25.3.2 Is Globalisation a New Phenomenon?

There is a common presumption that the present conjuncture, when globalisation is changing the character of the world economy, is altogether new and represents a fundamental departure from the past. But this presumption is not correct. Globalisation is not new. In many ways, the world economy in the late twentieth century resembled the world economy in the late nineteenth century. And there is much that we can learn from history, for "there is the past in our present".

25.3.3 Benefits of Globalisation, When?

Prof. Deepak Nayyar has emphasised the fact that, "The benefits of integration with the world economy, through globalisation, would accrue only to those countries, which have laid the requisite foundations for industrialisation and development. This means investing in the development of human resources and the creation of a physical infrastructure. This means raising productivity in the agricultural sector. This means the acquisition of technological and managerial capabilities at a micro-level. This means the creation of institutions that would regulate, govern and facilitate the functioning of markets. In each of these pursuits, strategic forms of state intervention are essential. The countries, which have not created these pre-conditions, could end up *globalising prices without globalising incomes.* In the process, a narrow segment of their population may be integrated with the world economy, in terms of consumption patterns or living styles, but a large proportion of their population may be marginalised even further".

25.3.4 Globalisation and State, When?

Globalisation has reduced the autonomy of the nation states in economic if not political matter. But there remain some degrees of freedom, which must be exploited in the pursuit of industrialisation and development. The object of any sensible strategy of development in the context of globalisation should be to create economic space for the pursuit of national interest and development objectives.

The process of globalisation has been uneven over time and across space. The inequalities and the asymmetries implicit in the process, which led to uneven development in the late nineteenth century, mostly for political reasons, are bound to create uneven development presently mostly for economic reasons. There is a real danger that some countries would experience an exclusion from prosperity. Such exclusion from the process of development would increase the economic distance between peoples of the world. This would be difficult to sustain in a world where demonstration effects are strong and are reinforced by globalisation, which creates strong aspirations for consumption patterns or life styles. Economic deprivation could accentuate social divides and political alienation.

Prof. Nayyar has rightly concluded that, "the nation states in the developing world cannot wish away these problems. The enthusiasts of globalisation must recognise that we have reached neither the end of the history nor the end of geography. We have not reached the end of history, for the market has met its match in Eastern Europe where it did not improve the living conditions of the people, and the electoral process is returning reformed communist parties to power in country after country. We have not reached the end of geography, for nation states cannot exist in a political vacuum and must strive to improve the economic conditions of their people". Therefore, strategic, economic and political role for the state must be recognised and performed. Otherwise, there is a possibility of globalisation reproducing uneven development.

However measured, globalisation has occurred and gives no sign of slowing down. Increased globalisation has been viewed with concern. There is a common belief that globalisation harms the interests of workers, especially unskilled workers. Still, despite the overall benefits of globalisation for national welfare, there are adjustment costs for particular groups within a nation: *globalisation produces winners and losers*. The adjustment of those groups of workers displaced by import competition occurs slowly and with significant costs, such as the need to obtain information about new opportunities, relocation, and the loss of firm or industry specific knowledge. Policymakers must keep in mind potential dislocations and ensure that those who are displaced do not become marginalised. In view of this there is a need for retraining programmes to minimise any adverse socio-economic effects and ease the re-absorption of labour in a growing economy. Resources saved, as a result of any reorganisation, can be used for essential state investment. This could be reinforced by a more efficient and progressive taxation policy to generate resources internally. The major challenge is combining the state with aspects of the market to enhance development under globalisation. However, the nature of interaction between the new phenomenon and economies (at the different levels) poses critical questions for prosperity or marginalisation of developing countries and their poor. In this frame, a critical analytical issue is the extent to which globalisation will undermine the state and its capacity to formulate macro-economic policies (Sumit Roy, 1997).

In this context, Prof. Sumit Roy has further stressed that "Given that India accounts for about a third of the world's absolute poor, the nature of her integration with the international economy has critical implications for liberlisation and globalisation reducing world poverty. Conceptually, the focus needs to be on domestic and external policies in the frame of globalisation. In this respect, it is essential to devise a typology, which can define the economic structure of a developing country to enable a *fuller understanding of domestic global interaction* and the scope of adapting to the international economy. India can be described as a relatively large, closed or protected economy, in the throes of industrialisation, with trade and foreign investment playing a limited role, low per capita income, and a significant agrarian sector, marked by sharp inequality. In this setting, the focus should be first on ways in which growth, in and through the agricultural sector, can be generated, including investment in infrastructure investment, credit and technology, coupled with institutional mechanisms to reform the highly unequal agrarian structures. Indeed, agricultural growth can be the major force in stimulating domestic demand for industrial goods. This requires significant state interventions to create the skills, technology and training and direct and indirect forms of support, including subsidised credit, to shape the industrialisation process, in conjunction with using the private sector in an appropriate manner to guide the latter. Such thrusts need to be complemented by employment and poverty reduction policies to provide social support and human capital, especially in the context of transition to a market economy. Secondly, policies on the external front need increasingly complement to those on the domestic front embracing ways in which foreign direct investment and portfolio flows can be accommodated with the overall development frame. These include their role in stimulating both domestic and export-led growth. However, such an orientation requires careful evaluation of the need for, and the scope of making the labour market more flexible, increasing public and private sector efficiency, selective privatisation, or even closing down ailing public enterprises".

Liberalisation, and increasingly globalisation, is exposing the Indian economy to major changes which demand pursuing a number of goals, including macro-economic stability, growth and reduction of poverty. The extent to which India will be able to reconcile such goals and minimize any negative effects of the new thrust is rooted in resolving pre-liberalisation economic problems. In this frame, the main challenge for policy-makers is how to combine the state with aspects of the market in order to stimulate growth and reduce poverty. The state has to play a forceful role by reexamining the role of agriculture in economic growth, the scope of reforming the unequal agrarian structure and the nature of investments in the agricultural and the industrial sector. This has to be supported by appropriate policies to reduce poverty including meaningful employment programmes coupled with effective nutrition, health and education policies to fulfil basic needs and build human capital. These thrusts need to be combined with selective liberalisation policies, which can make the economy more internationally competitive.

The analysis shows that the state has to play a major role in fulfilling such goals while creating the conditions for the market to function more effectively in line with goals of growth and poverty reduction, underpinned by making the economy more competitive internationally. This requires reassessing the role of agriculture in stimulating economic growth, including reforming the structure and technological support and supporting key industries, coupled with relevant employment programmes and investment in human capital exemplified by nutrition, health and education. These thrusts need to be combined with the strategic liberalisation: through measures such as making the public and the private sector more efficient to compensate for deficiencies in specific domestic and export-sectors.

In summary, it is essential to examine the ways in which national (micro sector and macro) and international global policies could be used to stimulate growth and reduce poverty in developing countries, particularly in south Asia and Africa. This requires reformulating liberalisation policies in line with the priorities of developing countries to maximise the potential benefits of globalisation.

Check Your Progress 2

1) What do you mean by globalisation ?

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2) Mention the four factors responsible for increasing globalisation.

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3) What are the likely benefits of globalisation ?

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25.4 CONCEPT OF PRIVATISATION

Privatisation means different things to different people. In the narrow sense, it means transfer of ownership from the public (anonymous bureaucrats and politicians) to the private (known individual) hands. In the wider sense, it means infusing competition, i.e., marketisation or liberalisation, where demand and supply are allowed to play their free roles instead of being controlled or directed by any centralised authority. In between these two extreme views lies one version, where a major or a small part of the equity of PSUs is sold out by the government to the private sector, a part of some of the PSE's activities is contracted out to the private sector, a hitherto reserved sector or industry is opened for the private sector to operate, an erstwhile public service is withdrawn, memorandum of understanding (MOU) is signed between the government and the management of the PSE, and so on. The work over all these options of the versions has been practiced with varied results. Besides, privatisation is known by different names around the world. For example, it is called "de-nationalisation" in the U.K. "dis-incorporation" in Mexico, "prioritisation" in Australia, "asset sales program" in New Zealand, "transformation" in Thailand, "people-isation" in Sri Lanka, and "dis-investment" in Pakistan.

In 1983, the Penguin Dictionary of Economics defined privatisation to be :

(a) "the sale of Government owned equity in nationalised industries or other commercial enterprises to private investors with or without the loss of Government control of the organisation;" (b) privatisation as a concept which encompasses denationalisation (where Government sold its holding); (c) deregulation (where legal barriers were thrown away with enabling private enterprises to compete) and (d) franchising (where for a defined period, contracts were awarded – here the private sector produced and the public sector provided them to the consumers).

In the latter edition of the "Dictionary of Economics" privatisation got redefined, apart from including sale of Government owned equity in the organisation, "other types of privatisation may take the form of deregulation of a state supported cartel or the subcontracting to the private sector of the work principally carried out by state employees. The major challenge is combining the state with aspects of the market to enhance development under globalisation. The poor should play an integral role shaping this process.

Thus, privatisation covers a wide continuum of possibilities, between denationalisation at one end and market discipline at the other:

1) Transfer (sale) of public assets (firms, parts of firms-'partial privatisation') or individual assets to private persons.
2) Transfer of individual public supply tasks to private persons (e.g., contracting out); also functional privatisation.
3) Transition to private business management in the sense of profit-oriented management.
4) Extension of the margin of autonomy for the management of public enterprises.
5) Debureaucratisation, in the sense of freeing from formal provisions and administrative instructions.
6) Decentralisation, in the sense of the delegation of authority to decide, plan and act.
7) Aligning the conditions under which public enterprises act on those which apply to private firms.
8) Promotion of competition by market processes (or market-like systems of incentives).
9) Dismantling of such state monopolies as are justified by referring to the traditional argument of 'natural monopoly'.
10) Adoption of wages and working and employment conditions to those applicable to the private sector : privatisation of jobs.
11) Unilateral reduction of the nature and scope of public services.
12) Privatisation of public resources.
13) Privatisation of public revenue: conversion of revenues from public investments into private profits, or private access to public capital and its revenues.
14) Denationalisation: pressures of international competition; increasing activity in foreign markets; take–over of capital shares and rights of disposal by foreigners.

25.5 RATIONALE BEHIND ECONOMIC REFORMS IN INDIA

When the new government assumed office in June, 1991 the task before it was two fold:

1) to restore macro-economic stability by reducing fiscal and balance of payments deficits, and

2) to complete the process of economic reforms, i.e., structural adjustments which for the proceeding ten years had been conducted on a partial basis, gradually and intermittently.

The announced aims of the current economic reforms strikes a revolutionary note. Reforms intended to achieve the following:

i) stabilisation and macro-economic balance through fiscal, monetary and exchange rate policies;
ii) a liberalised trade regime with no import licensing and tariff rates comparable to other industrialising developing countries;
iii) an exchange rate system which makes the rupee convertible, at least for current account transactions of the balance of payments;
iv) a competitive financial system with sound regulations;
v) an industrial sector free of many controls; and
vi) an autonomous, competitive and streamlined public enterprise sector.

Since there was overcentralisation of power of decision-making over investment, product-mix and pricing and formal and informal distribution control, public sector enterprises did not have enough autonomy for commercial viability. On the other hand, since the home market was protected, private enterprises were not compelled to improve the efficiency and quality of their products. Policy-makers believed that the slower and inefficient growth experienced by India during the last 40 years was the result of a tight regulatory system over the industrial and foreign trade sector of the economy. This had thus created an economy of subsidy and inefficiency. The new economic policy (NEP), of which the new industrial policy (NIP) of 1991 is the most important part, was launched against this background. The NIP of 1991 was a major part of the broad structural adjustment programme in India, which was specifically set in motion with a declared objective of transforming the basic nature of functioning of the economy in lieu of planned economic development over the period from 1951 to 1990.

Liberalisation is a process of economic policy changes specifically initiated from 1991 as declared state policy. It had its own economic, political and international compulsions. Indian economic reforms in their current form had been initiated with the help of financial support from the International Monetary Fund (IMF) and the World Bank, and lately also from the Asian Development Bank (ADB). This reform package (popularly called 'new economy policy') covered the areas of *macro-economic stabilisation policies and structural adjustment policies.*

25.5.1 Components of Economic Reforms

The major policy changes which are called economic reforms, or liberalisation in a nutshell are :

1) *Macro-economic stabilisation measures* which include : (a) management of the balance of payments crisis, (b) fiscal deficit management, and (c) monetary policy correctives.

2) *Major sectoral structural adjustment reforms*, which include : (a) trade policy (and associated policy) reforms, (b) industrial policy reforms, (c) policy reforms relating to the public sector, (d) policies for attracting foreign direct investment, technology and equity participation, (e) administrative reforms for faster investment approvals, (f) tax structure reforms, (g) tariff reforms for both capital goods and consumer goods, (h) financial sector reforms, (i) reforms in agriculture and related areas.

3) *Measures to share social costs of reforms* which include reform of the public distribution scheme (PDS), establishment of a national renewable fund (NRF).

The new industrial policy (NIP) of July 1991 effected some very fundamental policy changes such as near abolition of licensing, easing of the rigors of MRTP and FERA, reduced list of industries to be reserved for the public sector, automatic approvals of foreign technology agreements and 51 per cent foreign equity, defining a new role of state electricity boards, private investment in infrastructure, protection of consumers interest, new liberal location policy for industry, freer import of capital goods, reduced tariff for consumer goods, transport subsidy for backward areas, national renewal fund, de-regulation in small scale industrial units, and radically liberal policy measures for attracting FDI, new technology and NRI investment. The sole objective of these highly liberalised policy measures, was to enhance *productivity and efficiency* in Indian industries by creating a *competitive environment*.

Check Your Progress 3

1) What do you mean by privatisation ?

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2) Is denationalisation alone privatisation ?

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3) Describe in brief the circumstances under which the economic reforms programme was introduced in India.

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4) What are the aims of the economic reforms programme in India?

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25.6 LET US SUM UP

The Government of India embarked on major economic reforms programme in July, 1991 with the objective of moving Indian economy from a planned framework towards a market oriented one. In this process, we have explained in this unit, the concepts of liberalisation, privatisation and globalisation. Liberalisation is process of change in economic policy suitable for operation of market forces. Globalisation means movement of goods, capital, technology and labour across the globe. As regards India there is need to reformulate liberalisation policies in line with the priorities to maximise the potential benefits of globalisation. Privatisation can be taken in two senses: the narrow sense and the wider sense. In the narrow sense it means transfer of ownership from the public to the private hands. In the wider sense, it means infusing competition i.e., marketisation, where demand and supply are allowed to play free roles instead of being controlled or directed by any authority.

25.7 KEY WORDS

Denationalisation: Transfer of ownership and capital of a production units hitherto owned by the state to private enterprise.

Globalisation: Removal of barriers on the free flow of goods, services and capital .

Liberalisation: Policy whereby different controls and restrictions placed on industry are sought to be removed.

Privatisation: Assigning increasing role to private capital and enterprise.

Protection: Policy whereby domestic producers are protected against foreign competition by raising of tariff walls and non-tariff barriers.

25.8 SOME USEFUL BOOKS

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25.9 ANSWERS/HINTS TO CHECK YOUR PROGRESS EXERCISES

Check Your Progress 1

1) See Section 25.1

2) See Sub-section 25.2.1

3) See Sub-section 25.2.2

Check Your Progress 2

1) See Section 25.3

2) See Sub-section 25.3.1

3) See Sub-section 25.3.3

Check Your Progress 3

1) See Section 25.4

2) See Section 25.4

3) See Section 25.5

4) See Section 25.2

UNIT 26 PRIVATISATION IN INDIA

Structure

26.0 OBJECTIVES

This unit explains privatisation debate in India. After studying this unit, you will be able to answer the following:

- Reasons behind the debate of privatisation ;
- Why are public sector enterprises (PSEs) in India so inefficient ?
- The environment under which PSEs are working in India;
- Rationale behind the privatisation;
- Various techniques of privatisation;
- Identifying areas of privatisation in India;
- Progress towards privatisation; and
- Problems in India's privatisation experience.

26.1 INTRODUCTION

No country in the world has lately been immune from the trend of restructuring of its economy because of a compelling combination of circumstances. India at one time had a huge public enterprise sector. It consisted of nearly 1,300 enterprises, owned and managed by the central government, state and union territory governments, and local governments in the country. These had dominated many sectors of the economy by including: surface irrigation; water supply in rural and urban areas; railways; river transport; ports; postal services; telecommunications; mining (including hydrocarbons and coal); one-third of registered manufacturing (particularly steel, petrochemicals, capitals goods, pharmaceuticals, fertilizers); power generation and distribution; oil and gas production and marketing; air transport; one-third of bus transport; storage; and banking and insurance. As you may be aware, same of these sectors have been transferred to private sector recently.

26.2 REASONS FOR POOR PERFORMANCE OF PUBLIC SECTOR ENTERPRISES (PSEs)

Why are public enterprises in India so inefficient? The answer lies in the *environment that public enterprises in India operate in*, and in effect this environment has on the *public enterprise managers' incentives* to develop new, better and less expensive products, develop new markets, minimise capital and current costs, and maximize profits. Descriptions which illustrate this environment include: the government's deep involvement in the actual management of public enterprises, with the *concerned administrative ministries'* tendency to function as if they were a kind of super management on top of the Board of Directors; *Parliament's involvement in public enterprises'* affairs in several ways, including through numerous *questions and enquiries* ranging from questions of overall performance and policy issues to the minutest details of *day-to-day functioning*; and expansion of the horizon of *Article 26 of the Constitution* to treat even industrial, manufacturing and commercial public enterprises as '*state*' and thereby subject them to the various obligations that go with such a treatment.

26.3 PRIVATISATION

'*Privatisation,* is a term that is employed to convey a variety of ideas. The idea that it most prominently suggests is '*denationalisation'* (in the sense of transferring the ownership of a public enterprise to private hands). Another idea in vogue is '*liberalisation and deregulation'*; which unleash forces of competition. In this context, the concept of privatisation becomes wider to be understood, not merely in the structural sense of who owns an enterprise, but in the *substantive sense of how far the operations of an enterprise are brought within the discipline of market forces*. For convenience, a distinction could be made between *micro* (roll back as producer state); *macro* (roll back of state as producer, regulator, facilitator, and welfare provider); and *mega* (roll back in all dimensions including non-economic regulations). Micro privatisation referring to producer state essentially deals with public enterprise.

26.4 RATIONALE BEHIND PRIVATISATION

A few factors seem to have brought the issue of privatisation on the forefront. They are as under:

1) The *monopoly* status of public sector enterprises (PSEs) bred inefficiency.

2) *Lack of competitiveness* affects PSEs performance very adversely.

3) *Bureaucracy* was also responsible for poor performance of PSEs. It was certainly not always upto turning such enterprises around.

4) Restructuring of the PSEs by way of privatisation became very *common in developed* countries like UK and U.S.A.

5) A lot of *intellectual discussion and debate* started on privatisation all over the world and pressure of public opinion also exerted influence.

6) Some aid giving agencies even started forcing the pace by linking aid with privatisation.

7) Suggestions from management of public sector enterprises themselves led to fresh thinking towards privatisation.

26.4.1 Arguments in Support of Privatisation

Advocates of privatisation claim that it will lead to an *improved economic performance. The reasons for such a view are* the following:

i) *It will improve the environment* public enterprises operate in and thereby strengthen their managers' incentives to be efficient. These in turn can contribute to making the Indian economy substantially more efficient.

ii) Privatisation may create conditions for *substantial additional investment*, which may help in generation of a large number of productive employment opportunities, which in turn may contribute to removing poverty.

iii) *Consumers may* gain from privatisation.

iv) Privatisation can be of help in *reforming public enterprises*. These enterprises are engaged in innumerable activities such as manufacturing steel; building ships; generating and distributing electric power; running domestic and international airlines; exploring, producing and refining oil; operating domestic and international telecom network; running hotels; manufacturing polyester film; making condoms; producing fruit pulp and juice; running banks as also life and general insurance and electronic entertainment business; and so on. *Privatisation will allow the government to concentrate on things, which it has failed to do, but which it alone can do.*

v) Privatisation can be of *major help in reducing India's huge public sector deficit*. This can happen in three ways: (a) the proceeds from the sale of public enterprises can be used to finance the public sector deficit, (b) the proceeds can be used to *reduce the outstanding public debt*, both domestic and external; and (c) will reduce the *burden of interest payments* and thereby the deficit.

vi) Privatisation is expected to ensure generation of revenue to finance *social infrastructure and eradication of poverty.*

Check Your Progress 1

1) Give four reasons responsible for poor performance of public sector units in India.

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2) Distinguish between '*micro*' and '*macro*' privatisation.

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3) Mention four reasons in favour of privatisation in India.

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26.5 TECHNIQUES OF PRIVATISATION

Various experts have categorised privatisation into the following techniques:

1) *Public offering of shares:* all or part of a shares of the public limited company are offered for sale to the public as a running concern.

2) *Private sale of shares:* all or part of the shares of a state owned enterprise are sold to a private individual or a group of purchasers in the private corporate sector.

3) *New private investment in a state owned enterprise:* primary share issues are subscribed by the private sector or public.

4) *Sale of Government or state enterprises assets:* the assets of the public sector are sold as private sale instead of shares.

5) *Reorganisation or fragmentation into smaller units:* a holding company with a number of subsidiaries can be privatised separately.

6) *Management/Employee buy out:* the management or the employees acquire the controlling interest in the unit in which the shares are purchased on credits extended by Government or financial institutions.

7) *Lease and management contract:* the ownership remains with the Government while the lessee assumes full responsibility for operations and maintenance. Under management contract, the owner pays for the management and operational control.

26.5.1 Modes of Privatisation

In terms of policy initiative in the Indian context, privatisation is generally conceptualized in three broad ways, viz., *greenfield privatisation; cold privatisation* and *disinvestment or divestiture* (in particular distressed privatisation). The features of each of these modes are summarized below:

1) **Greenfield Privatisation**

Under this method the *barriers to entry*, including '*reservation*' for the public sector are removed and private sector is encouraged to enter. Under this mode actions move on the following lines:

a) removing barriers of entry for the private sector and it is allowed to do economic activity hitherto reserved for public sector;
b) not allowing any new investment or new activities on the part of the public sectors agencies;
c) preferential treatment being given to the private sector for increasing the level of its activities;
d) in enterprises where private and public sectors have been functioning side-by-side, such as the *joint sector*, the relative share of the private sector may be increased.

2) **Cold Privatisation or Proxy Privatisation**

Under this method public enterprise made to behave as private enterprises by:

a) giving financial autonomy to seek financial assistance directly from the bank/capital market;
b) giving autonomy to make investment decisions;
c) entering into a *Memorandum of Understanding (MOU)* for providing freedom to fix prices, output etc.;
d) making subsidies explicit;

e) taking recourse to corporations, i.e., converting a department enterprise into a corporate entity to ensure distancing.

3) **Disinvestment or Divestiture**

Disinvestment or divestiture is effected by *sale or transfer of shares* held by the government directly or through its agencies in enterprises (i.e., public activities organized under enterprise form) to the private sector. When a loss-making enterprise is turned over to the private sector because the government can no longer support and sustain it, this can be termed *'distressed privatisation.'*

It may be mentioned that alternative approaches are possible to analyzing techniques. For instance the techniques can be divided into:

a) privatisation of *financing* (that is charging for government services);
b) privatisation of *production or provision* (contracting out construction and maintenance or giving franchises to private sector);
c) *denationalization* or *load-shedding* (that is sale of shares or assets held by government); and
d) liberalization (removing restrictions and promoting competition).

Check Your Progress 2

1) Mention five techniques of privatisation.

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2) Distinguish between '*greenfiled privatisation*' and '*proxy privatisation*'.

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3) Define the term '*disinvestment*'.

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26.6 AREAS OF PRIVATISATION

Privatisation might be worth trying in a few cases as a means of shedding some unimportant or *low-priority activities* which need not have been in the public sector at all in the first instance; and that it might also be appropriate to try privatisation, if possible — *as an alternative to closure-in the case of loss-making enterprises* for which a package of remedial measures within the fold of the public sector is not feasible. As for privatisation as a solution to the public sector efficiency problem, it does not really solve but evades the problem: it would surely be much better to try a partial privatisation of style before attempting the privatisation of ownership.

26.7 INDIA'S PRIVATISATION EXPERIENCE

26.7.1 Disinvestment Strategy in Public Sector Undertakings in India

Disinvestment in the state owned enterprises has been adopted by both developed and developing countries during the last two decades as part of market oriented reforms. The process of disinvestment in equity was initiated by the Government of India (GOI) during 1991-92 as part of a package of Public Sector Undertaking (PSU) reform. For framing proper strategies of disinvestment of shares of PSUs, a Committee under the chairmanship of Dr. C.Rangarajan was appointed in 1993 by the Government of India. Further, Government of India constituted a five-member *Public Sector Disinvestment Commission* in August 1994 under the Chairmanship of Shri G.V. Ramkrishna for drawing a long-term disinvestment programme for the PSUs referred to the Commission. The Commission had wide ranging terms of reference and was asked to determine the extent of disinvestment in each PSU, the modalities of disinvestment and the order in which the process would be undertaken. The long-term strategy of the Disinvestment Commission had four objectives : (i) strengthen PSUs, where appropriate, in order to facilitate disinvestment, (ii) protect employees' interest, (iii) broad base ownership, and (iv) augment receipts for the government.

As a broad approach, the Commission was in favour of prior restructuring of the PSUs before disinvestment, based on global experiences that restructuring before disinvestment enhances share value and maximizes share proceeds.

The Commission was in favour of adopting a case-by-case approach in terms of unit specific disinvestment strategy after taking into account various aspects of the units, e.g., industry category, competitive position and profitability. Accordingly, the Commission broadly classified the PSUs into two categories for disinvestment. viz., *the core group and the non-core group*. The PSUs in the *core group* are defined as having a considerable market presence. In these PSUs, as the private sector is yet to mature fully, the public sector disinvestment would be limited to a maximum of 49 per cent for the time being. *The non-core group* industries are defined as the units where private sector players have already made huge investments. With the aim of enhancing the intrinsic value of PSU shares, the Disinvestment Commission recommended that the core as well as non-core PSUs should be restructured prior to disinvestment.

The Commission had made recommendations for a graded delegation of autonomy for three categories of PSUs, namely, '*general autonomy to all PSUs, additional powers to 'moderate performers and additional autonomy to strong performers*'. Further, it had made the following recommendations regarding the policy decisions to be delegated to the Board for greater autonomy of all the PSUs.

1) Professionalising the Board through outside recruitment.
2) Provisions of elected Directors to represent minority shareholders.
3) Selection of top management without having to go to the Appointment Committee of the Cabinet.
4) Rationalising salaries and incentives of top management for attracting talents.

5) Autonomy in price fixation of products and services.
6) Accountability through performance assessment at regular intervals.
7) Setting up of pre-investigation Board for evaluating projects in terms of commercial viability.
8) Strengthening the investor interface by transparent system of information disclosure.

While the above recommended areas of autonomy would apply to all the PSUs, the Boards of *'moderate performers'* among the PSUs would have additional power to transfer assets to a subsidiary and also have freedom of investment decisions subject to certain conditions. The investment limits for these PSUs could be fixed on the basis of the company's turnover and requirement of funds in the medium term. Further, the *'strong performers'* among PSUs have been recommended by the Commission to have power to form joint ventures without prior approval of the Government and have full freedom with regard to investments subject only to the condition that these projects are appraised and financed by banks or institutional lenders or where the total requirements of funds are met from internal accruals.

For granting autonomy, nine well-performing PSUs under the core category have been identified by the Government. These PSUs, popularly known as '*navratnas*', are BHEL, BPCL, HPCL, IPCl, IOC, NTPC, ONGC, SAIL and VSNL. The Union Cabinet has approved the autonomy package for these nine high performing PSUs, accounting for nearly 75 per cent of the profits of the entire PSUs, giving them total freedom to incur capital expenditure, raise resources and enter technology contracts. The Government also announced a package of financial and operational autonomy for 97 profit making public sector enterprises (called *'mini-ratnas'*) other than the '*navrathnas*'. However, the degree of financial freedom to these PSUs will be less than granted to the *'navratnas'*.

For ensuring smooth implementation, the Commission recommended the formation of a *Standing Empowered Group (SMG)*, comprising the Department of Public Enterprises, Administrative Ministry of the PSU along with the CEO of the concerned PSU. The group is intended to provide continuity to the process of disinvestment in various PSUs. However, the Disinvestment Commission has recommended only companies to be disinvested and the mode of disinvestment rests with the Government. The Disinvestment Commission has also evolved guidelines for modality of sale including retailing PSU shares to small investors and employees and selection of intermediaries that would lead to transparent and competitive procedures for disinvestment. The Commission also made specific recommendations for disinvestment in respect of a number of PSUs in its various reports. Thus, the Disinvestment Commission set the ground rules and the basic parameters for disinvestment. We can learn from experience and modify the modalities as we go along.

As part of the country's economic reforms programme, *the Sick Industrial Companies Act (SICA)* 1985 was amended in December 1991 to bring public enterprises under the purview of the *Board for Industrial and Financial Reconstruction (BIFR).* Consequently, until the end of 1998, 138 cases of sick public enterprises were registered with the BIFR. The BIFR has recommended winding up in 14 of these cases. But none of these public enterprises has been wound up so far. There have been cases of public enterprises whose control and management has been transferred to the private sector, but a substantial proportion of their equity, enough for managerial intervention, has continued to remain in the public sector. *India's privatisation experience also includes cases of complete or true privatisation, under which the control and management of a public enterprise are transferred to the private sector* (though some public sector equity holding, without managerial intervention, may continue).

A major initiative for turning India towards privatisation needs to be launched. In this context certain steps required to be taken are:

i) The people will have to be convinced that, given the extremely high opportunity costs, India cannot afford public sector misadventures in areas like, running hotels, manufacturing polyester film, making condoms and producing fruit pulp and juice). That properly belongs to the private sector.

ii) The Government should announce a properly structured and articulated privatisation policy for India. The policy will need to clearly address at least the following issues: *why privatise*?; *what to privatise*?; when to privatise?; which organization will serve as the nodal agency for privatisation and what will be its composition, powers and responsibilities? What are the institutional mechanisms that will be put in place to gain public enterprise employees' support for privatisation?; and what is the role that India would like foreign investors to play in its privatisation programme?

iii) Privatisation is a difficult process, it involves reconciling the government's political objectives and the business needs of given public enterprise and tap generate efficiencies. It will therefore be absolutely necessary to come up with training programmers designed to equip selected public enterprise managers and government officials in India with the knowledge and skills required for managing the various component of the privatisation process.

iv) The proposed initiative will address the issue of evaluating India's post-privatisation experiences. This will involve rigorous work on estimating the impact of privatisation on: (i) *efficiency and investment*, (ii*) public finance and balance of payments*, (iii) *employment*, (iv*) management practices and strategies*, and (v) *managers' skills, attitudes and behaviours*. Evaluations of post-privatisation experience along these lines may generate ideas that may help India maximize the gains from privatisation.

26.7.2 Problems Associated with Privatisation

Privatisation is not a very easy option. Problems are there and it is always not very easy to overcome them. Some of the major problems (see G.S. Gupta, 1996) are:

1) choice of PSEs for privatisation
2) opposition from employees
3) pricing of assets/or equity
4) extent of disinvestment
5) mode or preference of selling
6) political instability

These problems are very complex and it is not possible to find out an easy way out. The question of permission to be given to foreign investors, particularly in the consumer goods sector, is very difficult to decide. Disinvestment should be done, but in favour of whom? Should it be in favour of financial institutions or to be sold to general public? *If management control is retained by the Government then improvement in efficiency will be doubtful.* Sometimes, it is also feared that owing to political considerations the very policy of privatisation might to reversed. There has been sustained pressure from the organisation of employees against the policy of privatisation and disinvestment.

Check Your Progress 3

1) State in brief the disinvestment strategy as being followed in India.

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2) Make suggestions for delegation of more autonomy to PUSs in India.

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3) Highlight the major problems associated with privatisation in India.

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26.8 LET US SUM UP

Although the academic debate on en masse privatisation is still going on, the government has already made moves in that direction, since it is realised that without it the pace of liberalisation and marketisation of the economy would not attain the take off stage. Some of these are: (i) permitting the entry of the private corporate sector in such core sectors as steel, telecommunications, power, airlines, ports etc; (ii) no fresh budgetary support for public enterprises; (iii) issue of equity to the public by the identified PSUs; (iv) outright of sale identified PSUs. As the momentum picks up there is a need to formulate a comprehensive privatisation policy. The policy needs to address at least the following issues: why privatise? what to private? when to private? which organisation will serve as the nodal agency for privatisation and what will be its composition, powers and responsibilities? What are the institutional mechanisms that will be put in place to gain public enterprise employees' support for privatisation? And, what is the role that India would like foreign investors to play in its privatisation programme?

Privatisation does not remove problems from the public domain. Monopolies require regulation, can be water and electricity. The complex political interests and economic incentives within the country militate against the process of privatisation. The process of disinvestment is going on since 1991 and yet it remains more or less where it started. If meant to be meaningful, privatisation need to be pursued more systematically within a carefully designed framework of action.

26.9 KEY WORDS

Denationalisation: Mirror image of nationalisation, i.e., transfer to private control of equity hitherto owned by the state.

Departmental Enterprises: Those production units, which are organised as a department of a government.

Disinvestment: Selling of the government equity, partially or wholly, to private interests.

Government Company: An undertaking in which a government owns 50 per cent or more equity.

Sell-off: Transfer of total or majority ownership of the government in a unit to private enterprise.

26.10 SOME USEFUL BOOKS

Datt, Ruddar and K.P.M. Sundharan (2000): *Indian Economy*, S.Chand & Co., New Delhi (Chap.13)

Ganesh. G. (1998): *Privatisation Experience Around the World* (chapters 1,2 & 7) Mittal Publications, New Delhi.

Gouri, Geeta (1996): Privatisation and Public Sector Enterprises in India : Analysis of Impact of a Non-Policy, *Economic and Political Weekly*, Nov. 30.

Gupta, Anand (1996): Political Economy of Privatisation in India, *Economic & Political Weekly*, September 28.

Gupta, G.S. (1998): Privatisation : Theory, Practices and Issues, *The Indian Economic Journal*, Vol. 46, Oct.-Dec. (No.2).

Ramanadhan, V.V. (1989): *Privatisation in Developing Countries* (chapters 1, 8 and 20), Routledge, London.

Dingra, I.C. (2000): *The Indian Economy: Environment & Policy:* Sultan Chand & Sons, New Delhi (Chap.19).

Tandon, Pankaj (1997): Efficiency of Privatised Firms : Evidence and Implications, *Economic and Political Weekly*, December, 13.

26.11 ANSWERS/HINTS TO CHECK YOUR PROGRESS EXERCISES

Check Your Progresss 1

1) See Section 26.2

2) See Section 26.3

3) See Section 26.4

Check Your Progress 2

1) See Section 26.5.

2) See Sub-sction 26.5.1

3) See Sub-section 26.5.1

Check Your Progress 3

1) See Sub-section 26.6.1

2) See Sub-section 26.6.2

3) See Sub-section 26.6.3

UNIT 27 GLOBALISATION OF INDIAN ECONOMY

Structure

27.0 OBJECTIVES

As you go through this unit, you will come to understand and appreciate the implications involved in globalisation of Indian economy. This unit is expected to help you answer the following:

- Is globalisation a reality and has India been able to adopt this;
- Examine the implications involved in the process of globalisation;
- Analyse the impact of globalisation on Indian economy;
- How do different sectors prepare to face the challenge of globalisation;
- What policy measures need to be followed for globalisation of Indian economy; and
- What conditions are required to have the best possible results?

27.1 INTRODUCTION

In recent years there is no special phenomenon that attracts more attention in mass media and in the scientific public than globalisation. For nearly a decade the nation's preoccupation has been with economic reforms. The enthusiasm and the excitement over '*deregulation*', '*liberalisation*' and '*globalisation*' remain undiminished since the time the three buzzwords entered the scene. These terms are frequently used in any general discussion.The common person seldom understands the exact import of these terms but (s) he knows that they imply radical changes in life. The literate population surmises that *liberalisation* indicates a reduction of rigors in laws and procedures to permit more efficient conduct of business while *globalisation* stands for *removal of protective barriers against free flow of trade, technology and investments among countries*. It is also recognised that the insularity and sheltered culture of industry and trade have to give place to a competitive environment, which would demand basic adjustments by the population, be they manufacturers, traders, workers or consumers.

How this change is to be managed with the least pain and with maximum benefit is the major concern. There have been innumerable seminars and workshops on the three related terms in general and globalisation in particular. However, the ideas and the basic vision behind the dominant policy choices made since 1991 have not been explained in simple terms by those professing to understand the policy choices. Policy makers and seminar speakers often assume that the objectives of globalization are understood by all. They, therefore, dwell on the ways and means to achieve globalization.

27.2 GLOBALISATION AND ECONOMY

Globalisation has some very clear features (K.L. Chugh, 1992). Globalisation puts an emphasis on consumer concern and encourages competition. *It is co-operative venture, where organisations and people complement and supplement each other in the service of the consumer.* It is for this reason, that one now sees the international trend to source raw material from one country, process it in another country and then market it worldwide. As a result, globalisation helps to synergies the roles of each country. Globalisation leads to quality assurance and it is as a guarantee of their quality that manufacturers brand their products. *It means a borderless world where there is a free exchange of money, ideas and expertise, fostering partnerships and alliances to serve the consumer best.* Globalisation relies on the quality of people. No initiatives, no innovation, no solutions are possible without outstanding people. The quality and training of people, their vision and their commitment, is the very foundation of globalisation.

Globalisation is the reversal of business from a macro to a micro point of view. What matters is the contact and collaboration between individuals and firms in various countries. Globalisation is complete decentralization of location. It will internationalise human resources and remove geographical boundaries.

The policy of globalisation emphasises that export sector should form an important ingredient of the national macro-economic aggregates. When exports form an important economic aggregate, the industrial growth to a substantial extent becomes dependent upon the export sector. When industrial production is attached to the export sector, indirectly the other sectors of the economy specially banking and services sector are also integrated with the export sector. Finally, since exports are dependent on the GDP growth of the major trading partners, the domestic economy cannot grow at a rate much different from that in the world economies.

27.3 BENEFITS OF GLOBALISATION

What are the benefits of globalisation? Some of the benefits are as follows:

i) Improved resource allocation due to the presence of a competitive environment
ii) Exposure to international economies would lead to the availability of better technology, inputs and intermediate goods
iii) Transfer of know-how and economies of scale

Thus, globalisation implies a regime of perfectly competitive markets *with no entry or exist barriers*. However, the onset of such an environment is not without fulfillment of certain preconditions on the part of the corporates – *global vision and global capability. Global vision* implies that the corporate should have the ability to analyse the dynamic competitive environment and should be able to develop superior strategies in a way, which is relevant to the new global opportunities, i.e., should have the vision of analysis and leadership.*Global capability* attributes, on the other hand, are reflected in the ability to amass and deploy productive human, technological and financial resources at the right time and at the right place.

27.4 GLOBALISATION AND INDIAN INDUSTRIES

The road to globalised markets has only fast tracks. There is no lane earmarked for leisurely traffic. This is a primary factor to be understood. When the country opens up its markets and invites new investors and new technologies from abroad, proven suppliers can come in with their quality goods, technologies and services at competitive prices. There is thus *an anxiety that globalisation would become a one-way traffic, with imports flooding the local market, and throwing the indigenous industry and workers into misery*. However, given the fact that Indian industries have absorbed modern technologies and some quality standards over the past five decades, they have the requisite strength and resilience to face the immediate challenges of globalisation. What is needed is strategic planning to fully tap the existing strengths and meet the initial pressures. In any case, *the question today is not whether globalisation is inevitable, but how to tailor the method to fit each business when it embarks on globalization.*

One must turn the spotlight on *the information imperatives for global competitiveness.* Indian industry and business need to be on top of the corpus of information on a whole range of subjects such as product preferences, technology choices, price trends, rivals' strengths and weaknesses, and investment sources. Without such mastery, no business enterprise can successfully aspire to a razor-sharp competitive edge, which alone can assure it a recognizable market presence, let alone an unshakable market dominance.

Inevitably, companies have to spruce up all aspects of operations, in terms of technology and design, material procurement, manufacturing processes, quality levels, finance techniques and dynamics of marketing for export promotion taking fair advantage of the liberalised environment provided by the government. Effective managerial information and control systems are essential for improving in house efficiencies and for quick assessment of the external market opportunities. Timely decisions and responses from delivery dates, assured quality norms, pro-customer policies and above all, a goal orientation, are needed to succeed in global pursuits.

Productivity has to improve in all areas of management and the entire work force should wake up to the new realities through meaningful counselling and HRD techniques. A new sense of urgency to scale higher targets needs to be created in each employee and executive.Reduction in prices based on cost control and waste elimination could bring in more orders and larger profits on enhanced turnovers. This is how countries like Japan emerged world market leaders.

Competition has been the driving force for progress. A thorough reshaping of attitudes and redesign of work methods is imperative to bring in a totally new culture of activity and achievement. Each manager and supervisor has to lead by example, rather than by precepts, to prove that every new target can be achieved. Recognitions and rewards for meritorious performance in all cadres should serve as an incentive for better productivity.

Policies of trade and investment liberalisation have a crucial role to play in providing an outward orientation, which will impose external audit on the domestic cost structure. Marketing strategies will have to be evolved which should take account of the global economic restructuring that is going on in the world today. Marketing strategies suited to every target country relative to its tradition and culture should be evolved and modified from time to time for achieving results. Flexibility and effective local liaison should form the core of the strategies. It is in this context the following three points are important:

i) *Making India the premier production centre of the world.* In several sectors, particularly in *agro-based industries*, India has the skills and the investments, which make it the lowest cost producer in the world. These investments can easily obtain a share of the world market and all that is required is to develop alliances with partners overseas and support it with a national policy for each sector.

ii) Indian corporations to go into world markets and to become India's "multi-nationals abroad, with markets, and later, production centres spread across the globe. Here again, India has a natural advantage in certain sectors such as the *knowledge-led services and wide range of agricultural, industrial and fashion products*.

iii) *Attracting foreign investments* to make India their home base for their world markets. India has amongst the *world's largest trained manpower, including farmer and scientists, engineers and professionals, entrepreneurs and skilled workers*. The cost of people is much lower in India than in the developed world and provides a significant competitive advantage to India.

The introduction of *full convertibility of rupee on current account* will greatly accelerate not just foreign investments in India, but also the export-import trade.

If India succeeds in attracting foreign investment, particularly in the area of infrastructure, then it would be possible for the government to re-invest into the rural sector. This will have its own beneficial impact on the total economy, as India's prosperity is entirely dependent on the rural, farm economy. This will help to usher in a *second green revolution in the country*.

To successfully participate in the world economy, *India needs to build strategic alliances – not just between trading blocks, but between corporations; and not just between foreign partners and India but partnership within Indian industry itself*.

Check Your Progress 1

1) What do you mean by globalisation?

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2) What is the implication of globalisation for an economy?

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3) Highlight the implications of globalization for Indian industry?

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27.5 POLICY CHANGES SINCE JULY 1991

Globalisation presupposes two things — *political will at the macro level which is reflected in various policies pursued by the government and corporate will at the micro level which is established by the existence of a global vision and capability*. The government has moulded its policies. In this regard, one can take a look at the following policy changes:

i) *A two stage devaluation* of the rupee by about twenty percent in July, 1991 in an attempt to align the exchange rates with the world exchange rates and provide additional incentives to the exporters to offset some of the disincentives arising out of the import barriers.

ii) Introduction of a system of *partial convertibility* of the rupee under the *liberalised exchange rate management system (LERMS)* and then allowing full convertibility of rupee on current account.

iii) *Foreign direct investment (FDI)* has been liberalised and now the foreign investors are allowed to participate upto 51 per cent, 74 per cent, and even 100 per cent of the equity of select industrial sectors.

iv) The list of products requiring import license has been pruned which shows that *physical controls are given way to fiscal controls* (all *quantitative restrictions* are removed by April 1, 2001)

v) Import duties have been reduced.

vi) Import of *capital goods* has been allowed without any specific licence if the payment for the imported capital goods is made out of foreign exchange received for the purpose of equity participation.

vii) *Decentralization* of several items has taken place and those items, which were initially under the purview of government agencies, are now being opened to private companies.

viii) *Foreign institutional investors (FIIs)* are given permission to invest in the Indian capital market. In fact, SEBI has already recognised several FIIs for this purpose and they have started making investments also.

ix) Guidelines have been issued for the floating of *Euro* issues by the Indian companies.

x) A major step towards globalisation has been to amend the Foreign Exchange Regulation Act, 1973 (FERA), which substantially dilutes its regulatory provisions to bring it in line with the new liberalised industrial, trade and exchange rate policies. The Act has removed a large number of restrictions on companies with more than 40 per cent non-resident equity and removed FERA controls on Indian firms setting up joint ventures abroad. The amendment also incorporates into law all the changes, which have so far been made by issue of notification by the RBI or the central government. These changes pertain to facilities extended to FERA companies on the appointment of technical and management advisors, opening of branches, acquisition of immovable property by FERA companies in India, borrowing of money or acceptance of deposits by them etc. Also, in an effort to rationalise the Act, about a dozen sections of FERA, 1973 were deleted as these had lost relevance over time. (As a matter of fact FERA 1973 itself is repealed and in its place a new liberalised legislation has been enacted which is known as *"Foreign Exchange Management Act (FEMA")*.

xi) Guidelines have been specified for setting up of Indian Joint Ventures Abroad (IJVA), which would enable 90 per cent of the proposals to be covered through the automatic approval route. The main objective here is to liberalize Indian equity investment in joint ventures and wholly owned subsidiaries abroad as well as to simplify the procedures for investment abroad by the Indian parties.

xii) Automatic permission is given for foreign technology agreements upto certain ceilings covering the high priority industries.

xiii) Foreign technicians can now be hired by Indian companies without prior approval of RBI if certain conditions are met.

xiv) *The foreign investment promotion board* (FIPB) has been instituted to facilitate and promote foreign investment.

These measures establish the fact that the government is indeed serious to help the industry globalize. The industry, on its part, is becoming more and more receptive to these structural reforms. The industry has responded by opting for *industrial tie-up as a threshold to building a global strategic presence*. Thus, there is a wave of multinational corporations (Macs) entering the Indian market and Indian businessmen too are fast setting up shop on the foreign shores.

To survive the threat of global competition, *Indian companies have no choice other than to restructure their business.* The way to tackle this would be to understand the *need for change* (the way?), *the paradigm shift required* (the what?), the implementation process (the how?), and prioritisation of the problems awaiting solutions (what is next?).

27.6 GLOBALISATION OF FINANCIAL MARKETS

India has been making use of the international financial markets. Exchange rate and interest rate movements now constitute the key variables. The volatility of exchange rates has turned out to be both a proximate cause and effect of capital movements. This in turn has made them autonomous variables not directly related to movements in the real sectors of the economies concerned. Another aspect of the vulnerability results from the quick transmission of impulses generated in one leading market to others. Today, *financial markets are global in scope; where the distinction between money and other financial assets is not so clear cut and indeed there is continuum of liquidity; where the line of distinction between financial intermediation by the banking system and other non-bank intermediation is also getting blurred; and as a corollary of this where financial institutions themselves are losing their specialist character*. Their wide geographical coverage is matched by wide functional activity against the background of increasingly intense competition.This has meant better opportunities both for the players in the international financial markets and those that transact business with them. Never have the world financial markets been *so integrated and offered so wide a variety of services.*

India is affected by trends in capital movements, exchange rates and interest rates. A more liberal domestic financial sector would be better able to interact with international financial markets. India has only been reacting to events abroad, i.e., *India remains 'events takers' rather than 'events makers', but even so, there is need for providing for a measure of structured rather than ad hoc response to external events.* This is also a matter of determining the rational sequencing pattern of increasing its markets' linkages with the international markets.

A cautious and step-by-step approach in terms of a well thought out framework of such linkages is called for. While Indian financial institutions and business should gradually and in a structured way get into the operations of the international financial markets, globalisation of the Indian financial sector is indispensable if it has to become efficient, vibrant and truly competitive in the years to come. *The process of globalisation involves two distinct challenges: (i) technological upgradation through computeriation, and (ii) establishing and forging links with international financial markets*. The Indian financial sector has been a late starter in mechanizing and computerising its operations. Regrettably, introduction of new technology is rather slow. What is even worse, the installed hardware does not seem to have been utilised to its full potential. This unfortunate state of affairs must end. *The Narasimham Committee has endorsed the view of the Rangarajan Committee on computerisation*. At the economic policy level, the issue of forging links with the international financial markets is closely intertwined *with interest rate deregulation and convertibility of the Indian rupee.*

27.7 PROBLEMS OF GLOBALISATION

An outward looking or globalisation policy carries a price, as it demands certain constraints on the formulation of national policies. These constraints are:

i) The international economic environment has qualitatively changed. When the industrialised countries are subjected to economic fluctuations, the dependent developing countries will have to bear these economic shocks.

ii) There is a relationship on the one hand between investment made for export-output and income generated via the multiplier, and on the other hand between income generated and imports via propensity to import. This problem stems from the fact that income multiplier effect in a developing economy is higher than in a developed economy due to a higher marginal propensity to consume. Consequently, demand generated is also relatively higher in the developing economies than in the developed economies. This rise in demand, under certain given conditions, will push up the domestic price level and if marginal propensity to import does not recede, it will further lead to higher imports to the extent that proportionate rise in imports may exceed proportionate rise in exports and thus the trade balance is shaken.

iii) The formation of a trade block in North America that has given rise to free trade between the US and Canada has created a new situation. With this, cartel like conditions will prevail on the demand side in these markets whereas *competition amongst the suppliers, intra-country and inter-country, will continue.* It is in these changed market conditions that India has to adjust itself. *Thus, not to speak of pushing up its share, even survival will prove a gigantic task for India*. In view of this, a better course for India will be not to rely too much on an export-led growth under the existing world scenario.

In this market oriented world there is no *godfather* who may come to India's rescue without asking for its pound for flesh.*Globalisation is perhaps irreversible. Success comes to those who learn to live dangerously. At best one can moderate the pace of globalisation. But globaliation is a conditional boon. One must put one's own house in order or at least mismanage it much less to get the boon working. India's options are limited*. One of them is to let the rupee fall freely. If the rupee depreciates, then the expectations of capping prices through imports would also be punctured.

The existing framework of global governance is weak, ad hoc and unpredictable, with international economic decision-making dispersed over numerous institutions, which are mostly dominated by the rich countries. Continued inhospitable international economic environment will frustrate the developing countries' determined efforts to end stagnation through *liberalisation, market-oriented reforms and outward-looking policies. Denial of access to markets, debt burden, inequities in global monetary, financial and trade systems, barriers to transfer of technology, dwindling flows of concessional resources, reluctance of foreign direct investment to flow to developing countries are making quantum jump from stagnation to sustained growth almost impossible.*

Domestically, there are several problems and issues, which act as hurdle towards global integration. These are : (i) *gross inequalities in income*, (ii) *poor infrastructure*, (iii) *lack of research facilities*, and (iv) *the problem of bureaucratic set up.*

According to Professor, P.R. Brahmananda (1993*) the economies are being asked to perform functions assigned to market systems without the requisite infrastructures* in storage houses, communication framework, trading establishments, organised stock exchanges, future markets, banking and financial institutions with branches, employment exchanges, commercial news-papers, advertisement media etc. Thus, *the transformation of the market has been sought to be achieved in a vacuum. Private property in land, capital and financial assets etc., has yet to be established universally. The information basis for a market economy is virtually absent. The state is simply divesting itself of its functions without compensating new institutional arrangements. Capitalism cannot be established without capitalist institutions and a legal framework.* Consequently, the transaction costs in the transitional processes have risen enormously, and great profits are being made by informal financial trading and information intermediaries. Consequently, the underlying basis for elastic supply schedules in various relative production lines has not come to exist.

The institutions such as IMF, World Bank and WTO are emerging as the watchdogs and monitors of developing countries on behalf of the developed. The loans are sources of additional demand for the products of the developed. The pressures on the moving down of exchange rates of the borrowing countries will be stronger. Further, there will be strong pressures to make the developing countries bring down the import duties and to free domestic markets.

Internationally, the point of worry is that major economies of the world are going through a major recessionary phase and are increasingly turning inwards in an effort to balance their domestic and international priorities. Thus, even they continue to preach the articles of globalisation and opening up to the world, they themselves are forming closed trading blocs, *NAFTA, Paciffic Basic Trade Bloc*, being a few such examples. Thus, there are both, opportunities and hurdles in the entire process. Whereas the domestic ones can be overcome by the necessary reforms, the trade policies and structural movements towards opening up may be slowed down by the protectionist polices of the industrial countries.

According to Uncial's Trade and Development Report (TDR) 1997, *the invisible hand (market) now operates globally and with fewer countervailing pressures.* It has sounded out a wake-up warning to countries that their faith in markets and economic openness could be overwhelmed by political events, since evidence is mounting that slow growth and rising inequalities are becoming more permanent features of the global economy.

The policy efforts of developing world should be accompanied by an accommodating global milieu. But, among the asymmetrie of globalisation is the fact that liberalization of the world economy has proceeded so far in a lop-sided way that tends to prejudice the growth prospects of developing countries by discriminating against areas in which they could achieve comparative advantage. Thus, *liberalisation of trade in goods has proceeded more slowly in those sectors where developing countries are more competitive. Major trading blocs continue to protect their agricultural sector.*

New forms of protection against exports of manufactures from the South are being sought as a remedy for labour market problems in the North. While many curbs have been lifted on the freedom of capital and skilled labour to move where it is best rewarded, no attention has been paid to abolishing many restrictions on the freedom of movement of unskilled labour.

Ultimately global efforts to help developing countries could still come to nothing if the slowdown in economic growth in the North is not reversed. For a return to faster growth, the policy of full employment is not only a pre-requisite for resolving the twin evils of high unemployment and increasing wage inequality in the North, but is also essential for defusing the threat of a population backlash against globalisation, which might put the gains of global economic integration at risk.

Check Your Progress 2

1) Highlight the implications of globalisations for Indian financial markets.

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2) Mention three problems associated with globalisation.

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27.8 EFFORTS REQUIRED FOR GLOBALISATION

While globalisation has arrived in the world, most organisations are still not ready for it. Yet, there is little doubt that to be viable during the next century, all organisations whether domestic or international, will need to become more global in their outlook, if not in their operations. The global organisation is a consequence to several new and sophisticated forces that have come to shape the world economy over the last decade. These are: (i) aggressive and massive financial accumulation and relatively free-flowing resource turner; (ii) well-defined and efficient communication channels; (iii) information transfer and control systems; (iv) technology development and application that seek both leading edge and low-cost product creation and production and clear recognition of the potential for mass markets, mass customisation, and (v) global trends.

A joint industry-government working group set up by the Ministry of Commerce has recommended that the country should undertake corporate sector type advertising campaign in major international markets in order to improve the international image of Indian industry and goods and services. It suggested a two-step promotional strategy, beginning with a focus on image building for the country as a whole to combat its adverse image, followed by specific campaigns aimed at generating trade and investment flows.

The expansion of international trade and the rapid growth of products and services out of India will be enormously assisted *if the image of India is improved by a special, sustained and co-ordinated effort by government and industry working together. Many developing countries like India do not have strong reputations. It is therefore imperative to build credibility among a targeted group of buyers and investors.*

In this context, twelve different promotional techniques used by other countries have been advocated by the working group. These are: (i) advertising in the general economic media, (ii) participation in trade fairs and exhibitions, (iii) advertising in sector specific media, (iv) trade missions to select countries, (v) general information seminars on trade and investment opportunities, (vi) direct mail campaigns, (vii) industry or sector-specific missions to select countries, (viii) sector-specific seminars, (ix) firm-specific research followed by sales presentations, (x) provision of trade and investment counselling services, (xi) speeding up the processing of applications, and (xii) provision of post-investment and post-trade services.

Moreover, while a host of bodies such as the Ministries of commerce, external affairs and finance, and several chambers of commerce are involved, there are no national coordinated efforts. Therefore, promotional work should be entrusted to an agency owned and funded jointly by the government and industry. However, it should function outside the purview of normal civil service rules and practices, should perhaps be a registered society, and *"should be run as a non-governmental, private sector organisation with a work culture different from government"*.

It may be emphasised that the organisation must be staffed by multi-disciplinary professionals, drawn not from the government but from the private sector.

"Essentially, a small, compact, fast moving group of people, led by a dynamic leader with task of promoting India internationally. As the international orientation of the Indian economy and Indian industry increase, it becomes essential for Indian industry to take care of details. Sustained efforts over a period, therefore, become necessary to build credibility. With this as the objective Confederation of Indian Industries (CII) has drawn up a list of *"Do's and Don't"* for Indian industry to assist companies to deal effectively in international trade.

In justifying the structural reforms that are being introduced in the Indian economy, the advocates of these reforms have brought the question of competitiveness to the centre of the discussion. Their argument runs as follows: The Indian economy needs to be integrated to the world economy. Globalisation requires that the Indian producers be competitive in the global market. It is only through these reforms that they can acquire the competitiveness and, therefore, the reforms are essential pre-requisites for successful globalisation.

Globalisation has of late become an objective in itself. This is both dangerous and ludicrous. *Globalisation should not be considered a goal in itself and that it was merely a means to the ultimate aim of improvement of the economy*. This simple objective needs reinforcement among the experts if the avoidable pitfalls of an economy in transition are to be avoided. Transition is a word that triggers both unease and heightened expectations. It is very important for us to cope with the unease if we are to satisfy the heightened expectations of nearly a billion people. The strengthening of the internal economy was a pre-requisite for a globalising economy. Given the ultimate aim of globlisation and given the pre-requisite for a globalising economy, the ultimate aim of improving the economy appears to be both the means and the end. This simplification without the use of expensive-sugar-coated words is the right approach to addressing the unease and the positive expectations.

The theoretical elegance of globalisation has its own attraction. It may help India to find some partial explanations for success and failure by systematically analysing the ability of a small set of firms to manage change. *But India needs practical and profitable applications that would be relevant to the large set of firms and individuals.* It needs consistent policies that can help to upgrade India's position in international competition in a substantial and enduring way. Towards this, *India needs to find out what it is good at so that it can better achieve the best possible*. The process of finding out what India and its firms are good at is yet to be put into motion at the national level and all the talk about globlisation is at best wishful and premature. Globalisation requires both static efficiency and dynamic efficiency, more of the latter than the former, and India is at a stage when it is unsure of economy's static efficiency. A nation that is unsure of static efficiency is least equipped to pay for the dynamic extra options that are essential to guarantee success. The power blackouts in the states are an example of unsure, unreliable static efficiencies.

Check Your Progress 3

1) Mention five new forces that shape the world economy.

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2) Mention a few promotional techniques that need be adopted by India.

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27.9 LET US SUM UP

India ought to know what it is good at before embarking on what it needs to be good at in order to reduce the unease and sustain the expectations of a prosperous future. A prosperous future is predicted on the competitive advantage of firms in all sectors of the economy. The basis of competitive advantage in many sectors and industries, each seemingly distinct, depends on a set of critical elements common to a range of sectors. The set would obviously include transportation facilities, trained labour, energy, education and health. This set is indisputably at the heart of the economy. Its static efficiency needs to be improved. This is a prerequisite for sustaining and expanding the technical possibility set. Globalization would then be a clinch.

"Behind the cost of production of every commodity, there is a story. It may be a story of innovation, technical progress and modern labour process, or it may be one of sweated labour, primitive labour process and pollution. By putting a price sticker on all commodities, the market suppresses these stories, and thus hides more than it reveals. It is like one of those dark nights in which all horses appear gray. No country today can live behind closed doors. Third world countries therefore must globalise. But while attuning the economy to the needs of the global market, it should be kept in mind that globalization does not generate the process of development, it is the latter that leads to, and in turn is reinforced by, successful globalisation. Unless the process of development which is basically a highly localised process – successfully triggered off, globalisation may lead to the classification of the structure of underdevelopment, instead of causing its dissolution" (*Kalyan K. Sanyal, 1993*).

It is interesting to note that the Nobel Laureate Professor Amartya Sen support removal of government control over industry and commerce and even endorses globalisation provided welfare is not ignored. He admits unhesitatingly that with the initiation of the right kind of policies, globalisation would secure more prosperity.

27.10 KEY WORDS

Backwash Effects: These operate where the economic growth in one region of an economy has adverse effects on the growth of other regions.

Common Market: An area, usually combining a number of countries, in which all can trade on equal terms.

Exchange Rate: The rate at which one currency may be exchanged for another.

Financial Capital: The liquid as opposed to physical assets of a company.

Public Utility: Essential good or service like power, gas, transport etc. A company or enterprise, which is the sole supplier of some of these essential goods or services and is, in consequence, subject to some form of government control.

Trade Blocs: Association of group of countries for safeguarding their interest vis-à-vis other non-member countries, like European Union (EU) and North America Free Trade Agreement (NAFTA), ASEAN, APEC etc., are some of the example of such trading blocs. Members of these trading blocs have eliminated all barriers to trade amongst member countries. The 15 members of EU have created a single internal market.

27.11 SOME USEFUL BOOKS

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27.12 ANSWERS/HINTS TO CHECK YOUR PROGRESS EXERCISES

Check Your Progress 1

1) See Section 27.2

2) See Section 27.2

3) See Section 27.4

Check Your Progress 2

1) See Section 27.6

2) See Section 27.7

Check Your Progress 3

1) See Section 27.8

2) See Section 27.8

UNIT 28 ECONOMIC REFORMS AND SOCIAL JUSTICE

Structure

28.0 OBJECTIVES

After going through this unit, you will be able to answer the following:

- What were the most serious problems facing the Indian economy since the beginning of 1990s;
- How did the new government, which assumed office in June 1991, perceive the immediate task;
- What was the rationale behind change in the direction of economic policy;
- What is the content of new economic policy package;
- What has been the relative importance attached to the different aspects of policy;
- What has been the pace and progress of reform process; and
- Are the economic reform measures more responsive towards social justice.

28.1 INTRODUCTION

There is a feeling that the Nehruvian development model was wrong. Socialism has failed because it could not generate wealth on a sustained basis. Yet, basic socialist concerns about poverty and inequalities have still not disappeared. India's basic objectives have not changed but the need to change the strategy of growth has been increasingly accepted.

There is a passive consensus in favour of the strategic shift in the development strategy. So the real question in the process of environment reforms is not the "*sterile debate*" between "*the state and a pure market*" but the question of "how to manage the transition (i) from excessive to reduced state intervention; (ii) from intervention in the wrong areas to those in previously neglected important ones; and (iii) from one form of reliance on quantity controls to another form (reliance on prices) of policy".

The strategy of self-reliance based on import substitution followed so far has to be combined with the strategy of export promotion. The first phase of rapid industrial growth, from the 1950s till about 1965, was characterised by government stimulus in the form of public investment. The boom of the 80s was supported by public consumption in the form of government expenditure. This was not sustainable and resulted in the government slipping into a fiscal crisis and the economy suffering from balance of payments problems. But the basic point is that all the expansionary phases have so far been either based on public investment or public expenditure. The economic reforms and policy changes in India have focussed on two methods of increasing the aggregate demand:

i) private investment-led, and
ii) private consumption – led expansion, including exports.

There has been a lot of debate on the behaviour of private investment- domestic and foreign – in the context of reforms. Economic reforms reflect *a review of the role of Government, or more general of the State vis-à-vis the market.* By early 'nineties' most, if not all, economies have launched on a policy of redefining and reducing overall the role of the State. This phenomenon clearly signifies the new trade-off between *'State failures' and 'market failures'* or what may be termed as the new realities in the relationship between the State and the market.

28.2 PROBLEMS FACED BY THE ECONOMY IN 1990

Before considering the various steps for restructuring the economy, it is important to be clear as to what were the most serious problems facing the Indian economy in 1990. Consider the following:

1) A large *fiscal deficit*, the underlying cause of which is *expenditure outpacing revenues*.

2) A huge *foreign debt*, with a high debt-service ratio, and debt-exports ratio, which caused a downgrading of the country's credit rating and serious repayment problems.

3) *Low levels of efficiency economy-wide*, which result in huge wastage of resources.

4) More contemporaneously, *a recessionary situation in the industrial sector,* stagnant agricultural output and poor growth prospects in the economy as a whole, coupled with a *serious inflationary problem*.

The situation that the nation and the economy had to face in mid-1991 was grim. The balance of payments situation had deteriorated so sharply and the foreign exchange reserves had fallen so low that the possibility of default in payment was imminent. On the domestic side while the Indian economy had done extremely well in terms of real growth between 1985 and 1990, the fiscal situation had also deteriorated sharply. The *budget deficit* as well as the overall *fiscal deficit* had sharply increased contributing on the one hand to large increase in money supply and on the other, to sharp increase in interest payments. Fiscal deficit of the centre and the states taken together, which was about 7.5 per cent of the GDP in the late 70s, had increased to about 11 per cent by 1991. The fiscal deficit of the Central Government alone which was below 6.0 per cent in the late '70s had increased to 8.5 per cent by 1991. Consequently, interest payments in the Central Government's budget had become the single largest expenditure item rising from 2 per cent of GDP in 1980-81 to nearly 4 per cent of GDP in 1990-91. The country thus entered during the '90s with a fiscal deficit that was simply unsustainable.

28.2.1 Need for Economic Reforms

The reforms were imperative for the following reasons:

1) The *downgrading of India's* credit rating made commercial loans difficult.

2) *Funds flow from west Asia dried up* following the Kuwait crisis, there were large withdrawals of NRI deposits during the early part of 1991, and foreign direct investment was low.

3) *Aid for poorer countries was getting scarce* because of larger claims by the former Soviet states and increased demands in the United States for domestic spending. Compulsions of efficient use of aid made the case for reforms stronger.

4) Following the collapse of old attitudes worldwide and the emergence of a global market, India had no *other alternative but to initiate economy policy reforms.*

However, reforms cannot be wholly attributed to these economic compulsions. The necessity for macro-economic reforms had been steadily gaining credence in the 1980s. The control system under the *'permit raj'* had become unpopular. The timing was, therefore, ripe for an assault on the system and would be greeted with a sense of relief. It is well known that structural adjustment involves hard choices. The choices are described as being hard because they often have implications that find disfavour with the populace at large, at least in the short run.

For the Indian economy, 1991 was an *epoch-making year*. Bold measures were taken to resurrect the economy from the brink of a fiscal and balance of payments crisis. Sweeping market-oriented reforms in industry, foreign trade and investment were introduced to liberalise the economy from the shackle that were binding it for decades. The crucial test for its success is : *does it create conditions for durable growth*? The crisis underlined the need to set in motion *a series of structural changes in trade, industry and finance sectors* so as to provide the necessary springboard for the economy to take off for self-sustaining growth.

28.2.2 Objectives of Economic Reforms

When the Congress government headed by Mr. P.V. Narsimha Rao assumed office in June, 1991 the task before it was two fold:

1) to restore macro-economic stability by reducing fiscal and balance of payments deficits, and

2) to complete the process of economic reforms, i.e., structural adjustment which have for the preceding ten years been conducted on a partial basis, gradually and intermittently.

The announced aims of the current economic reforms strike a revolutionary note. Reforms intended to achieve the following:

1) *stabilisation and macro-economic balance* through fiscal, monetary and exchange rate policies;

2) *a liberalised trade regime with no import* licensing and tariff rates comparable to other industrialising developing countries;

3) an *exchange rate system* which makes the rupee convertible, at least for current account transactions of the balance of payments;

4) a *competitive financial system* with sound regulations;

5) an *industrial sector free of many controls*; and

6) an *autonomous, competitive and streamlined* public enterprise sectors.

There is a common thread running through all these measures. The objective is simple and that is to improve the efficiency of the system. The regulation mechanism involving multitude of controls has fragmented capacity and reduced competition even in the public sector. The thrust of the economic reforms or *New Economic Policy (NEP)* was towards *creating a more competitive environment in the economy as a* means to improving the productivity and efficiency of the system. This is to be achieved by removing the barriers to entry and the restrictions on the growth of firms.

28.3 THE ECONOMIC REFORMS PACKAGE

It is important to understand clearly what the economic reforms package was and equally important what it was not. Economic reforms can be briefly summed up as a package consisting of three separate sets of policies: (Arun Ghosh, 1992)

i) The *stabilisation of economy* meaning thereby, bringing into balance the aggregate demand and supply, the imbalance being in the main caused by large and endemic deficits in the Central Government's budget during the 80s, which got reflected in the spiral of inflation at home and deficit in external payments abroad. The policies adopted in this context relate to budgetary and credit policies.

ii) A *restructuring* of the Indian economy with a view to making Indian industry internationally competitive. The policies adopted in this context range from industrial and foreign trade policies to issues like the lending policies of financial institutions (including banks), the pattern of government expenditure and public investment, including the policy relating to the public sector, and the approach on sick units and in regard to *subsidies generally and the subsidisation of small business and farms in particular.*

iii) *The globalisation of the Indian economy*, throwing open, in stages, the import of all commodities including consumer goods, reducing the customs tariffs, allowing free inflow of foreign capital (including short-term capital), opening up the service sector to foreign capital, especially in the matter of banking, insurance and shipping and full convertibility of the rupee.

28.3.1 Implications of Reforms

According to Dr. Arun Ghosh the three pronged approach has major implications for the functioning of the economy and its future direction. They imply a complete and a sudden break from the past, and several issues arise relating to:

a) the *desirability of the pattern* of development sought;

b) the *timing of the various policies* and, more importantly, their sequencing (and in fact the wisdom of the frequent changes in policy which has the effect of creating uncertainties in the Indian economy);

c) the relative importance attached to the different aspects of policy, in as much as domestic *priorities relating to the* provision of education, health and employment, globalisation of the economy; and

d) the likely impact *of the package of policies* .

It must be noted that while the *stabilisation policies* are intended to correct the lapses and put the house in order in the short term, *the structural reform* was intended to accelerate economic growth over the medium term. Structural reform policies cannot succeed unless a degree of stabilisation has been brought about. But stabilisation by itself will not be adequate unless structural reforms are undertaken to avoid the recurrence of the problems faced in the recent period. Structural reforms were broadly in the area of industrial licensing and regulation, foreign trade and investment, and financial sector. In relation to foreign trade policy, the aim was to liberalize the regime with respect to imports and try to bring about a closer link between exports and imports. Yet another objective is to reduce the tariff rates. As regards import duties, the policy has been gradual and the tariff rate in India has been progressively reduced in order to avoid a high cost economy. As regards foreign investment, the new policy measures certainly make a break with the past. Regarding exchange rate devaluation of the rupee, the Exim Scrip Scheme, partial convertibility scheme, unified exchange rate and the subsequent full convertibility on current account are essentially intended to ensure that the import growth is not out of tune with exports.

28.4 PROGRESS OF ECONOMIC REFORMS

What *has been the content of economic reforms*? We present below a list of major economic policy decisions announced so far since the programme initiated.

1) Devaluation of the Rupee: Approximately 19% in two quick stages.

2) Trade Policy Reforms: Export subsidy abolished. EXIM Scrip introduced but then replaced with a so called partial convertibility of the rupee on trade account (the 40:60 formula), unified exchange rate, and full convertibility of the rupee on current account since August, 1994.

3) Industrial licensing scrapped except for 6 industries primarily those of strategic importance, or producing hazardous goods.

4) The whole chapter in the Monopolies and Restrictive Trade Practices Act, which was ostensibly meant to curb the concentration of economic power, is scrapped.

5) The convertibility clause abolished. This clause hitherto enabled the term-lending financial institutions to convert industrial loans into equity at the price and time chosen by the lending institutions.

6) Substantial liberalisation of rules and procedures for foreign private investment. Foreign Exchange Regulations Act (FERA) liberalised to allow 50% equity participation in most industries; the FERA has now been to be replaced by Foreign Exchange Management Act (FEMA).

7) The exclusive domain of the public sector has been pruned. Only five industries are now reserved (i.e., Defence related industries, Atomic Energy, Mineral Oils, Mining) for public sector. But the private sector is welcome to apply even in respect of these. Besides, partial privatisation of some of the profit making public enterprises has been initiated. Thus, the steps taken regarding PSUs pertain to: (i) limiting public sector to strategic, high-tech and essential infrastructure; (ii) referring sick PSUs to Board of Industrial and Financial Reconstruction (BIFR), (iii) disinvesting a part of the shareholding of the PSUs, (iv) granting greater autonomy for PSUs through the instrument of Memorandum of Understanding (MOU); and (v) to develop a *safety net* for workers who are likely to be retrenched as a result of measures to close down sick units or rationalisation of the staffing pattern of PSUs.

8) The problem of *black money* started being attacked at the root; some measures adopted to curb the generation of new black money (the flow), some others to mop up the black money generated (stock) for productive purposes.

9) Fiscal policy reforms: (a) resolved to cut on government expenditure; (b) reduced

rate and simplification of individual income tax, corporate tax, excise and customs duties.

10) *Financial Sector Reforms* initiated so far are: (a) mutual funds allowed in the private sector; (b) foreign institutions like pension funds permitted portfolio investments in Indian companies; (c) deposit interest rates liberalised; (d) for the first time ever the SLR (the Statutory Liquidity Ratio) is reduced, and that too drastically; banking sector thrown open to private enterprise; insurance sector also opened to private enterprise.

11) Steel industry deregulated.

12) Policy announcement was made regarding small and tiny sector.

13) Reforms in Gold Policy was introduced; imports of gold allowed under baggage rules.

14) Substantial de-compression of imports, with only a short negative list to become shorter.

However, it must be noted that the process is by no means complete. The unfinished tasks are numerous, and can be divided into three broad categories. They are: (i) whatever has been done is only the start. The process needs to be carried further and consolidated in each of the above areas; (ii) *there are several areas, which have not been touched as yet,* and (iii) the introduction of reforms has brought to surface some relatively *unanticipated problems* that need to be considered and addressed.

Altogether, the above package constitutes a sharp turn-around in policy thinking compared to the *license permit raj* built up during the 1960s and 1970s. Some measures were taken to relax controls during the late 1970s and 1980s but these moves were a pale shadow of what is underway now. Observers of the Indian scene were very impressed by the dispatch with which government issued one policy statement after another. This speed of taking decisions was indeed remarkable. If, however, relevant policy moves are assessed against what is required to be achieved under the fundamental aims of the reforms, then the record of policy decisions does not appear to be all that impressive. What has happened so far is surely a good start but it leaves many gaps to be filled up. The agenda of issues, which will have to be tackled, is very long indeed.

Check Your Progress 1

1) Write four problems faced by the Indian economy in June, 1990.

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2) What were the reasons for adopting economic reforms in India?

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3) What do you mean by economic reforms package?

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4) Examine the progress of economic reforms in India.

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28.5 ECONOMIC REFORMS AND SOCIAL JUSTICE

The important consideration is not whether the economic reforms measures are anti-poor or not, but whether they are in fact "*pro-poor*". In other words, is there an explicit "*equity*" dimension to the economic reforms or is the "humane face" merely an attempt to neutralise the negative impact that the reform measures would have on the extant structure of income and asset distribution? The very fact that the social sector spending policies, including the creation of the *National Renewal Fund (NRF)* for retrenched workers, is defined as a "*safety net*" such policies are meant to compensate for equity losses and would not necessarily improve the existing structure of incomes and asset inequality in the country.

There are areas in which government intervention is specifically required to ensure that apart from efficiency gains, the economic reform measures would have a positive impact on equity as well. These areas are: (i) employment, (ii) food security, (iii) health, (iv) education, (v) technology, and (vi) environment. While "*equity*" is not an explicit goal of the economic reforms measures, it is necessary that this is so and a clear definition of what equity should imply in the Indian context should be developed.

Another important consideration relates to the fact that while we are assessing the social impact of the reforms measures, a distinction be made between the direct "*transitional costs*" of reform measures in terms of equity losses, and the already pre-existing equity loss that occurs due to the inequitious nature of the extant economic regime. One should not confuse between the inegalitarian consequences of the existing social and economic order and what might be the specific product of the economic reform measures.

In measuring government's support for greater equity, it would not be correct to look only at budgetary allocation but one should also look at the efficiency of resource utilisation. Have the economic reform helped better utilisation of existing resources, even if fiscal stabilisation required a squeeze on total allocation?

The economic reform measures should not imply a retreat of government from all spheres of the economy and society. While in some areas there would have to be reduced governmental intervention/support, in others like health care, education and social welfare, they ought to be more purposive and better targeted in terms of equity intervention by the government.

The broad thrust relating to the education, health and the public distribution system is that public provisioning of these services is still important and there is inadequate attention being paid to improving the quality of these services in the public sector. On the other hand, the increasing privatisation of these services has created a dualistic structure in which *a high value, high quality private sector is growing while a low value low, quality public sector is stagnating*. Unless the government invests more money and improves the quality of the services rendered the retrogression in these sectors would have adverse social externalities resulting in a national loss.

If financial allocations are no measure of public support, there is no evidence either to suggest that the government be any more committed today than before to improving the efficiency of resource utilisation. The real challenge before the government today is, therefore, not *so much to reduce the role of the government in the social sectors but in fact to make government more responsive to the needs of the people*.

Indeed, *the popular base for economic reform can only be built when ordinary people perceive an improvement in the quality of life*. Deregulation, debureaucratisation, decontrol, disinvestment and so on are only ways to wind down the involvement of the government in the economic life of the people. While much of this is popular with the business community, most consumers of public services are desperately seeking a more efficient and humane government rather than just less government. For, less government is no substitute for good government (Sanjay Baru, 1993).

Prof. V.S. Vyas has cautioned the Central Government against resorting to *"unmindful cut in government expenditures"* on sectors like education and health, besides infrastructure and human resource development to reduce deficit. In our enthusiasm to reduce deficit we must not curtail the expenditure vital for development. Fiscal adjustment and economic reform is not simply a matter for the drawing room. In the period of transition, it imposes a burden of adjustment that is distributed in an asymmetric manner. Without correctives, the burden of adjustment is inevitably borne by the poor. Whatever we might say about social safety nets, we do not have the resources for this purpose. It cannot and will not suffice to assert that the burden of such adjustment would have to be borne by the affluent and the middle class, simply because the rich in our society have the incomes to immunise themselves from the burden of structural adjustment.

28.5.1 Need for Reforms with a Humane Face

There can be no adjustment without pain, but we must do everything possible to minimise the social costs of the transition, in particular the burden on the poor. Restructuring on the supply side, which follows structural reform, will inevitably impose a burden on wage-labour. The phrase '*adjustment with a humane face*' could then become hollow and deceptive (Deepak Nayyar, 1992).

In this context, one is inclined to agree with the view that "the agenda for sound macro-economic policies has to be harmonised with legitimate social objectives and the removal of longer-term constraints on growth. While no simple tune produces this harmony, there is no doubt that we need a radical departure in policies as well as popular attitudes and political behaviour. Indeed, all these are inextricably linked. (I.G. Patel,1991).

The policy makers should not ignore the fact that any experiment with India, no matter how well-intentioned, has to take into account the well-being of 1000 million people and not just the top 20 per cent, given that the creamy layer is attractive enough for the marketing needs of the Western World. Thus, even if high tech does come to the country, even if industrial systems are upgraded and even if exports pick up, unless reforms seek to wipe the tears off the face of the lowliest in the land, the bottom line will continue to suggest failure. *The concept of globalisation has no provision for the poor except for the safety nets.*

Assessing the humane face of structural adjustment and fiscal stabilisation in India, one may ask the question, what is the share of food subsidy in our gross domestic product? It would be over one per cent of GDP. Then, why bother about it when nearly 40 per cent of our population lives below the poverty line? Don't touch the food subsidy, but target it better. The public distribution system (PDS) should supply food at realistically affordable prices, especially because inflationary expectations seem to be strongly linked to PDS issue prices in India.

Dr. V.S. Vyas has highlighted the inconsistency of the Government's approach to the PDS. On the one hand, the government is of the view that it wants to target the PDS to the poor and on the other hand, it increases food prices. Dr. Vyas is concerned about the inflationary impact of the price hike and says, "a more courageous and desirable course would have been to reduce subsidies on inputs. In the quest for reducing fiscal deficits, the government is becoming unmindful of the social consequences". This goes against the government's desire to keep the rate of inflation within limits. The hike in food prices will serve some purpose if the government is really serious about fiscal discipline and can curb revenue expenditure sharply. If non-productive government spending does not come down, this can only have an inflationary impact. Food prices are very sensitive subjects and history reveals that stabilisation and adjustment programmes have been given a bad name by rising food prices.

By announcing that the grain distributed in tribal and some other backward areas will be sold at a cheaper price, the government has made an attempt to target the poor through PDS. It might also exclude better-off classes in urban areas, something more often recommended by economists but resisted by politicians of all hues. It remains to be seen whether such targeting succeeds, and does not fall a prey to leakages and corruption. The contents of the PDS basket need to be changed if the aim is to target the poor. There is no reason why superior foods like sugar and edible oil should be subsidised by the PDS. Coarse grains could form a good proportion of grains distributed in backward areas. Since inferior foods are disliked by better off sections leakages will be fewer. A better way of targeting the poor is to expand rural employment programmes at low wages, which will attract only the needy.

Fiscal adjustment, which sought to reduce the wide gap between the income and expenditure of the government, constituted the core of the macro-economic stabilisation programme. According to Professor Deepak Nayyar, the quality of adjustment leaves much to be desired. There are three reasons underlying this concern: (a) it cannot provide a sustainable solution to the fiscal crisis; (b) it is likely to constrain economic growth; and (c) it is disturbing the burden of adjustment in an unequal manner. In a period when we are imposing a substantial burden on the poor through expenditure adjustment, the equity principle demands that the rich and the better off share this burden through their contribution to direct taxes.

Thus, as has been pointed out by Professor Deepak Nayyar, it seems that the fiscal adjustment embodied in the budgets has lost sight of why the adjustment was necessary in the first place. The budget makers have been *concerned with form rather than substance and quantity rather than quality.* What is more, the adjustment has been regressive in its impact. The rich, who derived much of the benefit from the profligacy of the 1980's when the government and the country lived beyond their means, have been spared the burden of adjustment, while the cost is borne by the poor.

Professor A.M. Khusro is of the view that the new policy has so far impacted only the elite industrial and commercial society – the importers, the exporters, the traders, some manufactures and the NRIs. The logic of the policy is that once these elements are allowed freedom to perform and begin to produce competitively with improved efficiency, the output in various sectors will expand rapidly. The labour force required for expanded production would increase and improvement in production and supplies will restrain the rate of inflation and benefit the masses at large. In other words, if the policy does get implemented, the production and employment will trickle down of course, with a time lag. *Eventually, the masses will judge the policy through its effects on employment, prices, availability of output and a noticeable decline in the rate of inflation.* But all this will depend upon whether the first stage of implementation does or does not go through. That is why implementation is more important.

Check Your Progress 2

1) What do you mean by 'adjustment with a humane face'?

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2) What do you mean by a safety net?

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3) Mention the role of public distribution system in the on-going programme of economic reforms.

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28.6 LET US SUM UP

The task of reform is indeed a challenging one. The commitment to reform should go hand in hand with the concern for alleviation of poverty. A social safety net has been devised to take care of the consequences of the process of change. The imperatives of social policy as embedded in our social and economic framework mandate a concern for the poor and the deprived. The planning process should take care of this. *It is only appropriate that where markets distort the planning process, the State should take care of those who are disadvantaged. So long as one does not attempt to outguess the market but set right its distortions one can preserve the social goal of growth with equity. It is only on this basis that the process of reform can be sustained in an open society.*

With regard to economic reform with a humane face, the achievement seems to be far short of what was aimed at. After about ten years of liberalisation, large segments of the population have yet to share the benefits of progress of development. A clear assessment is not possible about the extent to which liberalisation objectives with regard to humane face have been attained. There are no quantified targets against which performance can be compared since what the economic reform measures indicate is a direction of movement, not a specific goal. *The pace of movement towa*Prof. S*rds achievement of humane face is much slower than what is acceptable. With the framework of the reform measures a greater degree of redistributive bias has to be built in.*

For long term strategy, we ought to focus national attention on seven issues: (i) a steep increase in the savings rate, especially the public and private corporate sector's savings rate, (ii) making rapid export growth a "national economic endeavor". (iii) to pay greater attention to exporting more; improve Indian industry's technological capability through greater attention being paid by firms to R&D, (iv) better tax compliance (v) greater concern for social justice, (vi) a greater concern for the environment – economic growth cannot continue without paying attention to the ecological costs of modernisation; and (vii) rural development which will take employment opportunities both in the agrarian and industrial sectors to rural areas so that there is rural enrichment and an end to urban crowding and decay.

28.7 KEY WORDS

Devaluation: A fall in the fixed exchange rate between one currency and others.

Depreciation: A situation where a currency falls in value against other currencies through changes in the forces of supply and/or demand.

Convertibility: An attribute of a currency, which is freely exchangeable for another currency, or for gold.

Terms of Trade: A relationship between the prices of exports and the prices of imports.

Deficits: A situation where outgoings exceed income, on an ongoing basis, or where liabilities exceed assets at a specific point in time.

28.8 SOME USEFUL BOOKS

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28.9 ANSWERS/HINTS TO CHECK YOUR PROGRESS EXERCISES

Check Your Progress 1

1) See Section 28.2

2) See Sub-section 28.2.1

3) See Section 28.3

4) See Section 28.4

Check Your Progress 2

1) See Section 28.5

2) See Section 28.5

3) See Section 28.5