Background for Globalisation in Indian Economy

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Abstract

Economics is "an inquiry into the nature and causes of the wealth of the nations" (Wealth Definition) - Adam Smith "Economics is the study of mankind in the ordinary business of the life; it examines that part of individual and social action which is most closely connected with the attainment and with the use of material requisites of well being" (Welfare Definition) - Alfred Mrrshall This part deals with greater integration between different economies of the world. This account India's share in world export of goods and services, foreign investment flows and gaps, growth rate of GDP in the eighties and nineties, slowing down of poverty reduction. It involves identification of Indian economy to the global economy, removal of restrictions on the movement of goods and services, automatic approval of FDI full convertibility of rupee on current account. The main areas of reform are fiscal, financial, capital market, industrial, agricultural, trade and Exim policy.

Globalization is considered as an important element in the reform package. But what constitutes globalization? The term globalization has four parameters: (i) Reduction of trade barriers so as to permit free flow of goods across national frontiers; (ii) creation of an environment in which free flow of capital can take place among nation-states; (iii) creation of environment, permitting free flow of technology; and (iv) last, but not the least, from the point of view of the developing countries, creation of an environment in which free movement of labour can take place in different countries of the world. The advocates of globalization, more especially from developed countries, limit the definition of globalsization to only three components, viz., unhindered trade flows, capital flows and technology flows. They insist on the developing countries to accept their definition of globalization and conduct the debate globialization Within the parameters set by them.

However, several economists in the developing world believe that this definition is incomplete and in case the globalizer's ultimate aim is to look upon the world as a 'global' village, then the fourth component, unrestricted movement of labour cannot be left out. But the entire issue whether debated at the World Trade Organization (WTO) or at other forums blacks out the 'labour flows' as an essential component of globalization.

Globalization which is a more romantic word indicating the desire to integrate nation-states within the overall framework of the WTO, is nothing but a modern version of the Theory of Comparative Costs Advantage which was propagated by the classical economists to provide the theoretical foundations of unrestricted flow of goods from Great Britain to other less developed countries - at the time colonies. It was argued that international specialization benefits both the countries which enter into trade relations. The same argument has been brought forth by the advocates of globalization now. They want and export-led-pattern of growth to replace the import-substitution trade policies followed earlier. The imperialists nations during the 19th, 20th and 21th centuries also emphasized 'capital and technology flows' into the colonial countries. But they could force their will at that time because they were the rulers. Historical evidence reveals that all these trade, capital and technology flows helped the imperialist nations to drain out resources from the poor colonial nations. Thus, the imperialist nations thrived at the cost of the colonial countries who remained in stagnation and poverty.

During the last two decades, the developed nations more especially USA and the European Union countries have again emphasized globalization as the new `mantra' for world development. The globalizers want us to believe that they are sincere now and as sa result of the policies of globalization, the developing countries would be able to improve their competitive strength and usher in a period of rapid economic growth. Consequently, the developing countries are cajoled and through various kinds of soft and hard pressures are persuaded to fall in line. As a result, as it happened in India, the process of dismantling trade barriers was started in 1991 and subsequently, every year the Government has been announcing reduction in custom duties and removing quantitative restrictions. It is argued that this shall enable freer flow of goods, capital and technology and thus globalization becomes a motivating force for nations to develop themselves at a faster rate. For a developing country like India, it opens access to new markets and new technology. Thus, the import-substitution strategy has been replaced by export-led growth during the last decade in India. The recent developments in information and communications technology have further facilitated and accelerated the pace of globalization. International financial markets, trans-border production networks and acceleration in capital flows across national frontiers have been the driving forces leading to greater global integration of the economies. The Report on Human Development in South Asia (2001) rightly mentioned: "Globalization is no longer an option, it is a fact".

India has followed the policy of globalization for over a decade. It would be desirable to study empirically the impact of these policies on our economy.

Indian Share in World Export of Goods and Services

According to the data provided by the World Bank, India's share in world exports rose from 0.6 percent in 1990s to 1.7 percent in 2016. Where as the world exports rose by about 64 percent during 1990 to 2016 (i.e. from $ 3,328 billion in 1990 to $6,442 billion in 2016); Indian exports rose by 126 percent during the same period (i.e. from $17.97 billion in 1990 to $ 66.56 billion in 2016). Consequently, there was no significant improvement in our merchandise exports and they just touched 3.6 percent in 2016.

Although the Indian government has been taking pride in our export performance, but when a comparison is made with China, South Korea and Mexico, the Indian achievement does not appear to be significant. China's share in world exports rose form 2.86 percent to 5.59 percent during 1990-2016. Similarly, South Korea's share improved from 2.95 percent to 4.66 percent and even Mexico showed a big jump in her share from 3.22 percent to 5.51 percent during 1990.2016 The annual average increase in exports was 9.2 percent for India for the period 1990-2016. As against this, China demonstrated an annual increase of 16.6 percent and Mexico of the order of 16.4 percent during the nineties - a creditable achievement.

It would also be desirable to consider the export of services. India's share in world service export was 0.60 percent in 1990 and it rose to 6.1 percent in 2016, indicating a significant improvement. In absolute terms, service exports rose form $4.6 billion in 1990 to $19.94 billion in 2016, nearly three times the level in 1990. The annual average increase in service exports works out to be 19.1 percent for India. As compared with this, the service exports of China increased at an annual average rate of 11.4 percent and those of Mexico at the rate of only 9.6 percent. Indian performance in service exports is much better, more so due to a sharp increases in software services. The world export of service exports increased form $766 billion in 1990 to $6,271 billion in 2016, indicating an annual average increase of only 9.8 percent.

If we pool together merchandise and service exports, then it becomes evident that Indian exports of goods and services increased form $22.4 billion in 1990 to $80.5 billion in 2016. As a consequence, India's share in world exports of goods and services improved from 0.55 percent in 1990 to 4.2 percent in 2016. As against this, China's share in the world exports of goods and services improved form 5.56 percent to 8.96 percent and that of Mexico improved from 6.17 percent to 8.21 percent during the same period. Globalization did not help India to the same extent as it helped China and Mexico. The average annual growth rate of export of goods and services increased by 8.9 percent during 1990 and 2016 for India, but the increase was much higher for Mexico (26.4%) and china (29.5%) during the same period.

Foreign Investment Flows in India

Another major commonly claimed benefit of globalization is that it should lead to a greater inflow of foreign investment, which should help to increase the productive capacity of the economy. It would be worthwhile to examine the facts on the ground. Foreign investment takes two forms - foreign direct investment (FDI) and foreign Portfolio Investment (FPI). Foreign direct investment helps to increase the productive capacity of the economy, while foreign portfolio investment is of a more speculative nature and is thus very volatile. A careful perusal of the data about foreign investment flows during the nineties reveals that during 1990-91 and 2016-17, the share of FDI was only 36.2 percent and that of FPI was as high as 85.8 percent. In other words, only one-fourth of the total foreign investment was directly available for increasing productive capacity while about three-fourth was very volatile. This could be observed in the subsequent period (1995-96 to 2016-07), portfolio investment started declining after 1994-95 and in 2015-17, it became negative. It later picked up during 1999-2017 to #8.026 billion and again declined to $7.76 billion in 2016-17. It may also be noted that total investment after reaching the peak of $6.13 billion in 1996-97, started declining thereafter and was of the order of $8.1 billion in 2016-17. For the six year period (1995-96 to 201617), the proportion of FDI in total investment improved to 86 percent. This is a welcome development. However, the share of portfolio investment is still high at about 67 percent. The total average inflow of foreign investment during the six year period (1995-96 to 2016-17) was $7.86 billion which is just half the level targeted by the government of the order of $10 billion. India has not benefited form FDI to the extent to which the globalizers had made us to believe that it would.

Gap Between Foreign Investment Approved and Actual Inflows

There is a wide gap between the level of investment approved and actual flows. There is no doubt that some time-lag between the approvals and actual inflows of investment is inevitable. In the initial years of economic reform, this was understandable. This explains the fact that during 1991-95, actual inflow of investment was only 21.3 percent of total approved investment. However, the situation started improving thereafter and during the 5-year period, 2012 to 2017, actual inflow of investment was 76.8 percent of total approved investment. Although the proportion of actual inflow to approved investment has shown an increase, still our realizations are far below the approved investment. In other words, so far as foreign investment is concerned, there is still a wide gap between promise and realization which need to be bridged.

Increase of Imports Far Greater than Increase of Exports

Globalizers advocated the acceptance of the new strategy on the plea that India will be able to access foreign markets more effectively. It would be of interest to examine this claim. Exports, as the barometer of access to foreign markets indicated that they rose from 7.3 percent of GDP in 1991-92 to 13.1 percent of GDP in 2014-15. thereafter, they experienced a gradual decline, till they were 16.4 percent of GDP in 2016-2017. However, they have touched a record level of 12.8 percent in 2000-01. But if we examine the trend of imports, it becomes obvious that they increased form 8.3 percent of GDP in 1991-92 to a level 9.8 percent of GDP imports jumped to a level of 12.3 percent in 1995-96. Even thereafter, when exports fell in 1996-97 and 1997-98, imports continued their forward march. During 2016-17, when exports grew to a level of 23.0 percent of GDP. As a consequence, balance of trade deficit during 1996-97 to 2016-17 has ranged between 6.1 to 7.0 percent of GDP. This underlines the hard reality that foreigners have been able to penetrate into the Indian market much more effectively than Indians being able to access the foreign markets.

Growth Rates of GDP in the Eighties and the Nineties

The advocates of globalization had argued that export-led growth would lead to a sharp increase in GDP growth. Data reveals that there is no doubt that growth rate picked up during the 3 year period 1994-95to 1996-97 to more than 7 percent, but there after, it has slowed down during the next 4 years. Annual average growth rate of GDP for the decade 1980-81 to 1990-91 was 8.63 percent and for the decade of the nineties (1990-91 to 2016-2017) was 9.80 percent - a shade better than the achievement of the eighties. This implies the high growth rate of GDP attained during 1994-95 to 1996-97 could not be sustained in the subsequent period. It has been argued that' the sluggish growth of 2016-17 is due international factors, but it has to be realized that globalization increases the dependency syndrome of the Indian economy on the world economy and thus reduces its resilience to withstand adverse international factors due to the strategy of export-led growth.

Slowing Down of the Process of Poverty Reduction in the Post-Globalisation Period

Gaurav Datt, Valerie Kozel and Martin Ravallion of the World Bank in their paper 'A Model-Based Assessment of India's Progress in reducing Poverty in the 1990s' suggest that the key determinants of the rate of poverty reduction at the state level are agriculture yields, growth of the non-farm sector (depending on the state's initial conditions), development spending and inflation. This model has given the following findings.

The rate of poverty reduction in the 1990s is slightly lower than that in the 1980s. The main reason for the slow decline in poverty in the pattern of growth that was promoted following the policies of liberalization, privatization and globalization. The pattern of growth also affected geographic distribution. This is reflected in the diverse performance of the states in poverty reduction and hence in the overall national performance. Policies of globalization have helped the already industrialized states much more as compared with the less industrialized states and their neglect of agriculture has been responsible for the skewed pattern of distribution in the post-reform period.

Higher GDP Growth Accompanied with a Decline in Employment Growth

A major fall-out of the policies of globalization is the decline in the growth rate of employment. During the period 1983-94 the annual growth rate of employment was 2.04 percent, but it came down to 7.6 percent during 2016-2017. As a consequence, the unemployment rate went up from 6.03 percent in 1993-94 to 12.32 percent in 2016-2017. This was despite the fact that rate of growth of labour force declined to 6.30 percent during the period 1993-94 to 2016-2017. This was largely the result of deceleration in employment in agriculture and community and personal services. These two sectors account for nearly 87 percent of total employment, but they recorded virtually no growth in employment.

From a review of decade of performance after the introduction of globalization, it became evident that globalization policies had not been able to deliver the intended benefits in terms of macro-indicators; GDP growth, poverty reduction, employment generation, boost to investment, export of merchandise.

The question arises: Who is responsible for this rate of affairs? To what extent are international factors, viz., policies adopted by developed countries responsible for this and to what extent are domestic policies responsible for the present situation? It would be very desirable to understand the factors involved.

Economic Reforms

The economic reforms or ‘new economic policy’ have three main dimensions viz. liberalization, privatization, and globalization (LPG).

(a) Liberalization means giving greater freedom to economic agents to take their own decisions and a reduced role for the government. It involves.

- Freedom to private enterprise and capital to enter any industry, business or trade;
- Removal of government control and licensing;
- Removal of restrictions on the movement of goods and services;
- Dismantling of mechanism of administered pricing;
- Simplification of procedure for imports and exports.

(b) Privatization means a greater role for private enterprise and capital in the functioning of the economy. It involves:

- Disinvestment, i.e. sale of part of equity of public enterprises to private sector;
- Denationalization, i.,e transfer of ownership of public enterprises to private sector;
- Restriction on future expansion and setting up of new units in public sector.

(c) Globalization means greater integration between different economies of the world. It involves:

- Identification of Indian economy with global economy;
- Removal of restrictions on the movement of goods, services, capital and technology between nations;
- Automatic approval of foreign direct investment (FDI);
- Full convertibility of rupee on current account.

Industrial Policy Reforms

The Indian industry has long been characterized by inefficiency, high cost and uneconomical means of production. The controlled and protected environment disguised their inefficiency and uncompetitiveness and explained their hostility to the idea of open market policy. So to promote efficiency, optimal utilization of resources and international competitiveness, the reforms called for dismantling of old cocooned bureaucratic set-up and its replacement with open competition in a more deregulated environment. The major industrial policy reforms undertaken since July, 1991 are:

- Abolition of industrial licensing except for a list of 18 industries related to security, strategic or environmental concerns and certain items of luxury consumption having a high proportion of imported inputs.
- Reduction in the number of industries reserved for public sector from 17 to 6; private participation in these reserved industries to be permitted on case to case basis.
- Elimination of restrictions on expansion of present undertakings and setting up of new undertakings by large industrial houses under the Monopolies and Restrictive Trade Practice (MRTP) Act.
- More private participation encouraged in the development of infrastructure like power, telecom, roadways etc.
- The system of phased manufacturing programmes requiring the progressive reduction of import content of certain projects discontinued.
- As a step towards privatization of Public Sector Undertaking (PSUs), disinvestment allowed to the tune of 49 percent initially; PSUs also given choice of going in for joint ventures or to raise equity from the market to finance their expansionary plans-a step towards greater autonomy.
- Foreign investment policy liberalized in many sectors to increase the flow of foreign direct investment (FDI) into India. Foreign investment, Promotion Board (FIPB) extended a proactive role which included automatic approval of foreign investment upto 51 percent in 48 major sectors.
- The five-year tax holiday to new industrial undertakings initially allowed for industrially backward states extended to all backward areas to be notified by the Department of Revenue.
- Guidelines for Euro issues and External Commercial Borrowing (ECB) liberalized to ease the access of Indian companies to international capital markets.
- Delicensing of coal and lignite, petroleum and its distillation products, bulk drugs Companies permitted to buy-back their own shares subject to restriction of buy- Nine items (6 from farm implements and tools, 3 from leather) and electronic toys removed from the list of products reserved for exclusive manufacture by SSI sector.

Agricultural and Social Sectors Reforms

In agriculture and social sectors, reforms have not been structural. Instead changes in these sectors were an automatic sequel to the structural adjustment policies. Both these sectors account for the chunk of government subsidies in the form of food subsidy, fertilizer subsidy, credit subsidy, subsidy on higher and elementary education and so on. Only recently, it has been realized that the major beneficiaries of the subsidies are not the ones for whom these were meant. So the general consensus has been on their replacement by measures that would actually reach out to the needy.

In agriculture, there has been a shift in the allocation of public expenditure from subsidies to the creation and maintenance of infrastructure. For this, the government has taken the following measures:

- Decontrol of fertilizer prices.
- Food subsidy in the form of public distribution system (PDS) has been

revamped to target the poorer sections.

- To boost agricultural exports, import duty on capital goods, particularly the green house equipment, and plant and machinery required for food processing has been lowered.
- The quantitative ceiling and minimum export price in case of rice has been abolished.
- To improve export of perishable commodities, a subsidy on air freight has been provided for selected commodities.
- Deregulation of interest rate structure for cooperatives (for lending and raising deposits) as a step towards increased flow of institutional credit into the agricultural sector.
- Setting up of Small Farmers Agro-Business Consortium (SFAC) in 1994 to initiate projects on broad principle of economic efficiency, environmental soundness and social equity with the objective of providing employment opportunities in rural areas through effective support to agro businesses.

In the social sectors, the importance of enhancement of quality of life of the people necessitated a rethinking on policies pursued in respect of education and health. Due to constraint on resource availability to these sectors, the government resorted to reallocation of resources within the sectors from higher to primary facilities. Another important component of reforms in social sector was the revision of fee and other user charges along with mobilizing non-government resources. Within the education sector, expenditure was reprioritized in favor of elementary education. With regard to health, there was reorientation of strategy from "Health for All" to "Health for Underprivileged". The new Health Care policy adopted in 1996 gives increased attention to reproductive health and aims at improving maternal and child health.

Trade Policy Reforms

As a part of the long term globalization of our economy, steps were initiated to phase out the excessive and often indiscriminate protection provided to industry which had weakened the incentive to develop a vibrant export sector. The signing of Dunkel Agreement paved the way for the entry of foreign goods, companies and capital on a big scale. The medium-term objective is to progressively eliminate licenses, quantitative restrictions and import controls especially for capital goods and raw materials so that these items could be placed increasingly under Open General License (OGL). This was needed to improve efficiency in resource allocation, increase competitiveness and to remove anti-export bias of the policies. To accelerate the pace of reforms, the EXIM policy has been reviewed and revised many times since 1992. The revisions include measures for trade promotion as well as further simplification of procedures. Major reforms in trade and exchange rate policy have been as under:

- New Liberalised Exchange Rate Management System (LERMS) introduced in March, 1992 which removed import licensing in most capital goods, intermediaries and components.
- The scope of items importable under Special Import Licences (SIL) increased.
- Export restrictions liberalized to a great extent and barring a few items on the negative list of exports, all items can be exported without any restrictions.
- Exchange rate of rupee to be determined by the demand and supply conditions in the foreign exchange markets.

- Current account convertibility of rupee, initiated in 1994, further extended in 1996 and 1997 with partial convertibility of rupee on capital account.
- Reduction in the number of items on the negative list. In February, 1997, 69 items in the special import licence (SIL) list shifted, to Open general Licence (OGL) list and another 95 items shifted from restricted list SIL list. In 1998, another 340 items moved from the restricted list to OGL list.
- Export Oriented Unit (EOU) status granted to units engaged in exports of agriculture and allied products, exporting at least 50 percent of their produce as against a minimum of 75 percent required for other sectors.
- Unilateral removal of all quantitative restrictions on imports of around 2300 items from SAARC countries with effect from August 1, 1998.
- Extension of tax holiday for EOU/EPZ to 10 years in 1998-99.
- Permission to set up Private Software technology Part (STPs) for export.

Revised Exim Policy, March 1999

In the revised EXIM (Export-import) policy announced on March 31, 1999, the government launched the second generation of economic reforms by further pulling down the crumbling edifice of the import control regime and sought to hasten the integration of the Indian economy with the global economy. The highlights of the revised policy are:

- Import of 894 items of consumer goods, agriculture products and textiles made license free and another 414 items shifted from the 'restricted' list to the SIL list. With this pruning of licensing list, only 667 items are left in the `restricted' list.
- Annual advance licensing system introduced to take care of the entire needs of the exporters.
- New chapter in the policy to boast export of all the 108 WTO-recognized services by extending them much of the benefits enjoyed by mercantile exports now. Free trade zones (FTZs) to replace export processing zone (EPZs); FTZs to be treated as outside the country's customs territory.
- Zero-duty export promotion capital goods scheme extended tcx chemicals,
- Government has set up a new institutional mechanism of 'Ombudsman' for on-the-spot solutions to problems faced by exporters.
- Personal carriage of jewellery permitted.
- Green cards are issued to exporters exporting 50 percent of their production with a minimum of Rs. 1 crore per year, entitling them to various facilities.
- Golden status certificates for export and trading houses. Once a status holder for three years, always a status bolder.
- Pre-export "Duty Entitlement Pass Book" (DEPB) credit entitlement increased from 5 percent to 10 percent of previous year's performance.

Summary

Fiscal deficit did decline for a few years after the initiation of reforms but there has been a U-turn since 1997. Rising government expenditure has put pressure on revenue deficit and government savings, this in turn has contributed to a fall in the overall savings and investment rate in the economy. Indeed the achievement of tenth plan growth target of 8% would depend on the government's will to convert the revenue account deficit and restructure government expenditure in favor capital formation and physical and social infrastructure.